MISSOURI BUDGET PROJECT

January 2017

Missouri Faces Additional Cuts to Services in Both Current Year, FIscal Year 2018

Due to a substantial decline in corporate income tax revenue, Missouri will likely need to cut public services by an additional $200 to $250 million before the end of the fiscal year in June. These cuts are on top of the almost $200 million already restricted for early education (Parents as Teachers and Missouri Preschool Program), school transportation, health and mental health services so far this year.

Unfortunately, the impact of budget shortfalls in fiscal year 2016, coupled with additional tax reductions, will have a ripple effect on next year's funding for schools, health care and social services, and infrastructure.[1]

As lawmakers begin planning for the FY 2018 budget, unless revenue growth improves substantially, Missouri will be unable to fully fund its schools next year or make other needed investments that would build our state's economy.

Consequences for the Upcoming Budget Cycle

Missouri began the current fiscal year in July with a revenue hole as a result of general revenue collections that were lower than budgeted for FY 2016. In addition, current year revenue is growing slower than anticipated as a result of factors that will be discussed further in the next section.

As a result, despite earlier budget restrictions, state general revenue would need to grow by nearly $250 million more than anticipated to avoid further cuts to the current year's budget.

Going into FY 2018, legislators will again face a shortfall. In order to fund the K-12 school formula and provide the level of services for residents that had originally been budgeted this year, general revenue next year would again have to exceed expectations by about $250 million for the fiscal year.

In other words, without intervention, Missouri would face the equivalent of $250 million in cuts to the FY 2018 budget that lawmakers will soon begin to debate.

MBP FY 2017 & 2018 Revenue Estimates

Based on collection trends to date, and an outlook of economic projections for the next 18 months,[2] the Missouri Budget Project has estimated that net state general revenue will grow 2.8 percent in FY 2017 and 3.6 percent in FY 2018. *(see Appendix for more details)*

Factors Influencing General Revenue

Even with solid economic growth and respectable increases in both Individual Income and Sales & Use tax, a number of factors will limit Missouri's ability to invest in education, transportation enhancements, or other services both this year and beyond. These include:

- **A collapse in Corporate Income Tax Collections** tied to changes in how taxable income for multi-state companies is treated
- **Additional tax reductions** passed in 2016 but not incorporated into FY 2017 budget estimates

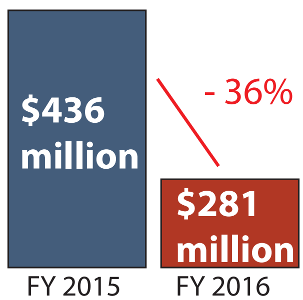
- **Implementation of personal and pass-through tax cuts included in SB 509** (from the 2014 legislative session)

Collapse in Corporate Tax Collections:

The primary reason for anemic revenue growth has been an unexpected collapse in corporate income tax collections. In FY 2016, Corporate Income/Franchise tax collections net of refunds declined nearly 36 percent. The trend continues, with collections for the first six months of FY 2017 declining another 29 percent.

Corporate Tax Collections Dropped 36%

Collections Net of Refunds Contiue to Decline in FY 2017



While many factors can influence corporate income tax collections, recent changes made to how corporate taxes are calculated for some companies has been a primary cause of rapidly declining collections.

House Bill 128 (effective August 2013) and Senate Bill 19 (effective August 2015) each provided multistate corporations that do business both inside and outside of Missouri with a profit allocation system that allows them to reduce their Missouri tax liability. With the lack of publicly available data, it is difficult at this juncture to know the exact impact that these two bills are having. It is apparent, however, that they are far more costly than the official fiscal notes had estimated upon their enactment.[3]

MBP's new estimate for state general revenue projects that this decline will continue for the rest of FY 2017, and level off during FY 2018. Nonetheless, this should be seen as a permanent and substantial tax cut that is likely to keep corporate income tax revenues well below FY 2015 levels for the foreseeable future.

Recent Tax Reductions Limit FY 2017 Growth

Further, several additional tax reductions will reduce state revenue by a further $65 million in FY 2017. Although the legislature passed these changes in the 2016 legislative session, they did not incorporate the impact into the state budget. These tax changes will result in an additional $49 million reduction in FY 2018.

Future Tax Cuts

Income tax cuts included in Senate Bill 509 (passed over Gov. Nixon's veto in 2014) are likely to go into effect in 2018, at a cost of $50 million in FY 2018. When fully implemented, SB 509 will cost at least $620 million a year – about one-fifth what the state spends on K-12 schools ever year.

Other Considerations

While the MBP forecast calls for solid growth rates in Sales and Use Tax, caution may be in order. Uncollected Internet sales and use taxes continue to erode collections at both state and local levels. In addition, the price of oil and thus gasoline is expected to increase over the next 18 months, which may reduce discretionary consumer spending and hinder sales tax growth.

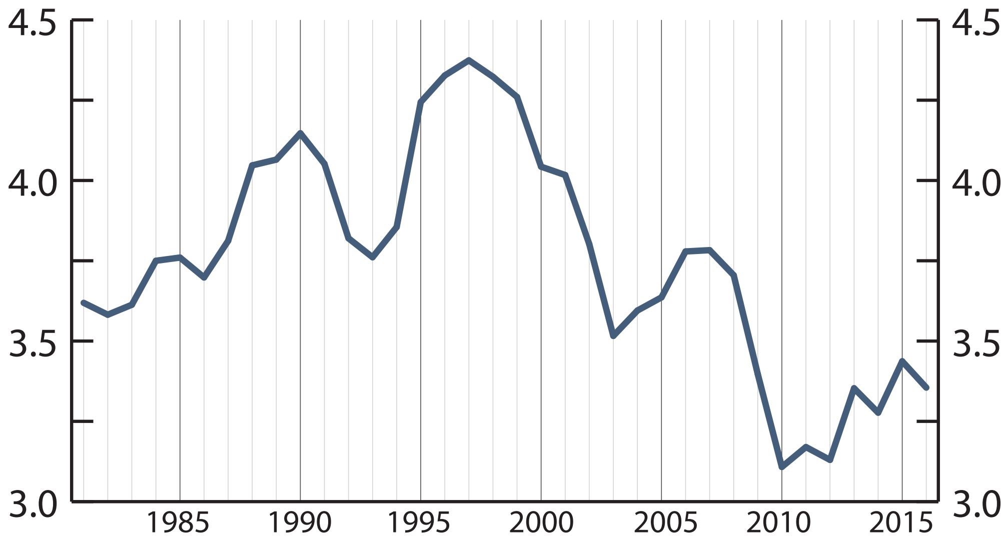
Missouri's Ability to Provide for Its Residents Continues to Erode

These revenue estimates reflect an ongoing erosion in Missouri's ability to meet the needs of its residents.

While the nominal size of Missouri's budget has grown over time, it has not done so sufficiently to keep up with inflation or an increased population. Relative to the size of the economy, state general revenue is at a nearly 35 year low, as a result of tax cuts and tax credits that have eroded the state's tax base.

Relative to the Economy, State General Revenue is at a Nearly 35 Year Low

Erosion Makes it Difficult to Invest in the Building Blocks of a Successful Economy



Notes

1. While the FY 2016 overall General Revenue (GR) budget was in reasonably good shape until mid-June 2016, GR collections (net of refunds) declined about 50 percent in the last two weeks of the fiscal year, compared to the previous year. As a result, net GR collections fell $169 million below what had been budgeted.

2. The economic outlook for the next 18 months as reported by Wells Fargo Securities in their December 2016 U.S. Economic forecast.

3. The fiscal note for HB 128 indicated a revenue loss of "Unknown" and the fiscal note for SB 19 indicated an annual revenue loss of $15 million.

APPENDIX

General Revenue Estimate for Fiscal Years 2017 & 2018

Tax	FY 2016		FY 2017		FY 2018	
	Actual	% change	Estimate	% change	Estimate	% change
Individual Income	$7,158.2	3.9	$7,473.0	4.40	$7,796.3	4.33
Sales & Use	$2,102.6	4.4	$2,159.2	2.69	$2,248.4	4.13
Corporate Income/ Franchise	$468.3	(16.2)	$385.3	(17.72)	$389.2	1.01
County For Ins	$247.3	3.4	$290.0	17.27	$307.4	6.00
All Other	$215.4	(5.9)	$228.2	5.94	$231.3	1.36
Gross GR	$10,191.8	2.6	$10,535.7	3.37	$10,972.6	4.15
GR Refunds	$1,405.0	14.9	$1,436.8	2.26	$1,503.6	4.65
Net GR Subtotal	$8,786.8	0.9	$9,098.9	3.55	$9,469.0	4.07
2016 Tax Reductions	$0.0		$64.9		$55.7	
Senate Bill 509 Reduction	$0.0		$0.0		$50.0	
Total Tax Reductions	$0.0		$64.9		$105.7	
Net GR Estimate	**$8,786.8**	**0.9**	**$9,034.0**	**2.81**	**$9,363.3**	**3.65**