



GOVERNOR OF MISSOURI

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May 1, 2014

TO THE SECRETARY OF THE SENATE  
97<sup>th</sup> GENERAL ASSEMBLY  
SECOND REGULAR SESSION  
STATE OF MISSOURI

Herewith I return to you Senate Substitute No. 3 for Senate Committee Substitute for Senate Bills Nos. 509 & 496 entitled:

AN ACT

To repeal sections 143.011, 143.021, and 143.151, RSMo, and to enact in lieu thereof four new sections relating to income taxes.

I disapprove of Senate Substitute No. 3 for Senate Committee Substitute for Senate Bills Nos. 509 & 496. My reasons for disapproval are as follows:

Much like last year's Senate Substitute for House Bill No. 253 (2013), Senate Substitute No. 3 for Senate Committee Substitute for Senate Bills Nos. 509 & 496 is an ill-conceived, fiscally irresponsible experiment. This unaffordable, unfair and potentially dangerous legislation will irreparably harm public education and the vital public services upon which Missourians rely, undermine our state's long-term fiscal health, and provide extraordinary benefits to the few with little for the many. For these reasons and to protect the long-term economic prosperity of our state, Senate Substitute No. 3 for Senate Committee Substitute for Senate Bills Nos. 509 & 496 cannot receive my approval.

**I. Senate Bill 509 Is Unaffordable**

Although the true fiscal impact of Senate Substitute No. 3 for Senate Committee Substitute for Senate Bills Nos. 509 & 496 could be far greater, even the legislature's estimated \$620 million annual general revenue reduction would dramatically undercut the state's ability to meet its obligations to support K-12 schools, higher education, and vital public services. As I said last year in my veto of Senate Substitute for House Bill No. 253 (2013):

Although Missourians expect to have low and predictable taxes, they also want good jobs, quality schools, and safe and healthy communities, and they are not willing to gamble these priorities on unproven experiments. With our taxes already among the lowest in the nation, the additional reductions called for by [the legislation] would leave a gaping budget hole for decades to come, requiring cuts of such magnitude that meeting even our basic obligations for K-12 education, for our colleges and universities, for public safety and for other vital services would be out of reach.

It is troubling that proponents have portrayed Senate Substitute No. 3 for Senate Committee Substitute for Senate Bills Nos. 509 & 496 as a way to grow our economy when it would undermine the foundation of our long-term economic growth—public education. The obligation to support public schools has long been part of our shared values as Missourians.<sup>1</sup> Our fiscal discipline and growing economy have put us within striking distance of meeting the legal obligation to fund schools embodied by the school foundation formula. However, by permanently and fundamentally altering the tax code, Senate Substitute No. 3 for Senate Committee Substitute for Senate Bills Nos. 509 & 496 would reduce the revenue available to meet this legal obligation and leave our schools unable to provide the skilled, educated workforce necessary for the long-term growth of our economy.

**a. Delaying the Tax Cuts Fails to Protect Education and Vital Public Services**

Senate Substitute No. 3 for Senate Committee Substitute for Senate Bills Nos. 509 & 496 superficially attempts to protect education and vital public services from drastic cuts by delaying the proposed tax cuts until 2017. Although such a delay would clearly shield many of the lawmakers who voted for the bill from ever having to put together a budget based upon it, the delay does nothing but postpone the difficult fiscal choices that will have to be made if this bill becomes law. Moreover, a two-year delay before the tax cuts take effect contradicts the economic argument advanced by proponents that immediate tax relief is needed in order to stimulate economic growth. It is difficult to see how a tax cut of \$32 for the average Missouri family in the year 2022 would provide the immediate economic shot of adrenaline supporters have made this bill out to be. Even if postponing the revenue reductions resulting from the legislation would enable the foundation formula to be fully-funded at least once before revenues begin to erode, a single year of full funding does not meet our legal obligation to schools. This obligation must be sustained year after year to ensure an education system capable of producing the workforce necessary for the jobs of today and the jobs of tomorrow. Senate Substitute No. 3 for Senate Committee Substitute for Senate Bills Nos. 509 & 496 jeopardizes our ability to live up to this obligation, whether the bill's impacts begin tomorrow or a decade from now.

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<sup>1</sup> Missouri's Territorial Charter of 1812 provided "Knowledge, being necessary to good government and the happiness of mankind, schools and the means of public education shall be encouraged and provided for." *Territorial Laws of Missouri*, vol. 1, ch. IV, sec. 14 (page 13) (approved June 4, 1812). Similarly, Missouri's Constitution provides: "A general diffusion of knowledge and intelligence being essential to the preservation of the rights and liberties of the people, the general assembly shall establish and maintain free public schools in this state within ages not excess of twenty-one years as prescribed by law." Mo. Const. Art. IX.

## **b. The Revenue Triggers Fail to Protect Education and Vital Public Services**

Some have relied on the so-called revenue “triggers” in the legislation that must occur before tax reductions take effect in order to claim that their vote in favor of this measure is not a vote against public education. However, as I pointed out last year in my veto of Senate Substitute for House Bill No. 253 (2013), such revenue triggers fail to protect against cuts to education and vital public services because they allow for permanent changes in the tax code based on a single year’s increase in revenue collections. In addition, the triggers are drafted so as to allow a reduction in taxes even during the depths of an economic recession. For example, if Senate Substitute No. 3 for Senate Committee Substitute for Senate Bills Nos. 509 & 496 had been in effect at the time, the more than \$150 million revenue collection increase in Fiscal Year 2008 would have triggered a tax rate reduction in 2009, despite the fact that there was a \$553 million reduction in revenue during Fiscal Year 2009 due to the economic recession that had begun in December 2007. Had this bill been in effect, steep cuts to education and vital public services would have been unavoidable, as the tax cuts would have continued reducing revenue regardless of objective economic conditions and the resulting decline in revenue collections.

Moreover, the revenue triggers in the legislation only apply until the tax cuts are fully phased-in. After that time, under the legislature’s own estimates, there would be at least \$620 million less in general revenue available each and every year, regardless of whether revenue collections are going up or down. In addition, the legislation’s annual cost would continue to grow above the legislature’s \$620 million annual estimate because the income bracket adjustments in the bill for increases in the consumer price index would continue indefinitely. *See* Section 143.011.3. This provision alone would result in an additional \$128 million in annual revenue reductions ten years after the legislation is fully phased-in, increasing each year into perpetuity.

## **II. Senate Bill 509 Is Unfair**

Senate Substitute No. 3 for Senate Committee Substitute for Senate Bills Nos. 509 & 496 provides extraordinarily generous benefits to the wealthy while providing little to working Missourians. Much of this inequity is due to the business income exemption, which as in last year’s Senate Substitute for House Bill No. 253 (2013), gives disproportionate tax benefits to select business owners without any requirement that they create jobs and no proof that they would.

### **a. The Business Income Exemption Is Poor Tax Policy**

Many have recognized that the business income exemption in Senate Substitute No. 3 for Senate Committee Substitute for Senate Bills Nos. 509 & 496 is poor tax policy.<sup>2</sup> It would provide a strong incentive to game the tax code through creative accounting, even to the point of forming a “business” simply to gain this generous new tax benefit. A special carve-out like this rewards

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<sup>2</sup> *See, e.g.,* “Tax Foundation Pans Missouri Income Tax Bills,” *available at* [http://www.stltoday.com/business/columns/david-nicklaus/tax-foundation-pans-missouri-tax-cut-bills/article\\_cc6b6b3a-7733-512d-9cb4-a9f57307ae82.html](http://www.stltoday.com/business/columns/david-nicklaus/tax-foundation-pans-missouri-tax-cut-bills/article_cc6b6b3a-7733-512d-9cb4-a9f57307ae82.html)

tax avoidance without concomitant economic activity and makes our tax code less efficient without any empirical evidence that it would improve our economy. In addition, creating a new loophole for select businesses violates the well-established principle of sound tax policy to ensure a broad tax base so that the overall tax burden remains low. Like the state's costly and inefficient tax credit programs, this new exemption narrows the tax base, thereby shifting a greater tax burden to the majority of taxpayers unable to utilize such loopholes.

**b. The Business Income Exemption Treats Certain Businesses Better than Others**

The business income exemption also provides preferential treatment for a select group of businesses, while discriminating against many others based solely on the paperwork the business filed to organize. Under this provision, businesses organized as “pass-through entities”—e.g., LLCs, partnerships, s-corps—would see up to a quarter of their taxable income treated as tax free, while other businesses would see no benefit at all. Privileging one form of business organization over another would create a perverse incentive for businesses to restructure for tax avoidance, not economic efficiency, while penalizing businesses that do not lend themselves to the pass-through form. This kind of governmental manipulation through the tax code unduly interferes with the free market by incentivizing economically inefficient behavior. There is no principled economic justification for the tax code to pick winners and losers based solely on elevating the form of a business's organizational structure over its economic substance.

**c. The Business Income Exemption Treats Business Owners Better Than Workers**

The business income exemption would result in a worker paying higher taxes than his or her employer, even if the worker and the employer reported exactly the same taxable income. For example, under this bill an owner of a pass-through business reporting \$40,000 in Missouri adjusted gross income would pay \$704 in income tax, while their employee reporting that same amount would pay \$1,123 in tax—more than 50 percent more in tax than the employer. No legislation that gives two taxpayers with identical incomes—one who happens to own a business and one who happens to work at one—such drastically different tax treatments can be called fair.

**d. The Business Income Exemption Is Not Targeted to Help Small Businesses**

While supporters contend that the business income exemption is designed to benefit small businesses, there is no such limitation in the law.<sup>3</sup> Indeed, the benefits of the exemption would go disproportionately to the wealthiest business owners. Less than one percent of all business income tax filers reported taxable income in excess of \$1 million, but they are projected to receive nearly 30 percent of the tax savings from the bill. Such individuals with taxable income in excess of \$1 million are projected to see an average tax cut of \$32,000 annually when the bill

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<sup>3</sup> The lack of any limitation targeting the exemption to small businesses is in sharp contrast to previous tax relief measures I have signed that were directly targeted to small businesses. *See, e.g.*, Section 143.173, RSMo (providing a tax deduction for small businesses consisting of fifty or fewer employees); Section 147.010, Senate Substitute No. 2 for Senate Committee Substitute for House Committee Substitute for House Bill No. 191 (2009) (eliminating the franchise tax for small businesses).

is fully phased-in. On the other side of the coin, more than 70 percent of all business income filers reported taxable income of \$50,000 or less, and they would see just 13 percent of the tax savings, with an average annual tax cut of \$135 by 2022.

**e. The Overall Bill Disproportionately Benefits the Wealthy**

Just as the business income exemption disproportionately benefits the wealthy, so does the overall bill. Taxpayers reporting more than \$100,000 in taxable income make up just seven percent of all Missouri tax returns filed. However, this small subset of taxpayers is projected to receive 52 percent of the total tax savings under the bill, with an average annual tax savings of \$1,145. Meanwhile, the 93 percent of Missouri taxpayers with taxable incomes below \$100,000 would see an average annual tax savings of just \$78. Under this bill, the owner of a casino organized as a pass-through entity with \$1 million in covered business income could write off \$250,000 of that income and receive a tax cut worth more than \$18,000. Meanwhile, an average Missouri family making \$44,000 a year would see a tax cut of about \$32 in 2022. Senior citizens on Social Security or receiving a pension would see little benefit from the bill, since Missouri law already exempts such income from tax, but they would feel the negative impacts of cuts to home-delivered meals and transportation to doctor appointments from the resulting revenue reductions.

**III. Senate Bill 509 Creates Dangerous Uncertainty**

The most far-reaching and potentially damaging aspect of Senate Substitute No. 3 for Senate Committee Substitute for Senate Bills Nos. 509 & 496 is the clear and unambiguous language eliminating the income tax altogether on Missourians with taxable incomes over \$9,000:

The bracket for income subject to the top rate of tax **shall be eliminated** once the top rate of tax has been reduced to five and one-half percent.

Section 143.011.2(4) (emphasis added). This single provision could blow a \$4.8 billion annual hole in the state budget—eliminating 97 percent of all income tax collections, cutting 65 percent of the state’s general revenue budget, and obliterating even basic funding for education and vital public services. Although legislators have portrayed this legislation as being free of the defects, unintentional or otherwise, that plagued last year’s Senate Substitute for House Bill No. 253 (2013), the \$1.2 billion drafting error in last year’s bill that caused the independent credit rating agencies to warn of a downgrade to the state’s spotless AAA credit rating, pales in comparison to the risk to our credit rating created by this year’s defect and its \$4.8 billion annual price tag.

**a. The Language of Senate Bill 509 is Clear and Unambiguous**

Under Senate Substitute No. 3 for Senate Committee Substitute for Senate Bills Nos. 509 & 496, Section 143.011 provides the income tax rates applicable to various levels—or brackets—of Missouri taxable income. As under current law, the bracket for income subject to the top rate of tax applies to taxpayers with Missouri taxable incomes of “Over \$9,000.” See Section 143.011. Section 143.011.2(1) of this legislation would reduce this top rate of tax by one-tenth of a percent each year until the top tax rate is reduced to five and one-half percent.

After the top tax rate has been reduced to five and one-half percent, Section 143.011.2(4), added by an amendment on the Senate floor, provides that the “bracket for income subject to the top rate of tax **shall be eliminated** . . .” (emphasis added). This language is clear and unambiguous—once the top rate of tax has been reduced to five and one-half percent, the “bracket for income subject to the top rate of tax”—“Over \$9,000”—would be eliminated. With this former top income bracket eliminated, Section 143.011.1 would have a new top tax bracket—“Over \$8,000 **but not over \$9,000**” (emphasis added). This new top tax bracket has an upper income limit—“but not over \$9,000”—and there is no language in the bill eliminating this upper income limit. With this new top tax bracket capped at \$9,000 in taxable income, Section 143.011.1 would no longer contain an income bracket or corresponding tax rate applicable to taxable incomes over \$9,000, leaving such taxpayers with no tax liability.

Further support for the clear and unambiguous language eliminating income tax on taxpayers with taxable income over \$9,000 is found when Section 143.011.2(4) is read *in pari materia* with the changes to Section 143.021, also added to the bill in the Senate floor amendment:

143.021. Every resident having a taxable income [of less than nine thousand dollars] shall determine his or her tax from [a tax table prescribed by the director of revenue and based upon] the rates provided in section 143.011. [The tax table shall be on the basis of one hundred dollar increments of taxable income below nine thousand dollars. The tax provided in the table shall be the amount rounded to the nearest whole dollar by applying the rates in section 143.011 to the taxable income at the midpoint of each increment, except] There shall be no tax on a taxable income of less than one hundred dollars. Every resident having a taxable income of nine thousand dollars or more shall determine his tax from the rate provided in section 143.011.

Section 143.021 (emphasis added). With the above change to Section 143.021, the General Assembly not once, but *twice* in just over four pages of legislative text, eliminated the reference to an income tax for individuals with taxable income in the top tax bracket. The elimination of all references to a tax on taxpayers with taxable income in the top income bracket in Section 143.021, confirms the clear and unambiguous language of Section 143.011.2(4) eliminating the top income bracket entirely.<sup>4</sup>

#### **b. Legislative Intent Is Derived From the Words Enacted**

Legislators have speculated in public comments that a court might ignore this clear and unambiguous language to avoid the dramatic consequences to the state’s fiscal well-being that would result. However, post-enactment statements of individual legislators after a problem has

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<sup>4</sup> The first time during the legislative process that the language in Section 143.011.2(4) eliminating the bracket for income subject to the top rate of tax and the change to Section 143.021 eliminating the reference to incomes of \$9,000 or greater appeared in the bill was in the Senate floor amendment. Had the Senate floor amendment retained the reference in Section 143.021 to taxpayers with taxable incomes greater than \$9,000, as prior versions of the bill had done, the language in Section 143.011.2(4) eliminating the top income bracket might have been ambiguous, since Section 143.021 would have continued to imply that such taxpayers may still be subject to tax.

been identified do not constitute legislative intent. “Legislative intent can only be derived from the words of the statute itself.” *State v. Rowe*, 63 S.W.3d 647, 650 (Mo. banc 2002); *see also Spradlin v. City of Fulton*, 982 S.W.2d 255, 261 (Mo. banc 1998) (Price, J.) (“[C]ourts must give effect to the language as written.”). Once a law has been enacted, a court must enforce the law by its terms and not by what individual legislators believed they were enacting. *See, e.g., Pipe Fabricators, Inc. v. Director of Revenue*, 654 S.W.2d 74, 76 (Mo. banc 1983) (affidavit of a former state senator as to the intent of use tax provision was inadmissible since court is bound by express written law, and not what may have been intended).

More fundamentally, passing a bill with a problem and then hoping a judge will fix it is an abdication of the legislature’s responsibility under our tripartite system of government. Under our Constitution, “[t]he legislative branch is exclusively vested with the power to make laws.” Mo. Const. Art. III, Section 1. This means that lawmakers must enact *laws*, not merely *ideas* for a court to one day mold into something workable. The words on the page are what matter, for those are the words that guide the conduct of Missourians. The test is not what individual legislators say they meant—the test is what the words actually *say*. Here, the clear and unambiguous language of Section 143.011.2(4) says to eliminate the top income bracket, the change to Section 143.021 reinforces the clear and unambiguous language of Section 143.011.2(4), and there is nothing in the words enacted to the contrary.<sup>5</sup>

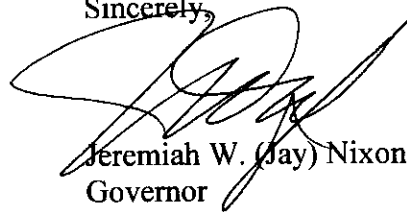
If Senate Substitute No. 3 for Senate Committee Substitute for Senate Bills Nos. 509 & 496 were to become law, it could be years from now before the court upon which legislators have pinned their hopes determines whether a taxpayer is correct that his or her income tax was eliminated by this bill. Even if, as legislators hope, this hypothetical court finds the language eliminating the income tax to be ambiguous, the court would still be required to construe that ambiguity in favor of the taxpayer and against the taxing authority. *Street v. Director of Revenue*, 361 S.W.3d 355 (Mo. banc 2012) (interpreting an ambiguous tax statute in favor of the taxpayer to invalidate long-standing local taxes on out-of-state motor vehicle purchases). Although by that time most of the legislators who voted for this bill will no longer be in the General Assembly, it will nonetheless be their handiwork that lies in wait to undermine the fiscal foundation of our state. And if this future court, with its thumb on the scale in favor of the taxpayer, does not rule the way that legislators hope, the Hancock Amendment would make the drastic consequences its ruling extremely difficult to undo—asking voters to approve a nearly \$5 billion tax increase. Risking the long term fiscal stability of the state, our perfect AAA credit rating, funding for our education system, and the future of our economy on what a judge might someday do is an unconscionable dereliction of duty, a disservice to the people of Missouri, and one in which I will not be complicit.

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<sup>5</sup> Proponents of the bill have also parroted the canon of statutory construction whereby a court might ignore the plain language of a statute to avoid an “absurd result.” Eliminating 97 percent of income tax collections and 65 percent of the state’s general revenue budget would certainly be dramatic and fiscally damaging. However, this result would be consistent with recent proposals advanced in the Missouri General Assembly and by initiative petition aimed at eliminating the income tax, defunding public education, and otherwise “starving” government. Indeed, as proponents of such proposals have pointed out, there are a number of states that have no income tax and instead rely on expanded sales taxes, higher property taxes, severance taxes, or other revenue streams to fund education and necessary public services.

In accordance with the above stated reasons for disapproval, I am returning Senate Substitute No. 3 for Senate Committee Substitute for Senate Bills Nos. 509 & 496 without my approval.

Sincerely,

A handwritten signature in black ink, appearing to read "Jay Nixon", written over the printed name and title.

Jeremiah W. (Jay) Nixon  
Governor