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Racing to the Bottom:
Missouri Senate Tax Cut Bill Would Devastate Services, Infrastructure and Economy

Amy Blouin, Executive Director

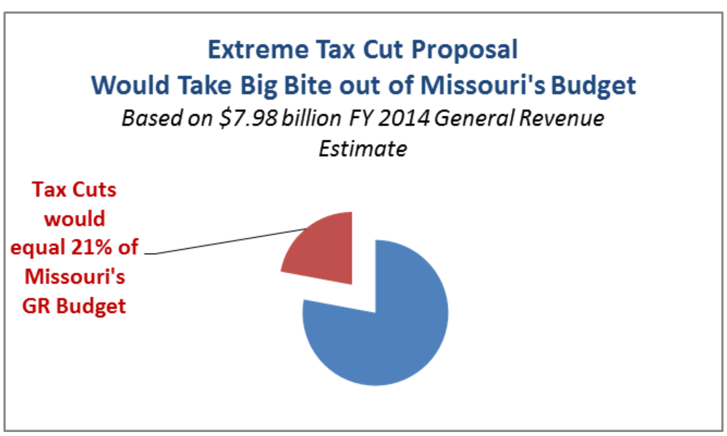
An extreme tax cut proposal, approved this week by the Senate Ways & Means Committee would slash Missouri's general revenue budget by more than one-fifth, resulting in devastating cuts to services throughout the state. Instead of spurring the economy, the proposal will severely undermine Missouri's ability to invest in the very services that make Missouri attractive to business. Further, as was recently experienced in Kansas, the proposal could compromise Missouri's bond rating. The measure is Senate Bill 26.

Tax Cuts Would Reduce Missouri General Revenue by More than One-Fifth

The Senate Committee Substitute for Senate Bills 26, 11 and 31 (referred to as SB 26) would make severe cuts to a number of state taxes, detailed below. The bill phases in the exemption for business income over a number of years. However, to demonstrate the full impact of the measure, the following assumes that the measure is fully effective in 2014:

- Reduces Missouri's top individual income tax bracket from $9,000 to $6,000 and cuts the top bracket tax rate from 6 percent to 4.5 percent, **reducing state revenue by $1.325 billion annually;**
- Cuts the corporate income tax rate from 6.25 percent to 4.75 percent, **reducing state revenue by $75 million annually; and**
- Exempts 50 percent of business income (including that for partnerships and s-corporations) from individual income taxes; **reducing state revenue by an additional $255 million annually.**

Altogether, Missouri Budget Project estimates the bill would cut state general revenue by $1.655 billion, or by more than one-fifth.



Tax Cuts Would Require Drastic Cuts to Most Services

Put into context, the amount of the proposed tax cut is the equivalent of 55 percent of Missouri's Foundation Formula, the state funding formula that directs state aid to local school districts, **or nearly two and a half times the amount of general revenue provided to Missouri's public four-year colleges and universities in the current year.**[1]

If lawmakers wanted to protect funding for local public schools and colleges, they could instead make dramatic cuts in a whole series of critical programs and ***still not meet the cuts required by the tax cut proposal***. For example, closing all 21 of Missouri's correctional facilities would only garner $272 million. However, that change would require Missouri to lay-off 7,900 employees within its correctional facilities and release 31,000 prisoners. Eliminating probation and parole oversight and offender rehabilitation services would garner an additional $245 million. Missouri could instead eliminate state general revenue funding for the highway patrol. However, that change would also require layoffs of highway patrol officers and would only garner slightly more than $30 million.

However, because a number of services are required under federal law, or at the very least are required in order to receive federal tax revenue into Missouri, **it is unlikely that lawmakers could protect education funding from cuts if a tax cut of this magnitude were to be approved.** Moreover, about one-third of Missouri's total state budget is funded through dedicated tax sources, which require that those tax revenues be spent on specific services. For example, conservation, parks and education all have constitutionally designated sales tax revenue; Missouri's gas tax and motor vehicle sales taxes are earmarked for transportation; lottery proceeds are designated for education. After removing federally mandated services and services that are funded by designated tax sources, there is very little left in the state general revenue budget that lawmakers would be able to cut.

Bill Would Undermine Missouri's Economic Recovery and Future Prosperity

Because Missouri is required to have a balanced budget, without a corresponding increase in a another form of tax, the proposed state tax cut measure would in reality result in deep cuts to an array of services including education, health and public safety. The cuts would undermine Missouri's economy in three main ways:

1. Sharp budget cuts would directly decrease employment that is funded by state services, including teachers, corrections and highway patrol officers and more;

2. Reductions in education, workforce training, infrastructure and other services would make Missouri less attractive for business or entrepreneurial investment and could increase business costs;

   For example, cuts in education funding over the last decade have already resulted in 2,500 fewer K-12 teachers and steep tuition increases for public college and university

[1] Based on Missouri funding for K-12 Foundation Formula and 4 Year Colleges in FY 2013

students.[2] <u>The budget reductions make the state less attractive for business investment by diminishing the education system and infrastructure that businesses need to be successful</u>.[3]

State tax reductions that result in less state spending could also increase costs for businesses. Companies may be forced to spend more of their own money educating and training their workers, providing health services for employees and their families, securing their workplaces, and repairing infrastructure.[4]

3. Reducing available state revenue could compromise Missouri's bond rating. Recently Moody's Investor Services downgraded Kansas' credit outlook. In their statement, Moody's said, **"Although subject to appeal, this ruling is credit negative for Kansas (Aa1 negative) and underscores challenges the state faces as it tries to offset revenue losses from the income tax cuts it enacted last year."**[5]

   Responsible financial management and a moderate debt burden are two factors that have allowed Missouri to hold a top credit rating for 46 years.[6] The strong rating allows Missouri to receive the lowest borrowing rates for bonds to undertake major improvements in infrastructure. Severe state tax reductions could lower Missouri's bond rating and result in diminished capacity to invest in infrastructure improvements at Missouri's universities, colleges, state parks and roads, further undermining Missouri's economy.

Tax Cut Package Largely Benefits only the Very Wealthiest Missourians

A new analysis conducted by the Institute on Taxation and Economic Policy of the impact of the tax cut proposal indicates that only the very wealthiest Missourians would receive a significant benefit from the extreme measure. As demonstrated in the table, below, **the wealthiest 1 percent of Missourians (those with average annual income exceeding $1 million) would reap 26 percent of the benefit of the income tax rate changes and 57 percent of the benefit of the business income exemption.** The wealthiest 1 percent of Missourians would receive an average annual tax cut of more than $16,000 for those two changes alone. **By comparison, the 40 percent of Missourians in the two lowest income quintiles, with annual incomes below $33,000, would receive only 2 percent of the benefit of the tax change.**

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[2] "Cutting to the Chase: What Multi-Year Budget Reductions Mean for Missourians," Missouri Budget Project, September 2012

[3] For more on business location decisions, see " Corporate Tax Rates Do Not Drive Business Decisions: Rate Cuts Could Impede Economic Growth," Missouri Budget Project, January 2013

[4] Robert Lynch, PH.D., "Rethinking Growth Strategies," published by the Economic Policy Institute, 2004

[5] Bloomberg News, "Bleeding Kansas Shows Peril of GOP Bid to End Income Tax," by Tim Jones, January 25, 2013

[6] Standard and Poor's, Global Credit Portal, Ratings Direct "Missouri Board of Public Buildings Missouri; Appropriations; General Obligation," August 2011

Tax Cut Proposal Largely Benefits the Very Wealthy Little to No Impact for Lowest Income Missourians *Analysis from the Institute on Taxation and Economic Policy, February 2013* *Based on 2012 Income Levels*							
Tax Reduction by Income Quintile							
2012 Income Group	**Lowest 20%**	**Second 20%**	**Middle 20%**	**Fourth 20%**	**Next 15%**	**Next 4%**	**Top 1%**
Income Range	Less Than $18,000	$18,000 to $33,000	$33,000 to $53,000	$53,000 to $85,000	$85,000 to $160,000	$160,000 to $394,000	$394,000 Or More
Average Income in Group	$11,000	$25,000	$42,000	$68,000	$111,000	$226,000	$1,038,000
Impact of Rate Cut of Top Individual Income Tax Bracket from 6 percent to 4.5 percent							
Tax Change as Percent of Income	–0.0%	–0.2%	–0.4%	–0.5%	–0.7%	–0.9%	–1.0%
Average Tax Change	$0	-$48	-$161	-$334	-$765	-$1,941	-$10,578
Share of Tax Change	0%	2%	8%	16%	28%	19%	26%
Impact of 50 Percent Exemption for Business Income							
Tax Change as % of Income	–0.0%	–0.0%	–0.0%	–0.0%	–0.1%	–0.3%	–0.7%
Average Tax Change	-$1	-$10	-$12	-$34	-$102	-$779	-$7,633
Share of Tax Change	0%	1%	2%	5%	11%	23%	57%
Combined Impact of Individual Income Tax Top Bracket Rate Cut and New Business Income Exemption							
Tax Change as % of Income	–0.0%	–0.2%	–0.4%	–0.5%	–0.8%	–1.1%	–1.6%
Average Tax Change	-$2	-$57	-$172	-$363	-$847	-$2,542	-$16,335
Share of Tax Change	0%	2%	7%	14%	25%	20%	32%