



Nicole Galloway, CPA

Missouri State Auditor

Review of Article X,
Sections 16 Through 24,
Constitution of Missouri
Year Ended June 30, 2018

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Nicole Galloway, CPA
Missouri State Auditor

CITIZENS SUMMARY

Conclusions in the review of Article X, Sections 16 through 24

Background

The Constitution of Missouri was amended in 1980 to add Article X, Sections 16 through 24, commonly referred to as the Hancock Amendment. This tax limitation amendment places restrictions on the amount of personal income used to fund state government, and the amount by which fees and taxes can be increased. Mathematical formulas are used by the Office of Administration, Division of Budget and Planning (OA-BP) to determine the relevant threshold amounts each year.

Section 18(a-d) of the Hancock Amendment requires no greater portion of Missourians' personal income (MPI) be used in any future year to fund state government than was the case in fiscal year 1981, except as authorized by a vote of the people.

Section 18(e) requires voter approval before taxes or fees can be increased by the General Assembly beyond a certain annual limit. Based upon the calculation provided by the OA-BP, the relevant annual revenue limit for fiscal year 2018 was \$102.9 million.

Fiscal Year 2018 Conclusions

For the year ended June 30, 2018, total state revenue was approximately \$3.9 billion under the refund threshold. As a result, no refund is due for the year ended June 30, 2018. This revenue limit has not been exceeded since the year ended June 30, 1999.

In addition, the OA-BP determined based on fiscal notes prepared for each bill by the Committee on Legislative Research - Oversight Division, as a result of general assembly legislative actions, net taxes and fees could decrease by a total of at least \$41.3 million. The projected net decrease does not include 9 bills for which the Section 18(e) fiscal impact could not be projected. Actual compliance with the Section 18(e) revenue limit can be determined after each tax and fee increase and decrease is fully effective. Since Section 18(e) was added to the Hancock Amendment in 1996, the 2016 legislative session was the only year the limit has been projected to be exceeded.

Because of the nature of this review, no rating is provided.

Review of Article X, Sections 16 Through 24, Constitution of Missouri

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NICOLE GALLOWAY, CPA **Missouri State Auditor**

Honorable Michael L. Parson, Governor
and
Members of the General Assembly
and
Sarah H. Steelman, Commissioner
Office of Administration
Jefferson City, Missouri

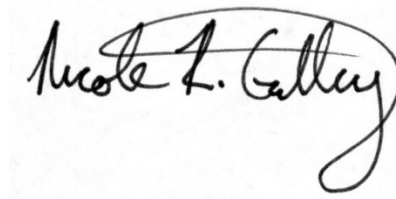
We have conducted a review of revenues of the state of Missouri for the year ended June 30, 2018, and the application to those revenues of Article X, Sections 16 through 24, Missouri Constitution, more commonly referred to as the Hancock Amendment (included as an Appendix). We previously reported on revenues of the state for the years ended June 30, 1982 through 2017. The amendment, which was adopted by the voters of Missouri on November 4, 1980, limits the growth of state revenues collected in any fiscal year. The objectives of this review were to:

1. Evaluate the formulas to calculate the state's revenue limits.
2. Determine the specific items included in total state revenue.
3. Verify the accuracy of the revenue limit computations and compare the limits to total state revenue and projected tax and fee increases from legislative actions.
4. Review the state's overall compliance with the provisions of the amendment.

Our review included only the application of the revenue limit to state revenues and, accordingly, did not include a review of the effects of the amendment on any local governmental unit.

Our methodology to accomplish these objectives included discussions with personnel of the Office of Administration, Division of Budget and Planning, inspecting relevant records and reports compiled by that office, and reviewing data and reports from the statewide accounting system.

The Executive Summary and the Background, Methodology, and Conclusions present our comments and conclusions concerning the state's overall compliance with the provisions of Article X, Sections 16 through 24, Missouri Constitution.

A handwritten signature in black ink that reads "Nicole R. Galloway". The signature is written in a cursive style with a large, looping flourish at the end of the word "Galloway".

Nicole R. Galloway, CPA
State Auditor

The following auditors participated in the preparation of this report:

Director of Audits:	Kim Spraggs, CPA, CGAP
Audit Manager:	Josh Allen, CPA, CFE, CGAP
Audit Staff:	Jeffrey Roberts, CISA, CFE
	Kristin A. Clink, MBA

Review of Article X, Sections 16 Through 24, Constitution of Missouri

Executive Summary

Executive Summary

The amendment, commonly referred to as the Hancock Amendment, limits annual state revenues, and tax and fee increases.

Total State Revenue (TSR) Section 18(a-d)

Section 18(a-d) of the Hancock Amendment requires no greater portion of Missouri's personal income (MPI) be used in any future year to fund state government than was the case in fiscal year 1981, except as authorized by a vote of the people. The amendment provides for taxpayer refunds of excess revenues.

For the year ended June 30, 2018, total state revenue (TSR) was approximately \$3.9 billion under the refund threshold. As a result, no refund is due for the year ended June 30, 2018. This revenue limit has not been exceeded since the year ended June 30, 1999. Over the last 5 years, the amount of TSR under the refund threshold has ranged from \$3.9 billion to \$4.2 billion.

Tax and fee increases Section 18(e)

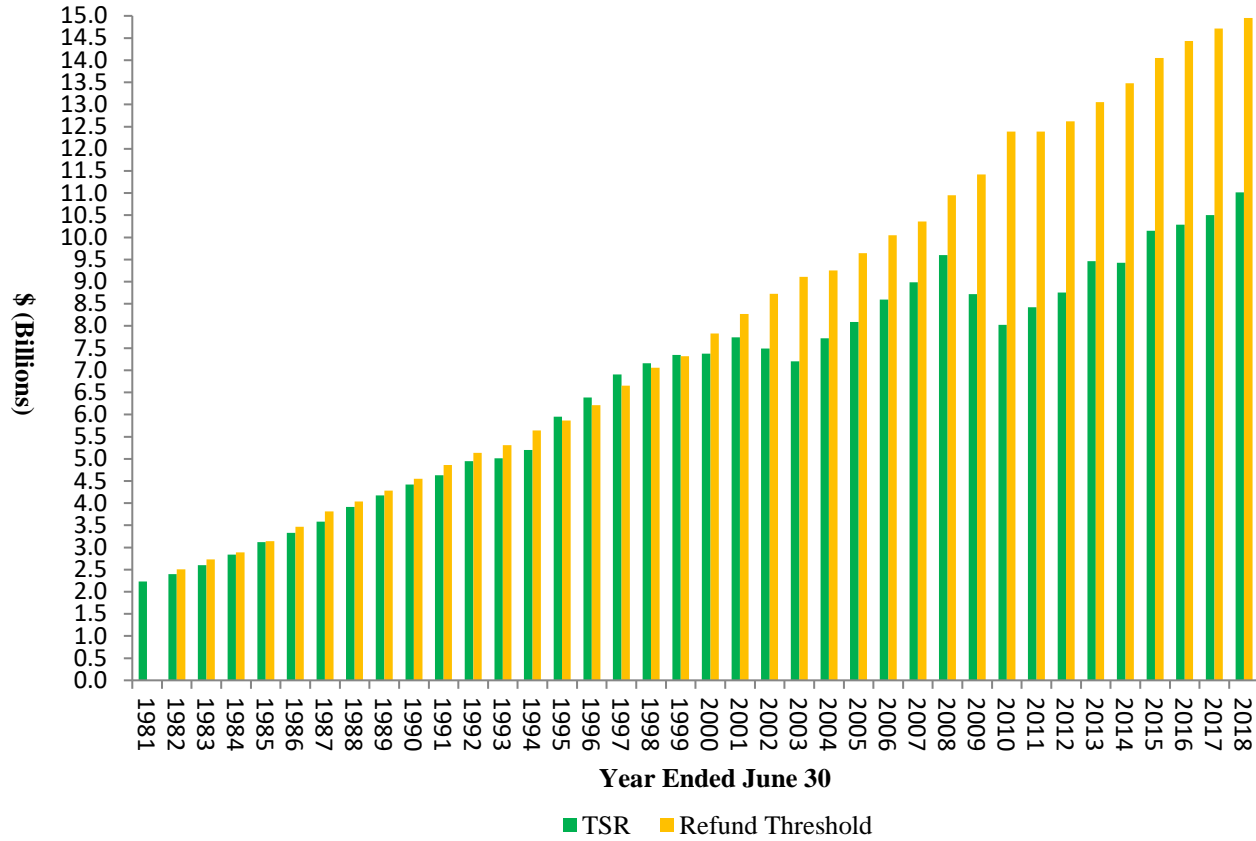
Section 18(e) of the Hancock Amendment states the general assembly shall not increase taxes or fees in any fiscal year, without voter approval, that in total produce new annual revenues greater than \$50 million adjusted annually by the percentage change in the personal income of Missouri for the second previous year, or 1 percent of TSR for the second fiscal year prior to the general assembly's action, whichever is less.

For the year ended June 30, 2018, the Office of Administration, Division of Budget and Planning (OA-BP) determined based on fiscal notes prepared for each bill by the Committee on Legislative Research - Oversight Division, as a result of general assembly legislative actions, net taxes and fees could decrease by a total of at least \$41.3 million. The projected net decrease does not include 9 bills for which the Section 18(e) fiscal impact could not be projected.

Actual compliance with the Section 18(e) revenue limit is determined by measuring the aggregate actual new annual revenues produced in the first fiscal year each tax and fee increase and decrease is fully effective. Since Section 18(e) was added to the Hancock Amendment in 1996, the 2016 legislative session was the only year the limit has been projected to be exceeded.

A bar graph of TSR compared to the refund threshold follows:

REVIEW OF ARTICLE X, SECTIONS 16 THROUGH 24,
 CONSTITUTION OF MISSOURI
 GRAPH OF TOTAL STATE REVENUE VERSUS REFUND THRESHOLD



Review of Article X, Sections 16 Through 24, Constitution of Missouri Background, Methodology, and Conclusions

On November 4, 1980, the voters of Missouri passed Constitutional Amendment No. 5, which added Article X, Sections 16 through 24 to the Constitution of Missouri. The amendment is commonly referred to as the Hancock Amendment.

This review addresses the components of the amendment that relate to state revenues, primarily the requirements outlined in Section 18(a-d) which limit annual state revenues and Section 18(e) which limits tax and fee increases.

Total State Revenue Section 18(a-d)

Section 18(a-d) of the Hancock Amendment requires annual total state revenue limits. The amendment limits the amount of personal income that may be used to fund state government to no greater than the portion used to do so in 1981, except as authorized by a vote of the people. The amendment provides for taxpayer refunds of excess revenues.

The Office of Administration, Division of Budget and Planning (OA-BP) calculates annual total state revenue (TSR), revenue limits, refund thresholds, and refund amounts.

Calculation

The following table summarizes the calculated TSR, revenue limits, refund thresholds, and refund calculations for the 5 years ended June 30, 2018.

	Year Ended June 30,				
	2014	2015	2016	2017	2018
	(in millions)				
TOTAL STATE REVENUE (TSR)					
Total revenues	\$ 24,616.14	25,845.98	26,737.22	27,249.91	28,525.80
Less excluded revenue	(13,878.69)	(14,442.15)	(15,019.33)	(15,326.03)	(16,087.60)
Less expenditure refunds	(1,328.25)	(1,278.49)	(1,459.78)	(1,474.61)	(1,480.78)
Add refundable tax credits	19.19	24.22	29.83	53.62	56.15
TSR	\$ 9,428.39	10,149.56	10,287.94	10,502.89	11,013.57
Missouri personal income (MPI)	\$ 235,661.00	245,771.39	252,482.44	257,338.33	261,547.77
Base year ratio (BYR)	x 0.056395	0.056395	0.056395	0.056395	0.056395
Base limit	13,290.10	13,860.28	14,238.75	14,512.60	14,749.99
Judicial article amendment	51.86	52.42	52.70	53.75	55.90
Revenue limit	13,341.96	13,912.70	14,291.45	14,566.35	14,805.89
1 percent adjustment	133.42	139.13	142.91	145.66	148.05
Refund threshold	\$ 13,475.38	14,051.83	14,434.36	14,712.01	14,953.94
TSR	\$ 9,428.39	10,149.56	10,287.94	10,502.89	11,013.57
Less refund threshold	13,475.38	14,051.83	14,434.36	14,712.01	14,953.94
Over (under) threshold	(4,046.99)	(3,902.27)	(4,146.42)	(4,209.12)	(3,940.37)
1 percent adjustment	0.00	0.00	0.00	0.00	0.00
Refund	\$ 0.00	0.00	0.00	0.00	0.00



Review of Article X, Sections 16 Through 24,
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Background, Methodology, and Conclusions

The calculation shows for the year ended June 30, 2018, TSR was approximately \$3.9 billion under the refund threshold. As a result, no refund is due for the year ended June 30, 2018. This revenue limit has not been exceeded since the year ended June 30, 1999.

Revenue limit formula

The OA-BP calculated the 1981 base year ratio of personal income to TSR as 5.6 percent, and uses this ratio to calculate the annual revenue limit.

Section 18(a) establishes the revenue limit formula as follows:

$$\begin{array}{l} \text{Revenue limit} \\ \text{for fiscal year} \\ \text{(FY) 20XX} \end{array} = \frac{\text{Total state revenue (TSR)} \\ \text{in FY 1981}}{\text{CY 1979 Missouri} \\ \text{personal income (MPI)}} \times \begin{array}{l} \text{The greater of MPI in the} \\ \text{calendar year (CY) prior} \\ \text{to the CY in which} \\ \text{appropriations are made} \\ \text{for FY 20XX or Average} \\ \text{MPI for 3 CYs preceding} \\ \text{FY 20XX.} \end{array}$$

The formula is composed of two principal parts. The first part of the formula, the base year ratio (BYR), is as follows:

$$\frac{\text{TSR in FY 1981}}{\text{CY 1979 MPI}}$$

The application of this ratio to the second part of the formula (future years' MPI) sets the revenue limit to ensure no greater portion of a future year's personal income will be used to fund state government than was the case at the time of passage of the amendment.

The MPI amounts used in the formula for the base year and subsequent years are reported by the U.S. Department of Commerce (DOC). The OA-BP uses the MPI first officially published by the DOC after the close of the calendar year to calculate the revenue limit for the applicable fiscal year. The OA-BP does not adjust the MPI used in the BYR or the second part of the formula for subsequent adjustments to the MPI by the DOC. Section 17(2) refers to ". . . total income . . . as defined and officially reported by" the DOC. Even though the amendment does not specifically refer to such adjustments, this wording suggests the revenue limit should be recalculated each time the MPI is adjusted by the DOC. For example, the BYR would be adjusted whenever the CY 1979 MPI is adjusted by the DOC. The use of the initial reporting of MPI provides at least two benefits. First, by having a consistent and unchanging BYR, the state can more easily plan and make appropriate adjustments to stay under the revenue limit. Second, if the initial MPI is subsequently adjusted, retroactive refunds are a possibility. That is, an adjustment to MPI for any prior year (including the base year) could reduce the revenue limit for a prior year below that year's TSR, providing a refund where one previously was not due. Therefore, we find this approach reasonable if it is followed consistently.



Review of Article X, Sections 16 Through 24,
Constitution of Missouri
Background, Methodology, and Conclusions

The BYR was calculated by the OA-BP as follows (dollar amounts are in millions):

$$\frac{\$2,232.204096}{\$ 39,581.0} = .05639584891$$

In its calculations of the revenue limit, the OA-BP rounded the BYR to .056395. To determine the revenue limit for the fiscal year, this amount is multiplied by the MPI in the calendar year preceding the calendar year in which appropriations were made for the fiscal year or the average MPI for the 3 calendar years preceding the fiscal year. For the fiscal year 2018 revenue limit calculation, the OA-BP used the CY 2016 MPI which was greater than the average MPI for the preceding 3 calendar years.

Adjustments

Section 18(d) provides the revenue limit may be adjusted, "[i]f responsibility for funding a program or programs is transferred from one level of government to another, as a consequence of constitutional amendment, . . . provided that the total revenue authorized for collection by both state and local governments does not exceed that amount which would have been authorized without such a change."

The OA-BP has adjusted the revenue limit for the transfer of deputy circuit clerks from the county payroll to the state payroll under Section 483.245, RSMo, effective on July 1, 1981. In *Kelly v. Hanson*, 959 S.W.2d 107 (Mo. Banc 1997), the Supreme Court held that this adjustment to the revenue limit is appropriate.

Refund threshold

Section 18(b) allows the state to exceed the revenue limit by less than 1 percent before a refund is due. Therefore, to determine the point at which the refund provision takes effect (the refund threshold) the revenue limit is adjusted upward by 1 percent. However, should TSR exceed the refund threshold, all revenues in excess of the revenue limit are subject to refund.

TSR

An integral part in applying the provisions of the amendment to state revenues is to determine what constitutes TSR. The amendment does not specify the methodology to be used to determine TSR. Consequently, procedures to calculate TSR have been established and certain decisions as to items that would be either included or excluded have been made, except for items ruled on by the Attorney General or the Missouri courts.

TSR includes all revenues recorded in the Statewide Accounting System for Missouri (SAM II) and receipted by the state treasurer, which may only be withdrawn pursuant to an appropriation or which stand appropriated by the Constitution of Missouri. Various funds not in the state treasury are not included in TSR. These funds include university local funds; local sales and



Review of Article X, Sections 16 Through 24,
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Background, Methodology, and Conclusions

use tax fund collections made by the Department of Revenue; various funds held in trust for inmates, patients, etc.; and various quasi-governmental agencies such as the Board of Public Buildings, the Housing Development Commission, the Higher Education Loan Authority, the Health and Educational Facilities Authority, and the state's retirement systems. The Hancock Amendment states the composition of TSR is, "defined in the budget message of the governor for fiscal year 1980-81." The funds described above were not addressed in the governor's budget message for that year since the funds were not in the state treasury and not appropriated. Thus, it is reasonable to conclude these funds should not be included in TSR.

From the revenue amounts obtained from SAM II, 7 funds are entirely excluded and 26 types of revenues are excluded to arrive at TSR, as defined in Section 17(1). These excluded funds and revenue types, and other exclusions and limits considered to arrive at TSR are described at Appendix C. A detailed schedule of SAM II revenue, adjustments for excluded funds and revenue types and other exclusions and limits, and resulting TSR for the 5 years ended June 30, 2018, is shown at Appendix A.

Tax and Fee Increases Section 18(e)

A 1996 amendment added Section 18(e) to the Hancock Amendment, which imposes an additional revenue limit on tax and fee increases.

Section 18(e) states the general assembly shall not increase taxes or fees in any fiscal year, without voter approval, that in total produce new annual revenues greater than \$50 million adjusted annually by the percentage change in the personal income of Missouri for the second previous year, or 1 percent of TSR for the second fiscal year prior to the general assembly's action, whichever is less. Sections 18(e) and 23 provide any taxpayer can bring suit in a court of law to enforce the provisions of the Hancock Amendment.

The OA-BP calculates the limits and monitors new legislation for tax and fee increases and decreases for each legislative session.

Calculation

The following table summarizes the OA-BP's annual projected net increases/decreases from legislative actions based on fiscal notes prepared for each bill by the Committee on Legislative Research - Oversight Division, calculated revenue limits, and projected amounts over/under revenue limits for the 5 years ended June 30, 2018.



Review of Article X, Sections 16 Through 24,
 Constitution of Missouri
 Background, Methodology, and Conclusions

	Year Ended June 30,				
	2014	2015	2016	2017	2018
LEGISLATIVE ACTIONS*					
Net tax and fee increases/decreases	\$ (619,541,539)	(20,823,150)	127,712,253	2,272,090	(41,321,078)
	At least		Up to		At least
REVENUE LIMIT					
By MPI growth	\$ 110,160,390	115,701,458	117,529,541	120,291,485	123,479,209
By 1 percent of TSR	\$ 87,556,705	94,623,204	94,283,895	101,495,508	102,879,357
Revenue limit (lesser amount)	\$ 87,556,705	94,623,204	94,283,895	101,495,508	102,879,357
DIFFERENCE					
Over (under) limit	\$ N/A	N/A	33,428,358	(99,223,418)	N/A

* Legislative action amounts do not include bills for which Section 18(e) fiscal impact could not be projected.
 N/A For fiscal years 2014, 2015, and 2018, the projections showed a net decrease in taxes and fees.

For the year ended June 30, 2018, the OA-BP determined based on fiscal notes prepared for each bill by the Oversight Division, as a result of general assembly legislative actions, net taxes and fees could decrease by a total of at least \$41.3 million. As noted in the Legislative actions section, the projected net decrease does not include 9 bills for which the Section 18(e) fiscal impact could not be projected.¹ As noted in the Compliance section, actual compliance can be determined after each bill is fully effective. The 2016 legislative session was the only year the limit has been projected to be exceeded.

Revenue limit formula

Section 18(e) establishes the revenue limit as the lesser of (1) \$50 million adjusted annually by the percentage change in MPI for the second previous year, or (2) 1 percent of TSR for the second fiscal year prior to the legislative session.

For fiscal year 2018, the OA-BP calculated the MPI growth limit at \$123.5 million by multiplying the fiscal year 2017 MPI growth limit (\$120.3 million) by the percentage change in the MPI for fiscal year 2016 (2.65%). The OA-BP calculated the TSR limit at \$102.9 million by multiplying the fiscal year 2016 TSR (\$10.29 billion) by 1 percent. The revenue limit was established at the lessor of these amounts, or the TSR limit of \$102.9 million.

Legislative actions

After each legislative session, OA-BP personnel prepare a spreadsheet to quantify the potential fiscal impact of tax and fee increases and decreases from legislation enacted during the session. In accordance with Section 18(e),

¹ OA-BP indicated the estimated fiscal impact of Senate Bill 882 was unknown but also noted the decrease of tax revenue was "possibly substantial."



Review of Article X, Sections 16 Through 24,
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the OA-BP includes each House Bill and Senate Bill truly agreed and finally passed during the session, except bills vetoed by the governor and not overridden by the general assembly, and the estimated fiscal impact amount.

The OA-BP determines estimated Section 18(e) fiscal impact amounts by compiling information and amounts in fiscal notes for each bill. The fiscal notes are prepared by the Oversight Division with input from state agencies and local political subdivisions. In accordance with Section 18(e), the OA-BP compiles an amount for the first fiscal year the bill is fully effective. For most bills with Section 18(e) fiscal impact, the OA-BP determines an increase or decrease amount based on information in the fiscal note. For some bills, the fiscal note indicates the fiscal impact is "unknown." Accordingly, the OA-BP lists "unknown," rather than a dollar amount, in the legislative actions spreadsheet for these bills. OA-BP personnel indicated they did not attempt to develop a more precise estimate for this calculation because in some cases, it is not possible to quantify the potential impact of the legislation. The legislative actions spreadsheet contains a net total tax and fee increase/decrease for all bills combined. That information is compared to the calculated revenue limit to determine potential Section 18(e) compliance. The netting of the tax and fee increases and decreases is reasonable and in compliance with the amendment language.

The OA-BP legislative actions spreadsheet for the fiscal year 2018 legislative session included 125 bills, 40 of which the OA-BP determined had potential Section 18(e) fiscal impact.

Compliance

Section 18(e)(4) provides compliance with Section 18(e) shall be measured by calculating the aggregate actual new annual revenues produced in the first fiscal year each individual tax or fee change is fully effective. For the fiscal year 2018 legislative session, actual compliance can be measured after each 2018 legislative session bill is fully effective.

Section 18(e)(5) provides any taxpayer or statewide elected official may bring action under Section 23 of the Hancock Amendment to enforce compliance with the provisions of Section 18(e). For actions brought by any statewide elected official, the Missouri Supreme Court shall have original jurisdiction. In such enforcement actions, the court shall invalidate the taxes and fees that should have received a public vote. The court shall order remedies in the amount of excess revenues collected, such as refunds or reductions in future taxes and/or fees.

Conclusions

TSR

For the year ended June 30, 2018, TSR was approximately \$3.9 billion under the refund threshold. As a result, no refund is due for the year ended June 30, 2018. This revenue limit has not been exceeded since the year ended June 30, 1999.



Review of Article X, Sections 16 Through 24,
Constitution of Missouri
Background, Methodology, and Conclusions

Tax and Fee Increases

For the year ended June 30, 2018, the OA-BP determined based on fiscal notes prepared for each bill by the Oversight Division, as a result of general assembly legislative actions, net taxes and fees could decrease by a total of at least \$41.3 million. The projected net decrease does not include 9 bills for which the Section 18(e) fiscal impact could not be projected.

Actual compliance with the Section 18(e) revenue limit can be determined after each tax and fee increase and decrease is fully effective. Since Section 18(e) was added to the Hancock Amendment in 1996, the 2016 legislative session was the only year the limit has been projected to be exceeded.