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HB 1619 : Corporate Franchise Tax Repeal

On April 24, 2006, The Missouri House passed HB 1619 which repeals the Corporate Franchise tax by the year 2010. The *Missouri Budget Project* believes that this would represent unwise tax policy. The primary reasons for our opposition are as follows.

State General Revenue Tax Base is Eroding

While the state revenue picture has brightened over the last two years, the General Revenue tax base is under strain and no longer produces enough revenue to adequately fund basic state services. The tax base erosion has been caused by but not been limited to:

- The loss of the Estate tax. In FY 2001, the Estate tax yielded about \$157 million. In FY 2007, the yield will be de minimus.

- The re-allocation of Motor Vehicle Sales tax MO-DOT. In FY 2005, the GR fund received \$116.8 million from the MV sales tax. In FY 2007, this total is expected to \$56 million, with further declines expected in FYs 2008 and 2009.

Repealing the Corporate Franchise tax will make this problem considerably worse.

Missouri Already Has a Favorable Business Tax Climate

By any reasonable standard, Missouri already has a very friendly business tax climate.

- Missouri Corporate Income taxes per capita consistently rank among the lowest in the nation. According to US Census data released in December 2005, Missouri Corporate Income tax Per Capita was \$38, well below the national average of \$131. Missouri's rank was 46th out of 46 states that levy this tax.

- The Missouri Corporate Franchise tax was substantially reduced in 1999 by legislation signed into law by Governor Carnahan. The asset threshold was raised to \$1 million from \$200,000 and the rate was lowered from 0.02% to 0.0333%.

- In Missouri, Corporate taxes make a relatively small contribution to state General Revenue. In FY 2005, Corporate Income and Franchise tax combined yielded \$328.1 million or 4.9% of net GR.

- Missouri already provides numerous tax credits and economic development incentives that foster business development.

In sum, there is no evidence to support the assertion that repealing the Corporate Franchise tax will improve Missouri's business climate and enhance economic development. There is also a substantial body of literature demonstrating that states which spend adequately on public education, infrastructure and other public services are more apt to attract/retain businesses. Repealing the Corporate Franchise tax would clearly impair these efforts in Missouri.

Revenue Impact of Repeal Uncertain

In FY 2002, the Department of Revenue (DOR) began a policy that permitted corporations that owed both Income and Franchise tax to pay this tax by filing just one return. It soon became evident that following this change, the DOR became unable to separate Income and Franchise tax. While efforts were made to resolve this problem, they apparently have not been successful. It is now standard operating procedure for Corporate Franchise tax and Corporate Income tax remittance payments to be reported as one tax, even though they are, in fact, different taxes.

As a result, it is difficult to estimate both the magnitude and timing of repealing this tax. The official fiscal note shows that neither the DOR nor the UMC Research Center appear to be anywhere close to being in agreement as to what the tax currently generates.

The Office of Administration – Division of Budget and Planning (OA-B&P) estimates that the tax yielded \$116.7 million in FY 2005. The Fiscal Note states that the GR loss associated with raising the asset threshold from \$1 to \$4 million would result in a revenue loss of only \$3.1 million or only about 2.5% of the total tax. If this is accurate, then the GR loss will increase quite rapidly in FYs 2009 and 2010 to around \$125 million or more. It would seem worthwhile to acquire comprehensive data on this and produce a more rigorous Fiscal Note. It should also be stated that the GR loss, whatever it is *would be* felt in FY 2007, based on the experience of the last CFT reduction in FY 2000.

Tax Simplicity

Proponents of HB 1619 have argued that the Corporate Franchise tax is complicated and can be difficult to comply with. The *MBP* and most other entities generally support reducing the complexity of the tax system. That said, this would seem to be a relatively small benefit when compared to an ultimate loss of \$120 million in GR.

It would seem reasonable to assume that most or all businesses with at least \$1 million in assets have a staff of professional accountants or the resources needed to hire accounting services. It would seem that for these relatively large businesses that the marginal costs of complying with this tax are not great.

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