

# Missouri's 2014 Tax Cut: Minimal and Slow with a Small Business Gimmick

By Scott Drenkard  
Economist

## Key Findings

- Missouri's 2014 tax package cuts income tax rates by 0.1 percentage points each year for five years starting in 2017, provided certain revenue conditions are met.
- The bill's revenue impact is minimal. Even if the full tax cut were phased in immediately, the budget would still grow by 7.3 percent next year.
- A deduction for pass-through businesses such as S corporations and LLCs lowers effective rates for those entities but misses an opportunity for lowering overall rates in the income tax.
- SB 509 inflation adjusts tax brackets to correct for "bracket creep."

## Introduction

Missouri legislators have concluded their two-year effort to enact an income tax cut over opposition from Governor Jay Nixon (D). While the legislature was unable to override the governor’s veto of the tax package passed by the legislature last year, on Tuesday, May 6, it overrode Gov. Nixon’s veto of this year’s bill, SB 509, making it law.<sup>1</sup>

The passage of the bill has been met with great outcries from celebrants and critics of the legislation alike. Americans for Tax Reform President Grover Norquist told reporters, “I think it is very real progress and competitive juices of the neighboring states are going. The race to zero is on,” while Senate Minority Leader Jolie Justus (D) commented, “we’ve done nothing to rein in this tax orgy. We have no clear tax policy in this state. I don’t think this is the right answer.”<sup>2</sup>

Both of these statements miss the mark. While Senator Justus is correct that the bill does not represent clear principles (an issue addressed below), it is a long stretch to classify SB 509 as a “tax orgy.” And while Mr. Norquist is correct that this cut is progress in the sense that Missouri has not cut income tax rates since 1921, Missouri is not “racing” anywhere—we have previously noted that the bill’s phase-in of the legislation moves at a “glacial pace.”<sup>3</sup>

## SB 509 Modestly Reduces Income Tax Rates, Inflation Adjusts Brackets, Includes Small Business Gimmick

Major components of SB 509 include:<sup>4</sup>

- A reduction in the top income tax rate by 0.1 percentage points each year that revenue conditions are met, fully phasing in to a total reduction in the top income tax rate of 0.5 percentage points. This will bring the top income tax rate down from 6 percent to 5.5 percent over a minimum of five years (Table 1). This is the first income tax rate reduction in Missouri since 1921 (Table 2)
  - For a cut to go forward, net general revenue collected in the previous fiscal year must exceed the highest amount of net general revenue collected in any of the three prior fiscal years by at least \$150 million.
- Inflation indexing of income tax brackets beginning in 2017.
- A deduction for pass-through entities that will fully phase in to 25 percent of all business income.

1 David A Lieb, *Missouri Lawmakers Override Veto, Enact Tax Cut*, ABC NEWS, MAY 6, 2014, <http://abcnews.go.com/Politics/wireStory/missouri-lawmakers-override-veto-enact-tax-cut-23606164>.

2 Jennifer DePaul, *Missouri General Assembly Overrides Veto of Income Tax Cut*, STATE TAX TODAY, MAY 7, 2014, [http://services.taxanalysts.com/taxbase/stn3.nsf/\(Number/2014+STT+88-2?OpenDocument&Login \[SUBSCRIPTION REQUIRED\]\)](http://services.taxanalysts.com/taxbase/stn3.nsf/(Number/2014+STT+88-2?OpenDocument&Login [SUBSCRIPTION REQUIRED])).

3 Liz Malm, *Missouri Income Tax Bills Could Use Some Work*, TAX FOUNDATION TAX POLICY BLOG, FEB. 24, 2014, <http://taxfoundation.org/blog/missouri-income-tax-bills-could-use-some-work>.

4 The final, passed version of Senate Committee Substitute for Bills No. 509 and 496 is referred to as SB 509 here.

- The deduction will be 5 percent the first year and will increase by 5 percentage points each year the above revenue requirements are met.
- An increase in the standard deduction from \$2,100 to \$2,600 for taxpayers with adjusted gross incomes less than \$20,000. For joint filers, the increase is from \$4,200 to \$5,200 if both parties have income below \$20,000 each.

Table 1. Projected Phase-in of SB 509 if Revenue Triggers are Met

Bracket	Current Tax System (2014-2016)	Proposed 2017	2018	2019	2020	2021
>\$0	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
>\$1,000	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
>\$2,000	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%
>\$3,000	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
>\$4,000	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%
>\$5,000	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
>\$6,000	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
>\$7,000	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
>\$8,000	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%
>\$9,000	6.0%	5.9%	5.8%	5.7%	5.6%	5.5%

Table 2. Historical Missouri Income Tax Rates

July 1, 1917	May 26, 1919	August 21, 1921	January 1, 1931	January 1, 1971
0.5%	1.5%	1%	1.0% > \$0	1.5% > \$0
			1.5% > \$1,000	2.0% > \$1,000
			2.0% > \$2,000	2.5% > \$2,000
			2.5% > \$3,000	3.0% > \$3,000
			3.0% > \$5,000	3.5% > \$4,000
			3.5% > \$7,000	4.0% > \$5,000
			4.0% > \$9,000	4.5% > \$6,000
				5.0% > \$7,000
				5.5% > \$8,000
				6.0% > \$9,000

## Even After Income Tax Cuts, Missouri Budget Will Grow Over 7 Percent Annually

While many media sources have quoted the total revenue impact in the fiscal note of SB 509, many fail to put that number into the context of the total Missouri budget. Even if the total cut were enacted immediately in 2015 (it does not phase in fully until 2021), it would amount to a reduction in the total size of the budget of only 2.2 percent.

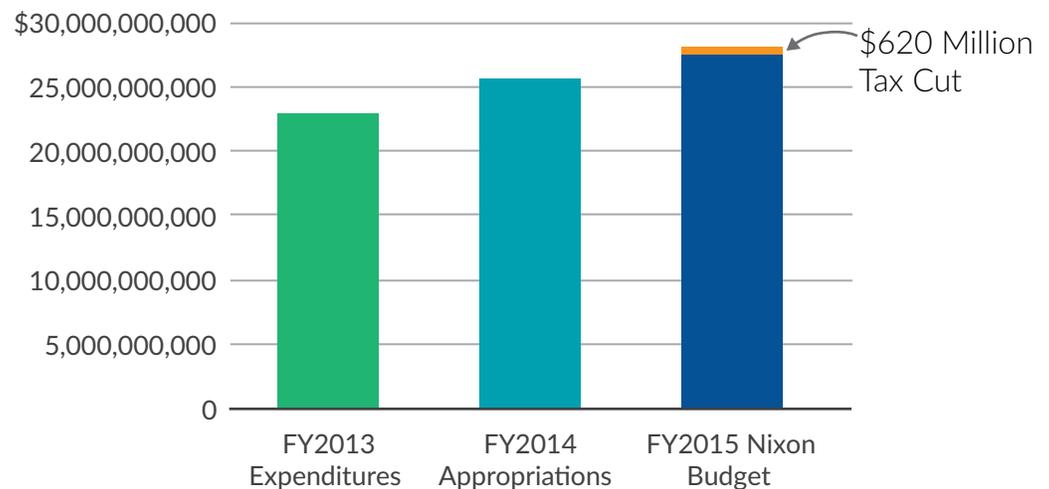
Table 3 and Figure 1 show that the size of the Missouri state government is budgeted to grow 9.7 percent over last year already, and subtracting the modest cut<sup>5</sup> would make for a budget that still grows at a hefty 7.3 percent over the previous year.<sup>6</sup>

Table 3. Missouri Budget with “Cuts”

	Total Budget Expenditures	Growth over previous year
FY2013 Expenditures	\$ 22,940,887,737	
FY2014 Appropriations	\$ 25,518,710,400	11.2%
FY2015 Nixon Budget	\$ 28,004,472,661	9.7%
FY2015 Nixon Budget with SB 509 phased in immediately	\$ 27,383,485,661	7.3%

Source: Missouri Budget FY 2015.

Figure 1: Missouri Budget if SB 509 Immediately Phased In



Source: Missouri FY 2015 Budget, Tax Foundation Calculations.

- See Missouri Committee on Legislative Research: Oversight Division, Fiscal Note L.R. No. 4324-18 (Apr. 29, 2014).
- See Missouri Budget, Fiscal Year 2015, <http://content.oa.mo.gov/sites/default/files/Budget%20Summary%20FY%202015.pdf>. Some sources note that the language of SB 509 could be interpreted as eliminating taxes for all income over \$9,000 because of a drafting error. If such an interpretation were made by enforcement authorities, a technical amendment could be passed in future sessions. See Letter from Cheryl D. Block, Professor of Law, Washington University in St. Louis, School of Law, to Doug Nelson, Commissioner, Missouri Office of Administration (Apr. 21, 2014), <https://governor.mo.gov/sites/default/files/Professor%20Block%20Letter%20509.pdf>.

## 2014 Tax Package is a Missed Opportunity for Reform

SB 509 phases the income tax cut in slowly based on revenue triggers and results in a total cut to the top income tax bracket of just 0.5 percentage points by 2021. Part of the reason this cut is so minimal is that legislators included a generous new deduction for pass-through businesses. After the provision is fully phased in, businesses such as S corporations and LLCs will be able to deduct 25 percent of adjusted gross income from taxation. While this provision lowers the effective tax rate of these entities, it limited the amount by which legislators could cut the overall rate.

In addition to this carve-out, the legislation misses an opportunity to broaden income tax bases or make significant structural changes to the code, only reducing the state's ten brackets to nine.

It bears noting that the state has not reformed its income tax bracket structure since the state adopted a progressive scheme in 1931 (Table 2).

### Conclusion

Tax reform discussions have been unusually rare in Missouri, so much so that the income tax has not been comprehensively reviewed in decades. A better move this session would have been to consolidate the large number of brackets into a flatter, simpler structure while using the revenue that was put toward the pass-through carve-out to instead lower the overall rate. 2014 represented an opportunity to engage in real tax reform, but the plan that passed was lackluster. Despite fantastical claims by supporters and detractors, these changes will have negligible positive or negative impact.

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Editor, Donnie Johnson  
Designer, Dan Carvajal

Tax Foundation  
National Press Building  
529 14th Street, NW,  
Suite 420  
Washington, DC 20045-  
1000

202.464.6200

[taxfoundation.org](http://taxfoundation.org)