GOVERNOR OF MISSOURI

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JEREMIAH W. (JAY) NIXON
GOVERNOR

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June 11, 2014

TO THE SECRETARY OF STATE OF THE STATE OF MISSOURI

Herewith I return to you Conference Committee Substitute for Senate Committee Substitute for Senate Bill No. 612 entitled:

AN ACT

To repeal sections 143.183, 143.451, 144.021, and 144.054, RSMo, and to enact in lieu thereof four new sections relating to taxation.

I disapprove of Conference Committee Substitute for Senate Committee Substitute for Senate Bill No. 612. My reasons for disapproval are as follows:

Conference Committee Substitute for Senate Committee Substitute for Senate Bill No. 612 would continue a damaging trend by the General Assembly to enact special tax exemptions and credits that pick winners and losers through the tax code and shift a greater proportion of the tax burden to the majority of Missourians unable to utilize such loopholes. Not a penny of the special breaks in this bill or in the others that I am vetoing today[1] was taken into account in the Fiscal Year 2015 budget passed by the General Assembly, leaving it significantly out of balance and requiring swift action to protect the State's fiscal well-being. This is fiscally irresponsible and cannot receive my support.

In enacting and its brethren in the final hours of the legislative session, the General Assembly disregarded the normal legislative process, slipping in costly provisions without public hearings and without fiscal notes reflecting the impact on the state budget. And just as legislators ignored

[1] Conference Committee Substitute for House Committee Substitute for Senate Bill No. 584; Conference Committee Substitute for House Committee Substitute for Senate Bill No. 662; Conference Committee Substitute No. 2 for House Committee Substitute for Senate Bill No. 693; House Committee Substitute for Senate Bill No. 727; Senate Committee Substitute for Senate Bill No. 829; Conference Committee Substitute for House Committee Substitute for Senate Substitute for Senate Bill No. 860; Senate Committee Substitute for House Committee Substitute for House Bill No. 1296; House Bill No. 1455; and Senate Substitute for Senate Committee Substitute for House Bill No. 1865.

the legislative process, so too did they disregard the budget process by passing a budget just a week earlier that failed to account for this final day spending spree. Unlike the fiscal impact of Senate Substitute No. 3 for Senate Committee Substitute for Senate Bill Nos. 509 & 496, which today's lawmakers have conveniently foisted off on future budgets for education, public safety and other vital public services, the fiscal impact of the special breaks I am vetoing today would begin impacting budgets in the fiscal year starting in less than 30 days. There are no delays, triggers, or other gimmicks that could be touted as shielding education, public safety, and other vital public services, at both the state and local level,[2] from the projected nearly $776 million in state and local revenue legislators voted to send to narrow special interests on the last day of session. While the General Assembly may have abdicated its fiscal responsibilities in failing to account for this budgetary impact, the resulting imbalance cannot be ignored and will have to be corrected through dramatic spending reductions.

Conference Committee Substitute for Senate Committee Substitute for Senate Bill No. 612 and the other measures I am vetoing today would add to the more than 260 sales tax exemptions and tax credits that litter Missouri's tax code without requiring the creation of a single new job. The continued erosion of the tax base through such individualized exemptions and credits violates well-established principles of sound tax policy calling for a broad tax base so that tax rates can remain low. The General Assembly has ignored repeated calls to reduce these costly and inefficient carve-outs and has instead rushed through many more, leaving Missouri families to pick up the tab for education and vital public services.

The unabated growth of such special carve-outs and the fiscal irresponsibility of failing to budget for them are all the more troubling when the General Assembly is simultaneously seeking to raise taxes on all Missourians with what could be the largest tax hike in Missouri history. While

[2] In addition to impacting the general local sales tax imposed under Section 32.085, exemptions from local sales tax would reduce revenue collected through numerous voter-approved local sales taxes that are targeted to specific, community supported needs. Examples include the County Anti-Drug Sales Tax, Sections 67.391, 67.392, RSMo; County Construction Sales Tax, Sections 67.550, 67.590, RSMo; Museums and Festivals Sales Tax, Sections 67.571, 67.578, RSMo; Law Enforcement Services Sales Tax, Sections 67.582, 67.584, 92.500, RSMo; Capital Improvements Sales Tax, Sections 67.700, 67.730, 94.577, 94.578, 94.890, RSMo; Storm Water Control and Public Works Sales Tax, Sections 67.701, 67.729, 94.413, RSMo; Public Recreation Projects and Programs Sales Tax, Sections 67.745, 67.782, RSMo; Regional Recreation Districts Sales Tax, Section 67.799, RSMo; Perry County Senior Services and Youth Programs Sales Tax, Section 67.997, RSMo; Economic Development Sales Tax, Sections 67.1300, 67.1303, 67.1305, 94.1008, 94.1010, 94.1012, RSMo; Community Improvement Districts Sales Tax, Section 67.1545, RSMo; Metropolitan Parks and Recreation Districts Sales Tax, Section 67.1712, RSMo; Children's Services Sales Tax, Section 67.1775, RSMo; Water Quality, Tourism, and Infrastructure Sales Tax, Section 67.1922, RSMo; Tourism Community Enhancement Districts Sales Tax, Section 67.1959, RSMo; Exhibition Center and Recreational Facility Districts Sales Tax, Section 67.2000, RSMo; Tourism Promotion Sales Tax, Section 67.2030, RSMo; Construction of Women's and Children's Shelter Sales Tax, Section 67.2040, RSMo; Theater, Cultural Arts, and Entertainment Districts Sales Tax, Section 67.2530, RSMo; Parks, Trails, and Greenways Districts Sales Tax, Section 67.5012, RSMo; Mass Transit Sales Tax, Section 92.402, RSMo; Public Safety Sales Tax, Sections 94.579, 94.581, 94.900, 94.902, RSMo; Community Center Sales Tax, Section 94.585, RSMo; Transportation Sales Tax, Sections 94.605, 94.660, 94.705, RSMo; Historical Locations and Museums Sales Tax, Section 94.950, RSMo; Medical Care for the Medically Indigent Sales Tax, Section 94.1000, RSMo; Kansas City Zoological District Sales Tax, Sections 94.1000, 184.503, RSMo; Transportation Development District Sales Tax, Section 238.235, RSMo; County Transit Authority Sales Tax, Section 238.410, RSMo; and Storm Water Control and Parks Sales Tax, Section 644.032, RSMo.

the benefits of the more than one billion dollars in annual tax breaks passed by the legislature over the past two months will go disproportionately to the wealthy, the burden of this multi-billion dollar tax increase for transportation would fall disproportionately on Missouri's working families and seniors.

The special breaks in Conference Committee Substitute for Senate Committee Substitute for Senate Bill No. 612 and the other bills that I am vetoing today are not the mere clarifications that their supporters claim. Instead, they seek to overrule no fewer than twenty Missouri Supreme Court cases going back to 1977 that have been followed by the department of revenue over the course of previous and current administrations. In nearly every one of the cases sought to be overturned, the court ruled that the law enacted by the General Assembly required a tax to be collected, notwithstanding that a particular businesses had hoped to be excused from the legal obligations we all share. While it is well within the rights of a losing litigant to petition their elected representatives, it is wholly disingenuous to call doing so here anything other than what it is—seeking a special exemption from the law, as currently written and as confirmed by the courts.

Throughout my time as Governor, I have worked with legislators on fiscally responsible ways to improve our tax code while protecting our state's fiscal health, including the four tax cuts that I have signed into law. Even during this legislative session, I worked directly with legislators to put forward a specific, concrete proposal that would have lowered taxes for Missourians and reined in costly and inefficient tax credits for special interests, broadened the overall tax base and reduced tax rates, while protecting our ability to invest in education and other vital public services. Unfortunately, the General Assembly refused to enact this broad tax relief in favor of narrow giveaways like those contained in Conference Committee Substitute for Senate Committee Substitute for Senate Bill No. 612 and the other bills I am vetoing today. For the reasons stated herein, this is an endeavor I cannot support.

Windfall Refunds and Retroactive Immunity

Conference Committee Substitute for Senate Committee Substitute for Senate Bill No. 612 would mandate governmental notification before a business is under any legal obligation to collect and remit sales tax under an administrative or judicial decision that modifies the items subject to tax. *See* Section 144.021.2. This ambiguously-worded provision is projected to reduce state and local revenues by up to $200 million annually.[3] As with the various other tax measures the General Assembly rushed through on the last day of session, the Fiscal Year 2015 budget they enacted fails to account for any of the revenue reductions that would result from this provision.

Mandatory governmental notification before a law applies would turn on its head the long-standing principle of our democracy that individuals are presumed to know the law. It is one

[3] A significant portion of the fiscal impact from this provision is due to its failure to prohibit a business that was properly collecting tax from claiming a refund for the taxes it paid prior to receiving the notification called for under the bill. Conference Committee Substitute for House Committee Substitute for Senate Bill No. 662, which I am also vetoing today, contains a similar provision but includes language that expressly prohibits refunds for businesses that had been correctly collecting the tax, thereby reducing its projected fiscal impact.

thing to require the government to provide information about recent developments in the law so that those affected can adjust their prospective conduct accordingly, but it is quite another to condition whether that law even applies based upon whether a person has received personal notification of the law's existence. This kind of governmental paternalism is unprecedented. This year alone the General Assembly passed nearly 200 bills modifying thousands of pages of Missouri law that apply to all manner of conduct. The General Assembly should not have to send a letter to every Missourian before this legion of new laws takes effect. Similarly, every potential criminal should not have to receive a notice describing this year's revisions to the state's criminal code before they can be prosecuted under it.

This provision in Conference Committee Substitute for Senate Committee Substitute for Senate Bill No. 612 also misunderstands tax law. Although a decision of the director of revenue is listed as an example of a "modification" triggering the duty to notify established by the bill, the director has no power to finally determine whether an item is taxable or not; that authority lies solely with those who write the tax laws—the General Assembly—and those that finally interpret them—the Missouri Supreme Court. *See* Mo. Const. Art. V, Sec. 3 (giving the Missouri Supreme Court exclusive appellate jurisdiction over the construction of the revenue laws of this state). Similarly, a decision of the administrative hearing commission is listed as something that can trigger notification. However, while the administrative hearing commission has the power to hear individual disputes, a decision of that body is not binding beyond the parties, and therefore it cannot finally "modify" what is taxable or not for other affected sellers.

Although a decision of the Missouri Supreme Court might "change[] which items of tangible personal property or services are taxable" within the meaning of the bill, the court decisions that purportedly prompted this provision and many of the new exemptions passed on the final day of the legislative session did not. In each of those cases, the Missouri Supreme Court found that the current law, as enacted by the General Assembly, required a tax to be paid, notwithstanding that a particular business had tried to get out of this legal obligation.[4] The decisions did not newly subject an item to tax; instead, they simply confirmed that such items were and are taxable. However, there is nothing in this bill to prevent a business from arguing that court decisions like these are "modifications" triggering a notification to all affected sellers that what was always taxable continues to be taxable as confirmed by the Missouri Supreme Court.

The bill provides far-reaching consequences for such a notification. Under the bill, a failure to notify an affected seller "shall relieve such seller of liability for taxes that would be due under the modification." *See* Section 144.021.2. Accordingly, receiving a notification gives any business that was not collecting taxes prior to the notice retroactive immunity for taxes that the

[4] This is true whether it was the court reaffirming this year the tax a laundry first sought to avoid in 1989, *see AAA Laundry & Linen Supply Co. v. Director of Revenue*, 425 S.W.3d 126, 127 (Mo. banc 2014) (discussing *Unitog Rental Services, Inc. v. Director of Revenue*, 779 S.W.2d 568 (Mo. banc 1989)), affirming that the General Assembly's laws did not exempt the purchases claimed as tax free by convenience stores, restaurants, or grocery stores, *see Aquila Foreign Qualifications Corp. v. Director of Revenue*, 362 S.W.3d 1, 2 (Mo. banc 2012); *Brinker Missouri, Inc. v. Director of Revenue*, 319 S.W.3d 433, 435 (Mo. banc 2010); *Union Elec. Co. v. Director of Revenue*, 425 S.W.3d 118, 120 (Mo. banc 2014), or clarifying in 2008 that "tax is due for 'fees paid to, or in any place of amusement, entertainment or recreation," *see Michael Jaudes Fitness Edge, Inc. v. Director of Revenue*, 248 S.W.3d 606 (Mo. banc 2008) (affirming denial of refund claim for taxes paid at fitness center based on *Wilson's Total Fitness Center, Inc. v. Director of Revenue*, 38 S.W.3d 424 (Mo. banc 2001)).

Missouri Supreme Court has confirmed should have been collected. Under this bill, even the specific business that had sought to avoid paying taxes, hired a lawyer to litigate the issue, and lost in court, could argue that it had no tax liability for any of the taxes the court ordered it to pay prior to being notified of the decision in its own case.

Even more problematic than retroactive immunity for businesses that had not been collecting and remitting the taxes required by the law would be the windfall for businesses that had been correctly collecting the taxes required prior to the court decision confirming their obligation to do so. Conference Committee Substitute for Senate Committee Substitute for Senate Bill No. 612 would waive any tax liability prior to receiving the required notification and, unlike a similar provision in Conference Committee Substitute for House Committee Substitute for Senate Bill No. 662, it does not expressly preclude a business that had been properly collecting the tax from this waiver of tax liability. Accordingly, there is nothing in this bill preventing a business that was properly collecting the tax from claiming a refund for the taxes it correctly collected prior to being notified of a Missouri Supreme Court decision confirming that the tax it had been correctly collecting was required under the law. Under this provision, the vast majority of businesses properly collecting tax could seek a windfall refund simply because a particular business had sought to avoid its legal obligation, litigated, and lost.

The problems with this provision extend beyond windfall refunds and retroactive immunity, to the additional governmental intrusion and burden on taxpayers that could result from the requirement to provide a personal notification to each and every affected seller. Such individualized notification would require the department of revenue to more closely and more frequently scrutinize sales data and other business information it obtains and to potentially require additional information in order to determine precisely which businesses might be affected by a given decision. In addition, because addresses, ownership and personal contact information change over time, the department would need to gather updated information more frequently and perhaps maintain a comprehensive database of such information to ensure cost-effective compliance with the personalized notification requirement of the bill. The need to continually maintain up-to-date sales and other business information would result in additional burdens for taxpayers that could be avoided with a less onerous, and likely more effective, method of providing generalized notice of updates in the law than the personal notification mandated by Conference Committee Substitute for Senate Committee Substitute for Senate Bill No. 612.

If it were to become law, Conference Committee Substitute for Senate Committee Substitute for Senate Bill No. 612 would create no shortage of work for tax attorneys and consultants. It provides a clear incentive for businesses to engage in otherwise unnecessary litigation in the hopes of obtaining a "decision" arguably constituting a "modification" in order to trigger individual notification and then either a windfall refund if they were complying with the law or retroactive immunity if they were violating it. Moreover, it will require all taxpayers to bear the cost of staffing and postage to comply with the personal notification mandate, while putting additional burdens on businesses through additional government intrusion into their affairs. While providing up-to-date information to taxpayers is a laudable policy, Conference Committee Substitute for Senate Committee Substitute for Senate Bill No. 612 fails to accomplish it and instead puts additional burden on taxpayers and significantly reduces state and local revenue. Accordingly, this measure does not receive my support.

Special Exemptions for Commercial Laundries and Dry Cleaners

Conference Committee Substitute for Senate Committee Substitute for Senate Bill No. 612 would exempt commercial laundries and dry cleaners from paying state and local sales and use taxes on their purchases of materials, goods, machinery, electrical energy and gas, chemicals, soaps, detergents, cleaning and sanitizing agents, and other ingredients used to treat, clean and sanitize textiles. These new tax exemptions would only be available for large commercial and industrial laundries and dry cleaners—facilities that process at least 500 pounds per hour and 60,000 pounds per week. There is no requirement that a benefitting business create any new jobs to take advantage of these broad new exemptions. Moreover, the General Assembly failed to account for the projected $2 million annual reduction in state revenue in the budget they enacted for the fiscal year starting July 1, as well as an additional $2 million reduction projected for local jurisdictions.

Like many of the exemptions and carve-outs rushed through on the last day of the legislative session, these new exemptions for laundries and dry cleaners are not mere clarifications of existing sales and use tax law. Instead, this provision would seek to overrule 25 years of legal precedent holding that cleaning dirty clothes is not the same as manufacturing. In 1989, the Missouri Supreme Court first "plumbed the sudsy depths of various sales and use tax exemptions and found no application to commercial laundry operations." *AAA Laundry & Linen Supply Co. v. Director of Revenue*, 425 S.W.3d 126, 127 (Mo. banc 2014) (discussing *Unitog Rental Services, Inc. v. Director of Revenue*, 779 S.W.2d 568 (Mo. banc 1989)). Earlier this year, the court similarly rejected a commercial laundry's attempt to avoid paying its taxes, reiterating that, as in 1989, the laws enacted by the General Assembly did not provide a tax exemption. *Id.* at 127-29. Following this decision, the laundry league lobbied lawmakers for tailor-made exemptions that would treat ironing out the wrinkles as "processing" a shirt and getting out the grass stains as "manufacturing" a pair of pants, thereby abrogating a quarter century of law and relieving the laundries of their previous legal obligations.

Because these new exemptions were enacted without regard for the normal legislative process—slipped into the bill without ever being in an introduced bill, without ever being the subject of a public hearing, and without ever being included in a fiscal note that reflected their cost—it is not surprising that they promote poor tax policy. First, these exemptions draw a seemingly arbitrary distinction between the laundries and dry cleaners fortunate enough to gain this generous new benefit and the rest who are left out to dry. Under this provision, a laundry that processes 59,999 pounds per week would have to continue paying their taxes, but a laundry processing a single pound more would be entitled to broad new exemptions from state and local taxes. This distorts the free market and puts smaller laundries and dry cleaners (not to mention the Missouri families who are doing their own laundry) in the position of subsidizing the operations of the larger ones. The large commercial laundries might be getting their detergent tax-free, but the rest of Missouri taxpayers would be getting taken to the cleaners.

Moreover, this provision does not simply give commercial laundries and dry cleaners the same tax exemptions enjoyed by other businesses. It gives them more lucrative ones. Although some of the tax exemptions available to manufacturers are limited solely to state taxes, these new

exemptions for laundries would apply to local taxes as well. With this provision, the General Assembly would be privileging washing dirty clothes over manufacturing new products, giving commercial dry cleaners and laundries a better deal than Missouri manufacturers without any clearly-articulated economic justification for doing so and without requiring the creation of a even a single new job. Particularly when coupled with the fiscal irresponsibility of failing to account for the fiscal impact in the budget, these exemptions represent poor tax policy and poor fiscal policy, and cannot receive my approval.

Corporate Income Allocation

Conference Committee Substitute for Senate Committee Substitute for Senate Bill No. 612 would enable additional businesses to reduce their corporate income taxes by utilizing an alternative method of calculating the amount of their income that is derived in Missouri. Legislation enacted last year authorized this alternative allocation method for manufacturers and other businesses selling tangible personal property. This provision would expand this alternative method to sellers of intangible personal property and service providers such as law firms, accounting firms, stock brokers, bond traders, real estate holding companies, and consultants.

Like many of the tax measures enacted during the final hours of the legislative session, this provision was never the subject of a public hearing and was not accounted for in the Fiscal Year 2015 budget passed by the General Assembly. A change to Missouri's tax policy that would reduce state revenues by up to $15 million annually according to the legislature's own estimate should be the subject of open debate, and the foregone revenue must be accounted for in the budget in order to receive my support.

In accordance with the above-stated reasons for disapproval, I am returning Conference Committee Substitute for Senate Committee Substitute for Senate Bill No. 612 without my approval.

Sincerely,

Jeremiah W. (Jay) Nixon
Governor