To the Honorable Members of this Committee:

Ladies and gentlemen, thank you for the opportunity to testify today. My name is Michael Rathbone and I am a policy researcher at the Show-Me Institute, a non-profit, non-partisan Missouri-based think tank that supports free-market solutions for state policy. The ideas presented here are my own. This testimony is intended to provide ideas about how to improve tax policy and administration in Missouri.

Overall, the three guiding principles in tax policy and tax administration should be simplicity, consistency, and equity. Complexity and inconsistency in administration can cause confusion not only for taxpayers, but also for the people charged with enforcing the state’s rules and regulations. This type of confusion should be avoided.

Equity is another guiding principle for tax policy and administration. The government should not favor a particular business, industry, item, or service unless there is a compelling public interest for doing so. When the government tries to pick winners and losers, it tends to pick losers. Free markets, and more specifically, the free people who comprise such markets, should be the ones determining whether a good, service, or business is needed. Government’s obligation is to make sure that the system works, for everybody.
Overall, the three guiding principles in tax policy and tax administration should be simplicity, consistency, and equity.

Proper Administration of Tax Laws

Executive agencies should be consistent in their application of rules and regulations. Comments from the public indicate that the Missouri Department of Revenue (DOR) has not been diligent in following this basic precept.

Let us acknowledge that the DOR may face difficulties in determining which transactions are subject to the state sales tax. Statutes that are poorly drafted or court decisions can impact the scope of transactions subject to sales taxes. When the court issues a decision, the DOR may have existing regulations that conflict with the court’s interpretation. For example, the DOR’s regulations, based on its reading of state statute, could say that personal trainers do not have to collect sales taxes for their services. The court, however, may determine that state statutes actually require personal trainers to collect sales tax. This holding which may conflict with the intent of the legislature is now the law. Many times in response to court decisions, the DOR issues letter rulings rather than revising existing regulations. Unlike regulations, letter rulings only apply to the taxpayer who requested the ruling and the specific fact pattern presented. All taxpayers are entitled to know the current state of the law without the added expenses and burden of obtaining letter rulings.

Clarity about the transactions subject to tax should be the hallmark of a taxing system. If the court’s interpretation of a statute is contrary to legislative intent, the legislature should take immediate steps to amend the law to provide clarification. If the court’s interpretation agrees with the legislature’s intent, then the DOR should promptly revise its regulations and tax form instructions to correspond with that interpretation. A thorough review of existing statutes and regulations should occur regularly to identify revisions that are needed to reflect the true state of the law.

The Problem with Sales Tax Exemptions and Economic Development Tax Credits

When the legislature attempts to clarify which items or services are subject to the state sales tax, it may grant exemptions for favored industries or activities. Giving tax advantages to favored goods or services while withholding those same advantages from other types of goods and services is generally a bad policy practice. This practice also has the effect of shrinking the tax base, which will either cause revenues to decline or force the search for other revenue sources, such as increased sales taxes on other items.

Instead of creating numerous exemptions, which could cost the state hundreds of millions of dollars, the state should keep the sales tax base as broad as possible. Such a practice would enable the state to maintain a lower tax rate for all goods and services instead of lower rates for some and higher rates for others.

Providing economic development tax credits is also poor policy because the tax credits behave similarly to sales tax exemptions. These tax credits favor preferred industries and activities and shrink the tax base. Last year provided
The government should not favor a particular business, industry, item, or service unless there is a compelling public interest for doing so.

Through tax credits, the state is picking winners and losers but there is little evidence to suggest that these tax credits actually boost the economy. In a review of the academic literature concerning the effectiveness of tax credits in spurring economic development, Lindenwood University Professor Howard Wall found that, "State tax credits do not tend to lead to higher levels of employment for local residents, nor, by extension, do they lead to higher levels of employment for state residents." Instead of issuing tax credits, a much better policy is to lower tax rates and leave those funds in the private sector.

Missouri Should Tax Business Income at the Same Rate

The current state income tax code also plays favorites in that it grants an advantage to one type of business over others. With the passage of Missouri Senate Bill 509 earlier this year, Missouri enacted its first tax cut in decades. Once fully enacted, SB 509 creates a 25 percent deduction for pass-through businesses such as sole-proprietorships, LLCs, and S-Corps. SB 509 also will lower the top tax rate to 5.5 percent once it is fully implemented. Both of these tax changes create a new effective top tax rate of 4.125 percent for pass-through businesses. Under current law, Missouri C-Corporations face a 6.25 percent income tax rate. Coupled with a 50 percent deduction for federal taxes paid, the effective tax rate of Missouri corporations is 5.16 percent.

There should be no difference in tax rates among businesses based on how they are structured. When the Tax Foundation examined Kansas' 2012 tax cut, which completely eliminated the income tax on pass-through businesses, they noted that, "Kansas's decision to exempt one type of business structure completely from taxation (pass-throughs) while continuing to tax others (C corporations) is problematic. It rewards certain business structures while punishing others. There is no sound economic justification for treating these two types of business activities so dramatically differently."

The difference in tax treatment for these types of companies is not as pronounced in Missouri as it is in Kansas, but the difference still remains.

The Show-Me Institute has numerous publications discussing the benefits of reducing income taxes for all businesses. Ideally, the effective tax rate for all businesses in the state would be zero. However, if that is not feasible, the state should lower the corporate income tax so that it equals the tax on pass-through entities. Lost revenue from reducing the corporate income tax can be offset by reducing the issuance of economic development tax credits.

Commercial Surcharge Property Taxes

The commercial property tax surcharge is not treated like other property taxes. Currently, the surcharge does not roll back as assessments increase, nor do local officials have the ability to change it. The surcharge should be able to
Executive agencies should be consistent in their application of rules and regulations.

Executive agencies should be consistent in their application of rules and regulations. roll back like other property taxes and be subject to the limitations that the Hancock Amendment set. Local officials also deserve the ability to lower the rate in response to changes in circumstances and, if lowered, to raise the rate in the future, but not beyond the current maximum level.

**Inconsistent Assessment Practices Among Counties**

Property taxes rely on assessments. Assessment practices in this state are not consistent and Missouri counties should not assess property under different systems. Currently, four counties account for 45 of the total assessed valuation in Missouri (Jackson, Saint Charles, Saint Louis, and the City of Saint Louis). Each of those counties requires the filing of Certificates of Value (COV) with the county assessor upon the sale of real estate. The remaining counties in Missouri do not require the filing of COV.

This failure can lead to inconsistent assessment practices within taxing entities. For example, the City of Pacific crosses county lines between counties with and without COVs. In this case, the same city is subject to different assessment practices. That is fundamentally unfair. Missouri should make assessment practices uniform across the state. Because it is generally agreed that property assessments that do not make use of COVs “operate under a handicap,” it would be preferable if the state applied COV requirements statewide. If residents are going to have local property taxes based on assessments, those assessments need to be as accurate as possible and done in a consistent manner.

Another inconsistent assessment practice is that some counties break down the value of real estate between the land and the improvement (i.e., the building), while many others just value the entire parcel as one. In the interest of accuracy, assessors should be expected to value the land and the improvement separately.

**Agriculture Assessment Practices**

It is important that properties in this state are assessed at the proper rate. However, Missouri’s actively used farmland is significantly undervalued for assessment purposes. That is why, currently, farmland makes up 65 percent of the land in Missouri, yet it accounts for less than 2 percent of the total property tax base. For example, in 2012, the United States Department of Agriculture valued all Missouri farmland at $84,100,000,000. During the same year, the Missouri State Tax Commission valued that same land and property at $1,716,102,886; thereby, setting the farmland base at just 2 percent of real market value.

Vacant and unused farmland is supposed to be assessed at 12 percent of real market value. However, Missouri statutes allow for actively farmed land to be assessed based on soil quality, which can significantly reduce the assessed value. The soil quality rating system for actively farmed land is, on average, much lower than 12 percent of real market value and has produced the lower assessed agricultural valuations described previously.
The consequence of this assessment method is that the state is being forced to transfer funds from urban and suburban areas in order to support local rural services (e.g., the school foundation formula). Suburban and urban taxpayers should not be paying extra money for services for rural Missourians because of this questionable assessment methodology. Over the past decade, the legislature has refused to follow State Tax Commission recommendations to increase the tax amount paid based on soil quality. The Missouri General Assembly and State Tax Commission moved in the right direction in 2014 by approving a small increase in farmland assessments, but more should be done. The legislature and the State Tax Commission should take further steps so that agriculture assessments in Missouri more closely reflect the 12 percent of market value of that property.

**Changes to Special Taxing District Authority**

Elected officials and voters should make the determination of whether or not tax policy is simple, consistently applied, and equitable. Currently, property owners can go to the courts to authorize tax increases without input from the public or elected bodies. Missouri is witnessing an expansion in the use of Community Improvements Districts (CIDs), Transportation Development Districts (TDDs), Neighborhood Improvement Districts (NIDs), and more. Some of these have proven disastrous, such as the Jackson County Lake Lotawana CID and the Jamestown NID in Greene County. Missouri needs tighter controls and greater transparency with respect to these new taxes —primarily sales taxes — that are imposed because of the establishment of these districts.

**Conclusion**

Missouri needs taxes that are low, equitable, and simple to understand. It also needs a government that administers those taxes consistently so that all taxpayers, not just the select few, are empowered to grow and prosper in the Show-Me State. However, these reforms will not just happen on their own, and it is up to Missouri policymakers to make these pro-growth, pro-market, and pro-people changes a reality.

*Michael Rathbone is a policy researcher and David Stokes is the development director at the Show-Me Institute, which promotes market solutions for Missouri public policy.*

Instead of creating numerous exemptions, which could cost the state hundreds of millions of dollars, the state should keep the sales tax base as broad as possible.
NOTES:


5 A previous Show-Me Institute essay shows how the money saved from a reduction in economic development tax credit issuances could be used to offset the revenue lost from completely eliminating the corporate income tax. For more on this proposal, see: Ishmael, Patrick, and Michael Rathbone. “Cutting the Ties that Bind: End Missouri’s Corporate Income Tax.” Show-Me Institute Essay. November 2012. View online here: http://showmeinstitute.org/publications/essay/taxes/864-end-corp-income-tax.html.


9 Missouri State Tax Commission, 2013 Annual Report “County Valuations.”


12 Missouri STC, 2012 Annual Report, Table III, State Recapitulation.

13 State Tax Commission, “Property Reassessment and Taxation,” State Tax Commission publication. January 2012. Agricultural land is supposed to be assessed at 12 percent of market value. For actively farmed land, the assessment is based on the productive capability of the land. That process can lead to dramatically lower assessments on agricultural land, as the figures above show. View the regulation online here: http://stc.mo.gov/files/reassessment_brochure.pdf.
Elected officials and voters should make the determination of whether or not tax policy is simple, consistently applied, and equitable.


