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Missouri House Committee Substitute Streamlined Sales Tax Bill Contains Significant Negative Policy Consequences

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The streamlined sales and use tax agreement would provide Missouri with the tools to efficiently collect sales taxes due on purchases made through online retail and would meet the goal of leveling the playing field between Missouri's bricks and mortar retailers and their online competitors. Currently, 24 other states have adopted the agreement.[1]

The Missouri House Committee on Tax Reform recently approved a substitute bill for HB 1356, which would enact this agreement in Missouri. However, the House committee substitute now includes language purported to make the bill "revenue neutral" by requiring that any sales tax generated under the agreement be used to decrease Missouri's corporate income tax rate, creating inherent, long-term policy consequences.

The Streamlined Sales & Use Tax is Not a New Tax

Enacting the Streamlined Sales and Use Tax Agreement in Missouri would not generate new state revenue, but instead allow the state to capture sales tax that is ***already due the state***. Missouri law currently requires consumers to remit sales tax for online and catalogue purchases through the "use tax."[2]

However, responsibility for compliance with the "use tax" falls completely on consumers rather than retailers, making collections difficult and cumbersome. Most Missourians are likely unaware of the use tax requirements and do not remit the tax they owe. In fact, the Missouri Department of Revenue reports that in 2010, only 125 Missourians remitted use taxes totaling just $110,784.[3] The streamlined sales and use tax agreement simply provides a more convenient sales tax collections mechanism that allows retailers to efficiently calculate and remit required state and local taxes on purchases made by Missouri consumers.

The most recent data from a University of Tennessee study estimates that Missouri will fail to capture $210 million in existing state and local sales tax in 2012 due to online retail purchases. However, because the streamlined sales and use tax agreement initially relies on voluntary compliance, the state is likely to generate closer to just $16 million in state revenue in the first year of full implementation (based on the average collections of Missouri's bordering states that have enacted the streamlined sales tax collections mechanism).[4]

[1] Streamlined Sales and Use Tax Governing Board
[2] Missouri revised statute 144.655
[3] Missouri Department of Revenue, Division of Taxation
[4] Mike Sutherland, *Missouri Wonk*, March 1, 2012

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***For Corporations Negligible Impact in the Short-Term, But Volatility in the Long-Term*:** In the first year of full implementation, the mechanism would capture approximately $16 million in state sales tax revenue. Under the committee substitute of the bill, a projected collection of $16 million would be used to reduce the state corporate income tax rate. Based on Fiscal Year 2013 projected tax collections, the amount would reduce Missouri's corporate income tax rate of 6.25 percent by just 3/1000 of one percent, a negligible amount.[5] The consequences for corporations far outweigh that negligible tax change.

However, linking the state corporate income tax rate to collections obtained by the streamlined mechanism would create uncertainty for corporations. Sales taxes generally can be volatile depending upon economic conditions. Moreover, the amount of revenue collected as a result of the agreement is likely to fluctuate significantly as the streamlined mechanism is implemented and companies enter into voluntary compliance. <u>Linking the corporate income tax rate to these collections would pass on the volatility to the corporate tax rate, creating uncertainty for companies projecting their annual costs of doing business in Missouri.</u>

In addition, tying the state corporate tax rate to streamlined collections could be particularly harmful during economic recessions. During an economic expansion, sales taxes would be expected to increase and, under the measure, corporate tax would decrease. During economic contractions however, as sales taxes decline the corporate income tax rate would <u>increase</u>. As a result, increases in the corporate tax rate would apply at times of most economic hardship for businesses.

***Increased Uncertainty for Tax Credits*:** As corporate tax rates decline or shift annually, the amount of allowable tax credits would also vary every year because they are based on the amount of corporate tax due. This variation would increase uncertainty for tax credit investors, particularly for projects that require multi-year commitments. Similarly, this dynamic would increase uncertainty for the state in projecting redemptions over multiple years.

***Increased State Budget Uncertainty*:** Over time, as more companies become compliant with the streamlined agreement, the amount of sales tax revenue collected will grow substantially. State sales taxes generate approximately 25 percent of the general fund budget, or $1.89 billion in FY 2013. By comparison, corporate income tax collections are expected to be $352 million in FY 2013.[6] As buying behavior changes and online retail increases, the reduction in Missouri's corporate income tax required under the committee substitute could actually <u>exceed</u> the amount of corporate income tax that is currently collected. As a result, the state could see increased budget uncertainty and severe reductions to the state budget.

***Lawmakers Likely Unable to Ameliorate Problems in Future Years*:** It is unclear whether state lawmakers could adjust the statute in future years to address the problems described here. Under the Hancock amendment within Missouri's constitution, state lawmakers are prohibited from <u>increasing</u> taxes or fees by more than $50 million in the current year.[7] Following the point when the amount generated through the streamlined agreement exceeds that level and results in a corresponding reduction in the corporate tax rate tax reduction, any changes to the statute could be a violation of the Hancock

[5] Corporate Income Tax is projected to generate $352 million in FY 2013 according to the Missouri Office of Administration, Division of Budget and Planning, Executive Budget FY 2013 Summary Information.
[6] Missouri Office of Administration, Division of Budget and Planning, Executive Budget FY 2013 Summary Information
[7] Missouri Office of Administration, Division of Budget and Planning, Executive Budget FY 2013

amendment. As a result, even if lawmakers determine in future years that the legislation was flawed, they may be unable to address the policy problems.

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The streamlined sales tax mechanism simply allows the state to collect taxes it is already owed. The change included in the House Committee Substitute to HB 1356 to reduce corporate taxes by an amount equivalent to the collections resulting from the streamlined sales tax agreement would create volatility for corporations and uncertainty for the state that may not be easily corrected by lawmakers in the future.

Enacting the streamlined sales tax agreement would close a tax loophole that will level the playing field for Missouri businesses. However, extra provisions included in the House Committee Substitute risk creating another set of problems for both Missouri businesses and the state.