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Tax Policy Reform: Issues to be Addressed to the Benefit of all Missourians

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ARTICLE

Tax Policy Reform: Issues to be Addressed to the Benefit Of All Missourians[1]

By Joel Walters[2]

ABSTRACT

Tax policy impacts the everyday decisions made by individuals, families, and businesses. Better tax policy can generate economic activity and lower the tax burden on individual taxpayers. Missouri Department of Revenue Director, Joel Walters, believes the current Missouri tax system can be changed in ways that would make it more simple, efficient, and fair. With this article, Director Walters seeks to engage Missourians in a dialogue about the strengths and weaknesses of the current tax policy environment in Missouri. The article comprehensively examines Missouri's tax system by discussing a wide variety of topics including corporate income tax, alternatives such as the gross receipts tax, margin taxes, and the corporate franchise tax, as well as individual income taxes, earned income tax credits, sales and use taxes, the U.S. Supreme Court's decision in Quill, motor fuel taxes and specific targeted provisions currently in the Missouri tax law, and more. This article also summarizes recent tax policy discussions in Missouri and the legal framework of reforming the tax code. The Director's ultimate goal is to drive a fact-based discussion of the challenges and options to ultimately create a best-in-class tax system that enhances Missouri's tax system for all its citizens and businesses, and provides a model for state tax reform nationwide.

1. This article was written at the request of The Governor's Committee on Simple, Fair, and Low Taxes. Tax Credit Reform: Recommendations to Make Missouri a Best-In-Class State, The Governor's Committee on Simple, Fair and Low Taxes, at 27-28 (June 30, 2017), https://ded.mo.gov/content/governors-committee-simple-fair-and-low-taxes. This white paper relies in part on the testimony and evidence provided to the Committee, which were partially incorporated into its report to Governor Eric Greitens.

2. Joel Walters is the Director of the Missouri Department of Revenue. Prior to accepting the role as Director of Revenue, he served as the lead partner for PricewaterhouseCoopers' inbound tax practice. In addition, Mr. Walters served in numerous senior finance roles in large multinational corporations over a twenty-year period, most recently with Diageo and Vodafone in London. He holds an accounting degree from Gustavus Adolphus College, a JD from the University of Minnesota, and an LLM from Georgetown University. He is also a Certified Public Accountant. He wishes to give special thanks to those who were involved in the creation of this project: Kayla Jeffers, John Whiteman, Ryan Asbridge, Michael Lanahan, Brian Bear, Todd Iveson, Richard Byrd, Brett Smith, James Galbraith, Desirae Fowler, Jeffrey Johnson, Aaron Hadlow, and Mark Godfrey.

I. EXECUTIVE SUMMARY

Tax policy matters. Tax policy impacts the everyday decisions made by individuals, families, and businesses throughout the state of Missouri. Tax policy is a gating issue when businesses consider where to locate or grow their operations. It is therefore critical that all those who engage in the discussion around the current and future tax environment in the state take the time to consider a balanced, fact based assessment of the situation and the options.

This article is my way of putting the debate front and center with a broad review of the current tax policy environment in Missouri, its strengths and weaknesses, and suggestions of possible steps to be taken to optimize the state's position by creating a simple, fair, low tax environment that competes and wins the battle to attract and retain economic activity, growth and jobs. My ultimate objective is to drive forward and participate in a debate that will ultimately lead to a package of tax reforms that benefit all citizens and businesses in the state of Missouri.

Having been in the business of investment decisions for three and a half decades, I know the importance of a simple, fair and low tax policy. As the head of PricewaterhouseCoopers' Inbound Tax Services Practice, I led the firm's efforts to help foreign companies grow their businesses and create jobs in the U.S. by guiding them through the complicated federal tax code. Before that, I held senior finance executive roles including responsibility for global tax affairs at two multinational corporations: Vodafone and Diageo. I accepted my current position with the goal of leveraging my past experience in private practice in order to help policy decision makers design a 21st century tax system for Missouri.

Building on the work of the Governor's Committee on Simple, Fair and Low Taxes ("the Committee"), this article summarizes a great deal of input and data from a full spectrum of stakeholders to create a foundation for a high-quality debate. The key challenges of the current environment are highlighted to focus attention on where action is most critically required. Finally, a number of potential options have been identified for consideration.

What this report does not do is make a recommendation on any individual component of overall tax reform in the state, or on the shape of a total package when fully enacted and implemented. All suggestions are merely that—suggestions for consideration. I look forward to working with all stakeholders to evolve these and other thoughtful ideas into a final plan.

One final introductory comment. Each of us thinks about policy matters through the lens of our own experiences and this article surely reflects mine. I have worked hard to cite a range of opinions to ensure a fair review, but there are principles that guide me in my approach to tax policy that I put forward to the reader here because they influence the suggested areas for consideration:

- Reductions in total tax burden, as well as finding the right balance as to who is taxed at what levels are the ultimate objective. Reductions in the total tax burden have positive impacts on the economic environment that will generate enhanced economic activity and increase tax revenue to the state.

- As enhanced revenues from tax reductions and enhanced overall tax environment are recognized, they should be returned as tax reductions to the citizens and businesses in the state to the maximum extent possible to create further economic momentum.

- Traditional income taxes are a less efficient method of taxation from the perspective of both the economic impact and the jurisdiction's revenue, as compared to broader economic activity based taxes, even if revenue or income based.

- Incentives can be an effective way to attract specific business activities, but should be used in a very targeted way to drive public benefits and incentivize activities that would not happen without the incentive. They must also produce a positive return on the investment made.

- Beyond targeted incentives, the best tax environments have particular characteristics in common, which are a low rate of tax applied to a broad base with minimal special provisions designed to pick winners and losers in chosen areas or industries.

- Above all else, a tax system should pursue the goal of simplicity over complexity. Simplicity makes the environment more attractive to businesses and individuals alike, creating a level and fair playing field and lending itself to transparent and certain administration of the tax system.

As mentioned, this article cites a broad range of views herein, including many that do not always agree with the principles stated above or my core views on tax policy. This diversity of views is intended to ensure the high quality of the debate. Throughout the process to come, we should include those perspectives even as we hold to our individual principles and the intent to enhance the tax and economic environment of Missouri to the benefit of all of its citizens. Only then will the process drive the thoughtful fact-based, thinking necessary to deal with this complex area.

II. Background and Overview

On June 30, 2017, the Governor's Committee on Simple, Fair and Low Taxes finished its duties and submitted its report (the "Committee's Report") to Governor Eric Greitens.[3] The Committee's report focused principally on tax credits and tax administration.[4] Its recommendations are included in Appendix A. However, the Committee heard testimony and received evidence on a number of additional and far ranging tax-related topics, including corporate income tax, individual income

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3. The Governor's Comm. on Simple, Fair, and Low Taxes, *Tax Credit Reform: Recommendations to Make Missouri a Best-In-Class State*, DED.MO.GOV 2 (June 30, 2017), https://ded.mo.gov/sites/default/files/TC%20Report%20FINAL.pdf [hereinafter *Missouri Tax Credit Reform*].
4. *Id.* at 6-27.

tax, sales tax, use tax and fuel tax.[5] The Committee reviewed information "on the numerous exclusions, exemptions, deductions, discounts, carve-outs, credits and loopholes that inhabit Missouri's current tax regime."[6]

As a next step beyond enactment of the recommendations, the Committee asked the Governor to charge the Director of the Missouri Department of Revenue to produce an article on the following topics:

1. Identify Missouri's tax laws and policies that hinder economic growth;

2. Compare Missouri's tax laws and policies to other states; and

3. Recommend a comprehensive plan, including legislation that would make Missouri's tax laws and policies achieve "best-in-class" status.[7]

This article builds upon the research, testimony, discussion, principles, and process that the Committee developed and relied upon during its existence. The article directly discusses the first two topics above, and begins the process of developing a package of proposals focused on the third by making suggestions worthy of further consideration. The intent of the article is to (1) put forward a thoughtful view on the challenges facing Missouri in the tax policy arena and (2) suggest ideas for further consideration in order to lay a foundation for high-quality, fact-based discussion leading to real, impactful action to position Missouri for the future.

The State of Missouri is imbued with great power to decide who, what, and how much to tax.[8] Tax policy influences economic choices; well-designed tax policies can encourage economic growth,[9] reduce budget deficits, and help bring debt ratios under control.[10] When the economy grows, tax revenues grow; when the economy performs poorly, tax revenues fall.[11] Policymakers can maximize growth and tax revenue by limiting taxes on factors that drive economic growth and moving away from economically inefficient taxes.[12] Tax policy can induce a greater rate of growth when it encourages working, saving, and investing in Missouri.[13]

Specifically, tax rate changes can enhance government revenue by promoting economic expansion. Stronger economic growth can come from lowering tax rates. Many governments try to find the balance between the level of tax rates and private-sector growth in jobs and income that is best for their citizens.[14] A key objective for

5. *Id.* at 27-28.
6. *Id.* at 28.
7. *Id.*
8. *An Overview of Tax Policy and Administration*, PRICEWATERHOUSECOOPERS, https://www.pwc.com/gx/en/services/tax/tax-policy-administration/what-is-tax-policy.html (last visited Dec. 9, 2017).
9. *Id.*
10. *Tax Policy Reform and Fiscal Consolidation*, OECD 2 (Dec. 2010), http://www.oecd.org/ctp/tax-policy/46600079.pdf [hereinafter *Tax Policy Reform*].
11. Andrew Lundeen, *Economic Growth Drives the Level of Tax Revenue*, TAX FOUND. (Oct. 15, 2014), https://taxfoundation.org/economic-growth-drives-level-tax-revenue.
12. *Id.*
13. William G. Gale & Andrew A. Samwick, *Effects of Income Tax Changes on Economic Growth*, DARTMOUTH 3 (Feb. 2016), http://www.dartmouth.edu/~samwick/Gale_Samwick.pdf; *Tax Policy Reform*, *supra* note 10, at 2.
14. Email from Bob Cline to author (Sept. 12, 2017) (on file with author).

attaining balance is finding the tax rates that maximize economic efficiency, while generating the revenue needed to fund public expenditures. However, if tax cuts are applied without proper care or understanding of the dynamic relationship of the economy, tax rates and the tax base, then simply lowering tax rates can have significant negative consequences.

Missouri has all the tools it needs to implement a bold tax policy proposal capable of enhancing the state's competitive business environment. Its economy is not dominated by one particular industry that demands special favors and special treatment. Its business community is engaged in state policy and willing to actively engage in tax reform matters. Missouri has a well-balanced mix of small, medium, and large population centers, businesses, and industries. Missouri's current pro-business political climate makes large scale reform a real possibility, and the Executive Branch is dedicated to making Missouri a hub for entrepreneurship and innovation. We are at a crossroads and could set the standard for smart, targeted growth.

Ultimately, the intent of this article is to build a foundation for the discussions that will chart a course for success over the long term. Once the challenges of Missouri's current tax regime are understood, a broader discussion of solutions can begin. This article provides suggestions on possible solutions rather than demanding changes that must be accepted without debate or discussion. Ultimately, it is up to Missouri's taxpayers, voters, and lawmakers to find effective solutions to the problems identified in Missouri's current tax regime.

This is a critical moment for our state. Taking the opportunity to develop a roadmap to the future will prime Missouri for future growth.

A. Guiding Principles

Before moving on to specific challenges in Missouri's tax environment and suggestions for possible courses of action, it is worth considering some core principles. Many commentators have laid out their views on the core principles of good tax policy and the pillars on which to build tax reform proposals.[15] An ideal tax structure would follow seven fundamental principles:

1. <u>Simple:</u> Our tax system should be simple, with fewer exemptions, credits, and special provisions for particular taxpayers and protected industries. These special provisions increase tax compliance costs and divert resources from more productive uses.[16] Individuals and businesses are forced to hire a multitude of accountants and lawyers to comply with the complexities of current tax laws.[17] Tax compliance costs also act as a barrier to entry for start-ups and new businesses.[18]

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15. *See* Aaron Hedlund, *A Guide to Tax Reform in Missouri: Report for the Governor's Committee for Simple, Fair, and Low Taxes*, FACULTY.MISSOURI.EDU 1 (May 1, 2017), https://faculty.missouri.edu/~hedlunda/policy/policy_taxes.pdf; *Principles of Sound Tax Policy*, TAX FOUND., https://taxfoundation.org/principles (last visited Dec. 8, 2017); Robert Cline et al., *What's Wrong with Taxing Business Services?: Adverse Effects From Existing and Proposed Sales Taxation of Business Investment and Services*, COUNCIL ON ST. TAX'N (Apr. 4, 2013), http://www.camarapr.org/Figueroa/What-is-wrongTaxingBusiness-Services.pdf.
16. Hedlund, *supra* note 15, at 2.
17. *Id.*
18. *Id.*

2. Fair: Missouri should have a fairer system that taxes all economic activities and comparable taxpayers similarly, regardless of a taxpayer's ability to hire advisors or other consultants to navigate the system. A fair system means a decrease in exemptions, exclusions, deductions and credits that the state has given to the well-connected. Similarly situated taxpayers should be treated the same.[19] The government should not be in the business of picking winners and losers.

3. Low: Missouri should aim for lower rates and a broader base of taxable activities rather than higher rates on a smaller segment of the economy. Lower tax rates would encourage prosperity for all Missourians, and broadening the base would enable Missouri to continue funding essential services. As the Governor stated in his Executive Order that established the Committee, "Missourians should pay no more in taxes than absolutely necessary to fund the essential services of state government."[20]

4. Efficient: The tax code should be designed to efficiently collect revenue for the state while minimizing distortions in taxpayers' choices. A taxpayer's decisions should be based on economic realities rather than tax regulations.[21]

5. Transparent: Taxpayers should know how their taxes are collected and where the state spends their money. Transparency holds the government accountable.[22] An opaque tax code allows lobbyists to tilt the tax code in favor of their clients.[23]

6. Stable: Stable revenue sources allow both businesses and the state to make long-term plans for economic development and job creation.[24] Stable revenue sources mean fewer cuts to government spending and fewer fee increases to account for future deficits. A stable and robust Missouri tax system should reduce fluctuations in tax revenues over the economic cycle, while generating additional revenues needed to fund public expenditures without tax rate increases as the economy grows over time.

7. Less Reliant on Income Tax: By its nature, a tax will increase the cost of the taxed item. By taxing income, the government makes earnings, savings, and investment more costly.[25] Missouri cannot encourage the social benefits of earning, saving, and investing by relying on individual income

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19. *Id.* at 3.
20. *See* John R. Ashcroft, *Executive Order 17-07*, MO. SECRETARY OF ST. (Jan. 25, 2017), https://www.sos.mo.gov/library/reference/orders/2017/eo7.
21. Hedlund, *supra* note 15, at 2-3.
22. *See, e.g.*, *Accountability and Transparency: Essential Principles*, DEMOCRACY WEB, http://democracyweb.org/accountability-principles (last visited Dec. 8, 2017).
23. Hedlund, *supra* note 15, at 3.
24. *Id.* at 4.
25. *Id.* at 3.

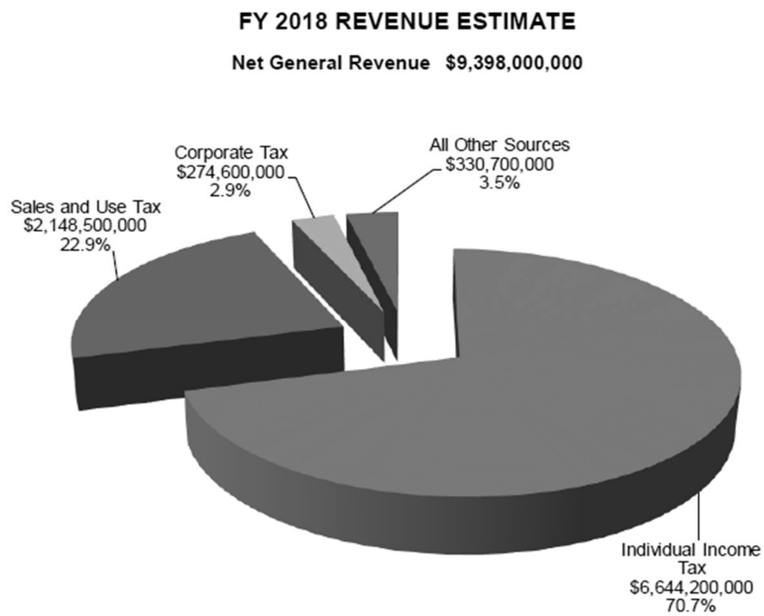
taxes for the majority of its revenue. The objective is a more balanced use of different taxes on income, consumption, and property.

These above principles guide the suggested recommendations throughout this article. Those recommendations should be considered—together with the changes proposed by the Committee—as a single package to build a best-in-class tax system for Missouri. With the exceptions of local sales taxes discussed below, this article does not address issues of local taxes or implications of federal tax policy changes. This article also does not address the effect of federal tax reform on Missouri's tax environment.

B. Missouri's Current Tax Landscape

Missouri collects the bulk of its general revenue from the individual income tax.[26] For Fiscal Year 2018, individual income tax is projected to comprise 70.7% of Missouri's total net general revenue.[27] The state's next largest source of state general revenue comes from sales and use tax; the Office of Administration projects that state sales and use tax will comprise 22.9% of Missouri's total net general revenue in Fiscal Year 2018.[28] The state's corporate income tax is projected to comprise 2.9% of Missouri's Fiscal Year 2018 net general revenue.[29]

Figure 1: Estimated Missouri Revenue (FY 2018).[30]



26. *See The Missouri Budget Fiscal Year 2018 Summary*, MO. OFF. OF ADMIN. 8, https://oa.mo.gov/sites/default/files/FY_2018_Budget_Summary.pdf (last visited Dec. 9, 2017) [hereinafter *The Missouri Budget*].
27. *Id.*
28. *Id.*
29. *Id.*
30. *Id.*

Missouri is sometimes referred to as a low tax state, although the evidence of this is mixed.[31] According to the Federation of Tax Administrators, Missouri has one of the lowest overall state tax burdens in the country, ranking 45th per capita and 44th as a percentage of personal income.[32] According to The Tax Foundation, Missouri has the 15th best business tax climate in the U.S., ranking 5th for corporate income tax.[33] Notably, many of the states ranked ahead of Missouri in business climate rankings do not impose one of the major tax types, such as corporate income tax, individual income tax, or sales and use tax.[34]

The praise that Missouri earns in some state tax comparisons obscures a much more mixed overall picture of Missouri's tax policy health.[35] For example, The Tax Foundation's annual State Business Tax Climate Index measures how well each state structures separate components of their tax systems.[36] The Tax Foundation's index ranks Missouri's individual income tax system as 24th in the nation while Missouri's sales tax comes in at 28th in the nation.[37] As discussed below, local jurisdictions play a large role in increasing Missourian's tax burden.[38] As a percentage of income, Missouri has a high effective state tax burden for many families.[39] According to Professor Aaron Hedlund, of the University of Missouri's Department of Economics, a family earning $50,000 per year faces a total tax burden of 10.3% in Kansas City, compared to 8.7% in Indianapolis, and 6.9% in Denver.[40] Additionally, a family earning $75,000 faces a higher total tax burden in Missouri than in most other states (see Figure 2 below).[41]

31. *See, e.g.*, Dave Helling, *Taxes in Kansas and Missouri: A Shifty Subject*, KANSAS CITY STAR (Mar. 31, 2014, 11:33 PM), http://www.kansascity.com/news/local/news-columns-blogs/the-buzz/article343823/Taxes-in-Kansas-and-Missouri-a-shifty-subject.html; Patrick Ishmael, *Putting to Bed the "Missouri is a Low Tax State" Myth*, FORBES (Mar. 23, 2014, 1:16 PM), https://www.forbes.com/sites/patrickishmael/2014/03/23/putting-to-bed-the-missouri-is-a-low-tax-state-myth/#1c3dabdf33c8.

32. *2016 State Tax Revenue*, FED'N OF TAX ADMINS., https://www.taxadmin.org/2016-state-tax-revenue (last visited Dec. 8, 2017) (noting that Missouri ranks are similar when state and local tax burden are combined; Missouri ranks 45th per capita and 44th as a percentage of personal income).

33. Jared Walczak et al., *2017 State Business Tax Climate Index*, TAX FOUND. (Sept. 28, 2016), https://taxfoundation.org/2017-state-business-tax-climate-index.

34. *Id.*; Morgan Scarboro, *State Corporate Income Tax Rates and Brackets for 2017*, TAX FOUND. (Feb. 27, 2017), https://taxfoundation.org/state-corporate-income-tax-rates-brackets-2017 [hereinafter Scarboro, *State Corporate Income*]; Morgan Scarboro, *State Individual Income Tax Rates and Brackets for 2017*, TAX FOUND. (Mar. 9, 2017), https://taxfoundation.org/state-individual-income-tax-rates-brackets-2017.

35. *See* Jared Walczak et al., *supra* note 33; *see also Taxes in Missouri*, TAX FOUND., https://taxfoundation.org/state/missouri (last visited Dec. 9, 2017).

36. *See* Jared Walczak et al., *supra* note 33; *see also Taxes in Missouri*, *supra* note 35.

37. Jared Walczak et al., *supra* note 33.

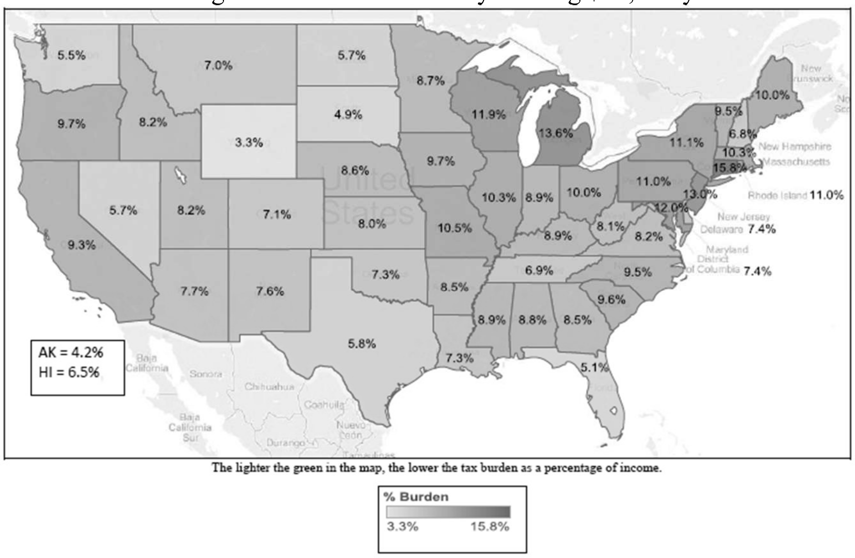
38. *See* discussion *infra* Part V. B.

39. Hedlund, *supra* note 15, at 4.

40. *Id.*; *see also infra* Figure 2.

41. Hedlund, *supra* note 15, at 4.

Figure 2: 2014 Total State Tax Burdens (Income, Sales, Property, and Auto) as a Percentage of Income for a Family Earning $75,000/year.[42]



1. *Constitutional Mandates*

An investigation into the current tax policy of the state of Missouri must acknowledge Missouri's constitutional and budgetary boundaries.

i. Hancock Amendment

In 1980, the state's electorate voted to add Article X, §§16-24, often referred to as the Hancock Amendment, to the Missouri Constitution.[43] The Hancock Amendment restricts the amount of taxpayers' personal income that can be used to fund state government.[44] No more than 5.6% of taxpayers' personal income can be used to fund state government unless the revenue increase is approved by a vote by the people; in 2016, Missouri was $4.1 billion under that threshold.[45] Article X, §18 of the Missouri Constitution also places a monetary cap on the amount of new annual revenues that the General Assembly may produce without a vote of the people.[46] For Fiscal Year 2017, the cap for new annual revenues was $101.5 million.[47]

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42. Gov't of D.C., *Tax Rates and Tax Burdens in the District of Columbia – A Nationwide Comparison*, CHIEF FIN. OFFICER 22 (Dec. 2015), https://cfo.dc.gov/sites/default/files/dc/sites/ocfo/publication/attachments/2014%2051City%20Study.pdf.
43. Nicole Galloway, *Review of Article X, Sections 16 through 24, Constitution of Missouri Year Ended June 30, 2016*, MO. ST. AUDITOR (May 2017), https://app.auditor.mo.gov/Repository/Press/2017033485180.pdf.
44. *Id.*
45. *Id.*
46. MO. CONST. art. X, § 18(e), cl. 1.
47. *The Missouri Budget*, *supra* note 26, at 6.

ii. Amendment 4

In November 2016, Missourians voted to add Article X, § 26 to Missouri's Constitution, commonly referred to as Amendment 4.[48] Amendment 4 prohibits the imposition of sales, use, or similar transaction-based taxes on any service or transaction that was not subject to such taxes on January 1, 2015.[49] As the U.S. economy becomes more service-centric, Amendment 4 will play an increasingly prominent role in Missouri's tax future by reducing Missouri's ability to tax this fast growing segment of the economy.

iii. Budgetary Constraints

It is imperative to point out that the Missouri Constitution demands that the General Assembly pass a balanced budget each year.[50] Missouri cannot engage in the deficit spending that has led the federal government to saddle future generations with governmental debt.[51] Missouri must meet its obligations.[52] These obligations are met through a number of different taxes.[53]

Recommendations for Missouri's tax policy must be considered in the context of short-term budgetary challenges. Missouri has experienced a recent plague of budget shortfalls, including a deficit of over $500 million that awaited Governor Greitens upon his inauguration.[54] Budget deficits have led to constant funding battles for critical state functions such as education and infrastructure.[55] According to the Missouri Budget Project, Missouri's spending for primary and secondary education ranks 34th nationally.[56] As a result, the responsibility for school funding continues to shift to localities, furthering a funding disparity amongst the state's school districts.[57]

With these guideposts firmly established, we can now discuss how the following taxes specifically impact Missouri's overall economic environment: corporate income tax, individual income tax, sales tax, fuel tax and non-competitive discounts currently provided by the state.

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48. *State of Missouri Election Night Results*, MO. SECRETARY OF ST., http://enrarchives.sos.mo.gov/enrnet/default.aspx?eid=750003949 (last visited Dec. 8, 2017) (select "State of Missouri – General Election, November 8, 2016" in drop-down menu; then click "Submit" button). *See also* MO. CONST. art. X, § 26.

49. MO. CONST. art. X, § 26.

50. Hedlund, *supra* note 15, at 4.

51. *See* MO. CONST. art. III, § 37.

52. *See id.*

53. *See The Missouri Budget*, *supra* note 26, at 8.

54. *See, e.g.*, Kurt Erickson, *State Budget Woes Could Hamper Efforts to Boost Missouri Worker Pay*, ST. LOUIS POST-DISPATCH (Jan. 11, 2017), http://www.stltoday.com/news/local/govt-and-politics/state-budget-woes-could-hamper-efforts-to-boost-missouri-worker/article_dfdcf0d2-3a02-50f8-b68b-5f27bc885085.html.

55. *See* Jason Hancock, *Welcome to the Governor's Office – Eric Greitens Could Face Big Missouri Budget Shortfall*, KANSAS CITY STAR (Nov. 15, 2016), http://www.kansascity.com/news/politics-government/article114980593.html.

56. *See Education Spending Per Student by State*, GOVERNING.COM (Dec. 8, 2017), http://www.governing.com/gov-data/education-data/state-education-spending-per-pupil-data.html.

57. *See* Michael Leachman et al., *Most States Have Cut School Funding, and Some Continue Cutting*, CTR. ON BUDGET & POL'Y PRIORITIES (Jan. 25, 2016), https://www.cbpp.org/research/state-budget-and-tax/most-states-have-cut-school-funding-and-some-continue-cutting.

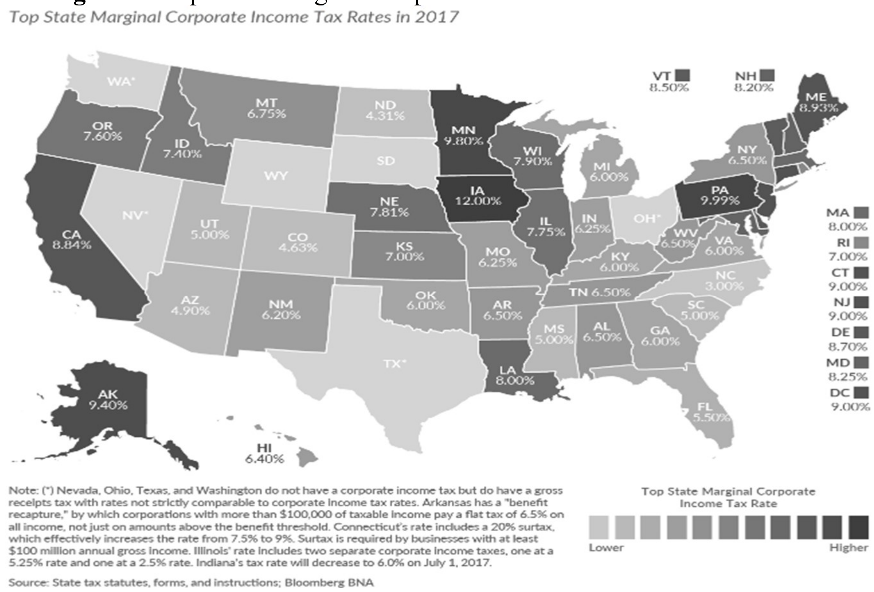
III. CORPORATE INCOME TAX

The public at large often views the corporate income tax as a fair method of tax, since profit-driven corporations must pay a portion of their taxable income to the state in exchange for publicly provided goods and services.[58] These publicly provided goods and services include the rule of law and access to the market.[59] States receive the extra benefit of meeting their obligations by levying taxes on corporations instead of directly taxing their voting constituents.[60]

For reasons such as these, the corporate income tax has gained widespread acceptance in state legislatures around the nation, with some variance in implementation. Forty-four states, including Missouri, levy a corporate income tax.[61] In the states that levy a corporate income tax, the rate of corporate income taxation ranges from 3% in North Carolina to 12% in Iowa; the average top state corporate income tax rate is 7.06%.[62] Missouri's rate stands at a flat 6.25%.[63] Note that this article will compare Missouri's tax rates to the tax rates of its neighboring states: Arkansas, Illinois, Iowa, Kansas, Kentucky, Nebraska, Oklahoma, and Tennessee ("Missouri's border states"). Of Missouri's border states, only Kentucky and Oklahoma have a top statutory rate of corporate income tax that is lower than Missouri's 6.25% rate.[64] Fourteen states have a bracketed corporate income tax system, which ranges from two brackets (e.g. Kansas, Nebraska, New Mexico, and Oregon) to ten brackets (e.g. Alaska).[65]

58. WALTER HELLERSTEIN & JOHN A. SWAIN, STATE TAXATION ¶ 6.04 THE THEORETICAL AND JURISPRUDENTIAL UNDERPINNINGS OF STATE JURISDICTION TO TAX INCOME: RESIDENCE AND SOURCE 1-2 (3d ed. 2017), 1999 WL 1398868.
59. *Id.*
60. Scarboro, *State Corporate Income*, *supra* note 34.
61. *Id.*
62. *Id.*
63. *Id.*
64. *Id.* (noting that Kentucky and Oklahoma each have a top corporate income tax rate of 6%).
65. *Id.*

Figure 3: Top State Marginal Corporate Income Tax Rates in 2017.[66]



Texas, Ohio, Nevada, and Washington levy a type of gross receipts tax in lieu of a corporate income tax or as a component of their corporate tax.[67] South Dakota and Wyoming stand alone as the only states that impose neither a corporate income tax nor a gross receipts tax.[68]

A. Inherent Drawbacks

Despite its widespread acceptance, the corporate income tax inherently carries a multitude of drawbacks.[69] Higher corporate taxes diminish a number of desirable economic activities, such as new business formation, capital investment, employment growth, and higher wages.[70] One example of the distortions that can be driven by the corporate income tax is that the federal corporate income tax regime allows corporate taxpayers to deduct interest payments but not dividend payments—as a result, it is possible that corporations may leverage themselves through debt financing, which decreases taxable income, because of the tax system rather than commercial drivers.[71] Additionally, corporate income faces the specter of double taxation: first, the corporation itself pays taxes on its net income; then, corporate shareholders pay individual taxes on the dividends distributed by the corporation.[72]

Moreover, the corporate income tax is passed on to others rather than absorbed by the companies.[73] While a tax on corporations may be more politically palatable than an additional tax levied specifically on individuals, corporations factor in taxes

66. *Id.*
67. *Id.*
68. *Id.*
69. Hedlund, *supra* note 15, at 6.
70. *Id.*
71. *Id.*
72. *Id.*
73. *Id.*

when pricing their services, products and determining what they can afford to pay for their inputs, including labor.[74] For example, corporations may have less money to pay their workers due to the corporate income tax if they sell their products and services in competitive markets.[75] As another example, the dividends that shareholders would have received from a corporation are decreased when corporate income tax lowers a company's retained earnings, if the tax cannot be shifted forward to consumers in higher prices or backwards to their employees in lower wages.[76]

Bob Cline, a former senior advisor for the Organization for Economic Cooperation and Development notes, "[e]conomists are particularly concerned about the potential negative impacts of relative high tax rates on mobile investment, such as plant and equipment, due to income and property taxes."[77] It is well understood that the corporate income tax imposes a drag on economic activity because it is a material reduction of investment returns, imposes an administrative burden due to its complexity, and is inconsistently applied.[78] All of these factors combine to reduce the attractiveness of a state's overall business environment the more it relies on a corporate income tax.[79]

B. Implementation Issue: Apportionment

Apportioning corporate income tax in Missouri is simple—for Missouri corporations that only have nexus in Missouri. A Missouri corporation's state income tax is based on the federal taxable income that it reports on its federal corporate income tax return.[80] Next, the return is adjusted based on any Missouri modifications and adjustments.[81] Finally, the tax is calculated at a flat rate of 6.25% of Missouri taxable income.[82]

However, for multi-state or multinational corporate income tax filers, the calculation can be more complex. Under the U.S. Constitution, states may only tax income that is "rationally related to [the taxpayer's] values connected with the taxing [s]tate[s]."[83] This means that states are required to offer an apportionment method to a corporation with business from outside of the state.[84] The goal is to tax the income that is attributable to Missouri, while avoiding double state taxation of the corporation's income.[85]

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74. *See* Juan Carlos Suarez Serrato & Owen Zidar, *Who Benefits From Corporate Tax Cuts? Evidence from Local US Labour Markets*, MICROECONOMIC INSIGHTS (Nov. 2, 2017), http://microeconomicinsights.org/benefits-corporate-tax-cuts-evidence-local-us-labour-markets/?utm.

75. *See* Bruce Bartlett, *Who Pays The Corporate Income* Tax, N.Y. TIMES: ECONOMIX BLOG (Feb. 19, 2013, 6:00 AM), https://economix.blogs.nytimes.com/2013/02/19/who-pays-the-corporate-income-tax/.

76. *Cf. id.*

77. Email from Bob Cline to author, *supra* note 14. Note that property tax is outside the scope of this paper.

78. *See Missouri Tax Credit Reform*, *supra* note 3, at 3.

79. *Id.*

80. MO. REV. STAT. § 143.431 (2012).

81. *Id.*

82. *Id.* § 143.071.

83. Quill Corp. v. North Dakota, 504 U.S. 298, 306 (1992).

84. *Id.* at 311.

85. *See* MO. REV. STAT. § 32.200 (2016) (Multistate Allocation and Three Factor Apportionment, Multistate Tax Compact).

Missouri offers eight apportionment methods.[86] Comparable to other states, Missouri offers methods for specific industries such as railroad and transportation.[87] However, Missouri also offers three methods available to any corporation, including the three factor apportionment method that takes into account the taxpayer's, sales, property, and payroll in Missouri, and also an optional single sales factor apportionment method that only apportions corporate income based on the taxpayer's sales in Missouri.[88] These multiple methods give taxpayers the opportunity to select the most beneficial method, which leads to less revenue collected for the state.

The Missouri Budget Project submitted written testimony to the Committee, in which it noted that state corporate income tax revenue has fallen by 60% since 2015.[89] The Missouri Budget Project said that Missouri's current law favors multistate businesses based in states other than Missouri.[90] To combat this imbalance, they advocated replacing all current apportionment options with a simple, single sales factor formula that all companies must utilize.[91] The shift to a single sales factor apportionment formula is clearly a nationwide trend. As of January 1, 2017, 20 states use the single sales factor as the basis for apportioning a taxpayer's multistate corporate income.[92] Twenty-two states use the three factor apportionment method.[93] As any change in the apportionment formula can either increase or decrease the taxes paid by specific businesses, proposals for apportionment changes should be evaluated carefully in terms of overall revenue impacts and distributions of the changes across industries and types of businesses.

C. Limited Benefit and Large Volatility

In addition to its inherent drawbacks and its implementation issues, Missouri's corporate income tax raises a very small percentage of the state's tax revenue.[94] As shown in Figure 1 above, the Missouri Office of Administration estimates that corporate income tax will make up 2.9% of Missouri's net general revenue in Fiscal Year 2018.[95] Additionally, the corporate income tax does not account for a large percentage of the tax burden paid by Missouri businesses.[96] In 2015, Missouri's corporate income tax provided 5.6% of its total state and local business tax

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86. *See id.*; MO. REV. STAT. § 143.451.2(2) (2011) (Business Transaction Single Factor Apportionment); § 143.451.2(3) (Optional Single Sales Factor Apportionment); § 143.451.3 (Transportation); § 143.451.4 (Railroad); § 143.451.5 (Interstate Bridge); § 143.451.6 (Telephone and Telegraph); § 143.461.2 (Other Approved Method).

87. *See* § 143.451.3 (Transportation); § 143.451.4 (Railroad).

88. *See* § 32.200 (Multistate Allocation and Three Factor Apportionment, Multistate Tax Compact); § 143.451.2(2) (Business Transaction Single Factor Apportionment).

89. Amy Blouin, *MO Has Better Choices to Balance the Budget*, MO. BUDGET PROJECT (Apr. 19, 2017), http://www.mobudget.org/mo-has-better-choices-to-balance-the-budget/.

90. *See generally* Amy Blouin, *Guest Commentary: Bad Tax Policy at the Core of Missouri's Budget Problems*, KANSAS CITY STAR (Apr. 23, 2017, 8:30 PM), http://www.kansascity.com/opinion/readers-opinion/guest-commentary/article146095024.html.

91. *Id.*

92. *State Apportionment of Corporate Income*, FED'N OF TAX ADMINS. (Jan. 1, 2017), https://www.taxadmin.org/assets/docs/Research/Rates/apport.pdf.

93. *Id.*

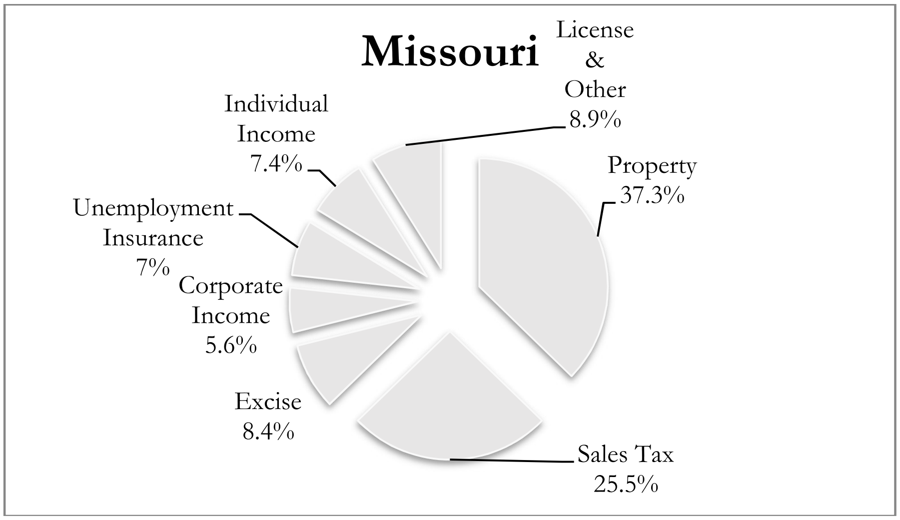
94. Hedlund, *supra* note 15, at 6.

95. *The Missouri Budget*, *supra* note 26, at 8.

96. Hedlund, *supra* note 15, at 6.

revenue.[97] This is the lowest percentage of the states bordering Missouri except for Oklahoma, whose corporate income tax provides 5.4% of its total state and local business tax revenue.[98]

Figure 4: Missouri Composition of State and Local Business Taxes by Type, Fiscal Year 2015.[99]



Nationwide, corporate income taxes make up only 9.5% of the total, as shown in Figure 5 below.[100]

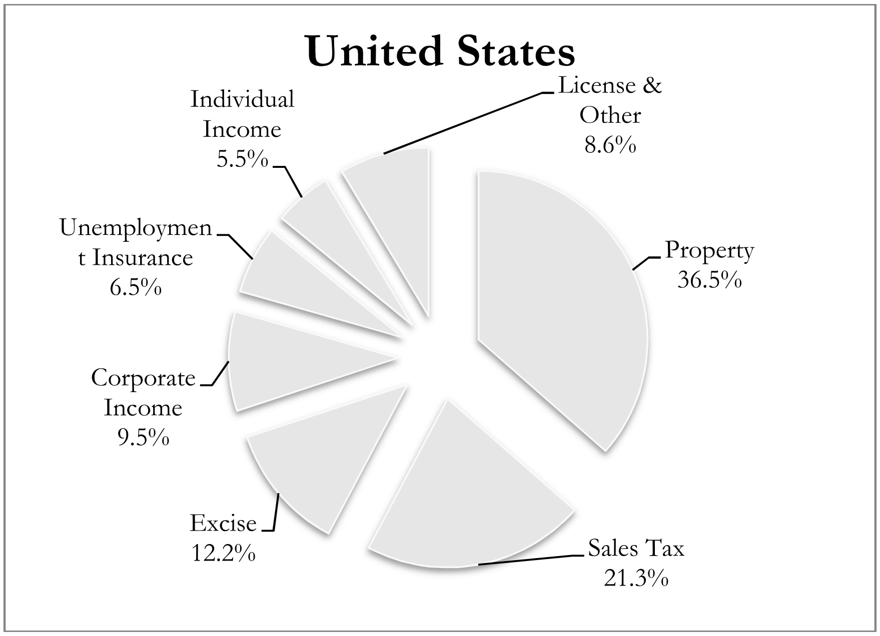
97. *See Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2015*, COUNCIL ON ST. TAX'N 23 (Dec. 2016), http://www.cost.org/globalassets/cost/stri/studies-and-reports/burden-study-2016.pdf.

98. *See id.*

99. Douglas L. Lindholm, *Testimony Before the Governor's Committee on Simple, Fair, and Low Taxes*, COUNCIL ON ST. TAX'N 2 (May 15, 2017) (on file with the University of Missouri School of Law Business, Entrepreneurship & Tax Law Review).

100. *Id.*

Figure 5: Composition of State and Local Business Taxes by Type, Fiscal Year 2015.[101]



Moreover, the corporate income tax is a volatile revenue source that swings widely with changes in corporate net income over the economic cycle. It is a volatile revenue source because it is only collected when a corporation's revenue is not offset by deductions, tax credits, or other means of decreasing taxable income.[102] Corporate income tax revenues respond heavily to economic upswings and downturns.[103] Additionally, its malleability is shown by Missouri's recent legislative changes to the corporate income tax.[104]

D. Pass-Through Entities

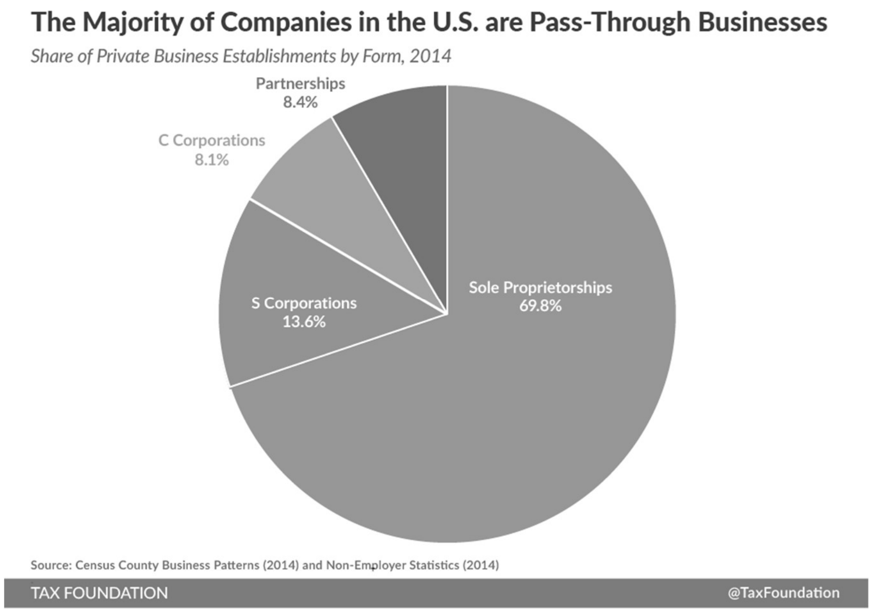
The corporate income tax is not levied on all types of business income. It does not affect business income earned by non-corporate legal entities such as partnerships, S-corporations, and limited liability companies ("LLCs"), collectively known as "pass-through" entities.[105] Pass-through entities do not face the problem of double taxation to which C-corporations (hereafter referred to as simply "corporations") are subjected.[106] A corporation must pay corporate income tax on its net income earned.[107] When corporations distribute their retained earnings to their

101. *Id.*
102. *See* Zahradnik et al., *Tax Revenue Volatility Poses Budget Challenges for Some States*, THE PEW CHARITABLE TR. (Feb. 2, 2017), http://www.pewtrusts.org/en/research-and-analysis/analysis/2017/02/02/tax-revenue-volatility-poses-budget-challenges-for-some-states (discussing revenue volatility of different tax types).
103. Lindholm, *supra* note 99, at 3.
104. *See, e.g.*, S.B. 19, 98th Gen. Assemb., 1st Reg. Sess. (Mo. 2015).
105. *See* Hedlund, *supra* note 15, at 6.
106. *See id.*
107. *See id.*

shareholders through a dividend, the shareholders must pay tax on that dividend again.[108] In contrast, a pass-through entity does not have to pay any income tax at the business-entity level on the income it earns.[109] Instead, the owners of the pass-through entity include the income generated by the pass-through entity in their own income.[110] Income earned by a pass-through entity is only taxed once.[111]

The majority of business in the United States is conducted by pass-through entities and sole proprietorships rather than corporations.[112] In 2014, only 8.1% of businesses in the United States were corporations and nearly 70% of companies were sole proprietorships.[113] In 2012, pass-through businesses in the U.S. earned over $1.6 trillion of net income, while corporations earned approximately $1.1 trillion.[114] In every state but Hawaii, pass-through entities are responsible for employing over half of the private workforce.[115]

Figure 6: Share of U.S. Private Business Establishments by Form, 2014.



Best practice suggests that the business activities of traditional corporations, pass-through entities, and sole proprietorships should be taxed in the same manner. Similar tax treatment would seek to eliminate any tax motivation in the choice of a particular legal entity type, and would call for a system that taxes income once at

108. *See id.*
109. *See id.*
110. *See id.*
111. *See id.*
112. Scott Greenberg, *Pass-Through Businesses: Data and Policy*, TAX FOUND. (Jan. 17, 2017), https://taxfoundation.org/pass-through-businesses-data-and-policy/.
113. *Id.*
114. *Id.*
115. *Id.* (noting that in Hawaii, pass-through businesses are responsible for employing 49.9% of the private workforce).

the same tax rate for all businesses.[116] This supports the principle of taxing comparable businesses uniformly.

E. Business Tax Approaches of Other Jurisdictions: Gross Receipts Tax, Margin Tax, Franchise Tax, and No Tax

In lieu of a corporate income tax, some states have pursued a replacement in the form of a gross receipts tax.[117] Gross receipts taxes differ from standard corporate income taxes because a gross receipts tax levies a tax on total business revenue rather than net income.[118] In other words, the gross receipts tax is an income based tax that does not allow for deductions of business expenses.[119] Gross receipts taxes first became popular in the late 1920s and early 1930s due to decreased state revenues from the Great Depression.[120] Gross receipts taxes typically have a wider base than the corporate income tax.[121] The wider base allows for the same amount of tax revenue to be generated with a lower rate.[122] Since the gross receipts tax levies a tax on gross receipts rather than net income, the gross receipts tax is less responsive to economic cycles and therefore more predictable than a corporate income tax.[123]

The gross receipts tax may also provide states with a greater ability to collect some level of tax on remote sellers who do not have a physical presence in the state. As a revenue-based tax, the gross receipts tax is subject to a less stringent nexus test than transaction-based taxes, like sales and use taxes.[124] In many cases, Missouri is limited in its ability to collect sales and use tax on remote sellers who do not have a physical presence in Missouri.[125]

Some states have enacted a gross receipts tax with apparent success. Ohio's Commercial Activity Tax ("CAT") imposes a tax on the privilege of doing business in Ohio and uses a business's gross receipts to measure the base in determining the amount of tax owed.[126] As the CAT was phased in, Ohio steadily phased out two separate taxes, the tangible personal property tax and corporate franchise tax, for most of the entities that do business in Ohio.[127] While the CAT concept has been

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116. *See* Paul Burnham, *Taxing Businesses Through the Individual Income Tax*, CONG. BUDGET OFF. 20-25 (Dec. 2012), https://www.cbo.gov/sites/default/files/112th-congress-2011-2012/reports/Taxing-Businesses_OneColumn.pdf. (discussing policy implications of federal tax reform that would specify the taxation of pass-through entities).

117. Eric J. Coffill & Jessica N. Allen, *Some Observations on Gross Receipts Taxes*, EVERSHEDS SUTHERLAND (July 2017), https://us.eversheds-sutherland.com/portalresource/lookup/poid/Z1tOl9NPluKPtDNIqLMRV56Pab6TfzcRXncKbDtRr9tObDdE-oWZDp43!/fileUpload.name=/Some%20Observations%20on%20Gross%20Receipts%20Taxes%20(JMT%20July%202017).pdf.

118. *Id.*

119. Email from Bob Cline to author, *supra* note 14.

120. Nicole Kaeding, *Gross Receipts Taxes: Lessons from Previous State Experiences,* TAX FOUND. (Aug. 10, 2016), https://taxfoundation.org/gross-receipts-taxes-state-experiences/.

121. Lindholm, *supra* note 99, at 5.

122. *See generally* Coffill & Allen, *supra* note 117.

123. *Id.*

124. *See* Crutchfield v. Testa, No. 2015-0386, 2016 WL 6775765, at *42-43 (Ohio Nov. 17, 2016).

125. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 317-18 (1992).

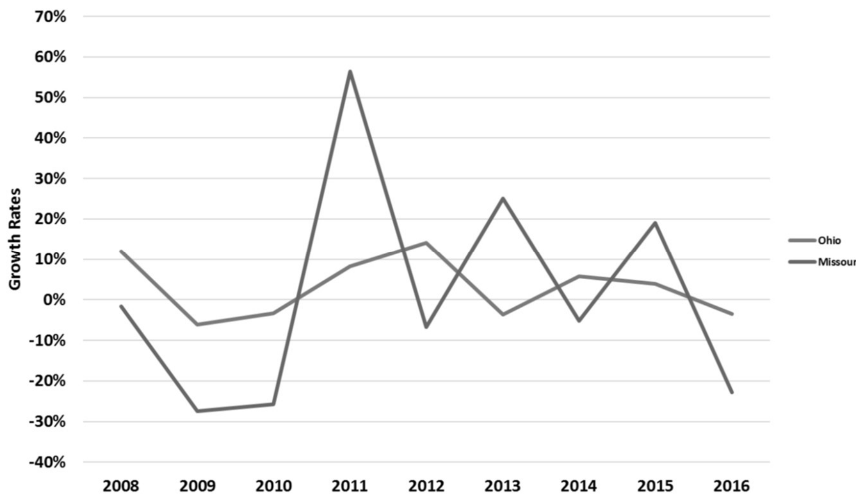
126. *Commercial Activity Tax*, OHIO DEP'T OF TAX'N 38, http://www.tax.ohio.gov/Portals/0/communications/publications/annual_reports/2015_annual_report/2015_AR_Section_2_Commercial_Activity_Tax.pdf (last visited Dec. 9, 2017).

127. *Id.*

considered more recently in other states, no state has adopted the CAT tax at this time. The Ohio CAT is discussed in detail here because it is a model worthy of careful study.

In his testimony before the Committee, Bob Cline noted that over the past decade, Ohio's CAT has displayed a number of positive qualities.[128] First, the CAT has a very stable base.[129] Ohio's actual gross receipts revenues in 2012 were only 5% below its 2005 estimates, despite the intervening Great Recession.[130] Professor William Fox, Director of the University of Tennessee-Knoxville Boyd Center for Business and Economic Research, emphasized the CAT's stability in his testimony before the Committee.[131] Professor Fox compared the growth and reduction rates in Ohio's CAT to Missouri's corporate income tax. Professor Fox's findings are displayed in Graph 1, below.

Graph 1



To be clear, there are strong critics of the gross receipts tax.[132] Critics point to a negative impact on businesses with low net income or even net loss positions, which could have high effective tax rates under the gross receipts tax.[133] Some maintain that the gross receipts tax can lead to higher consumer prices, lower wages, and fewer job opportunities.[134] After investigating the gross receipts tax experiences of Indiana, New Jersey, Kentucky, and Michigan, Nicole Kaeding of The Tax Foundation wrote, "these types of taxes violate principles of sound tax policy. They are not neutral, competitive, fair, transparent, nor equitable."[135]

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128. *MBR Testimony Highlights the Week at the Statehouse*, COUNTY COMMISSIONERS ASS'N OF OHIO 1-2 (Mar. 28, 2014), https://www.ccao.org/userfiles/SHR20140328.pdf.
129. *Commercial Activity Tax*, *supra* note 126, at 1.
130. *See* Jared Walczak, *Why Does Misssouri Want a Gross Receipts Tax?*, TAX FOUND. (Sept. 26, 2017), https://taxfoundation.org/missouri-want-gross-receipts-tax/.
131. *See generally* Jared Walczak, *Ohio's Commercial Activity Tax: A Reappraisal*, TAX FOUND. (Sept. 26, 2017), https://taxfoundation.org/ohio-commercial-activity-tax-2017/#_ftn61.
132. *See, e.g.*, Kaeding, *supra* note 120.
133. *See* Coffill & Allen, *supra* note 117.
134. *Id.*
135. Kaeding, *supra* note 120.

Gross receipts tax can be referred to as an "alternative base tax," meaning that it is levied on a different tax base than the corporate income tax.[136] In his testimony before the Committee, Doug Lindholm, the President and Executive Director of the Council on State Taxation, recommended avoiding "alternative base" business taxes.[137] Lindholm noted, "[g]ross receipts taxes are widely acknowledged to violate numerous tax policy principles," such as creating tax pyramiding. [138] Tax pyramiding results when goods and services are taxed multiple times during production and distribution.[139]

1. Other States' Approaches

Other states have taken different approaches in reforming business taxes. For example, Minnesota imposes a franchise tax on businesses, a form of income taxation.[140] Minnesota also imposes a minimum fee on all corporations and partnerships for doing business in the state.[141] The minimum fee is based on the total amount of sales, payroll, or property sourced in the state.[142] This is an alternative tax base measured by instate economic activity, not just net income.[143]

Texas administers a margin tax, which contains elements of both a gross receipts tax and a corporate franchise tax.[144] The margin tax is imposed solely on business entities.[145] Texas' margin tax is difficult to calculate as it is a tax upon a margin, which is determined by total revenue minus certain deductions.[146] Further, the tax is heavily tailored by industry with myriad deductions and exclusions.[147] According to Bob Cline:

> [a]nother variation is the business tax system in New Hampshire that imposes a value-added tax base through the interaction of different types of business taxes, an income tax and a value added tax excluding profits. Michigan had a value-added business entity tax on all forms of doing business for a number of years, before replacing it more recently with a corporate income tax.[148]

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136. *See generally* Lindholm, *supra* note 99, at 4.
137. *See id.* at 6.
138. *Id.* at 4.
139. Cline et al., *supra* note 15, at 7.
140. Joel Michael, *Corporate Franchise Tax*, MINN. HOUSE OF REPRESENTATIVES (June 2015), http://www.house.leg.state.mn.us/hrd/pubs/ss/sscorpft.pdf.
141. *What is the Minimum Fee?*, MINN. DEP'T OF REVENUE, http://www.revenue.state.mn.us/Pages/FAQ.aspx?WebId=bdadcc45%2Dd292%2D4cbe%2D9a25%2Dd63acdab3f54&Owner=Corporation%20Franchise%20Tax&Topic=What%27s%20New#FAQ23 (last visited Dec. 8, 2017).
142. Michael, *supra* note 140.
143. *Id.*
144. *Understanding the Texas Franchise – or "Margin" – Tax*, TEX. TAXPAYERS AND RES. ASS'N 1 (Oct. 2011), http://www.ttara.org/files/document/file-4ea5bda9239ef.pdf.
145. *Id.*
146. *Id.*
147. *See generally id.* at 3-4.
148. Email from Bob Cline to author, *supra* note 14.

F. The Future of the Missouri Corporate Income Tax

Missouri's current corporate income tax structure is complex, opaque, volatile, and slanted towards special interests that can afford lobbyists, accountants, and tax attorneys to wade through the morass of statutes and regulations. Tax reform is needed to even the playing field. In particular, effective corporate tax reform would address five specific problems.

First, any tax reform would need to reduce complicated special provisions presently available in Missouri. Second, tax reform would need to fix Missouri's complicated apportionment system. Third, tax reform would need to simplify state tax compliance—the burden of untangling the inherent complexities in Missouri's corporate income tax law is far too great to support a healthy economic climate in Missouri. Fourth, tax reform should end Missouri's current practice of rewarding businesses for choosing one legal entity type over another. Fifth, tax reform should pursue a stable revenue source. Finally, any tax reform should be implemented strategically using economic triggers. Closely monitoring and re-evaluating throughout the reform process will be key to success.

IV. INDIVIDUAL INCOME TAX

The individual income tax has been lauded as a "highly desirable form of taxation" because it closely taxes individuals according to their ability to pay.[149] Proponents justify the individual income tax for many of the same reasons that they justify the corporate income tax: individuals enjoy "the privileges of residence in the state and the attendant right to invoke the protection of its laws," and these privileges are "inseparable from the responsibility for sharing the costs of government."[150]

Two factors make the individual income tax simple, cost effective and attractive when compared to other taxes. First, the majority of the tax is deducted directly from Missouri taxpayers' paychecks and paid to the state by the employer.[151] Second, Missouri begins its taxable income calculation with a figure that each taxpayer must calculate regardless of state tax: the taxpayer's federal adjusted gross income.[152]

A. Inherent Drawbacks

Despite its apparent simplicity, the individual income tax shares many drawbacks with the corporate income tax. The individual income tax is inefficient and less desirable than other tax methods for a number of reasons:

1. It implicitly discourages productive activity that would otherwise benefit society and the economy, including work, risk-taking, saving,

149. WALTER HELLERSTEIN & JOHN A. SWAIN, STATE TAXATION ¶20.01 INTRODUCTION 1 (3d ed. 2017), 1999 WL 1399040.

150. WALTER HELLERSTEIN & JOHN A. SWAIN, STATE TAXATION ¶20.04 INCOME TAXATION OF RESIDENTS 1 (3d ed. 2017), 1999 WL 1399043 (quoting New York ex rel. Cohn v. Graves, 300 U.S. 308, 313 (1937)).

151. *See* MO. REV. STAT. § 143.191 (2016).

152. *See id.* § 143.121.

investment, and the accumulation of monetary and human capital.[153] The higher the marginal tax rate, the greater the disincentive;

2. It depresses growth with rising marginal tax rates;[154] and

3. It may adversely impact labor market high performers.[155]

B. Rates and Brackets

Forty-three states collect revenue through individual income taxes.[156] The average top state individual income tax rate across all states is 6.31%, which is higher than Missouri's top rate of 5.9%.[157]

Missouri remains in the middle of the pack for individual income tax competitiveness.[158] In contrast, states like North Carolina and Indiana have increased their competitiveness and moved up in national rankings by cutting their individual tax rates.[159] North Carolina recently reduced its highest individual income tax rate from 7.75% to 5.499%,[160] and Indiana decreased its individual income rate from 3.3% to 3.23%.[161] At the other end of the spectrum, states like California suffer from cyclical revenue volatility in part due to income tax surcharges on high incomes.[162]

Missouri has a unique system of taxing individual income. Missouri's ten tax brackets were established in 1931.[163] Missouri and California are the only states in the country with ten individual income tax brackets.[164] Two of Missouri's border states tax individual income at a flat rate; the tax brackets of the remaining states range from two to nine, with an average of six.[165] Missouri's individual income tax brackets increase at very small increments of taxable income. Missouri begins to tax income at a higher rate once an individual's taxable income exceeds $1,000.[166] While many states begin taxing income as soon as taxable income exceeds $0, Alabama and Georgia are the only states whose second tax bracket takes effect at a lower amount of taxable income than Missouri.[167] To the extent that Missouri

153. Hedlund, *supra* note 15, at 5.
154. *Id.*
155. *Id.*
156. Nicole Kaeding, *State Individual Income Tax Rates and Brackets for 2016*, TAX FOUND. (Feb. 8, 2016), https://taxfoundation.org/state-individual-income-tax-rates-and-brackets-2016/ [hereinafter *State Individual Income Tax Rates and Brackets for 2016*].
157. *See id.*
158. Hedlund, *supra* note 15, at 5.
159. Jared Walczak et al., *supra* note 33.
160. *Id.*
161. *Id.*; *2017 Indiana Individual Income Tax Rate Changes Announced*, IND. DEP'T OF REVENUE (Dec. 14, 2016), http://www.in.gov/activecalendar/EventList.aspx?fromdate=12/14/2016&todate=12/27/2016&display=&type=public&eventidn=255077&view=EventDetails&information_id=253522.
162. Hedlund, *supra* note 15, at 5.
163. *See* Inst. on Taxation and Econ. Policy, *State Taxes Hit Poor & Middle Class Missourians Far Harder than Wealthy*, MO. BUDGET PROJECT (Nov. 18, 2009), http://www.mobudget.org/files/Who%20Pays%20Release%202009.pdf.
164. *See State Individual Income Tax Rates and Brackets for 2016*, *supra* note 156.
165. *See id.*
166. *Id.*
167. *Id.*

income tax rate progressivity is greater than in border or competitive states, it may affect the state's economic competitiveness.

Missouri's individual income tax brackets increase by increments of $1,000 until reaching the highest tax bracket of $9,000.[168] Of the states with individual income tax brackets, only three states set their highest individual tax bracket at a lower level of income than Missouri: Alabama, Georgia, and Oklahoma.[169] Missouri's current rates were implemented in 1971, when the average wage in the United States was slightly over $6,400.[170] The current structure is now outdated, as shown in Figure 7 below, because the bracket widths were not indexed for inflation until 2017.[171]

Figure 7: Missouri Income Tax Brackets if Adjusted for Inflation, Based on 2016 Data.

2016 Actual Brackets	**2016 Brackets if Adjusted for Inflation**
$1,000	$6,055.73
$2,000	$12,111.46
$3,000	$18,167.19
$4,000	$24,222.91
$5,000	$30,278.64
$6,000	$36,334.37
$7,000	$42,390.10
$8,000	$48,445.83
$9,000	$54,501.56

As a result of Missouri's bracket structure, some consider the state to have a flat income tax since, low- and middle-income families are taxed at the same rate as high income earners.[172] In its written submission to the Committee, the Missouri Budget Project noted that Missouri's tax structure creates a heavier burden on lower income taxpayers.[173]

In 2014, the Missouri General Assembly passed Senate Bill 509, which enacted a tax trigger to ultimately lower Missouri's top individual income tax rate to 5.5%.[174] The bill stated, "[e]ach reduction in the top rate of tax shall be by one-tenth of a percent and no more than one reduction shall occur in a calendar year."[175] Senate Bill 509 contains triggers that would prevent a tax rate decrease from occurring unless "the amount of net general revenue collected in the previous fiscal year exceeds the highest amount of net general revenue collected in any of the three fiscal

168. MO. REV. STAT. § 143.011.1 (2012).
169. *See State Individual Income Tax Rates and Brackets for 2016*, *supra* note 156.
170. *See National Average Wage Index*, SOC. SECURITY ADMIN., https://www.ssa.gov/oact/cola/AWI.html (last visited Dec. 10, 2017); § 143.011.1.
171. *See 2016 Tax Chart*, MO. DEP'T OF REVENUE, http://dor.mo.gov/forms/2016%20Tax%20Chart_2016.pdf (last visited Dec. 10, 2017); *See CPI Inflation Calculator*, BUREAU OF LAB. STAT., https://www.bls.gov/data/inflation_calculator.htm (last visited Dec. 10, 2017).
172. *See generally Forms and Manuals*, MO. DEP'T OF REV., http://dor.mo.gov/forms/index.php?category=&formName=table (last visited Dec. 10, 2017).
173. Tom Kruckemeyer et al., *The Case for Combined Reporting: Changing Missouri's Tax Policy Makes Good Business Sense*, MO. BUDGET PROJECT 7 (Apr. 19, 2007), http://www.mobudget.org/files/Combined%20Reporting%20Benefits%20for%20_MO%20Apr%2007.pdf.
174. *See* MO. REV. STAT. § 143.011 (2012).
175. *See id.*

years prior to such fiscal year by at least $150 million dollars."[176] However, Senate Bill 509 only applies to the top tax rate; it will not cut the rates to 5.5% for some time, and would do so only if triggers are met.[177] If Missouri wants simple, fair, and low individual income taxes, a restructuring of all individual income tax brackets is necessary.

Since the individual income tax raises such a significant proportion of overall state revenue, any change could have very large revenue implications. The Department of Revenue conducted a review of current filers to put this into context. If Missouri were to keep its same rate structure and impose a 1% decrease to the state's top rate, the Department of Revenue estimates that the state would see a reduction in revenue of approximately $858.2 million.[178]

C. Other Approaches: Earned Income Tax Credit

The federal government and many states provide an Earned Income Tax Credit ("EITC"), which offsets some of the regressive effects of tax policy while encouraging individuals to enter and remain in the workforce.[179] The Tax Reduction Act of 1975 introduced the EITC at the federal level.[180] The EITC was then expanded in the Tax Reform Act of 1986 at President Ronald Reagan's behest.[181] The EITC serves as a refundable tax credit for working families that counterbalances the costs of essential needs and other taxes.[182] The EITC differs from other assistance programs by requiring the individual to be in the workforce, serving as a supplement rather than a replacement of their income.[183] The credit awarded also decreases as taxable income increases, rather than ending entirely at a certain income level as many other government programs do.[184]

According to the Internal Revenue Service, 27 states and cities provide an EITC.[185] All of those 27 states and cities provide a credit that ranges from 4% to 85% of the federal EITC.[186] Professor Hedlund described this program as "the most

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176. *See id.*

177. *See id.* The first of the triggers was met in 2017. Press Release, Eric Schmitt, *Tax Cuts on the Way for Missourians in 2018*, MO. ST. TREASURER (July 6, 2017), https://www.treasurer.mo.gov/newsroom/news-and-events/Item/2017/07/06/treasurer-schmitt-tax-cuts-on-the-way-for-missourians-in-2018.

178. Written Statement of Todd Iveson, Div. Dir., Mo. Dep't of Revenue, to The Governor's Comm. for Simple, Fair and Low Taxes 2 (Apr. 17, 2017) (on file with author).

179. *See* Thomas L. Hungerford & Rebecca Thiess, *The Earned Income Tax Credit and the Child Tax Credit: History, Purpose, Goals, and Effectiveness*, ECON. POL'Y INST. (Sept. 25, 2013), http://www.epi.org/publication/ib370-earned-income-tax-credit-and-the-child-tax-credit-history-purpose-goals-and-effectiveness/; *see also States and Local Governments with Earned Income Tax Credit*, INTERNAL REVENUE SERV. (Oct. 1, 2017), https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/states-and-local-governments-with-earned-income-tax-credit.

180. *See* Tax Reduction Act of 1975, Pub. L. No. 94-12, 89 Stat. 26.

181. Chuck Marr, *Reagan's Actions Made Him a True EITC Champion*, CTR. ON BUDGET AND POL'Y PRIORITIES (Aug. 01, 2014, 11:03 AM), https://www.cbpp.org/blog/reagans-actions-made-him-a-true-eitc-champion.

182. Hungerford & Thiess, *supra* note 179.

183. *See id.*

184. *Id.*

185. *States and Local Governments with Earned Income Tax Credit*, *supra* note 179.

186. *See id.* California offers 85% of the federal credit, up to one half of the federal phase-in range. *Id.* Minnesota offers a credit that ranges up to 45% of the federal credit. *Id.* Vermont offers a state EITC that equals 32% of the federal credit. *Id.*

effective anti-poverty program in the U.S."[187] In Professor Hedlund's report to the Committee, he noted, "[u]nlike traditional cash assistance welfare, the [EITC] actually *increases* labor market participation."[188] Twenty-three of the 27 states and cities with an EITC offer refundable tax credits.[189]

Rod Chapel, the President of the Missouri chapter of the NAACP, testified before the Committee on the impact of tax policy on working class families.[190] Mr. Chapel noted that the EITC relieves pressure on low income families who work full time but still live in poverty.[191] Mr. Chapel also noted that the state should be aware of who it might seek to target with an EITC-like program.[192] If the state wanted to benefit working families, then a per child tax credit would be most beneficial.[193] If the state wanted to target the workforce as a whole, then it should enact an income credit.[194] Provided that an EITC-like program does not increase regressivity, Mr. Chapel noted that it could be more impactful than the state's reduced sales tax rate on food or its low income housing tax credit program.[195]

Mr. Chapel also observed that EITCs can counteract the potential regressivity of consumption taxes.[196] Consumption taxes, such as sales taxes or indirect consumption taxes that may be passed along to consumers, are sometimes referred to as regressive taxes because they tax all parties at the same rate regardless of their income; therefore, individuals with smaller incomes pay a larger percentage of their income than those with higher incomes.[197] An EITC-like program could assist the working poor by relieving the impact of any perceived regressivity.[198]

In a letter to the Committee, the St. Louis Regional Chamber expressed its support for a state EITC.[199] It offered several justifications for its support. First, the Chamber noted that "lower-income workers generally spend an EITC immediately on goods and services."[200] Near-immediate spending would quickly put money back into the local economy.[201] Second, the EITC encourages work and augments working income.[202] The Chamber wrote, "[f]ull-time work experience often translates into better job opportunities and a higher wage over time."[203] Sixty percent of taxpayers who receive an EITC use it for only a year or two at a time.[204] Since filers who claim the credit are required to work, most only utilize the credit for a few

187. Hedlund, *supra* note 15, at 11.
188. *Id.* (emphasis added).
189. *See States and Local Governments with Earned Income Tax Credit*, *supra* note 179. (noting that Delaware, Maine, Ohio and Virginia do not offer a refundable state EITC).
190. *Hearing Before the Governor's Comm. On Simple, Fair, and Low Taxes* (May 30, 2017) (statement of Rod Chapel, President, Missouri NAACP) (on file with author).
191. *Id.*
192. *Id.*
193. *Id.*
194. *Id.*
195. *Id.*
196. *Id.*
197. *See* Carl Davis et al., *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*, INST. ON TAX'N & ECON. POL'Y 1-2 (Jan. 2015), https://itep.org/wp-content/uploads/whopaysreport.pdf.
198. *See id.*
199. Letter from Joe Reagan, President & CEO, St. Louis Reg'l Chamber, to The Governor's Comm. On Simple, Fair, and Low Taxes 2 (May 10, 2017) [hereinafter Reagan Letter] (on file with author).
200. *Id.*
201. *Id.*
202. *Id.*
203. *Id.*
204. *Id.*

years before they have progressed in their work environment, increased their pay, and no longer qualify for the EITC.[205]

Additionally, an EITC could be administered at a low cost to the state since it could be based on income tax information that employers are already required to provide. Missouri could also mirror the federal qualifying criteria, or use federal criteria from previous years so that changes to the federal formula would not automatically impact Missouri's EITC issuance. Either way, Missourians would benefit from the gradual reduction of the EITC as their income rises. This gradual reduction stands in stark contrast to other programs that shut off immediately when a taxpayer's income reaches a certain level.

The Center on Budget and Policy Priorities ("CBPP") noted that a state EITC-like program could help reduce poverty among children.[206] In 2015, nearly 10 million U.S. children in families with working adults lived below the poverty line.[207] According to the CBPP, EITCs are "one of the nation's most effective tools for reducing the struggles of working families and children."[208]

A state-level EITC would carry extra weight if the tax credit were refundable. With a refundable credit, some low-income households would not only see a benefit of a lower tax bill, they would also see a return of some of their withheld income. This could help boost morale and encourage the taxpayers to keep working, while also helping them to meet basic needs.[209]

According to Professor Hedlund's review, if Missouri were to implement a form of Working Family Tax Credit, it may want to adjust some of the guidelines used by the federal government's EITC.[210] For instance, most people who qualify for the federal EITC program have a dependent.[211] Professor Hedlund recommended that a state EITC-like program should also cover childless adults.[212] Professor Hedlund also recommended separating the Working Family Tax Credit from benefits for children.[213] Finally, Professor Hedlund noted that benefits should be based on personal income instead of total family income.[214]

D. The Future of the Missouri Individual Income Tax

The defects in Missouri's current individual income tax system are hindering the state's competitiveness and the economic well-being of our taxpayers. As

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205. *Id.*
206. Erica Williams, *States Can Adopt or Expand Earned Income Tax Credits to Build a Stronger Future Economy*, CTR. ON BUDGET AND POL'Y PRIORITIES (Feb. 08, 2017), https://www.cbpp.org/research/state-budget-and-tax/states-can-adopt-or-expand-earned-income-tax-credits-to-build-a.
207. *Id.*
208. *Id.*
209. *See id.*
210. *See* Hedlund, *supra* note 15, at 11.
211. Chuck Marr et al., *EITC and Child Tax Credit Promote Work, Reduce Poverty, and Support Children's Development, Research Finds*, CTR. ON BUDGET AND POL'Y PRIORITIES (Oct. 1, 2015), https://www.cbpp.org/research/federal-tax/eitc-and-child-tax-credit-promote-work-reduce-poverty-and-support-childrens.
212. Hedlund, *supra* note 15, at 11.
213. *Id.* at 12-13 ("A childless male making $11,000 qualifies for a credit of $1,011 under the Obama-Ryan model in 2016. If he marries a spouse with two children making about $20,000 and getting a credit of $5,172, they would get only ne credit of $4,018, a loss of $2,165 from the combined credits of $6,273 they had before marriage.") (internal citation omitted).
214. *Id.* at 12.

explored above, Missouri's individual income tax brackets are outdated and unnecessarily numerous. The individual income tax increases the costs of social goods that the state should instead encourage: earnings, savings, and investment. Overreliance on one source of revenue means that reductions of individual net income could lead to severe budget deficits. Therefore, the following recommendations are worthy of further study and discussion.

1. Possible Approach: Update and Reduce Missouri's Individual Income Tax Rates

The individual income tax brackets and rates could be modernized to increase efficiency and lower the rates. This could lower taxes for all Missourians when taken as part of a comprehensive reform package. However, policymakers must be careful not to increase the individual income tax burden when modernizing the individual income tax rates.

This modernization would update the 1971 tax brackets to better fit current income data while reducing the unnecessary number of tax brackets. The update would cut the top individual income tax rate immediately, rather than waiting for the rate reduction triggers in Senate Bill 509 to take effect.

2. Possible Approach: Adopt a Working Family Tax Credit

Adopting a working family tax credit could help counteract the potential regressivity of sales taxes and allow lower-income workers to increase spending on basic needs. This option could incentivize lower and middle-class employees to generate more earned income. A working family tax credit would decrease as family income increased, instead of turning off automatically after household income reached a certain amount.

However, implementing this option could lead to some, albeit low, administrative costs and add a further wrinkle to an already complex tax code. The state would need to provide fraud safeguards that would prevent taxpayers from gaming the system and receiving a tax credit to which they are not entitled. Further, a working family tax credit could lead to a large loss of annual revenue.

V. SALES TAX

Retail sales tax, a form of consumption tax, efficiently collects tax revenue at the time of the taxable transaction. Forty-five states collect statewide sales tax, including all of Missouri's border states.[215]

215. Scott Drenkard & Nicole Kaeding, *State and Local Sales Tax Rates in 2016*, TAX FOUND. (Mar. 9, 2016),
https://taxfoundation.org/state-and-local-sales-tax-rates-2016/.

A. Sales and Use Tax Base

Sales tax applies a constant rate of tax on "the volume or value of commodities or services transferred or exchanged."[216] It is, in essence, "a levy imposed on the purchaser's use or consumption of the item," with the tax burden intended to be borne by the consumer.[217] Sales tax is distinguished from use tax, even though use tax is often imposed at an equivalent rate to sales tax.[218] Use tax is imposed on goods that are purchased outside the state and brought into the state for use, storage, or consumption.[219] In effect, use tax attempts to capture the amount of sales tax that would have been imposed had the sale of property occurred within the state.[220] Sales and use tax bases typically "include within [their] scope all business sales of tangible personal property at the retailing, wholesaling, or manufacturing stage, with the exceptions noted in the taxing law."[221]

While the sales tax is simple in concept, in practice it is one of the most complex state taxes. More than 200 exemptions or exclusions currently riddle Missouri's sales and use tax base.[222] Most exemption costs are not tracked by the Department of Revenue. However, in Fiscal Year 2016, Missouri saw total state revenue losses of $4.5 million for the textbook sales and use tax exemption, and $55.8 million for one of many manufacturing exemptions.[223]

Missouri taxes certain foods at a reduced rate.[224] Most states exempt certain food items from being taxed at the full rate.[225] Currently, six states (including Missouri) tax groceries at a reduced sales tax rate.[226] Only seven states tax food at the same rate as other sales of tangible personal property; however, four of these states offer a credit or rebate to offset some of the taxes paid on groceries.[227] Missouri's food tax exemption does not apply to most restaurants.[228]

In its first year of implementation, Missouri's food sales tax exemption led to a revenue reduction of nearly $134 million.[229] This revenue reduction increased each year until a decrease in fiscal year 2001, likely the result of the recession in

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216. WALTER HELLERSTEIN & JOHN A. SWAIN, STATE TAXATION ¶ 12.01 INTRODUCTION TO THE AMERICAN RETAIL SALES TAX 1 (3d ed. 2017), 1999 WL 1398962.
217. *Id.* at 2.
218. *Id.*
219. *Id.*
220. *Id.*
221. *Id.* at 1.
222. *See Listing of Missouri Sales and Use Tax Exemptions and Exclusions*, MO. DEP'T OF REVENUE, http://dor.mo.gov/business/sales/exemption-list.php (last visited Dec. 10, 2017).
223. Mickey Wilson, *Program Evaluation: Review of the Missouri Department of Revenue State Sales Tax Exemptions*, MO. GEN. ASSEMBLY 8, 10 (Jan. 2010), http://www.moga.mo.gov/oversight/over09/pdfs/revenue%20sales%20tax%20exemptions.0150i.arc.pdf (noting that the manufacturing exemption in question is found in MO. REV. STAT. § 144.054 (2012)).
224. Eric Figueroa & Samantha Waxman, *Which States Tax the Sales of Food For Home Consumption in 2017?*, CTR. ON BUDGET AND POL'Y PRIORITIES (Mar. 1, 2017), http://www.cbpp.org/research/state-budget-and-tax/which-states-tax-the-sale-of-food-for-home-consumption-in-2017.
225. *Id.*
226. *Id.*
227. *Id.* (noting that Oklahoma, Kansas, Hawaii and Idaho offer rebates on food tax).
228. *See* MO. REV. STAT. § 144.014 (2016).
229. Email from Joel Allison, Deputy Dir. of Taxation, Mo. Dep't of Revenue, to Todd Iveson, Dir. of Taxation, Mo. Dep't of Revenue (Apr. 18, 2017) (on file with author).

the early 2000s.[230] In fiscal year 2016, Missouri's food sales tax exemption led to a revenue reduction of over $406 million.[231]

Missouri's sales tax base is further limited by Amendment 4.[232] Amendment 4 prevents the General Assembly from levying a sales or use tax (or any other similar transaction-based tax) on any service or transaction that was not subject to sales, use or any other similar transaction-based tax before January 1, 2015.[233] Thus, any consideration of sales tax reform must take Amendment 4 into account.

B. Sales Tax Rates

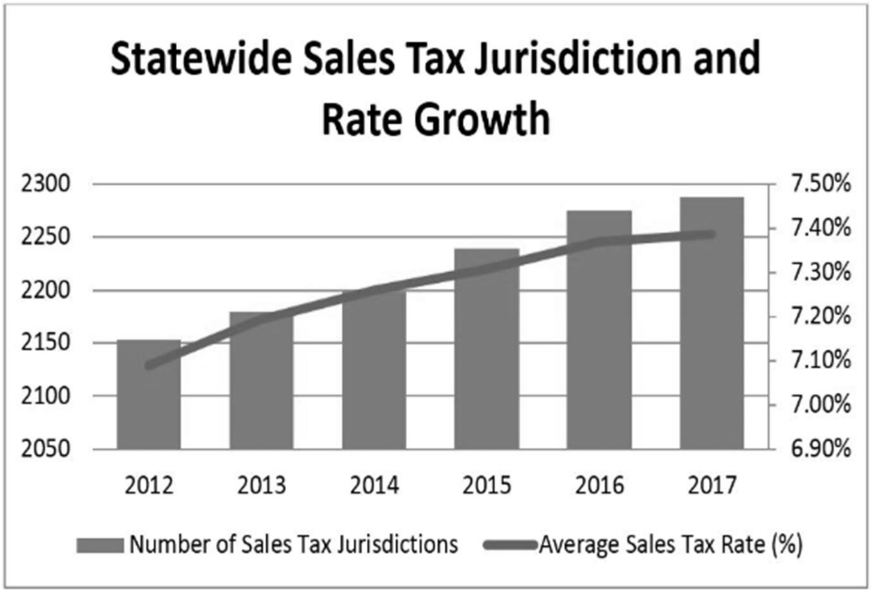
Both the state of Missouri and local jurisdictions can levy sales taxes. While Missouri has a relatively low state sales tax rate, its average local sales tax rate is a different matter. Missouri has a state sales tax rate of 4.225%, lower than each of its border states and well below the national average of 5.64% for states with a state sales tax.[234] In contrast, Missouri's average local sales tax rate is higher than most of the other 37 states that collect local sales tax.[235] Nationally, the average local sales tax rate is 1.81%, less than half of Missouri's average of 3.64%.[236] Missouri has the second highest average local sales tax rate compared to its border states, trailing only Oklahoma at 4.32%.[237] According to a study by The Tax Foundation, only 13 states have higher combined state and local sales tax rates than Missouri.[238] From an economic perspective, Missouri's combined state and local tax rate can affect the decisions of consumers and businesses that pay a significant portion of the sales tax on their input purchases.

Currently, Missouri does little to limit the nearly 2,300 local sales tax jurisdictions that complicate the state's overall sales tax environment. Missouri's combined state and local sales tax rates range from a low of 4.725% in Clinton and St. Clair Counties to highs of 10.863% in Woodson Terrace (a municipality in St. Louis County), and 10.679% in parts of the City of St. Louis.[239] In October 2012, Missouri had 16 taxing jurisdictions with a combined state and local sales tax rate of more than 10%.[240] In June 2017, Missouri had 53 taxing jurisdictions with combined state and local sales tax rate of more than 10%.[241] A myriad of local sales tax rates, Tax Increment Financing districts ("TIFs"), Transportation Development Districts ("TDDs"), and Community Improvement Districts ("CIDs") add to the combined sales tax and increase the burden on Missouri citizens and businesses.[242] Concurrent with the growth of these various tax jurisdictions, Missouri's average sales tax rate

230. *Id.*
231. Email from Michael Harris, Taxation Legislative Coordinator, Mo. Dep't of Revenue, to Kayla Jeffers, Mo. Dep't of Revenue (May 31, 2017) (on file with author).
232. *See supra* Section I.
233. MO. CONST. art. X, § 26.
234. Drenkard & Kaeding, *supra* note 215.
235. *Id.*
236. *Id.*
237. *Id.*
238. *Id.*
239. *See Sales/Use Tax Rate Table: April, May, and June 2017*, MO. DEP'T. OF REVENUE (Mar. 21, 2017), http://dor.mo.gov/pdf/rates/2017/apr2017.pdf.
240. *See id.*
241. *See id.*
242. *See id.*

has risen from 7.1% to nearly 7.4% over the past five years.[243] Raising further concern, some of Missouri's special sales tax districts have been criticized for corruption, conflicts of interest, and poor accountability to taxpayers.[244]

Figure 8: Statewide Sales Tax Jurisdiction and Rate Growth.[245]



Source: Missouri Department of Revenue

C. Sales Tax Implementation Issue: Out of State Vendors

Every state in the nation that collects sales and use tax is limited by the 1992 U.S. Supreme Court decision, *Quill Corp. v. North Dakota*.[246] In *Quill*, the Supreme Court held that states may not collect use tax from remote sellers who do not have a physical presence in that state.[247] According to the National Conference of State Legislatures, "states lost an estimated $23.3 billion in 2012 from being prohibited from collecting sales tax from online and catalog purchases."[248] Specifically, Missouri lost an estimated $210.7 million due to uncollected use tax on electronic

243. Graham Renz, *Missouri's Troubling Sales Tax Mosaic*, SHOW-ME INST. (Feb. 16, 2017), http://showmeinstitute.org/blog/local-government/missouri%E2%80%99s-troubling-sales-tax-mosaic (*see* Table 15).

244. *See, e.g.*, Thomas A. Schweich, *Lake Lotawana Community Improvement District: Citizens Summary*, MO. ST. AUDITOR (Oct. 2012), https://app.auditor.mo.gov/repository/press/2012-133.pdf; Mike Faulk, *Auditor: Missouri's Taxing District Law Allows Unethical Practices, Poor Oversight*, ST. LOUIS POST-DISPATCH (Apr. 10, 2017), http://www.stltoday.com/news/local/govt-and-politics/auditor-missouri-s-taxing-districts-law-allows-unethical-practices-poor/article_ef84fda0-3823-5e5d-8616-6b69c2f12d1f.html.

245. Renz, *supra* note 243.

246. Quill Corp. v. North Dakota, 504 U.S. 298, 317-18 (1992).

247. *Id.*

248. *Collecting E-Commerce Taxes: E-Fairness Legislation*, NAT'L CONF. OF ST. LEGISLATURES (Nov. 14, 2014), http://www.ncsl.org/research/fiscal-policy/collecting-ecommerce-taxes-an-interactive-map.aspx.

transactions during that same timeframe.[249] A 2012 study by the University of Missouri estimated that Missouri would lose approximately $358.3 million of tax revenue in 2014 due to the inability to collect use tax from remote sellers.[250]

With the continued growth of internet sales, many states are looking for new ways to collect tax on remote sellers who sell into their states.[251] States are taking a number of approaches in this area, including challenging the current nexus standard with state legislation, challenging *Quill* in state and federal court, changing their reporting requirements, entering into multi-state compacts, and waiting for Congress to act.

D. Economic Nexus Legislation

In 2017, 35 bills to challenge *Quill's* constraints on taxing out-of-state sellers were introduced in 17 states.[252] These efforts take a variety of forms. Indiana is attempting to implement an economic nexus law that would establish a bright line sales threshold: if a remote seller with no physical presence in Indiana exceeds a certain threshold, that seller is considered to have nexus in the state and therefore must report and collect sales tax.[253] Indiana's thresholds are established as a specific dollar amount, number of transactions, or both.[254] South Dakota has adopted its own standard under which a taxpayer establishes a nexus if its sales into South Dakota exceed $100,000 or the taxpayer has more than 200 separate transactions in South Dakota.[255] The South Dakota Supreme Court recently found this law to be unconstitutional.[256] An appeal to the U.S. Supreme Court is pending.

E. Reporting Requirement Legislation

Colorado took a different approach to its *Quill* challenge. In 2010, Colorado passed a bill that requires retailers who sell to Colorado customers but do not collect and remit Colorado use tax to report certain information about such purchases to

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249. *Id.*
250. Ying Huang, John Kosash, & Andrew Wesemann, *Internet Sales And Use Tax Issues In Missouri*, HARRY S. TRUMAN SCH. OF PUB. AFF. (Apr. 2012), https://ipp.missouri.edu/wp-content/uploads/sites/2/2014/06/internet_sales_and_use_tax.pdf.
251. *State Business Tax Reform: Presentation to The Governor's Comm. for Simple, Fair, and Low Taxes* (May 15, 2017) (statement of Robert Cline, Former OECD Senior Advisor, State Tax Policy Consultant) (on file with author).
252. Joe Crosby, *Economic Nexus is the Most Prevalent Type of Sales Tax Compliance Legislation This Year*, MULTISTATE INSIDER (Jan. 27, 2017), https://www.multistate.us/blog/economic-nexus-is-the-most-prevalent-type-of-sales-tax-compliance-legislation-this-year.
253. Tom Chrzanoski & Mo Bell-Jacobs, *Indiana Enacts Economic Sales Tax Nexus Provisions*, RSM (May 3, 2017), http://rsmus.com/what-we-do/services/tax/state-and-local-tax/sales-and-use-tax/indiana-enacts-economic-sales-tax-nexus-provisions.html.
254. *Id.*
255. *South Dakota Enacts S.B. 106: Physical Presence No Longer Required for Sales Tax Collection*, DELOITTE (Mar. 30, 2016), https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-mts-alert-south-dakota-enacts-sb-106-physical-presence-no-longer-required-for-sales-collection.pdf.
256. South Dakota v. Wayfair Inc., 901 N.W.2d 754, 756 (S.D. 2017); *see also 2016 Senate Bill 106: Remote Seller Compliance*, S.D. DEP'T OF REVENUE, http://dor.sd.gov/Taxes/Business_Taxes/SB106.aspx (last visited Dec. 10, 2017).

the customers and to the Colorado Department of Revenue.[257] Such retailers must do the following:

- Notify Colorado customers that the retailer does not collect Colorado sales tax, and therefore, the customer is obligated to self-report and pay use tax to the Department of Revenue.[258]

- Provide each of their Colorado customers with an annual report detailing that customers' purchases from the retailer in the previous calendar year, including a notice that the customer is obligated to pay use tax.[259]

- Provide the Department of Revenue with an annual report, which includes customers' names and total purchases from the retailer. This requirement applies only to retailers with $100,000 or more of gross annual sales in Colorado.[260]

Reporting was scheduled to begin January 31, 2011.[261] In January 2011, Direct Marketing Association challenged the notice and reporting law and the District Court of Colorado permanently enjoined enforcement of the notice and reporting requirements under the federal Tax Injunction Act.[262] In a 9-0 decision, the U.S. Supreme Court held that the Tax Injunction Act was "keyed to the acts of assessment, levy and collection themselves, and enforcement of the notice and reporting requirements is none of these."[263] The case was remanded to the Tenth Circuit Court of Appeals.[264]

F. Streamlined Sales Tax

Some states have tried to collect tax on remote sellers by joining a multi-state agreement called the Streamlined Sales and Use Tax Agreement ("the Agreement"). "The Agreement minimizes costs and administrative burdens of tracking retailers that collect sales tax, particularly retailers operating in multiple states."[265] The Agreement "encourages 'remote sellers' selling over the [i]nternet and by mail order to collect tax on sales to customers living in the [s]treamlined states [and] levels

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257. *See* Tripp Baltz, *Colorado Bill Would Zap Reporting Rules for E-Retailers*, BNA DAILY TAX REP. (Mar. 17, 2017), https://www.bna.com/colorado-bill-zap-n57982085374/.
258. COLO. REV. STAT. § 39–21–112(3.5)(c)(I) (2017).
259. *Id.* § 39–21–112(3.5)(d)(I)(A).
260. *Id.* § 39–21–112(3.5)(d)(II)(B).
261. *Tax Insights from State and Local Tax Services: Colorado – Use Tax Notice and Reporting Law Upheld, No Discrimination Against or Undue Burden on Interstate Commerce*, PRICEWATERHOUSECOOPERS 2 (Feb. 25, 2016), http://www.pwc.com/us/en/state-local-tax/newsletters/salt-insights/assets/pwc-colorado-use-tax-reporting-law-upheld-no-burden-on-interstate-commerce.pdf.
262. *Id.*; *see also* Direct Mktg. Ass'n v. Brohl, No. 10-cv-01546-REB-CBS, 2011 WL 250556, at *1 (D. Colo. Jan. 26, 2011).
263. Direct Mktg. Ass'n. v. Brohl, 135 S.Ct. 1124, 1131 (2015).
264. *Id.* at 1134.
265. *What Is the Streamlined Sales and Use Tax Agreement*, STREAMLINED SALES TAX GOVERNING BOARD, INC., http://www.streamlinedsalestax.org/index.php?page=gen1 (last visited Dec. 10, 2017).

the playing field so that local 'brick-and-mortar' [businesses] and remote sellers operate under the same rules."[266] However, retailers must volunteer to collect and remit sales and use tax from remote sales under the Agreement.[267] Twenty-four states fully comply with the Agreement, including six of Missouri's neighboring states.[268] Tennessee is an associate member of the Agreement, meaning that it has achieved substantial compliance with the terms of the Agreement as a whole, but not necessarily each provision.[269] Illinois is Missouri's only neighboring state that does not comply in some way with the Agreement.[270]

G. The Future of Missouri's Sales and Use Tax

Missouri's current sales tax regime distorts taxpayers' choices by effectively taxing goods sold over the internet differently than it taxes goods sold by local Missouri retailers. Its numerous exclusions and exemptions leads to a complex, opaque tax code that does not treat similarly situated sales similarly. It is with these problems in mind that the following recommendations should be studied and discussed:

1. Possible Approach: Adopt a Single State Sales and Use Tax Rate

Missouri could adopt a simple, single sales and use tax rate. All state sales and use tax exemptions could be eliminated—with two exceptions—creating more transparency in the tax code. First, the sale of certain food like groceries could remain taxed at a reduced rate. Second, identified business to business transactions will be exempt from sales and use tax. This exemption for business purchases is fundamental to the design of a retail sales tax that is intended to tax only final consumption of goods and services by consumers, not inputs purchased by businesses.

This reform could increase the amount of revenue that the state collects from sales and use tax, thus enabling the state to decrease the amount of revenue that it collects from state income tax. A working family's tax credit, along with the use of economic triggers, would offset some of the regressivity in moving to a single sales and use tax rate. By adopting these changes in a comprehensive tax reform package, Missouri can achieve tax reform that is simpler, fairer, and less reliant on income taxes than the current regime.

The lack of exemptions and exclusions could compel some Missouri residents to cross state lines to purchase goods. The purchase of many of these goods will still be subject to Missouri use tax, though use tax may be difficult to collect.

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266. *Id.*

267. *State Taxation of Remote / Online Sales*, AM. INST. OF CERTIFIED PUB. ACCT., https://www.aicpa.org/Advocacy/Tax/StateLocal/Pages/StateTaxationofRemoteOnlineSales.aspx (last visited Dec. 10, 2017).

268. *How Many States Have Passed Legislation Conforming to the Agreement*?, STREAMLINED SALES TAX GOVERNING BOARD, http://www.streamlinedsalestax.org/index.php?page=gen6 (last visited Dec. 10, 2017) (noting that Kansas, Nebraska, Iowa, Arkansas and Oklahoma participate in the Agreement).

269. *Streamlined Sales Tax*, TENN. DEP'T OF REVENUE, https://www.tn.gov/revenue/taxes0/sales-and-use-tax/streamlined-sales-tax.html (last visited Dec. 10, 2017).

270. *See Streamlined State Status 01-01-17*, JOHN GOLDHAMER, http://www.johngoldhamer.com/Tax-Tools/Streamlined-Sales-Tax-Status-State-Map.pdf (last visited Dec. 10, 2017).

2. *Possible Approach: Impose a Cap on Sales Tax Rates Throughout Missouri*

Missouri's many sales tax jurisdictions and rates are confusing, complicated, and poised to increase in the future. To promote simplicity and fairness, the General Assembly could cap the overall sales tax rate, including any add-on sales taxes imposed by TIFs, TDDs, and CIDs. Local control of local issues is an important goal, but state oversight seems prudent in the face of Missouri's ever-expanding sales tax landscape.

A statutory sales tax cap could mirror Missouri's "Mack's Creek Law," which places a cap on the amount of revenue that municipalities can generate from traffic tickets.[271] Mack's Creek Law requires that any municipality's traffic ticket revenue that exceeds a statutorily-set percentage of the municipality's annual revenue be remitted to school districts, thus curbing municipalities' incentives to exploit traffic tickets as a disproportionate source of revenue.[272]

In the sales tax context, if the General Assembly were to cap sales tax at a certain rate, then any sales tax collected in a county, municipality, or taxing jurisdiction that exceeds that specified rate would not be collected. To simplify remittance and discourage the proliferation of special tax jurisdictions, such remittance should be remitted by the last taxing jurisdiction to obtain authority over the transaction (likely a TIF, TDD, or CID).

The cap on local sales tax would prevent individual taxing jurisdictions from increasing the total tax burden of taxpayers. It would compel citizens to prioritize the most important functions of government. It could also be far less burdensome than currently anticipated, if taxing jurisdictions were to reap the windfall of increased revenues from the state's elimination of sales and use tax exemptions.

Opponents may raise strong challenges. Local jurisdictions could see the state's increased reliance on sales and use tax and wonder why they could not set their own consumption tax rates. After all, this would arguably contradict the principles of local control and smaller government. Still, the removal of most sales and use tax exemptions could create a windfall for local jurisdictions by broadening the base of their local sales and use taxes.

3. *Possible Approach: Adopt an Economic Nexus Standard to Collect Unpaid Sales Tax*

Missouri could adopt a new economic nexus standard similar to the South Dakota standard to capture tax revenue from out-of-state sellers that is otherwise lost. Additionally, Missouri could join the Streamlined Sales and Use Tax Agreement. Enacting such legislation could make Missouri's sales tax scheme better suited for an economy where e-commerce continues to grow. It also would eliminate unfair advantages that out-of-state retailers currently enjoy.

It is unclear whether a direct challenge to the *Quill* standard will eventually be upheld by the U.S. Supreme Court as constitutional. The U.S. Supreme Court may not make a determination on South Dakota's nexus standard in the near future. Thus, such efforts may only provide false hope to Missouri retailers.

271. MO. REV. STAT. § 479.359 (2016).
272. *Id.*

VI. FUEL TAX

To become a best-in-class state, Missouri must have high-quality infrastructure that connects people and businesses. Paradoxically, Missouri has the nation's seventh largest state highway system, but the fourth lowest funding per mile.[273] Missouri also has the sixth most bridges of any state.[274] Typically, bridges must be replaced every 50 years; yet Missouri's current transportation funding levels set the state's bridge replacement pace at every 200 years.[275] Missouri falls short by $170 million per year for high-priority maintenance needs and $300 million per year for necessary major interstate reconstruction.[276]

Missouri's infrastructure revenue comes from a combination of state consumption fees, federal funding, and appropriations from the General Assembly.[277] Nearly two-thirds of Missouri's infrastructure revenue is generated through consumption fees such as fuel tax and license registration fees.[278] Combined with federal transportation-related fees, the average Missouri driver pays about $30 per month to use the state's vast system of roads and bridges.[279] The largest source of revenue from Missouri's consumption fees comes from the state gas tax of $0.17 per gallon of gasoline.[280] However, Missouri's fuel tax rate was set in 1996 and holds less than half of the purchasing power it had 20 years ago due to inflated prices of steel, concrete, and asphalt over the same period.[281]

Compared to its peer states, Missouri lags behind in infrastructure funding. Missouri's funding amounts to slightly more than $50,000 per mile of state-maintained highway, which is less than one fourth of the national average and lower than all but one of Missouri's border states.[282] Additionally, Missouri has a lower fuel tax rate than every border state except Oklahoma (see Figure 9 below), which generates a significant portion of its revenue from toll roads.[283]

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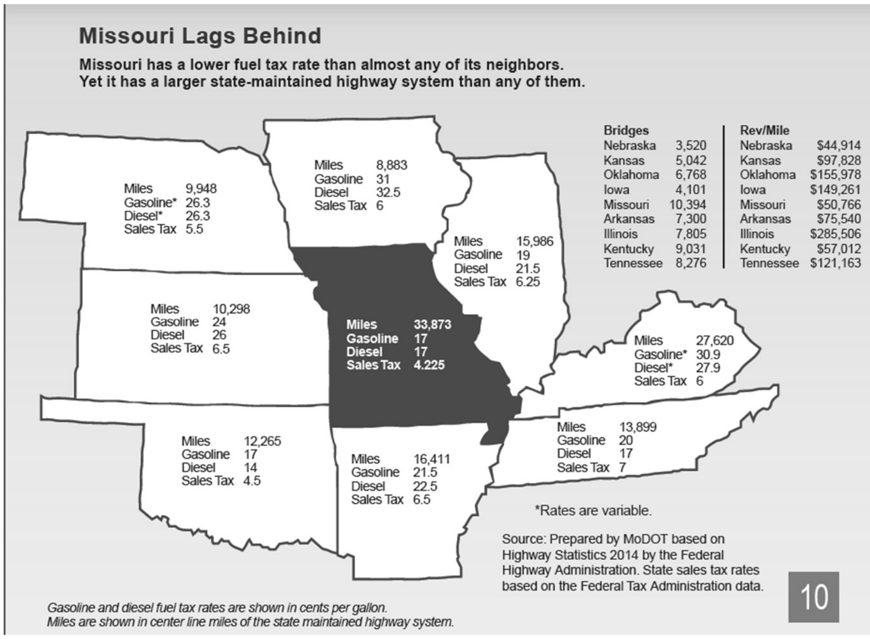
273. *See Citizen's Guide to Transportation Funding in Missouri*, MO. DEP'T OF TRANSP. 10 (Nov. 2016), http://www.modot.org/guidetotransportation/documents/CompleteGuide.pdf.
274. *Id.*
275. *Hearing Before the Governor's Comm. On Simple, Fair, and Low Taxes* (May 30, 2017) [hereinafter McKenna Statement] (statement of Patrick McKenna, Director of Missouri Department of Transportation).
276. *See Citizen's Guide to Transportation Funding in Missouri*, *supra* note 273, at 34.
277. *See id.* at 4-9.
278. McKenna Statement, *supra* note 275.
279. *Citizen's Guide to Transportation Funding in Missouri*, *supra* note 273, at 3.
280. *Id.* at 5. Fuel taxes are "excise taxes" that are "typically imposed on the number of gallons of the product sold, purchased, used, or stored upon the distributor or dealer, who is given the right and privilege of passing the tax on to the consumer or user." 71 AM. JUR. 2D *State and Local Taxation* § 533, Westlaw (database updated Aug. 2017).
281. McKenna Statement, *supra* note 275.
282. *See Citizen's Guide to Transportation Funding in Missouri*, *supra* note 273, at 11.
283. *See id.* at 10.

Figure 9: Missouri's Transportation Funding Compared to its Border States.[284]



Until recently, Missouri was not alone in its out-of-date fuel tax rate. From 1993 to 2015, Georgia did not adjust its fuel tax for the rate of inflation; by 2015, the state faced a $1 billion deficit for infrastructure maintenance and improvement.[285] To address this shortfall, Georgia enacted legislation that updated its fuel tax to match the rate of inflation and account for modern vehicles' ever-increasing fuel economy.[286] Since its enactment, Georgia's legislation has resulted in a large influx of much needed infrastructure revenue.[287]

A. The Future of Missouri Fuel Tax

Missouri could gradually adjust its fuel tax, via the use of economic triggers, to account for the rate of inflation and increasing fuel economy of modern vehicles. Such an adjustment would provide Missourians with more modern and safer infrastructure. It could be a simple, fair, low, transparent, and efficient method of funding tax dollars for infrastructure.

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284. *Id.*
285. *See Summary of 2015 Transportation Legislation*, GA. TRANSP. ALLIANCE, http://www.gatransportation.org/wp-content/uploads/2015/09/GTA-Final-Summary-of-HB-1701.pdf (last visited Dec. 10, 2017); Keith Laing, *Georgia Hikes Gas Tax*, THE HILL (Apr. 2, 2015, 10:16 AM), http://thehill.com/policy/transportation/237709-georgia-hikes-gas-tax.
286. McKenna Statement, *supra* note 275.
287. James Salzer, *Georgia Ends Fiscal Year With a Revenue Boost of Nearly 10%*, THE ATLANTA J.-CONST. (July 12, 2016, 4:31 PM), http://www.myajc.com/news/state--regional-govt--politics/georgia-ends-fiscal-year-with-revenue-boost-nearly-percent/KWcizhRgNjgPStXaWgb8GK/; James Salzer, *Fuel Tax Hike Fueling Big Revenue Boost for Georgia*, THE ATLANTA J.-CONST. (Oct. 13, 2015, 11:26 AM), http://www.ajc.com/news/state--regional-govt--politics/fuel-tax-hike-fueling-big-revenue-boost-for-georgia/mXtvrHJmK2MC4JAONZL8XK/.

The problems with Missouri's fuel tax have plagued the state for more than two decades and will not be solved overnight. Even among people who recognize Missouri's problem with funding road and bridge maintenance, divisions exist as to how to solve the issue. Stark facts and detailed economic analysis should be used to verify how much Missouri can gain from an adjustment to the fuel tax. Helping businesses ship their products and helping families travel safely throughout the state can only aid commerce and reduce business impediments. Missouri deserves a modern transportation infrastructure just as much as it deserves a modern tax infrastructure.

VII. DISCOUNTS

There is a strong argument that Missouri offers special deductions and discounts that distort the overall tax environment and provide a minimal competitive advantage to the state.

A. Federal Corporate Income Tax Deduction

Missouri corporate taxpayers may deduct 50% of their federal corporate income tax from their state corporate income tax.[288] Only three other states allow their corporate taxpayers a *full* federal corporate income tax deduction from their state taxable income: Alabama, Iowa, and Louisiana.[289] Louisiana's federal income tax deduction has been criticized for its ineffectiveness in helping Louisiana compete with neighboring states.[290] The downsides of the federal corporate income tax deduction are not new. Almost a decade ago, the Missouri Budget Project identified the federal corporate income tax deduction as one of the reasons contributing to an "apparent disconnect between reported corporate profits nationally, Missouri economic growth and the decline in Missouri corporate tax" revenue.[291] In Tax Year 2014, Missouri lost approximately $92.9 million in revenue due to its federal corporate income tax deduction.[292]

B. Federal Individual Income Tax Deduction

As with the federal corporate income tax deduction, Missouri is one of only a handful of states to allow individual taxpayers to deduct federal income tax paid from state taxable income. The Department of Revenue estimates that Missouri lost over $679 million in 2014 due to the federal individual income tax deduction. Currently, only five other states offer a deduction for federal individual income taxes paid.[293] Both Montana and Missouri cap the deduction at $5,000 for single, and

288. *Form MO-1120 General Information*, MO. DEP'T OF REVENUE, http://dor.mo.gov/forms/MO-1120%20Instructions_2011.pdf (last visited Dec. 10, 2017).
289. *Why States That Offer the Deduction for Federal Income Taxes Paid Get it Wrong*, INST. ON TAX'N AND ECON. POL'Y (Aug. 1, 2011), https://itep.org/why-states-that-offer-the-deduction-for-federal-income-taxes-paid-get-it-wrong/.
290. *See generally id.*
291. Kruckemyer & et al., *supra* note 173, at 5.
292. Email from Michael Harris to Kayla Jeffers, *supra* note 231.
293. *Why States That Offer the Deduction for Federal Income Taxes Paid Get it Wrong*, *supra* note 289.

$10,000 for married taxpayers.[294] However, Montana also requires its taxpayers to itemize their state returns in exchange for utilizing the federal income tax deduction.[295]Oregon's federal income tax deduction has a cap of $5,950 and phases out as a taxpayer's income increases.[296]

The benefits of the deduction for federal individual income tax paid are quite localized. Due to the progressive federal tax rate structure, low income families are shielded from federal income taxes and do not benefit from the state deduction of federal income taxes paid.[297] In addition, when low and middle-income families decrease their federal tax to nearly nothing with exemptions, deductions or credits, they do not benefit from the federal income tax deduction.

C. 2% Discount on Employer Withholding Tax

Missouri is the only state to offer employers a discount for timely filing of withholding tax.[298] In exchange for on-time remittances of withholding tax to the Director of Revenue, a business is allowed to retain a percentage of the total amount withheld.[299] The percentage ranges from 0.5% to 2%, depending on the amount collected.[300] In tax year 2016, the Missouri Department of Revenue saw a reduction in revenue of $29 million due to timely filing allowances for withholding.[301] Essentially, Missouri's tax system rewards employers for something employers are already obligated to do.

D. Vendor 2% Discount

Much like the withholding tax timely filing discount, Missouri also provides a 2% sales tax discount for vendors who timely remit the sales tax they collect.[302] In fiscal year 2016, this discount reduced sales tax revenue by approximately $115 million (approximately $56 million in state revenues and $59 million in local revenues).[303]

Twenty-eight states provide a vendor discount for sales tax, including five of Missouri's border states.[304] However, many of these states include a per-month or per-year cap for the discount claimed.[305] For example, Kentucky only allows $50 per month, while Oklahoma offers $2,500 per month.[306] Missouri does not cap the amount of discount that can be claimed.[307] Except for Colorado, each state with a higher vendor discount rate than Missouri either caps the total dollar amount that

294. *Id.*; MO. REV. STAT. § 143.171.1 (2016).
295. *Why States That Offer the Deduction for Federal Income Taxes Paid Get it Wrong*, *supra* note 289.
296. *Id.*
297. *Id.*
298. *See* § 143.261.1.
299. *See id.*
300. *See id.*
301. *See id.*
302. MO. REV. STAT. § 144.140.1 (2016).
303. Reagan Letter, *supra* note 199, at 2.
304. *State Sales Tax Rates and Vendor Discounts*, FED'N OF TAX ADMINS. (Jan. 1, 2017), https://www.taxadmin.org/assets/docs/Research/Rates/vendors.pdf.
305. *Id.*
306. *Id.*
307. *See* § 144.140.1.

companies can retain or applies the higher rate to a limited dollar amount.[308] For example, Georgia offers a 3% vendor discount, but only on the first $3,000 of sales tax that the vendor collects.[309]

In 2016, the Department of Revenue gathered data regarding possible timely filing discount caps for Missouri's sales and use tax. Below are some of the Department of Revenue's findings:

- A cap of $1,500 per month results in $58.6 million savings annually;
- A cap of $2,500 per month results in $51.6 million savings annually;
- A cap of $1,500 per year results in $90.8 million savings annually;
- A cap of $2,500 per year results in $84 million savings annually;
- A cap of $18,000 per year results in $57.5 million savings annually; and
- A cap of $30,000 per year results in $50.6 million savings annually.[310]

E. The Future of Missouri's Noncompetitive Discounts

The federal corporate and individual income tax deductions prevent the General Assembly from lowering income tax rates on corporations and individuals. The federal corporate and individual income tax deductions add complexity to the tax code; they prevent Missouri from collecting income tax in the most efficient manner possible. The 2% withholding-of-tax discount and the 2% vendor discount add complexity and opaqueness to the tax code in exchange for paying people to follow the law. It is with these challenges in mind that the following recommendations should be the subject of further study and discussion:

1. Possible Approach: Repeal the State Corporate Income Tax Deduction for Federal Corporate Income Taxes Paid

Repealing the state corporate income tax deduction for federal corporate income taxes paid would simplify the tax code by eliminating a step in tax preparation while providing an opportunity to lower the corporate tax rate. The General Assembly could initiate this repeal while replacement revenues are phased in. Transition costs could impact businesses and government administration. It could also result in a higher effective corporate tax rate if not coupled with a broad-based cut in the corporate tax rate, which could in turn reduce wages and limit competitiveness.

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308. GA. CODE ANN. § 48-8-50(b) (2015); *State Sales Tax Rates and Vendor Discounts*, *supra* note 304.
309. § 48-8-50(b)(1).
310. Email from Todd Iveson, Dir. of Taxation, Mo. Dep't of Revenue, to Kayla Jeffers, Mo. Dep't of Revenue (May 12, 2017) (on file with author).

2. *Possible Approach: Eliminate Missouri's Federal Individual Income Tax Deduction from State Individual Income Taxes*

Eliminating the deduction would enable Missouri to lower individual income tax rates in a revenue-neutral manner. However, this reform would align Missouri with the best practices of 44 other states. It would also reduce the complexity of Missouri's tax code. This option could effectively increase the tax burden on Missouri's taxpayers unless it is coupled with a reduction in individual income tax rates or a broad deduction or credit.

3. *Possible Approach: Eliminate Missouri's Withholding Tax Timely Filing Discount*

Eliminating the timely filing discount would stop the practice of rewarding employers for performing a task they are already obligated to do. It would eliminate a loophole that complicates Missouri's tax code, drains state resources, and provides a competitive advantage. It is another instance in which Missouri pays people to follow the law.

However, this option would lead to administrative transition costs, including changes to the Department of Revenue's employer withholding filing process. Eliminating the timely filing discount would restrict cash flow into businesses that had previously relied on it. The only remaining state-based incentive for businesses to timely remit withholding tax would be the consequences of breaking the law.

4. *Possible Approach: Repeal the 2% Vendor Discount*

The 2% vendor discount once alleviated the costs of manually calculating and remitting sales tax to state and local governments, but advances in technology have reduced these costs for vendors.[311] This loophole currently exists solely to incentivize taxpayers to timely comply with the law. The state could repeal the vendor discount and reallocate the new funds to help lower tax rates.

However, the repeal of the 2% vendor discount could lead to an increase of untimely filing. State revenues may decrease. A repeal of the 2% vendor discount could also lead to higher consumer prices, as vendors attempt to make up for the loss in their revenue.

VII. FINAL REMARKS

Missouri deserves a simple, low, and fair tax system. Tax reform can allow Missourians to know how their taxes are assessed, understand how to calculate and pay their taxes, and then get back to business. Broad bases and low rates enable taxpayers to seek out opportunities presented by the market, rather than pursuing legislatively created tax breaks. A state that has reduced the costs of doing business places itself at a competitive advantage. This paper has sought to illustrate the

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311. *Timely Filing Discount Costs Missourians Millions*, MO. BUDGET PROJECT (Oct. 2016), http://www.mobudget.org/wp-content/uploads/2016/10/Timely-Filing-Discount-Costs-Missourians-Millions.pdf.

challenges facing Missouri in the tax policy arena while suggesting ideas for further consideration. The facts are in. Let's now work together on the solutions.

APPENDIX A: COMMITTEE RECOMMENDATIONS

The recommendations in the above article are considered part of a comprehensive package with the recommendations from the Governor's Committee for Simple, Fair, and Low Taxes, which are reprinted below (please note, this is an exact copy of the original Governor's Committee Report).[312]

Tax Credits (General Reforms Applicable to All Tax Credits)

1. **Recommendation:** allow denial of any tax credit application that fails to meet a public purpose
2. **Recommendation:** Allow denial of a tax credit application if the activity would occur without state incentives
3. **Recommendation:** for economic development tax credits, allow denial of applications that fail to demonstrate a positive fiscal return to the state
4. **Recommendation:** Allow DED to deny applications for failure to show technical or financial ability to perform
5. **Recommendation:** Annually appropriate the amount of tax credits for each program and allow for gubernatorial withholding
6. **Recommendation:** enact a general false claims act to rein in fraud, waste, and abuse

Tax Credit Stabilization Fund

1. **Recommendation:** The General Assembly should create a Tax Credit Stabilization Fund ("TCSF") to pre-pay for new tax credit authorizations.

Low Income Housing Tax Credits

1. **Recommendation:** Convert the state LIHTC program to a low- or no-interest loan program (the "LIH Loan Program") for affordable housing construction, as demonstrated in Figure 1.3 in the Report.
   - Switching to the LIH Loan Program would eliminate most of the inefficiencies of the current tax credit program, including third-party syndication fees. 100% of State LIH Loans would go toward housing construction, a vast improvement from the current LIHTC's 42% efficacy.
   - MHDC has an AA+ bond rating and could effectively transition from issuing LIHTCs to LIH Loans.
   - MHDC's enabling statute currently permits MHDC to form a nonprofit corporation to be called the Missouri Equity Fund Support Corporation ("MEFSC") in order to syndicate credits. The existing statute could be amended to give MEFSC the authority to issue LIH Loans to developers and separately issue new certificated tax credits to investors via auction.
   - Proceeds from certificated tax credit sales could be allocated directly to LIH Loans. In the interim, sale proceeds could build interest in a trust fund, which could provide additional affordable housing support through LIH Loans.
   - Alternatively, proceeds from tax credit sales could be remitted to the State's general revenue and the General Assembly could appropriate funds for the LIH Loan Program.

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312. *Missouri Tax Credit Reform*, *supra* note 3.

2. **Recommendation:** Repurchase outstanding LIHTCs through MHDC's non-profit entity and exchange them for bonds, saving the State 15-20% of its outstanding LIHTC liabilities in the process.
   - Under a certificated tax credit model, MHDC would issue certificates that investors could purchase to reduce their Missouri tax liability. Unlike the current state LIHTCs, certificated tax credits could be transferred to persons outside of the ownership group, expanding the pool of potential investors.[313] This would increase the credits' marketability.
   - MEFSC could be authorized to issue bonds necessary to pay current state LIHTC holders for their outstanding credits, which would be cancelled by the State (the "LIHTC Repurchase Program").
   - According to Stifel, for every dollar of outstanding LIHTCs repurchased, the State would save approximately 15-20% of its associated liability.
3. **Recommendation:** Subject the LIH Loan Program to the overall Tax Credit Stabilization Fund authorization cap (discussed above) and subject the LIHTC Repurchase Program to appropriations.
   - The TCSF would place a cap on the overall amount of LIH Loans issued in a given year, and the LIH Loan Program would be subject to appropriation for the General Assembly to adjust the program's budget allocation as needed.
   - Affordable housing is important, but in a world of limited resources, the LIH Loan Program must be evaluated along with other critical budget needs, like schools and mental health funding.
   - Under appropriations, the General Assembly could decide the amount of outstanding state LIHTCs to be repurchased each year, saving the State 15-20% for every dollar of credit repurchased.
4. **Recommendation:** Include a 5-year sunset provision for the LIH Loan Program and LIHTC Repurchase Program.
   - A sunset provision would require the General Assembly to conduct an in-depth review of the LIH Loan Program and LIHTC Repurchase Program to determine whether the programs are achieving their intended purposes, and if not, how to address any shortcomings in future years.
   - A sunset provision has been widely recommended in recent years,[314] and there is no reason why the LIH Loan Program or LIHTC Repurchase Program should be exempt from regular review.

Historic Preservation Tax Credits

1. **Recommendation:** Consolidate the HPTC and Brownfield remediation tax credit into one Redevelopment Tax Credit program (the "RTC").
   - HPTCs and Brownfield remediation tax credits are often stacked on individual redevelopment projects. Consolidating them into one program would make sure that taxpayers don't pay twice for the same development.
2. **Recommendation:** Subject the RTC to the overall Tax Credit Stability Fund authorization cap (discussed in the Report above), not to exceed $50 million per year.

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313. *See* Thomas A. Schweich, *Economic Development: Low Income Housing Tax Credit Program*, MO. ST. AUDITOR 13-15 (Mar. 2014), https://app.auditor.mo.gov/Repository/Press/2013014719305.pdf.

314. *Id.* at 15; *See* Nicole Galloway, *Tax Credit Programs*, MO. ST. AUDITOR 17-18 (June 2017), https://app.auditor.mo.gov/Repository/Press/2017051896073.pdf.

- The current HPTC authorization cap is $140 million per year, and there is no cap to the amount of Brownfield remediation tax credits authorized. Apart from the HPTC authorization cap, the State has no certainty as to how many credits will be authorized, issued, or redeemed in any given year. The Tax Credit Stability Fund would place a cap on the overall amount of tax credits authorized in a given year, and the RTC program would be subject to appropriations for the General Assembly to properly allocate resources based on the program's viability to the State.
- The appropriations process would pre-fund tax credits and make it clear how much is allocated to each program. This would simplify reporting and make it easier for taxpayers to see how the State is investing their tax dollars. Additionally, this would increase predictability of State revenues allocated to specific tax credit programs and would help mitigate unforeseen budget shortfalls due to excessive tax credit redemptions in a given year.
- Capping total appropriations to $50 million per year is justifiable given the HPTC program's poor economic returns to the State. Additionally, this cap would give the State a degree of certainty regarding the HPTCs' future impact on Missouri's budget.

3. **Recommendation:** Institute a per-project cap of $2 million to ensure equitable funding opportunities for RTC projects in large and small cities.
    - Large projects in urban centers tend to use much higher amounts of HPTCs and Brownfield remediation tax credits than do modest-sized projects in rural areas of the State. A per-project cap would ensure that a handful of large RTC projects don't deplete the Tax Credit Stability Fund at the expense of projects that require only a fraction of the credits.
4. **Recommendation:** Institute a per-square footage value cap to prevent RTCs from subsidizing unnecessary expenses.
    - Unnecessary expenditures that raise the value per square footage (e.g. marble counters, premium flooring) provide additional benefit to developers, but not to the public.
5. **Recommendation:** Include a 5-year sunset provision for the RTC program.
    - A sunset provision would require the General Assembly to conduct an in-depth review of the RTC program and determine whether the program is achieving its intended purpose, and if not, how to address any shortcomings going in future years. A sunset provision has been widely recommended in recent years, and there is no reason why the RTC program should be exempt from regular review.
6. **Recommendation:** Exclude private residences from RTC eligibility.
    - Private residences do not provide a public benefit and should not receive public funding.
7. **Recommendation:** Eliminate the HPTC carry-back period and shorten the HPTC carry-forward period to 3 years.
    - These steps would make the credits' revenue impact on the State more predictable and stable, which would help mitigate unforeseen budget shortfalls due to excessive tax credit redemption.

Missouri Works Program

1. **Recommendation:** Subject Missouri Works' withholding tax retention benefit to DED's discretionary approval, pursuant to the same guidelines applicable to the Missouri Works tax credits.
   - Currently, businesses can qualify for withholding tax retention regardless of whether such benefit affects their decision to locate to Missouri. As long as a Missouri Works applicant meets its job creation, wage, and health insurance goals, it is entitled to the benefit.
   - Shifting the withholding tax retention benefit to a discretionary award would allow DED to properly allocate the benefit to companies who would not locate to or expand in Missouri without it.
2. **Recommendation:** Update the Missouri Works Training Program to allow job training programs for new jobs, retained jobs, or any combination thereof.
   - According to DED, it is administratively difficult to distinguish between training programs for new jobs and retained jobs, particularly as retained jobs evolve due to automation and technological advancement. A minor statutory amendment would make it simpler for DED to allocate the Missouri Works Job Development Fund to worthy training programs.