Office of Missouri State Auditor

Nicole Galloway, CPA

Cost of Tax Incentives and Exemptions

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CITIZENS SUMMARY

Findings in the audit of Cost of Tax Incentives and Exemptions

Improvements Needed to Measure Impact of Legislation	Improvements are needed in the fiscal note process to provide additional information on the impacts of legislation that affect state revenues. State law does not require a post-implementation review to determine the actual fiscal impact of legislation passed in comparison to fiscal note estimates. Also, the Department of Revenue does not track sufficient data to determine the actual fiscal impact of legislation involving the exemption of portions of the sales tax base.
Timely Sales and Use Tax Discount	State laws allowing retailers to retain a portion of sales taxes collected if they remit to the DOR in a timely manner result in state and local governments forgoing significant revenues, are more generous to businesses than surrounding states, and significantly benefit the state's largest retailers. The DOR is not required to and does not routinely report the amount of timely discounts retained by businesses to the General Assembly, local governments impacted, or to the general public.
Timely Withholding Tax Discount	Missouri is the only state to offer a discount for timely remittance of employee withholding taxes. The discount is unnecessary and results in the state forgoing significant revenue. In addition, the DOR is not required to and does not routinely report the amount of timely withholding discounts issued to the General Assembly or the general public.
Internet Sales	The General Assembly has not passed legislation to allow Missouri to participate in the Streamlined Sales and Use Tax Agreement, costing the state millions in potential sales tax revenue.

Because of the limited objective of this review, no overall rating is provided.

Cost of Tax Incentives and Exemptions
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Missouri State Auditor

Honorable Eric R. Greitens, Governor
and
Members of the General Assembly
and
Joel W. Walters, Director
Department of Revenue
Jefferson City, Missouri

We have audited certain operations of the Department of Revenue and the state's legislative fiscal note process related to the cost of tax incentives and exemptions, in fulfillment of our duties under Chapter 29, RSMo. The scope of the audit included, but was not necessarily limited to, the year ended June 30, 2016. The objectives of our audit were to:

1. Evaluate the internal controls over significant management and financial functions for the cost of tax incentives and exemptions.

2. Evaluate compliance with certain legal provisions for the cost of tax incentives and exemptions.

3. Evaluate the economy and efficiency of certain management practices and operations for the cost of tax incentives and exemptions.

We conducted our audit in accordance with the standards applicable to performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides such a basis.

Government Auditing Standards require us to obtain and report the views of responsible officials of the audited entity concerning the findings, conclusions, and recommendations included in the audit report. Due to the nature of this report, and due to the majority of the findings being legislative in nature, we were unable to obtain views of responsible officials for the findings, conclusions, and recommendations outlined in findings 1, 2 and 3 of the Management Advisory Report. The views of a responsible administering agency were obtained and included where appropriate. In addition, portions of this report include information presented in previously issued audit reports. Additional management responses to those issues are included in the original audit report.

For the areas audited, we identified (1) no significant deficiencies in internal controls, (2) no significant noncompliance with legal provisions, and (3) deficiencies in management practices and operations. The accompanying Management Advisory Report presents our findings arising from our audit of the Cost of Tax Incentives and Exemptions.

The accompanying Organization and Statistical Information is presented for informational purposes. This information was obtained from the department's management and was not subjected to the procedures applied in our audit of the department.

Nicole R. Galloway, CPA
State Auditor

The following auditors participated in the preparation of this report:

Director of Audits:	Robert E. Showers, CPA, CGAP
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Cost of Tax Incentives and Exemptions
Introduction

Background

Missouri taxes retail sales of tangible personal property and certain taxable services. However, there are a number of exemptions from Missouri's sales and use tax laws. In addition, Missouri offers businesses discounts for timely payment of sales and use taxes. Missouri also taxes the income of Missouri residents and non-residents, as well as the income of corporations. Discounts are also offered to businesses for timely payment of employee income tax withholdings.

Selected state taxes

General Sales Tax
The general sales tax, authorized by Section 144.020, RSMo, is a 4 percent tax on the purchase price of tangible personal property or services sold at retail, excluding exemptions. Disposition of the tax is three-fourths to the state General Revenue Fund and one-fourth to the School District Trust Fund.

General Use Tax
The general use tax, authorized by Section 144.610, RSMo, is a 4 percent tax on the value of tangible personal property purchased outside the state for the privilege of storing, using, or consuming that property within the state, excluding exemptions. Disposition of the tax is three-fourths to the state General Revenue Fund and one-fourth to the School District Trust Fund.

Individual Income Tax
The individual income tax, authorized by Section 143.011, RSMo, is a tax on the taxable income of Missouri residents and on taxable income earned in Missouri by non-residents. The tax rate ranges from 1½ to 6 percent of taxable income. Disposition of the tax is to the state General Revenue Fund except as otherwise prescribed by state law.

Corporation Income Tax
The corporation income tax, authorized by Section 143.071, RSMo, is a tax on a corporation's taxable income from Missouri sources. The rate is 6¼ percent of taxable income. Disposition of the tax is to the state General Revenue Fund.

Corporation Franchise Tax
The corporation franchise tax, authorized by Chapter 147, RSMo, was a tax on all in- and out-of-state corporations based on assets apportioned to Missouri. The tax rate was phased out between 2012 and 2015, and no franchise tax was imposed beginning on or after January 1, 2016. Disposition of the tax was to the state General Revenue Fund.

Tax review commissions and committees

Section 136.450, RSMo, effective August 28, 2015, established the Study Commission on State Tax Policy to, among other things, "make a complete, detailed review and study of the tax structure of the state and its political subdivisions, including tax sources, the impact of taxes, collection procedures, administrative regulations, and all other factors pertinent to the fiscal operation of the state." The Commission issued a preliminary report in December 2016, noting similar topics and observations addressed in this report. The Commission's final report and formal recommendations on tax policy issues to the Governor and General Assembly is due December 31, 2017.

On January 25, 2017, the Governor created by Executive Order No. 17-07 the Governor's Committee for Simple, Fair and Low Taxes to compare Missouri's tax credit programs and tax rates to those of its peer states; assess the economic impact of existing state tax credit programs; assess the possibility of financing cuts to overall state tax rates with cuts to tax credit programs; and recommend comprehensive tax reform legislation to the Governor no later than June 30, 2017. The committee's report issued June 30, 2017, centered its final recommendations on tax credit reform.

Scope and Methodology

To gain an understanding of the cost of tax incentives and exemptions, we reviewed applicable legislation, the related fiscal notes, financial records, and other pertinent documents; interviewed various personnel of the Department of Revenue (DOR) and the Legislative Oversight Division, as well as certain external parties; and performed analysis of comparative data obtained.

We obtained an understanding of the internal controls that are significant within the context of the audit objectives and assessed whether such controls have been properly designed and placed in operation. We obtained an understanding of legal provisions that are significant with the context of the audit objectives, and we assessed the risk that illegal acts, including fraud, and violations of legal provisions could occur. Based on that risk assessment, we designed and performed procedures to provide reasonable assurance of detecting instances of noncompliance significant to those provisions.

1. Improvements Needed to Measure Impact of Legislation

Improvements are needed in the fiscal note process to provide additional information on the impacts of legislation that affect state revenues. State law does not require the use of post-implementation reviews to monitor the actual financial impact of legislation enacted, and the Department of Revenue (DOR) does not adequately capture and track data necessary to perform such analyses. As a result, the actual fiscal impact of legislation put into effect is not monitored and reported to the General Assembly (GA). Without knowledge of the actual fiscal impacts of past legislation, the GA cannot make informed decisions about the cost of enacted legislation and the need for potential legislative changes.

Background

Each year legislation is enacted that impacts General Revenue (GR) Fund revenues from income and sales tax. Section 23.140, RSMo, requires each piece of proposed legislation to be accompanied by an estimate of the fiscal impact, referred to as a fiscal note. Legislation enacted in 2014, 2015, and 2016, potentially affecting state GR Fund tax revenue is summarized in Appendix A. According to fiscal note estimates, the net maximum impact of the legislation was approximately a negative $7.7 million in fiscal year 2015, negative $20.9 million in fiscal year 2016, negative $83 million in fiscal year 2017, negative $205.1 million in fiscal year 2018, negative $289.3 million in fiscal year 2019, and an additional negative $1.5 billion through fiscal year 2022.

Fiscal notes

Each fiscal note is prepared by the nonpartisan Legislative Oversight Division (Oversight) with input from various state agencies (e.g. DOR), local political subdivisions, and sometimes outside experts. For example, since 1972, the University of Missouri's Economic & Policy Analysis Research Center (EPARC) has provided tax data and analysis to the GA by providing the fiscal impact of proposed legislation. EPARC relies on a model built solely to calculate how changes in tax law would impact state tax revenue.

The fiscal note process begins when the drafter in either Senate Research or Legislative Research forwards a copy of a bill draft to Oversight with a request for a fiscal note. Oversight personnel review the draft and forward a copy to affected state agencies and local political subdivisions. Personnel at these entities then review the draft and determine what fiscal impact, if any, it will have upon their agency. Oversight personnel compile all responses and together, with their own research, prepare a fiscal note stating the estimated fiscal impact to state government, local governments, and small businesses.

By statute,[1] fiscal notes prepared provide state and local fiscal impact estimates for 2 fiscal years. They also may include long-range implications of the legislation, beyond the 2 fiscal years, when appropriate. The financial note is an estimate, sometimes based on data that may be several years old (e.g. the last year of complete tax information), and may indicate the financial impact is "unknown," "could exceed . . .," or be "more than . . ." rather than provide a specific dollar estimate.

Fiscal note estimates are not subsequently reviewed

State law does not require a post-implementation review of fiscal notes to determine the actual fiscal impact of legislation enacted in comparison to fiscal note estimates. Post-implementation reviews would be especially beneficial for legislation impacting the tax base or for which the fiscal note included an estimated impact on tax revenues. Our review of fiscal notes determined 27 enacted bills during the last 3 legislative sessions with unknown and estimated impacts on state tax revenues. Of these 27 bills, 13 had estimated fiscal impacts of $1.5 million or more in a one year period, with 6 of those bills having estimated impacts of more than $10 million in a one year period. Examples of bills with fiscal notes that projected significant loss of state general revenue that should be considered for post-implementation review include:

- Senate Bill (SB) 19 (2015) created a new method of allocating corporate income from interstate sales between states for tax purposes and was estimated to result in a negative $15.2 million in state general revenues beginning in fiscal year 2016 and thereafter.

- SB 20 (2015) created a sales and use tax exemption for materials and utilities used by commercial laundries and was estimated to result in a negative $1.25 million in state general revenues in fiscal year 2016 and a negative $1.5 million in state general revenues beginning in fiscal year 2017 and thereafter.

- SB 509 (2014) would modify provisions related to income taxes, including reducing the individual income tax rate beginning in 2017, and when fully phased in was estimated to result in a negative $621 million in state general revenues.

- SB 794 (2016) created a sales tax exemption for parts and accessories of certain types of medical equipment and was estimated to result in a reduction of state general revenue that could exceed a negative $100,000. However, the Office of Administration, Division of Budget and Planning, estimated the legislation would decrease state general

[1] Section 23.140, RSMo

revenues by $16 million in fiscal year 2018 and thereafter in its fiscal note submission.

- SB 814 (2016) allows an individual to deduct income earned through active military duty from his/her Missouri adjusted gross income and was estimated to result in a negative $3.6 million in state general revenues beginning in fiscal year 2017 and thereafter.

- SB 1025 (2016) exempts instructional fitness classes from sales taxes and was estimated to result in a reduction of state general revenue that was unknown or could exceed a negative $100,000. However, the Office of Administration, Division of Budget and Planning, estimated the legislation would decrease state general revenues by $5.7 million in fiscal year 2017 and $6.9 million in fiscal year 2018 and thereafter in its fiscal note submission.

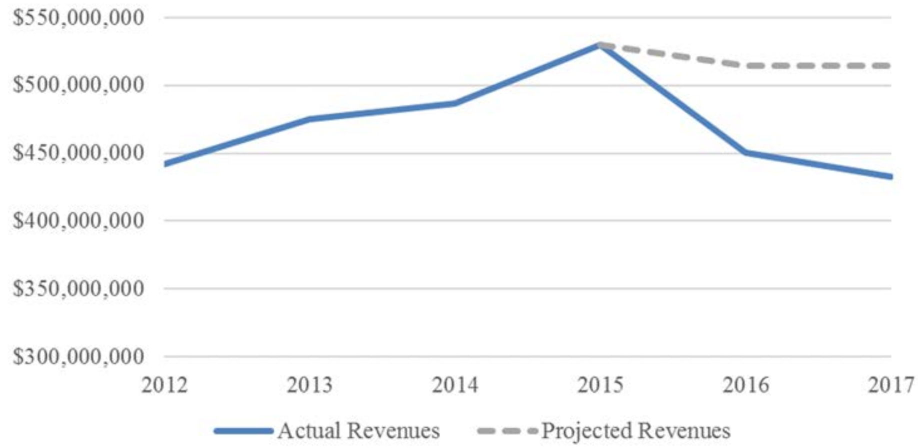
There are sometimes significant variation in the fiscal analysis performed by the agencies preparing them and the final fiscal note approved by Oversight. Post-implementation reviews would allow policymakers to assess the actual impact of such legislation and make more informed decisions on legislation going forward. Such an analysis would allow policymakers to identify if enacted legislation was having a larger, or smaller, impact on revenues than initially estimated. Our analysis of SB 19 (2015) provides an example of why post-implementation reviews are necessary.

Fiscal impact of Senate Bill 19 was significantly understated

The fiscal note for SB 19 (2015) significantly underestimated the loss in state revenue due to the bill. DOR officials estimated the loss of total state revenue could be up to $15.2 million annually based on an assumption of the number of filers who would be able to take advantage of the new filing methods. However, the DOR analysis was limited because the department did not have sufficient data to identify the filers who would be able to use the changed filing method, and estimates were calculated using outdated tax year 2011 information because it was the most recent complete tax year data available.

While the fiscal note estimated the resulting revenue reduction of SB 19 at $15.2 million annually in the corporate income tax, or a total of $30.4 million from the 2015 base year revenue for fiscal years 2016 and 2017, the actual revenue reduction in corporate income taxes over that same timeframe was approximately $177 million, or more than 5 and a half times the fiscal note estimate. As seen in Appendix B, Corporate Income Tax increased from fiscal year 2012 through fiscal year 2015, and then sharply decreased $79.2 million in fiscal year 2016, and decreased an additional $18.2 million in fiscal year 2017.

Figure 1: Senate Bill 19 actual vs. projected revenue



Source: DOR records and fiscal note information

DOR personnel could not identify the actual cause in the reduction in corporate income taxes, but indicated SB 19 (2015) was likely one of the contributing factors along with other potential factors including "other legislative changes" and "changes in the overall economic market." However, no other legislation was projected to significantly impact corporate income taxes over this timeframe and economic conditions have remained steady.

Post-implementation reviews performed in neighboring state

While Missouri law does not require a post-implementation review of fiscal notes, one of our neighboring states does. The Tennessee legislature requires its fiscal review committee staff, within 90 days after each regular legislative session, to select a sample of at least 5 laws enacted within the last 5 years to review and compare the actual fiscal impact to the original fiscal note estimation. A summary of the results of each review is provided to each member of the general assembly.

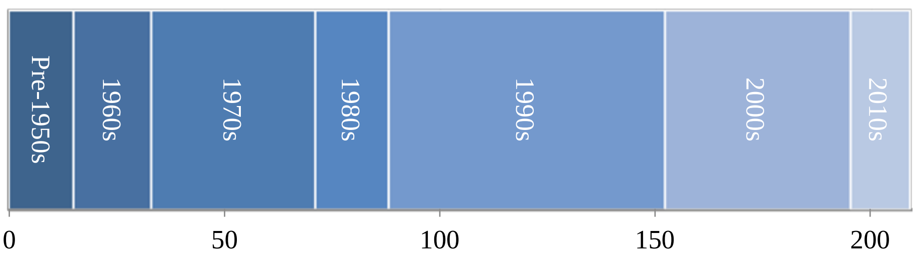
A Tennessee official indicated all analysts meet to discuss progress and available data to determine if a law should be reviewed or the review delayed until adequate data can be obtained. The overall aim of the process is to determine the accuracy of the fiscal note estimates and help identify areas of the fiscal analysis process that could be improved. According to the official, the reviews have identified inadequately implemented programs that did not meet their original projections, and in one instance, the legislature passed new legislation to terminate a program.

If Missouri had such a review process, the actual impact of SB 19 (2015) could be formally evaluated as compared to the estimated impact and better understood, and the significantly higher fiscal impact of the legislation would be made known to policymakers as well as the public.

Data not tracked to determine the impact of the majority of sales tax exemptions[2]

For legislation involving the exemption of portions of the sales tax base there is insufficient data tracked by the DOR to determine the actual fiscal impact of such legislation. As a result, the fiscal impact of each sales tax exemption, and the cumulative fiscal impact of all sales tax exemptions on state and local revenues cannot be determined. According to DOR records, as of June 30, 2016, there were 209 sales and use tax exemptions provided by state law. Figure 2 shows the cumulative number of sales and use tax exemptions enacted by decade.

Figure 2: Number of sales and use tax exemptions enacted by decade



Source: DOR (http://dor.mo.gov/business/sales/exemption-list.php accessed May 2017)

The DOR tracks only 3 of 209 exemptions (1.4 percent); the 3 percent state general revenue sales tax reduction on food sales,[3] the textbook sales tax exemption, and the manufacturing sales tax exemption. Per DOR officials, these items are subject to local sales and use tax and are listed as a separate item on the sales and use tax return. As a result, they are easily tracked. DOR records indicate these three exemptions resulted in sales tax revenue reductions of approximately $466.7 million for 2016 and $455 million for 2015, or 4.6 percent of total General Revenue Fund collections each year.

In the 2015 and 2016 legislative sessions, sales and use tax exemptions were created for aircraft manufacturers,[4] commercial laundries,[5] data storage centers,[6] fitness classes,[7] and medical equipment.[8] The fiscal notes for these exemptions estimated a fiscal impact of over $2.5 million, however, the Office of Administration, Division of Budget and Planning, estimated the impact of these exemptions at over $20 million per year. No data is tracked to determine the actual impact.

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[2] Use of the term exemption in this section and throughout the remainder of this finding refers to both sales and use tax exemptions (i.e. law eliminating taxes ordinarily due on an item) and exclusions (i.e. items never subject to tax).

[3] A separate sales tax is imposed on food at the rate of one percent [the regular tax rate of 4 percent was previously imposed, but modified by House Bill (HB) 548 (1999)].

[4] HB 517 & 754 (2015)

[5] SB 20 (2015)

[6] SB 149 (2015)

[7] SB 1025 (2016)

[8] SB 794 (2016)

Vendors remit monthly, quarterly, or annual sales and use tax returns to the DOR. The returns include gross sales receipts, adjustments to gross sales receipts, and taxable sales. The adjustment amounts include, but are not limited to, exempt sales for the period of the sales tax return (filing period), and corrections of errors from previous periods. However, the DOR does not require vendors to provide detailed information or an explanation of the adjustment total on returns, and according to DOR personnel, only taxable sales are reported on some returns, with the gross sales receipts or adjustment amounts excluded.

DOR personnel indicated the prior computerized system was not equipped to track the specific exemptions related to adjustment information tracked. In addition, the DOR did not include exemption tracking in its new computerized system (implemented in September 2017) because DOR personnel indicate they believe most businesses would not adequately track and report exemptions. However, by not requiring businesses to track these adjustments, the DOR and policymakers are unable to determine the fiscal impact of these various exemptions on the state budget. In addition, the use of a post-implementation review system would encourage the DOR to track the impact of such legislation in the future.

A similar condition was noted in our prior audit, *Department of Revenue Sales and Use Tax*, Report No. 2015-080.

Conclusion

Estimates of the fiscal impact of potential legislation are not always based on the most current data and often involve the use of significant assumptions to estimate a dollar value impact. Fiscal note post-implementation reviews would make agencies aware additional data may need to be tracked, and would provide the GA and the public with information needed to evaluate the impact of past legislation. In addition, these reviews may provide Oversight and the GA with recommendations on improving the fiscal note process going forward. The evaluation of the actual impact of any legislation which negatively impacts the state's tax base is especially critical considering Hancock Amendment[9] limitations on legislation to increase revenues.

Recommendation

The General Assembly should modify current fiscal note statutory procedures to include a follow-up, or post-implementation, review of changes in tax law that may significantly affect the state's operations.

The DOR begin tracking of exemption information so the reductions of state revenue related to each exemption can be quantified and reported to the General Assembly.

[9] Article X, Sections 16 Through 24, Constitution of Missouri

Auditee's Response

Tracking and reporting exemptions is an appropriate goal. Reporting exemptions would substantially increase the burden on businesses. Also, based on prior attempts to track limited exemptions, the data collected is likely to be highly inaccurate due to businesses errors in reporting. In addition, to track and report exemptions, the DOR would require a substantial increase in full-time employees, which the current budget does not support. The DOR is in the process of implementing an integrated revenue system that may be able to track at least some exemptions, but tracking and reporting the data will still be a significant burden on businesses and the data collected will still likely be inaccurate.

2. Timely Sales and Use Tax Discounts

State laws allowing retailers to retain a portion of sales taxes collected if they remit to the DOR in a timely manner result in state and local governments forgoing significant revenues, are more generous to businesses than surrounding states, and significantly benefit the state's largest retailers. In addition, the DOR does not routinely report to the GA the amount of timely sales and use tax discounts retained by businesses.

Generous discounts

Missouri's timely sales tax discount is the second most generous discount in the nation.[10] Sections 144.140 and 144.710, RSMo, allow businesses remitting sales and use taxes to retain 2 percent of taxes payable to the DOR if the business remits payments in a timely manner.[11] The amount of discount is not capped. As a result, state and local sales tax revenues of approximately $115 million and $110 million were collected from purchasers, but retained as discounts by businesses remitting sales and use taxes in fiscal years 2016 and 2015, respectively.[12] In fiscal year 2016, sales and use taxes comprised approximately 21 percent of the state's general revenue. With sales and use tax revenues being used to fund significant portions of state and local government budgets, such large discounts are significant.

According to the Federation of Tax Administrators,[13] 27 other states offer similar vendor discounts, however, 16 of the state's offering discounts have

[10] Colorado's uncapped discount of 3.33 percent is the most generous.

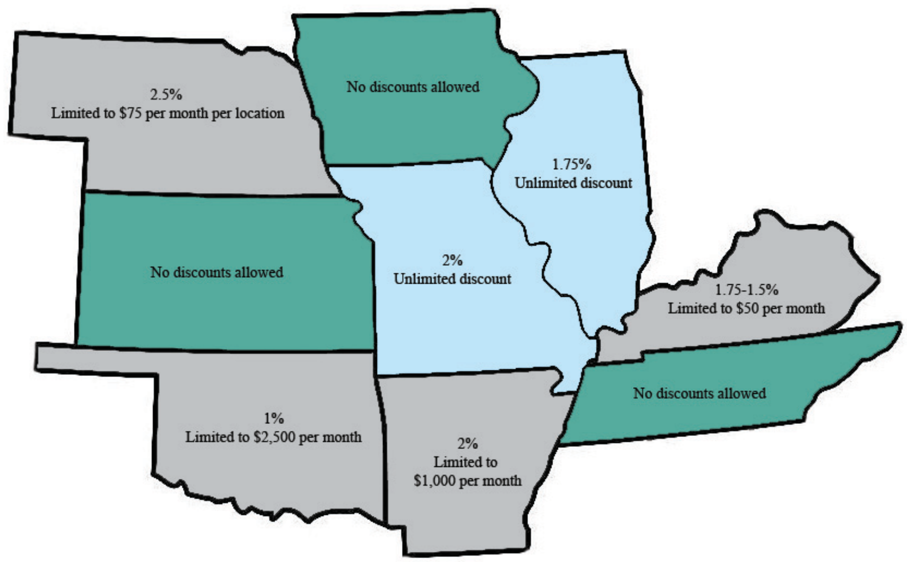
[11] Per Section 144.080, RSMo, if filing annually applicable taxes are due by January 31 of the following year, if filing quarterly applicable taxes are due the last day of the month following the completed quarter, and if filing monthly applicable taxes are due the 20th of the following month. Per Section 144.081, RSMo, if filing quarter-monthly applicable taxes are due within 3 business days following the completed quarter-monthly period.

[12] Based on state's average sales tax rate of 7.86 percent, there is a 53.75/46.25 split between state and local revenues. So for 2016 and 2015, timely sales and use tax discounts resulted in foregone state revenue totaling approximately $121 million and foregone local revenues totaling approximately $104 million.

[13] "State Sales Tax Rates and Vendor Discounts (January 1, 2017)," <https://www.taxadmin.org/assets/docs/Research/Rates/vendors.pdf>, accessed on June 9, 2017.

established ceilings to limit the amount of discount and/or compensation retained by businesses. In addition, 10 of the remaining 11 states either have a lower discount rate than Missouri or only apply the highest discount rate to a limited dollar amount of sales tax collected (e.g. the first $3,000, then a lower rate applies). Of the eight states contiguous to Missouri, three (Iowa, Kansas, and Tennessee) do not allow businesses to retain any sales tax receipts for timely payments, and four (Arkansas, Kentucky, Nebraska, and Oklahoma) allow discounts based on a percentage of taxes, but have established ceilings. These ceilings range from a low of $50 per month for each business location, up to a high of $2,500 per month per business. Also, Kentucky reduced its ceiling from $1,500 per month to $50 per month in July 2013.

Figure 3: Sales tax discounts in surrounding states



* Kentucky's larger discount (1.75%) applies to the first $1,000.

Cap on discount would result in increased revenue

Changing state law to include a monthly cap on the amount of timely discount eligible to be retained would significantly increase state and local revenues. For example, applying Oklahoma's cap of $2,500 per month (the largest cap of contiguous states) to Missouri would result in approximately $52 million in state and local sales tax revenue, according to DOR data.

In fiscal year 2016, 723 sales tax filers received timely discounts in excess of $2,500 in at least one month during the year. Limiting those filers to Oklahoma's $2,500 monthly cap would have resulted in an additional $27.9 million in state sales tax revenue and $24 million in local sales tax revenue. A lower cap, such as Arkansas's $1,000 per month cap, would result in even higher revenue to the state and local governments, approximately $64.6 million.

Cap on discount would only impact the state's largest retailers

A monthly timely discount cap similar to Oklahoma's would not affect the majority of sales tax filers. Based on the state's average sales tax rate of 7.86 percent,[14] only businesses with monthly taxable sales of approximately $1.6 million would have their timely discount capped. Retailers with less than $1.6 million in monthly taxable sales would continue to receive the full 2 percent timely discount. In fiscal year 2016, the 50 largest sales tax collecting businesses retained approximately 72 percent of timely discounts exceeding $2,500, with the single largest sales tax collecting business receiving $10 million in discounts.

The timely sales tax discount was established for businesses to recover a portion of their costs for compliance with state sales tax laws and to encourage timely remittance of sales and use taxes. With increased use of electronic systems to calculate and remit sales tax collections, it is not clear if the continued use of such a discount is necessary to achieve these objectives.[15] The current law allowing uncapped timely discounts results in the state and local governments providing a sizable subsidy to the largest retailers in the state, and is more generous than all but one other state. Implementing a cap on timely discounts would result in additional revenues to the state and local governments without increasing taxes on consumers.

Amounts of timely discounts are not routinely reported

The DOR is not required to report, and does not routinely report the amount of timely discounts retained by businesses to the GA, local governments impacted, or to the general public. DOR officials stated this data is provided upon request. However, this information could be useful to the GA when making various budget decisions and ensuring the state and local policymakers and the general public are informed of the continuous cost of various tax incentives.

Recommendation

The General Assembly evaluate the necessity of a timely sales tax discount. If such a discount is deemed necessary, consider the implementation of a monthly cap on the amount of discount retained.

The DOR annually report the reduction of state revenue related to the timely discount to the General Assembly, applicable political subdivisions, and to the general public.

[14] Scott Drenkard and Nicole Kaeding, "State and Local Sales Tax Rates in 2016," <https://taxfoundation.org/state-and-local-sales-tax-rates-2016/>, (March 2016), accessed on June 7, 2017. Calculation regarding the estimated monthly taxable sales was based on this estimated average sales tax rate.

[15] "Timely Filing Discount Costs Missourians Millions," <http://www.mobudget.org/timely-filing-discount/>, (October 2016), accessed on September 18, 2017.

Auditee's Response

The DOR has provided information regarding timely sales tax discount when requested by elected officials, but has not been requested to report this information on a regular basis. The DOR is willing and able to do so.

3. Timely Withholding Tax Discount

Missouri is the only state to offer a discount for timely remittance of employee withholding taxes. The discount is unnecessary and results in the state forgoing significant revenue. In addition, the DOR does not routinely report the amount of withholding discounts taken.

Section 143.261, RSMo, allows businesses remitting withholding taxes to retain 2 percent of $5,000 or less, 1 percent of $5,001 to $10,000, and/or 0.5 percent of amounts exceeding $10,000 in taxes payable to the DOR if the business remits payment in a timely manner.[16] As a result, approximately $29 million and $28 million in withheld income tax revenues were collected from employees, but retained by employers, as withholding discounts in fiscal years 2016 and 2015, respectively.

This discount, effective since 1973, was originally implemented to compensate staff time calculating employee withholdings and to incentivize timely filing. However, Sections 143.731 and 143.751(3), RSMo, authorize the DOR to charge interest and penalties on delinquent payments. Also, considering the development of available technology, income tax withholding calculations can be computed much faster and with less manpower than when the statute in question was implemented.

Offering a discount to businesses for making timely payments, something they are already required to do, and will be penalized for if they do not comply, is unnecessary and is unlikely to result in improved compliance. In addition, because Missouri is the only state to provide an incentive for timely payment of withholdings, eliminating this discount would bring Missouri in line with other states and increase state revenues.

Amounts of timely discounts are not routinely reported

The DOR is not required to report and does not routinely report the amount of timely withholding discounts to the GA or the general public. DOR officials stated this data is provided upon request. However, this information could be useful to the GA when making various budget decisions and ensuring policymakers and the general public are informed of the continuous cost of such tax incentives.

[16] Per Section 143.221, RSMo, if filing annually applicable withholdings are due by January 31 of the following year. If filing quarterly applicable withholdings are due the last day of the month following the completed quarter. If filing monthly applicable withholdings are due for the first 2 months of each quarter by the 15th of the following month and for the last month of each quarter by the last day of the following month. Per Section 143.225, RSMo, if filing quarter-monthly applicable withholdings are due within 3 banking days after the end of the quarter-monthly period.

Recommendation

The General Assembly evaluate the necessity of the timely withholding discount.

The DOR annually report the reduction of state revenue related to the timely withholding discount to the GA and the general public.

Auditee's Response

The DOR has provided information regarding the timely withholding discount when requested by elected officials, but has not been requested to report this information on a regular basis. The DOR is willing and able to do so.

4. Internet Sales

The GA has not passed legislation to allow Missouri to participate in the Streamlined Sales and Use Tax Agreement (SSUTA), costing the state millions in potential sales tax revenue.

Background

State law currently requires Missouri businesses to collect sales tax on online sales if the business has a physical presence (nexus) in the state. However, under a 1992 U.S. Supreme Court ruling,[17] states cannot require companies that do not have nexus to collect state and local sales taxes. As a result, Missouri cannot require businesses without nexus to collect sales tax on goods sold to Missouri residents. Federal legislation has been proposed that would enable states to require online retailers to collect and remit sales taxes, while also providing businesses with an effective means to comply. Such legislation includes the Market Place Fairness Act of 2017 (U.S. Congress Senate Bill No. 976) and the Remote Transaction Parity Act of 2017 (U.S. Congress House Bill No. 2193). If implemented, these bills would allow states to collect sales tax on products sold by out-of-state businesses with no nexus.

State law requires individual consumers to pay consumer use tax on purchases when the total annual purchases for which the use tax was not collected by the seller exceed $2,000. Taxpayers are required to file a separate use tax form, rather than include the information on their individual income tax form. Table 1 shows less than 1,500 consumers filed returns and remitted less than $1,000,000 in use taxes in 2016.

[17] *Quill Corp v, North Dakota*, 504 U.S.298 (1992)

DOR records indicate the following consumer's use tax remittances were made by sole proprietors[18] for fiscal years 2016, 2015, and 2014:

Table 1: Consumer use tax remittances, fiscal years 2014 - 2016

	Fiscal Year		
	2016	2015	2014
Remittances	1,495	2,030	2,149
Taxable sales	$18,288,066	$25,318,658	$25,913,266
Total tax	$911,736	$1,381,777	$1,370,891

Online sales increasing

With the increasing popularity and usage of online shopping, e-commerce sales have grown significantly in recent years. Estimates from the U.S. Census Bureau[19] show e-commerce sales for the first quarter 2017 now account for approximately $100 billion of $1.25 trillion in total retail sales (approximately 8 percent), up from approximately $36 billion in the second quarter 2008. Prior to the increase in online shopping activity, a 2009 study[20] estimated Missouri state and local governments have lost, and will continue to lose, sales/use tax revenue of approximately $210.7 million annually by not collecting taxes on these sales. A more recent 2012 study,[21] built upon the 2009 study and other research, estimated that Missouri would lose approximately $358 million in sales/use tax revenue in 2014. These studies also noted local vendors face a competitive disadvantage because consumers who make purchases online avoid paying sales/use taxes. However, it is possible if taxes were collected on e-commerce sales, consumer purchasing habits could change resulting in less revenue for the state than forecasted. The issues of revenue, consumer spending habits, and the economic impact of increased taxation are beyond the scope of this report.

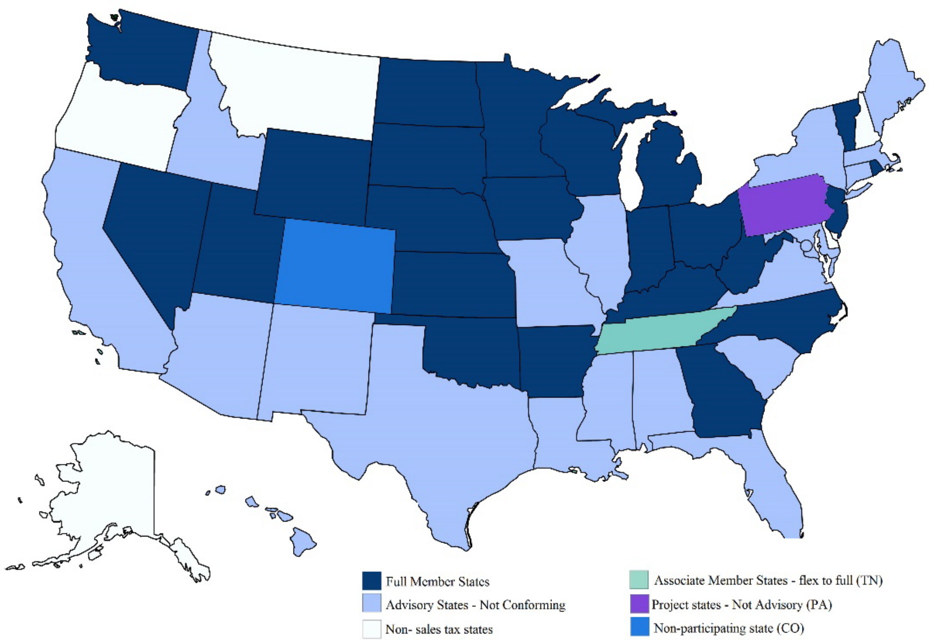
Streamlined Sales and Use Tax Agreement

Implementation of the SSUTA would allow Missouri to collect a portion of online sales taxes the state is currently forgoing. The SSUTA, adopted in November 2002, is a cooperative effort among states, local governments,

[18] DOR personnel could not isolate the collections specific to the Individual Consumer's Use Tax Return, form 4340, based on the way they process those returns. Therefore, they provided us data for all consumer's use tax remittances, through both the forms 4340 and 53-C. Because more than individuals filed form 53-C, DOR personnel broke out the collections between individuals (including sole proprietors) and all other registered business types.
[19] U.S. Department of Commerce, "Quarterly Retail E-Commerce Sales 1st Quarter 2017," <https://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf>, accessed on June 5, 2017.
[20] Bruce, Donald, William F. Fox, LeAnn Luna, "State and Local Government Sales Tax Revenue Losses from Electronic Commerce," University of Tennessee, Center for Business and Economic Research, <http://cber.bus.utk.edu/ecomm.htm>, accessed on May 31, 2017.
[21] Ying Huang, John Kosash, and Andrew Wesemann. (2012). "Internet Sales and Use Tax Issues in Missouri" Report 04-2012. University of Missouri Columbia, Institute of Public Policy, <https://ipp.missouri.edu/publications/internet-sales-and-use-tax-issues-in-missouri/>, accessed June 14, 2017.

and businesses to simplify sales and use tax collection and administration by retailers and states. It allows member states to collect a portion of the sales taxes that cannot be collected on online sales from out of state vendors. The SSUTA aims to minimize costs and administrative burdens on retailers collecting sales tax, while also encouraging out-of-state sellers to collect tax on sales to customers in the member states. Forty-four states, including Missouri, participated in the Streamline Sales Tax project and are considered advisory states. However, only 24 of these states (member states) have enacted legislation to conform to at least part of the SSUTA, which allows them to collect sales taxes from vendors in other states. In addition, one state not in the original 44 is working toward joining the SSUTA (project state). The following map shows the breakdown of the states:

Figure 3: SSUTA participation



Source: Streamlined Sales Tax Governing Board, Inc., <http://www.streamlinedsalestax.org, Streamlined State Status 01-01-17>, accessed on June 6, 2017.

Bills introduced in Missouri during the 2017 legislative session and in prior sessions to implement the provisions of the SSUTA have failed to pass. Participation in the SSUTA is voluntary for businesses; therefore, Missouri cannot require out-of-state sellers without nexus to collect sales taxes on purchases made by Missouri residents. However, according to Streamlined Sales Tax Governing Board, Inc., 5 peer states with similar populations to Missouri (+/- 2 million) have joined the SSUTA and received millions in additional sales tax revenues, as follows:

Table 2: Peer SSUTA member state revenues, fiscal year 2014 - 2016

Member State	Fiscal Year 2016	Fiscal Year 2015	Fiscal Year 2014
Indiana[1]	$ 19,163,000	24,434,000	15,621,000
Kentucky	16,329,219	15,315,854	12,761,999
Minnesota	21,565,986	20,593,606	11,307,397
Washington	25,850,531	18,396,980	16,604,933
Wisconsin	9,836,422	7,454,172	5,724,755
Average	$ 18,549,032	17,238,922	12,404,017

Source: Streamlined Sales Tax Governing Board, Inc.
[1] Indiana had not reported complete collections for 2016.

The average peer state collected over $18 million in additional sales tax revenues in 2016. These amounts provide an estimate of the additional tax revenues Missouri may receive by implementing the agreement.

State legislation

Due to the failure of the U.S. Congress to pass federal legislation allowing states to collect sales tax on products sold by out-of-state businesses with no nexus, several states (including some of those already participating in the SSUTA) have enacted legislation or adopted applicable rules in attempts to collect lost sales tax revenue on remote sales:

- Indiana (2017), North Dakota (2017), South Dakota (2016), Tennessee (2017), Virginia (2017), and Wyoming (2017) require out-of-state sellers that have no physical presence in a state but that have sales exceeding a defined amount to collect and remit applicate sales and use taxes. However, as a result of the new requirements, some states have faced or been threatened with litigation. All of these states, except Virginia, are member states to the SSUTA.

- Alabama (2017) and Colorado (2010) require out-of-state sellers that are not currently collecting and remitting applicable taxes to report sales information for tax purposes to the state and/or consumer.

Missouri enacted legislation in 2013 allowing taxation of a business' sales if an "affiliate" relationship with another entity existed, but this law can easily be rendered ineffective as companies end their affiliate program in Missouri (e.g. Amazon ended its program, Amazon Associates, prior to the legislation taking effect). In addition, Missouri has failed to enact legislation to participate in the agreement or other legislation meant to recover lost revenues on additional remote sales. While enacting more comprehensive "economic nexus" legislation similar to other states should be considered, the benefits would need to be weighed against potential litigation costs.

Conclusion

The state is forgoing revenue from online sales by not pursuing options to capture sales taxes on such sales. Becoming a SSUTA member state would allow the state to capture a portion of sales taxes from out of state online activity. Such an option is more efficient and practical than trying to enforce use tax compliance for such activity.

Recommendation

The DOR work with the General Assembly to evaluate the estimated fiscal impact of not implementing the Streamlined Sales and Use Tax Agreement.

Auditee's Response

The DOR has provided information regarding the estimated fiscal impact of the Streamlined Sales and Use Tax Agreement to the General Assembly when requested, and is willing and able to provide any further support as requested.

Cost of Tax Incentives and Exemptions
Organization and Statistical Information

Department of Revenue

The Department of Revenue (DOR) was created by Article IV, Section 12, Missouri Constitution as the central collection agency for state revenues. The Director of the DOR is appointed by the Governor, with the advice and consent of the Senate, and is responsible for all operations and policies. DOR responsibilities include:

1) Administering and collecting state taxes and fees, including sales and use tax, motor vehicle sales tax, and highway use tax.
2) Collecting certain taxes and fees for local governments, including local sales and use tax.
3) Titling and licensing motor vehicles, trailers, and boats.
4) Licensing motor vehicle operators.

The DOR consists of the Director's office and four divisions: the Motor Vehicle and Driver Licensing Division, the Taxation Division, the Administration Division, and the Legal Services Division.

The Directors of Revenue from July 2015 to April 2017 include:

Nia Ray, December 2014 to October 2016
John R. Mollenkamp, (Acting) October 2016 to January 2017
Wood Miller, (Acting) January 2017 to March 2017

In April 2017, Joel W. Walters was appointed Director.

Legislative Oversight Division

The Legislative Oversight Division's (Oversight) primary duties include the preparation of fiscal notes on all bills pending before the General Assembly. Chapter 23, RSMo, requires Oversight to prepare a fiscal note on each bill before action may be taken on it.

The fiscal note must state, among other items, the cost of the proposed legislation to the state. Oversight prepares new fiscal notes on bills and joint resolutions at various points in the course of the legislative process. Oversight may also prepare draft fiscal notes that are considered confidential until the legislative proposal is publicly introduced.

The Oversight Division prepares approximately 3,000 fiscal notes during a regular legislative session.

The Director of the Legislative Oversight Division is Mickey Wilson, CPA.

Appendix A

Tax Legislation Enacted in 2014, 2015, and 2016 - Estimated Net Maximum Impact on State General Revenue Fund

Year	Bill No.	Description	Year Ended June 30, 2015	2016	2017	2018	2019	2020	2021	2022
2014	HB 1132[1]	Increased the amount of various tax credits.	$ (1,500,000)	(1,500,000)	(1,500,000)					
2014	HB 1190	Exempted out-of-state businesses and their employees from state tax while responding to a disaster in Missouri.	(Unknown)	(Unknown)	(Unknown)					
2014	HB 1237	Extended allocation of tax revenue from General Revenue (GR) to other funds through December 31, 2020.	0	0	(7,920,000)					
2014	HB 2029	Made permanent the existing sales tax exemption for materials, replacement parts, and equipment for aircraft.	(more than 100,000)	(more than 100,000)	(more than 100,000)					
2014	HB 2141[1,3]	Modifies measurement standards and tax rates for compressed and liquified natural gas as a motor fuel through 2024.	0	(100,000)	0					
2014	SB 509[2]	Modifies provisions related to income taxes.	0	0	0	(145,679,000)	(267,206,000)	(388,620,000)	(505,453,000)	(620,987,000)
2014	SB 727[1]	Created a sales and use tax exemption for farm products sold at farmers' markets.	(Unknown)	(Unknown)	(Unknown)					
2014	SB 729[1]	Modified provisions related to tax credits.	(6,000,000)	(7,000,000)	(7,000,000)					
2014	SB 829	Shifted the burden of proof to the Department of Revenue (DOR) in certain tax disputes.	(more than 106,085)	(more than 113,529)	(more than 114,682)					
2015	HB 384	Authorized a period of tax amnesty and other tax program changes.		17,039,971	(14,972,413)	(7,307,908)				
2015	HB 514	Modified provisions related to tax increment financing.		(12,000,000)	(12,000,000)	(12,000,000)				
2015	HB 517 & 754[1]	Changed several provisions relating to the DOR and taxation.		(could exceed 203,444)	(could exceed 105,013)	(could exceed 105,499)				
2015	SB 18	Requires the DOR to notify sellers if there is a change in sales tax law interpretation.		(425,394)	(435,213)	(445,547)				
2015	SB 19	Created a new method of allocating corporate income from interstate sales between states from tax purposes.		(15,200,000)	(15,200,000)	(15,200,000)				
2015	SB 20	Created a sales and use tax exemption for materials and utilities used by commercial laundries.		(1,250,000)	(1,500,000)	(1,500,000)				
2015	SB 149	Created state and local sales and use tax exemptions for data storage centers.		(80,757)	0	(more than 750,000)				
2015	SB 194[2]	Extended the date that a business must commence or expand operations to qualify for a Business Facility Tax Credit to Janaury 1, 2025.		0	0	0			(could exceed 5,291,242)	
2015	SB 231[1]	Modified provisions relating to watercraft.		(9,177)	(11,012)	(11,012)				

Appendix A

Tax Legislation Enacted in 2014, 2015, and 2016 - Estimated Net Maximum Impact on State General Revenue Fund

			Year Ended June 30,							
Year	Bill No.	Description	2015	2016	2017	2018	2019	2020	2021	2022
2015	SB 463	Extended sunset on the Residential Treatment Agency Tax Credit and the Developmental Disability Care Provider Tax Credit to 2027.		0	0	0				
2016	HB 1582	Changed withholding tax filing requirements for certain small businesses.			(Unknown)	0	0			
2016	HB 1941	Provided licensing and taxation for daily fantasy sports games.			Unknown	Unknown	Unknown			
2016	HB 2030	Created a tax deduction for employer stock ownership plans.			(65,426)	(10,300,000)	(10,300,000)			
2016	SB 641	Created an income tax deduction for payments from agricultural disaster programs.			(18,137,584)	(Unknown)	(Unknown)			
2016	SB 665[1,2]	Modified provisions related to agricultural tax credits and programs.			(130,071)	(8,000,000)	(8,000,000)	(8,000,000)		
2016	SB 794	Created a sales tax exemption for parts and accessories of certain types of medical equipment.			(could exceed 100,000)	(could exceed 100,000)	(could exceed 100,000)			
2016	SB 814	Allowed an individual to deduct income earned through active military duty from their Missouri adjusted gross income.			(could exceed 3,637,746)	(could exceed 3,600,000)	(could exceed 3,600,000)			
2016	SB 1025	Exempted instructional fitness classes from sales tax.			(Unknown, could exceed 100,000)	(Unknown, could exceed 100,000)	(Unknown, could exceed 100,000)			
		Total	$ (7,706,085)	(20,942,330)	(83,029,160)	(205,098,966)	(289,306,000)	(396,620,000)	(510,744,242)	(620,987,000)

[1] The applicable fiscal note also included provisions not related to state taxes. The estimated net maximum impact of these additional provision(s) to the General Revenue Fund, if any, is not included above.
[2] Full implementation of the legislation extends beyond the number of years required to be included in the applicable fiscal note summary and is reflected as such above.
[3] While full implementation of the legislation extends beyond the number of years required to be included in the applicable fiscal note summary, the estimated net maximum impact was not projected and is not included above.

Source: Missouri House and Senate Joint Bill Tracking, http://www.house.mo.gov/billcentral.aspx

Appendix B

Comparative Statement of State General Revenue Fund Collections

	Year Ended June 30,									
	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Sales and Use Tax	$ 2,147,141,091	2,102,633,661	2,014,363,065	1,969,386,251	1,897,543,412	1,873,305,715	1,809,696,987	1,791,663,893	1,883,719,016	2,000,469,768
Income Tax - Individual	7,320,599,807	7,158,240,866	6,890,815,625	6,352,519,233	6,367,971,142	5,844,676,938	5,632,978,448	5,483,884,463	5,935,194,860	6,110,159,127
Corporate Income Tax	432,354,603	450,579,240	529,803,120	486,652,005	475,229,871	442,092,992	467,484,097	414,893,941	442,351,197	532,145,167
Corporate Franchise Tax[1]	2,743,150	17,709,783	28,826,007	54,063,500	50,449,123	60,761,359	69,811,933	87,280,002	85,928,402	81,354,312
County Foreign Insurance	280,410,231	247,270,230	239,199,446	202,590,279	191,234,333	191,832,380	211,208,380	194,198,220	203,801,149	209,633,065
Liquor	25,601,633	24,760,965	27,591,587	27,227,515	26,075,287	25,579,812	25,351,065	27,946,833	26,892,668	26,128,940
Beer	7,666,892	7,798,378	7,708,889	7,887,262	8,044,713	8,151,881	8,222,901	8,286,676	8,849,672	8,476,533
Inheritance/Estate	55,785	56,183	92,215	129,700	174,751	170,966	2,117,783	263,642	3,068,343	3,451,099
All Other Taxes	33,455,639	30,018,949	29,720,041	28,721,570	26,310,688	23,254,367	22,300,880	23,087,544	47,498,791	89,226
Interest	6,596,265	4,688,248	4,517,089	5,358,641	7,038,083	7,091,824	7,268,426	12,319,106	32,685,825	63,648,043
Licenses, Fees, & Permits	86,944,780	85,564,867	85,994,331	79,633,499	77,950,917	78,087,161	77,143,329	75,030,041	73,007,290	74,515,771
Sales, Services, Leases, & Rentals	18,614,649	7,693,354	7,814,925	7,621,148	17,084,302	17,966,470	55,467,567	65,434,341	94,674,933	86,949,927
Refunds	6,577,987	9,126,045	10,015,727	9,548,572	33,419,337	16,741,705	20,257,659	23,166,701	19,466,396	16,071,125
Interagency Billings/Inventory	907,905	166,281	185,596	468,548	8,993,212	1,453,567	210,401	3,482,585	966,675	983,901
All Other Receipts	62,463,930	45,428,475	55,211,737	50,127,979	74,527,597	28,109,257	37,008,459	32,612,525	33,568,364	48,196,569
Total Collections	10,432,134,347	10,191,735,525	9,931,859,400	9,281,935,702	9,262,046,768	8,619,276,394	8,446,528,315	8,243,550,513	8,891,673,581	9,262,272,573
Refund Expenditures	1,415,892,381	1,404,962,430	1,222,692,108	1,278,645,960	1,179,358,292	1,278,687,045	1,336,944,835	1,469,226,983	1,440,889,669	1,258,398,181
Total Collections Net of Refunds	$ 9,016,241,966	8,786,773,095	8,709,167,292	8,003,289,742	8,082,688,476	7,340,589,349	7,109,583,480	6,774,323,530	7,450,783,912	8,003,874,392

[1] The DOR continues to collect corporate franchise tax payments as filers submit late returns or make delinquent payments for periods in effect prior to the phase out.

Source: The Missouri Director of Revenue, Administration Division