COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 3398H.01I
Bill No.: HB 1985
Subject: Economic Development
Type: Original
Date: April 26, 2022

Bill Summary: This proposal authorizes tax deductions for financial institutions that provide loans in rural areas.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2023	FY 2024	FY 2025
General Revenue *	$0	$21,622 to $40,628	$21,622 to $40,628
Total Estimated Net Effect on General Revenue	**$0**	**$21,622 to $40,628**	**$21,622 to $40,628**

***Oversight** notes there are likely other loans that may qualify outside of those the Department of Revenue and Office of Administration - Budget and Planning have based their estimates on. Oversight does not have information on these loans. Therefore, actual revenue impacts may exceed the amounts shown on the fiscal note.

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2023	FY 2024	FY 2025
Total Estimated Net Effect on Other State Funds	**$0**	**$0**	**$0**

Numbers within parentheses: () indicate costs or losses.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2023	FY 2024	FY 2025
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2023	FY 2024	FY 2025
Total Estimated Net Effect on FTE	**0**	**0**	**0**

☐ Estimated Net Effect (expenditures or reduced revenues) expected to exceed $250,000 in any of the three fiscal years after implementation of the act or at full implementation of the act.

☐ Estimated Net Effect (savings or increased revenues) expected to exceed $250,000 in any of the three fiscal years after implementation of the act or at full implementation of the act.

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2023	FY 2024	FY 2025
Local Government	**$0**	**($243,158 -$456,904)**	**($243,158 -$456,904)**

FISCAL ANALYSIS

ASSUMPTION

Section 143.1121 Corporate Tax Deduction

Officials from the **Department of Revenue (DOR)** note the proposed legislation, in Section 143.1121, creates the "Missouri Rural Credit Opportunity Act". For all tax years beginning on or after January 1, 2023, this proposal allows a deduction, for Missouri income tax purposes, to a qualified taxpayer in an amount equal to such taxpayer's qualified interest income amount. A "qualified taxpayer" is essentially a bank or similar financial institution subject to Missouri income tax, and a "qualified interest income amount" is essentially interest income received by that taxpayer from certain agricultural real estate loans and certain loans for rural single family residences.

DOR notes that according to the Division of Finance at the Department of Commerce and Insurance, there are 209 banks in Missouri.

This proposal requires the loans given for a qualified rural single-family residence to be a designated rural area by the U.S Department of Agriculture. Based on the requirement that the area have less than 2,500 inhabitants, the only county that would qualify is Worth County. However, approximately 550 cities have a population less than 2,500. These kinds of loans can occur all over the state except in the major metropolitan areas.

All financial institutions are required to pay the financial institutions tax (FIT), while some are also required to pay corporate income tax. When they file corporate income tax, they are allowed to receive a credit for the FIT paid on their corporate return. This proposal is adding the interest collected from these agricultural real estate loans as a deduction to those corporate returns.

DOR notes it is unknown how many of these loans are made each year and the amount of qualified interest income the financial institutions collect. DOR notes this will be an unknown loss to general revenue that could exceed $100,000 annually. Deductions do not reduce revenue on a dollar for dollar basis, but rather in proportion to the top tax rate applied. This deduction will first be claimed on the returns filed January 1, 2024.

This will be a new deduction and will need to be added to the MO-1120 corporate income tax return. This will require programming, form and website updates. This is estimated to cost $6,386. Should this increase the amount of correspondence received then they Department may need the following staff.

- 1 FTE Revenue Processing Technician for every 14,700 errors created
- 1 FTE Revenue Processing Technician for every 5,700 pieces of correspondence generated

Oversight assumes the Department of Revenue is provided with core funding to handle a certain amount of activity each year. Oversight assumes DOR could absorb the costs for programming upgrades related to this proposal. Given the low number of potential qualifiers for this deduction, Oversight assumes DOR can absorb the administrative impact of this proposal

Officials from the **Office of Administration - Budget and Planning (B&P)** note Section 143.1121 would grant a corporate income tax deduction for the interest income earned on qualifying loans, starting tax year 2023. Section 148.731 would grant a financial institution tax deduction for the interest income earned on qualifying loans, starting tax year 2023. Both tax deductions shall sunset in 2030, unless reauthorized.

Qualifying loans include the following:

- Real property that is substantially used for the production of agriculture products.
- Rural single-family residences located in a rural area as defined by the U.S. Department of Agriculture (USDA). Loans include both purchases and improvements of such property.

B&P notes that banks may file both a corporate income tax return and a financial institution tax return. However, if banks are required to file both returns, they are granted a tax deduction on their corporate income tax return equal to the amount paid under the financial institutions tax.

B&P further notes that while this proposal would begin for tax year 2023, both deductions would not be taken until financial institutions file their annual tax returns the following calendar year.

B&P notes that the USDA either directly loans or guarantees loans that would qualify under this provision. Based on data published by the USDA, at the end of federal fiscal year 2021, the USDA had $285,907,000 outstanding obligations in Missouri for their farm loan programs and $49,991,342 for the socially disadvantaged home buying/repair loan programs. Therefore, B&P estimates that at least $335,898,342 in loans may qualify under this proposal. B&P notes there are likely other loans that would qualify outside of the USDA programs. However, B&P does not have information on such loans. Therefore, the estimates provided are a minimum impact.

Based on additional data published by the USDA interest on the farm loans range from 1.5% to 3.0% and interest on the socially disadvantaged home loans range from 2.5% to 3.66% (market rate as of 1/5/2022). Therefore, B&P estimates that approximately $5,538,389 to $10,406,893 in interest would qualify under one or both deductions.

<u>Section 148.731 FIT Deduction</u>

DOR notes Section 148.731, appears to try to create a deduction to be applied to the different types of taxes collected under Chapter 148. There are several different taxes assessed under

Chapter 148 including the financial institutions tax. However, based on the definition of qualified taxpayer, it would limit this deduction to certain types of financial institutions.

Banks and similar financial institutions (credit unions, savings & loans) are required to pay the financial institutions tax (FIT) on their net income. The FIT requires banks to include all their gross income minus statutorily defined deductions to calculate net income. That net income is then multiplied by the tax rate (currently 4.48%) to determine their FIT amount.

Each financial institution pays the FIT to the state. General revenue receives 2% of the tax while the remaining 98% is distributed to the local political subdivisions were the financial institution is located. The money is dispersed based on the local levies in that district. Therefore, the county, city, school districts and others in the area receive some of the funding.

This proposal would allow the banks to add this qualified interest income to the deductions for determining the net income. It would then lower what is owed in FIT.

It is unknown how many of these loans are made each year and the amount of qualified interest income the financial institutions collect. This will be an unknown loss to general revenue that could exceed $100,000 annually. Deductions do not reduce revenue on a dollar for dollar basis, but rather in proportion to the top tax rate applied. This deduction will first be claimed on the returns filed January 1, 2024.

DOR states it should be noted that for those banks required to file both the FIT and corporate income tax return, they apply the one tax as a credit against the other and pay the higher tax to the state.

This would be a new deduction and will be a new deduction that will need to be added to the MO-4347 financial institutions tax return. This will require programming, form and website updates. This is estimated to cost $6,386. Should this increase the amount of correspondence received then they Department may need the following staff.

- 1 FTE Revenue Processing Technician for every 14,700 errors created
- 1 FTE Revenue Processing Technician for every 5,700 pieces of correspondence generated

Oversight assumes the Department of Revenue is provided with core funding to handle a certain amount of activity each year. Oversight assumes DOR could absorb the costs for programming upgrades related to this proposal. Given the low number of potential qualifiers for this deduction, Oversight assumes DOR can absorb the administrative impact of this proposal.

Officials from the **Office of Administration - Budget and Planning** note that the corporate tax rate is 4.0%, while the financial institution tax rate is 4.48%. In addition, corporate income tax is deposited 100% into GR, while the financial institution tax is distributed 2% to GR and 98% to local funds.

Based on the information above, B&P estimates that corporate income deductions could exceed $221,536 to $416,276 annually and financial institution tax deductions could exceed $248,120 to $466,229 annually. However, as mentioned above, financial institutions that file both a corporate income tax return and financial institute tax return receive a deduction on their corporate income tax return for financial institution taxes paid. Table 1 shows the estimate impact by tax type.

Table 1: Estimated Impact by Tax Type

Corporate Income Tax	Low	High
Interest Deduction	($221,536)	($416,276)
Financial Institution Deduction	$248,120	$466,229
Net Corporate Tax	$26,584	$49,953
Financial Institution Tax		
Interest Deduction	($248,120)	($466,229)

Table 2 shows the estimated impact by fund.

Table 2: Estimated Impact by Fund

	FY 2024		FY 2025	
State Impact	Low	High	Low	High
General Revenue				
Net Corporate Tax Impact	$26,584	$49,953	$26,584	$49,953
Financial Institution Tax	($4,962)	($9,325)	($4,962)	($9,325)
Net General Revenue Impact	$21,622	$40,628	$21,622	$40,628
Local Impact				
Financial Institution Tax	($243,158)	($456,904)	($243,158)	($456,904)

B&P notes there are likely other loans that would qualify outside of the USDA programs. However, B&P does not have information on such loans. Therefore, actual revenue impacts may exceed the amounts shown above.

Officials from the **Joint Committee on Administrative Rules** assume this proposal is not anticipated to cause a fiscal impact beyond its current appropriation.

Oversight assumes JCAR will be able to administer any rules from this proposed legislation with existing resources.

Officials from the **Office of the Secretary of State (SOS)** note many bills considered by the General Assembly include provisions allowing or requiring agencies to submit rules and regulations to implement the act. The SOS is provided with core funding to handle a certain amount of normal activity resulting from each year's legislative session. The fiscal impact for this fiscal note to the SOS for Administrative Rules is less than $5,000. The SOS recognizes that this is a small amount and does not expect that additional funding would be required to meet these costs. However, the SOS also recognizes that many such bills may be passed by the General Assembly in a given year and that collectively the costs may be in excess of what the office can sustain with its core budget. Therefore, the SOS reserves the right to request funding for the cost of supporting administrative rules requirements should the need arise based on a review of the finally approved bills signed by the governor.

Oversight assumes the SOS could absorb the costs of printing and distributing regulations related to this proposed legislation. If multiple bills pass which require the printing and distribution of regulations at substantial costs, the SOS could request funding through the appropriations process.

Officials from the **Missouri Department of Agriculture** and the **Department of Economic Development** each assume the proposal will have no fiscal impact on their respective organizations. **Oversight** does not have any information to the contrary.

FISCAL IMPACT – State Government	FY 2023 (10 Mo.)	FY 2024	FY 2025
GENERAL REVENUE			
Revenue Gain- §143.1121 – Net Corporate Income Tax Interest Deduction (p. 3-4)	$0	$26,584 - $49,953	$26,584 - $49,953
Revenue Loss - §148.731 – Net Financial Institution Tax Deduction (p. 4-6)	$0	($4,962 - $9,325)	($4,962 - $9,325)
ESTIMATED NET EFFECT ON GENERAL REVENUE	**$0**	**$21,622 - $40,628**	**$21,622 - $40,628**

FISCAL IMPACT – Local Government	FY 2023 (10 Mo.)	FY 2024	FY 2025
Revenue Reduction - §148.731 - Financial Institution Tax Deduction p. 4-6	$0	($243,158 - $456,904)	($243,158 - $456,904)
NET ESTIMATED EFFECT ON LOCAL POLITICAL SUBDIVISIONS	**$0**	**($243,158 - $456,904)**	**($243,158 - $456,904)**

FISCAL IMPACT – Small Business

Financial institutions who qualify for the tax deduction as defined in the bill could be impacted by this proposal.

FISCAL DESCRIPTION

The proposed legislation authorizes tax deductions for financial institutions that provide loans in rural areas.

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION
Office of Administration - Budget and Planning
Office of the Secretary of State
Joint Committee on Administrative Rules
Missouri Department of Agriculture
Department of Economic Development
Department of Revenue

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