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What The "fair tax" Costs Missouri Families: Senate Substitute Bill Increases Hardship

A substitute version of Senate Joint Resolution (SJR) 29 was recently unveiled in the Missouri Senate. The substitute bill makes a number of changes including exempting a handful of services and purchases from the sales tax. However, those changes would actually increase the financial burden on Missouri families and our state's economy.

The fundamental items and services that individuals and families need in order to be able to live healthy, quality lives, and the services that provide families with the ability to go to work, would still be taxed. In fact, while a few exemptions were added to the bill, those exemptions would necessitate an increased sales tax rate on everything else, increasing the burden on low and middle income families. **The state sales tax rate needed to pay for the costs under the substitute proposal could likely reach 12.96 percent.**

Summary of Major Changes in the Senate Substitute Bill

Additional Exemptions:

The original proposal exempted business to business transactions, higher education tuition and fees and used items (for instance used cars would not be subject to the tax while new cars would) from the new sales tax. The substitute bill adds the following as exempted categories:

- Tuition and fees for private K-12 education and vocational education;
- Motor fuel (which will remain subject to the excise tax);
- Insurance premiums; and
- Donations to charitable organizations.

Any additional exemptions would require a two-thirds vote of the general assembly and approval of the governor to enact.

Because the additional exemptions restrict the base of what would be taxed, the rate of the sales tax on everything else must increase. **An analysis of the substitute bill by the Institute on Taxation and Economic Policy found that the state sales tax rate would need to increase to 12.96 percent as a result.**[i] This rate would apply to the fundamental items that families and individuals need to be able to live healthy, quality lives. In addition, the services that provide families with the ability to go to work would still be taxed, including:

- Food
- Rent
- New home purchase and realtor services
- Child care
- Family counseling & mental health
- Nursing home care and assisted living
- Transportation
- Financial services
- Prescription drugs
- Health care and dental care
- New cars, auto repair
- Utilities
- Tutoring and educational services
- Home repairs
- Funeral services
- Legal services

"Prebate" is no longer required

In the original proposal, a prebate was provided to every household based on the new sales tax rate multiplied by the federal poverty level, regardless of income. Proponents argued that the "prebate" diminished the regressivity of the tax shift. **However, the senate substitute bill makes the prebate <u>completely</u> subject to the approval and**

will of the state legislature. The legislature is not only **not** required to provide a prebate, but the method for determining the design and amount of the prebate is undefined.

Without requiring a prebate, the shift in the tax structure would place an even larger burden on low and middle-income Missourians. This will be felt particularly by young families who rely on child care to be able to work, Missouri seniors living on fixed incomes, and Missourians who face significant illness and related medical costs. **In fact, 95 percent of Missourians would continue to pay significantly higher state taxes without receiving any benefit from increased services, enhancements in education or infrastructure.**

The current income tax structure provides most Missourians with considerable tax deductions.Personal and dependent exemptions and deductions, the federal child care tax credit, and the Missouri state tax deduction for federal taxes paid all reduce the amount of state taxable income, and the percent of income that is subject to tax. For instance, a family with an income in the middle income quintile in Missouri, with an average income of $40,400 per year, currently pays 2.8 percent of their income in state income taxes after deductions and 2.8 percent in state sales tax.[ii] A family in the lowest income quintile in Missouri, with incomes below $17,000 per year pays less than one percent of their income in state income tax and 3.6 percent in state sales tax.[iii] By contrast, higher income families, those with an average income of $1.1 million per year, pay 4.4 percent in state income taxes but only 0.6 percent of their income in sales tax.

As indicated, the lower an individual or family income level is, the higher the percent of income that is currently subject to the sales tax. The inverse is true for income taxes. This basic component of taxation is what makes the sales tax “regressive”, meaning it creates a larger burden on those with low and middle incomes. **By shifting to a total reliance on sales tax, the percent of income for Missouri families that would be subject to tax would dramatically increase,** particularly because the tax is applied to nearly everything a family purchases as well as the services a family buys. Without the “prebate”, the regressive nature of the sales tax is not offset at all, increasing the burden for low and middle income Missourians that results from this tax shift.

The substitute proposal also inherently creates an incentive for the general assembly to avoid creating a prebate altogether. Without providing the prebate, the overall costs of the bill decrease. An analysis of the substitute bill by the Institute on Taxation and Economic Policy found that the new state sales tax rate would need to increase to 12.96 percent if the general assembly provides a prebate as was designed within the original bill. However, the necessary sales tax rate would decrease to 8.3 percent if no prebate is provided. The “lighter” rate would certainly serve as an incentive to the general assembly to forego the rebate altogether. This creates an unwinnable dilemma as the legislature would be forced to choose between a lower state sales tax rate that also places a significantly higher tax burden on low and middle income Missourians, or a higher state sales tax rate.

Continues to Propose a Constitutional Amendment, But with a Five Year Phase-In:

The senate substitute bill included several other changes, including:

- A five year phase-in of the tax shift beginning in 2013 and completed by 2018;
- In the first year of the phase-in, the substitute proposal caps the amount of the sales tax at 7 percent. However, the language within the bill allows the legislature to increase the state sales tax rate above that amount as the changes are phased in. The 7 percent rate, therefore, should NOT be misconstrued as a total cap on the new state sales tax rate.

One of the most concerning elements of the proposal has not changed: If passed by the Legislature and approved by Missouri voters, the proposal would place the tax changes into Missouri’s Constitution. The result is that even if state policymakers realize later that they made a mistake, they will have no recourse. Missouri would be stuck with a flawed tax structure that could have very dire consequences for Missouri families and the economy.

Comparing the New Sales Tax Rate with Missouri Neighbors:

Missouri’s new sales tax rate would be significantly higher than neighboring states. More significantly**, no other state taxes services such as child care and health care as broadly as Missouri would under this proposal.**

New Missouri Sales Tax Rate Compared with Neighboring States[iv]:

- ***New* Missouri Sales Tax Rate: 8.3 – 12.96 percent (depending on prebate)**
- Arkansas: 6 percent
- Iowa: 5 percent
- Illinois: 6.25 percent
- Kansas: 5.3 percent
- Kentucky: 6 percent
- Nebraska: 5.5 percent
- Oklahoma: 4.5 percent
- Tennessee: 7 percent

Conclusion:

The "fair tax" proposal would **raise taxes on 95 percent of Missouri individuals and families** without generating any new revenue for services or benefits for families. Most Missourians continue to pay significantly more under the substitute bill because the tax proposal shifts the responsibility of funding state services and infrastructure away from a diversely shared responsibility of individuals and corporations to one that relies entirely on the spending of individuals. **In order to replace the revenue lost as a result of eliminating corporate and individual income tax, the increased sales tax rate would have to be at least 12.96 percent,** assuming the general assembly approved the "prebate". This new rate would apply to nearly ALL of the goods and services a family purchases including child care, dental and health care, prescriptions, food, utilities, rent and most other basic needs.

No other state currently taxes services this broadly and the consequences are unknown. What is clear is that the items and services that individuals and families need in order to be able to live healthy, quality lives and the services that provide families with the ability to go to work would be taxed. **Further, the proposal would create a Constitutional Amendment. Even if Missouri policymakers decided that they made a mistake, it would be nearly impossible to fix.**

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[i] To learn more about the Institute on Taxation and Economic Policy see www.itepnet.org

[ii] "Who Pays: A Distributional Analysis of The Tax Systems in All 50 States", Institute on Taxation and Economic Policy, November 2009.

[iii] IBID

[iv] Federation of State Tax Administrators