MISSOURI STATE AUDITOR'S OFFICE
FISCAL NOTE (09-76)

Subject

Initiative petition from Marc Ellinger regarding a proposed amendment to Chapter 92 of the Revised Statutes of Missouri. (Received December 7, 2009)

Date

December 24, 2009

Description

This proposal would amend Chapter 92 of the Revised Statutes of Missouri.

The amendment is to be voted on in November, 2010.

Public comments and other input

The State Auditor's Office requested input from the **Attorney General's Office,** the **Department of Agriculture,** the **Department of Economic Development,** the **Department of Elementary and Secondary Education,** the **Department of Higher Education,** the **Department of Health and Senior Services,** the **Department of Insurance, Financial Institutions and Professional Registration,** the **Department of Mental Health,** the **Department of Natural Resources,** the **Department of Corrections,** the **Department of Labor and Industrial Relations,** the **Department of Revenue,** the **Department of Public Safety,** the **Department of Social Services,** the **Governor's Office,** the **Missouri House of Representatives,** the **Department of Conservation,** the **Department of Transportation,** the **Office of Administration,** the **Office of State Courts Administrator,** the **Missouri Senate,** the **Secretary of State's Office,** the **Office of the State Public Defender,** the **Office of the State Treasurer, Boone County, Clay County, Cole County, Jackson County Legislators, Jasper County, St. Charles County, St. Louis County,** the **City of Cape Girardeau,** the **City of Columbia,** the **City of Jefferson,** the **City of Joplin,** the **City of Kansas City,** the **City of Kirksville,** the **City of Kirkwood,** the **City of Mexico,** the **City of Raymore,** the **City of St. Joseph,** the **City of St. Louis,** the **City of Springfield,** the **City of Union,** the **City of Wentzville,** the **City of West Plains, Cape Girardeau 63 School District, Hannibal 60 School District, Rockwood R-VI School District, Linn State Technical College, Metropolitan Community College, University of Missouri, St. Louis Community College.**

Marc Ellinger provided information as a proponent of the proposal to the State Auditor's Office.

Assumptions

Officials from the **Attorney General's Office** assumed that implementation of this proposal would create no fiscal impact on their office.

The **Department of Higher Education** indicated that this initiative petition would not have any direct, foreseeable fiscal impact on their department.

The **Department of Health and Senior Services** indicated this initiative petition is a no impact note for the department.

The **Department of Insurance, Financial Institutions and Professional Registration** indicated this initiative, if passed, will have no cost or savings to the department.

The **Department of Mental Health** indicated this proposed initiative petition should have no fiscal impact to the department.

The **Department of Corrections** indicated this initiative petition will have no impact on the department.

The **Department of Revenue** indicated this initiative petition will not impact the department.

The **Department of Social Services** indicated that this initiative petition will not have any fiscal impact to the department. City earnings taxes are collected by local jurisdictions for general revenue purposes. Such taxes do not fund DSS programs.

Officials from the **Governor's Office** indicated there should be no added costs or savings to their office if this amendment is approved by the voters.

Officials from the **Missouri House of Representatives** indicated this proposed initiative petition will have no fiscal impact to the operations budget of their agency.

The **Department of Conservation** indicated no adverse fiscal impact is expected to their department as a result of this proposal.

The **Office of Administration** indicated that Budget and Planning (B&P) has reviewed these petitions from the State Auditor's Office. The petitions provide statutory changes related to local earnings taxes. The various petitions contain one or more of the following main components: 1) requires voter approval every five or ten years for continuation of the tax; 2) phases out the earnings tax over a five-year or ten-year period; 3) eliminates the earnings tax; 4) prohibits additional cities from establishing an earnings tax after 2011; 5) establishes a legislative joint committee to determine a plan to replace earnings tax revenues.

To the extent that existing earnings taxes are eliminated, those applicable proposals will have the following estimated fiscal impacts:

1. Office of Administration. There will be minimal fiscal impact on the Office of Administration due to changes needed in the state's payroll system related to the withholding of applicable employees' local earnings taxes. The Office of Administration expects to absorb these costs within existing resources.

2. Reduced local revenues. According to the St. Louis City 2008 CAFR[1] approximately $174.9M in earnings taxes are collected annually. Similarly, the Kansas City 2009 CAFR[2] reports $202.5M in annual earnings taxes. Therefore, this proposal would lower local revenues by $377.4M when fully implemented.

3. Increased general and total state revenues. Local income taxes are deductible from federal income tax, if the taxpayer chooses to itemize deductions. Therefore, up to $377.4M that is currently deducted may not be deducted from Missouri taxable income when fully implemented. However, not all taxpayers choose to itemize their taxes. The Missouri Dept. of Revenue reports to B&P that, in tax year 2008, $105.9M in deductions were claimed for earnings taxes. Therefore, assuming a 4.5-percent effective individual income tax rate, this proposal will increase general and total state revenues by $4.8M annually when fully implemented; $0.5M in the first year.

The provisions establishing the Joint Committee on Earnings Tax Revenue Replacement provide for reimbursement of members expenses. The Committee may also request assistance from the General Assembly's appropriations and research staffs, as well as the Departments of Revenue and Economic Development. B&P defers to those entities for estimated fiscal impacts.

The **Office of State Courts Administrator** indicated there is no cost to the courts for this initiative petition.

Officials from the **Missouri Senate** indicated that the initiative appears to have no fiscal impact as it relates to their agency.

Officials from the **Secretary of State's Office** indicated their office is required to pay for publishing in local newspapers the full text of each statewide ballot measure as directed by Article I, Section 26, 27, 28 of the Missouri Constitution and Section 116.230-116.290, RSMo. The Secretary of State's office is provided with core funding to handle a certain amount of normal activity resulting from each year's legislative session. Funding for this item is adjusted each year depending upon the election cycle with $1.3 million historically appropriated in odd numbered fiscal years and $100,000 appropriated in even

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[1] http://stlouis.missouri.org/citygov/comptroller/docs/cafr2008/FY08CAFR.pdf , p. 207

[2] http://www.kcmo.org/idc/groups/finance/documents/finance/cafr09.pdf, p. A-62

numbered fiscal years to meet these requirements. The appropriation has historically been an estimated appropriation because the final cost is dependent upon the number of ballot measures approved by the General Assembly and the initiative petitions certified for the ballot. In FY 2009, at the August and November elections, there were 5 statewide Constitutional Amendments or ballot propositions that cost $1.35 million to publish (an average of $270,000 per issue). Therefore, the Secretary of State's office assumes, for the purposes of this fiscal note, that it should have the full appropriation authority it needs to meet the publishing requirements.

Officials from the **Office of the State Public Defender** indicated this initiative will not have any impact on their office.

Officials from **Jasper County** indicated the proposed amendments to Ch. 92, RSMO as a result of the subject initiatives would be of no cost to Jasper County or any city within Jasper County. In reviewing Ch. 92 in its current form, it appears that these statutes may apply to charter cities only and not to counties. There are no cities in Jasper County that have an earnings tax, nor that meet the criteria described in subject initiatives. Jasper County nor any cities in Jasper County have an earnings tax and there are no plans to enact one.

Officials from the **City of Jefferson** indicated the City does not anticipate any fiscal impact should this petition become law.

Officials from the **City of Kansas City** indicated they wish to incorporate their prior statements regarding the impact of the elimination of the earnings tax, as the five revised petitions appear to exclude Kansas City, but because of concerns regarding the drafting and subsequent interpretation of the petition, there is a risk a court would find the drafters failed to exclude Kansas City even though that is the intention.

Their prior statements regarding the impact of the elimination of the earnings tax are as follows:

Staffing municipal government would be, at best, difficult because of the lack of stability in the workplace. This would leave those who might consider a career in government to avoid such service. Furthermore, with possible decreases in municipal pensions for those who have already served and retired, recruiting employees may be nearly impossible if the current wages and benefits are not weighed against a future pension.

An emaciated general fund could also preclude the issuance of any bonds that relied upon the City's credit since the earnings tax is a large percentage of the City's general fund.

It is also possible that this petition would automatically eliminate the earnings tax in Kansas City because the exceptions are tied to the federal census. If the City is reported to have less than 450,000 people in the federal census there are no exceptions. The petition does not reflect any recognition of the City's ability to appeal the federal government's first assessment as it has successfully done in recent years. Also, the statutes that would be enacted by the petitions speak of the last federal decennial census; but the 2010 census will not be reported until 2011, after the statutes would go into effect. If the courts would interpret the statute to mean the last completed census Kansas City would fall below 450,000 people and the exceptions in the statutes because its 2000 census population was less than 450,000.

The most recent adopted budget reflects the following receipts attributable to the earnings tax:

FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10
(Actual)	(Actual)	(Estimated)	(Budgeted)
$198,023,750	$201,252,331	$202,400,000	$199,200,000

Exclusive of special revenue, enterprise funds, and special assessments, these sums represent approximately 38% of the City's general revenue that may be devoted to general fund supported programs.

The exclusion of this revenue would further restrict the City of Kansas City in its obligations to its citizens. The revenue these petitions would periodically place in jeopardy equal the elimination of all general fund support of these departments and offices: City Attorney's Office, City Auditor's Office, City Clerk's Office, City Planning and Development Department, Finance Department, Fire Department, General Services Department, Human Resources Department, Information Technology Department, Municipal Court, Neighborhood & Community Services Department, Office of City Manager, Parks and Recreation Department, and the Public Works Department.

Options would have to be presented to the voters to determine what other revenue sources would be appropriate. For example, to recover the lost earnings tax revenue property taxes would need to be increased by about 500%. Utility taxes, which are passed through to customers, would have to more than triple. Court fines would have to increase by 1,100%. Of course, many of these revenue increases would require statutory or constitutional changes and approval by the voters.

Additionally, the options are limited for alternative revenue because authorized sales taxes are already devoted to specific purposes with only a small portion of a penny available for capital improvements – not for general fund activities that would be eliminated by the initiatives.

It is not hyperbole to state that elimination of the earnings tax without replacement revenue could render the City of Kansas City unlivable. The City has already cut over $80 million from its budget for the current year, and may need to reduce another $60 million next year – even though the earnings tax exists.

The expectations people have of local government already exceed the ability to perform in many instances. The State of Missouri is in no place to provide funding for municipal purposes; it already allows local government like Kansas City to take on county or state functions such as the public health care subsidies provided to safety net providers through a special property tax.

The fiscal impact of the adoption of this petition if the earnings tax was eliminated, is currently $200 million with a domino effect for the city that would render the losses devastating.

Officials from the **City of Kirkwood** indicated the initiative petition does not have any impact on the city.

Officials from the **City of St. Louis** indicated they believe that the fiscal impact of the changes to the earnings tax statutes proposed in some of these initiative petitions could be both disastrously serious and disastrously negative. There may be a legal question as to whether some of the petitions would apply to the City of St. Louis. They are not ready to take a position on those matters. Therefore, the City's analysis assumes all ten of the petitions would apply to the City of St. Louis.

The 1% earnings tax is responsible for $141-million or approximately 39% of the City's discretionary revenue. If the City were to lose all or most of that revenue, it could no longer function as a viable municipal government. The consequences of losing all or most of the earnings tax revenue without replacing it with alternative sources of revenue and/or eliminating extra costs created by the City's unique structure would result in cuts to public safety services so deep as to end the City's viability as a place to live, work and visit.

Also related to the phase out of the tax, unless the revenue lost is replaced by revenue from another source simultaneously, there would be serious cash-flow consequences regardless of the phase-in period. And costs will increase due to inflation over the phase-out period, adding to the impact of the earnings tax loss. Whatever the time line, if the City did not replace the lost revenue and/or reduce its administrative costs, the consequences would be disastrous.

On the other hand, it is possible that the voters would choose to keep the earnings tax in place. If so, there would be no fiscal impact.

If the voters chose to eliminate it, the people could replace the earnings tax with different taxes, higher tax rates, or new revenue streams, the State of Missouri might help replace it, or the City could gain relief from some of the unique administrative expenses of being a City not within a county. Any or all of those might result in a more friendly tax environment which could over time attract more people, businesses and jobs into the City. That could result in an increase in tax revenues. Predicting whether that will occur, how long it would take, and by how much revenue would grow is not possible for us. Therefore, they will not make any projections regarding that possibility.

Proponents of the initiative petitions argue the petitions would give the City of St. Louis time to find alternatives to an unpopular tax. But, the time available to the City varies widely in the petitions from as little as two years to begin phasing it out, to ten years to eliminate it. It is almost impossible to imagine the City could replace 20% of the earnings tax within two years, or eliminate it entirely within five years. However, it is not outlandish to think the City could find ways to replace it within a decade.

Because they do not know which of the ten petitions will go forward, and because it is difficult to predict the City's chances of successfully replacing the earnings tax within the required time lines, they will provide fiscal information on what would happen if the City utterly fails to replace the tax. As this chart shows, the earnings tax makes up 39% of the current general fund budget. If the City were to lose that source of funding, it would be forced to make deep cuts in vital city services including police and fire. Those cuts most certainly would result in a loss of businesses and population. If you assume the City were to lose 10% of its businesses and 10% of its population, it would lose another $31-million in tax revenue. So, combined, the City would lose 47% of its current general fund budget.

CITY GENERAL FUND--FY2010 BUDGET		
General Fund Budget:	**$453,899,455**	
LESS: Debt Service Payments:	**($30,184,975)**	
LESS: State-Mandated Services:	**($53,300,270)**	
LESS: Other Mandatory Payments:	**($3,833,754)**	
General Fund "Discretionary" Income:	**$366,580,456**	
Estimated Direct Loss--Earnings Tax:	**($141,225,000)**	**-39%**
Estimated Indirect Loss--Other City Revenue Sources Affected by Business and Population Losses:	**($30,614,841)**	**-8%**
Remaining Discretionary Income:	**$194,740,615**	**53%**

Obviously, if the City lost 47% of its discretionary funding, the results would be so disastrous that they would result in the City's ruin. For instance, the elimination of the estimated 47% of City General Fund revenues would result in the elimination of more than 2000 jobs. The people who now hold these jobs would join the ranks of the unemployed, and whether or not they were able to find new jobs would depend on the state of the regional and national economics at the time these layoffs occur.

It comes down to this. If the City has enough time and can identify better ways to generate revenue, eliminating the earnings tax could spur economic growth and increase tax revenues. If it cannot, it would require deep cuts that would severely damage the City's quality of life.

Officials from the **City of Wentzville** indicated since this petition pertains to earnings taxes and larger population cities, this would not have any effect on the City of Wentzville.

Officials from **Linn State Technical College** indicated that based on the information presented, there appears to be no fiscal impact on their organization.

Metropolitan Community College indicated this petition would have no direct fiscal impact on their organization.

Marc Ellinger provided information as a proponent of this initiative petition. He indicated the proposal will have no fiscal impact on the state of Missouri, counties, or political subdivisions.

The State Auditor's Office did not receive a response from the **Department of Agriculture**, the **Department of Economic Development**, the **Department of Elementary and Secondary Education**, the **Department of Natural Resources**, the **Department of Labor and Industrial Relations,** the **Department of Public Safety,** the **Department of Transportation, Office of the State Treasurer, Boone County, Clay County**, **Cole County**, **Jackson County Legislators**, **St. Charles County**, **St. Louis County**, the **City of Cape Girardeau**, the **City of Columbia**, the **City of Joplin**, the **City of Kirksville**, the **City of Mexico**, the **City of Raymore**, the **City of St. Joseph**, the **City of Springfield**, the **City of Union**, the **City of West Plains**, **Cape Girardeau 63 School District**, **Hannibal 60 School District**, **Rockwood R-VI School District**, **University of Missouri**, **St. Louis Community College**.

Fiscal Note Summary

The proposal could eliminate certain city earnings taxes. For 2010, Kansas City and the City of St. Louis budgeted earnings tax revenue of $199.2 million and $141.2 million, respectively. Reduced earnings tax deductions could increase state revenues by $4.8 million. The total cost or savings to state and local governmental entities is unknown.