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This brief examines the four most important sources of tax revenue for the state, three of which, the individual income tax, sales and use taxes, and the corporate income tax, comprise over 90% of the moneys credited to the general revenue fund. The general revenue fund is the source from which appropriations are made for education, public assistance including Medicaid, mental health services, and general governmental functions. The motor fuel tax is the fourth tax examined here.[2]

These taxes are evaluated to assess the extent to which they cause less rational spending choices, create a competitive advantage for the state, are easy to administer, produce adequate revenue, and are fair. The criteria used to evaluate taxes and tax systems is outlined below (see box).[3]

Efficiency – Does the tax interfere with efficient allocation of resources and consumer choices?
Competitiveness – Does the tax encourage business or individuals leave Missouri or limit the state's ability to attract business?
Administrative simplicity – Is the tax easy to comply with and to administer?
Adequacy – Does the tax allow the state to meet the needs of its citizens in good times and bad?
Equity – Is the tax fair?[4]

[1] Judith I. Stallmann is a Professor of Agricultural Economics and Rural Sociology at the University of Missouri – Columbia.
[2] Revenue from the tax on motor fuel is dedicated to highway uses by Article IV, Sections 30 (a) and 30 (b) of the Missouri Constitution.
[3] Stallmann, J. I. (2004). *Evaluating Tax Systems,* Report 17-2004. Retrieved [Month, Day, Year], from University of Missouri System, Missouri Legislative Academy Web site: http://www.truman.missouri.edu/ipp/mla/publications/publications.htm
[4] Equity refers to the principle of ability to pay. A progressive tax charges a higher percentage to wealthier taxpayers while a regressive tax does the opposite. Most scholars accept the proposition that a regressive tax, one that imposes a greater proportional burden on those with smaller incomes, is not equitable. For another view see Richard J. Joseph, 1996, "Why Progressive Taxation?" Tax Notes (January 15), 313-318.

Individual Income Tax

Missouri's individual income tax is established in Section 143.011, Revised Statutes of Missouri (RSMo). The taxes have ten brackets with the top bracket at $9,000 of taxable income. Missouri taxable income is the amount of the individual federal adjusted gross income.

Economic Efficiency: The complexity of the individual income tax code does affect people's decisions as they switch to choices that lower their tax liability but these decisions are driven largely by the features of the federal income tax system.

Economic Competitiveness: Missouri's tax is economically competitive. Missouri ranks just above the national median in individual income tax. Kentucky and Iowa rank higher than Missouri. Both Illinois and Kansas rank lower than Missouri on the individual income tax. This could be a factor for some families in the St. Louis and Kansas City regions choosing to locate in those states rather than Missouri. Both cities have an earnings tax on income earned in the city, perhaps lowering the tax advantage to locating in Illinois or Kansas and commuting into the cities for work.

Administrative Simplicity: The federal income tax code is very complex and the state code follows the federal code, lowering the administrative burdens for both the taxpayer and the state as compared to what it would be if the state did not follow the federal code.

Adequacy: In a progressive tax structure, inflation generally results in bracket creep so that in times of high inflation, revenues may grow rapidly. Given the limited number of tax brackets and that all taxpayers with taxable income (similar to their federal taxable income) of $9000 or more pay at the highest rate of 6%, bracket creep is not a factor in Missouri. In an economic downturn, wages and salaries of the workers most subject to tax (the lowest income workers do not pay the tax) do not decrease dramatically. Unearned income, however, may decrease dramatically resulting in lower tax revenues as occurred with the recent decrease in stock prices. Changes in the federal individual income tax code can also affect the adequacy of state revenues by automatically reducing state tax collections.

Equity or fairness: Among the lowest four family income levels, constituting 80% of Missouri taxpayers, families of higher incomes pay a higher percentage of their income in income tax than do families with lower incomes, evidence of a moderately progressive tax system. The highest income families, however, pay a lower percentage of their income in taxes than do families with incomes of $41,000 to $67,000 (Table 2).

Sales and Use Taxes

State sales taxes and exemptions to those taxes, are set out in Chapter 144, RSMo. Missouri's sales tax rate is 4.225%, of which 3% is allocated to general revenue.[5]

Economic efficiency: The general sales tax is based on consumer goods. There are a significant number of exemptions, the most important of which is an exemption for unprepared foods for

[5] One percent is dedicated to education ("Proposition C" revenues), .125% provides moneys for the Department of Conservation, and .1% finances state parks and soil and water conservation projects.

home use.[6] These exemptions do reduce the efficiency of the tax in a small way. The state taxes a limited number of services, such as amusement services, lodging, rentals, and intrastate transportation. Because there are few taxes on services, the sales tax base for services is very narrow, so narrow in fact that avoidance may not have major efficiency impacts.

Businesses also pay sales tax on purchases, excluding raw materials and machinery and equipment used in farming, manufacturing, and residential utilities. Businesses may react in a similar manner as consumers, substituting untaxed goods and services for taxed goods and services. Given the broader range of exemptions, it is possible for firms' decisions to be influenced by what is taxed and what is not. An example would be the firm doing its own distribution within the state to avoid the tax on intrastate transportation.

Economic competitiveness: Except along state borders, individuals generally do not physically cross state lines to make purchases outside of the state to avoid the higher sales taxes. Missouri has the lowest state sales tax rate of the eight states that it borders. Local government sales tax rates added to the state rate could, in come cases, exceed the rate in bordering states. The main concern is whether the rates in St Louis and Kansas City exceed the rates of their sister cities. Both Kansas and Illinois do allow local option sales taxes. Thus, the economic competitiveness of businesses that sell directly to consumers generally is not adversely affected.

A broader competitive issue is the ability of state firms to compete with Internet sales, which, like catalog sales, currently do not pay sales tax if the seller does not have nexus in the state. Internet sales are a small (1.1% of retail sales) but a growing component of sales and the exclusion of such sales from taxation narrows the tax base. Catalog and internet companies do pay sales taxes in states where they have a physical presence. The larger issue may be the business to business transactions via the internet that are not taxed. The state has a use tax to be paid for the use of items purchased out of state, but the ability of the state to enforce this tax is limited.

Administrative simplicity: Consumers understand the sales tax, are readily aware of the tax on any given purchase, and easily comply with the tax. Consumers, however, are not aware of the annual total sales tax they pay and businesses sometimes complain about having to be tax collectors. Administration is complex both because of definitions of taxable and non-taxable items and because of the large number of exemptions. In addition, local governments have been given new sales tax options, which increase the state's administrative duties in the collection and remittance of local sales taxes.

Adequacy: The adequacy of the sales tax is an issue because sales tax revenues respond to the economic cycle, turning down as the economy slows. Several changes in the economy and consumer preferences are affecting the adequacy of sales tax revenues and will become more important in the future. The partial exemption for food also lowered sales tax revenues by approximately $250 million per year. Retail sales are being lost to the Internet where sales taxes currently are not collected on all sales. In addition, consumers are spending more on services, which are generally not subject to sales tax. All of these factors have contributed to a decline in

[6] For sales tax exemptions, see Chapter 144, RSMo, generally, and for a recent analysis see Claire McCaskill, Department of Revenue, Division of Taxation and Collection, Sales and Use Tax, Two Years Ending June 30, 2002, Report No. 2003-55, released June 26, 2003. Use taxes are taxes imposed on purchases made out-of-state, other than Internet purchases.

sales tax revenues as a percentage of Gross State Product. Changes in the sales tax rate are subject to the provisions of the Hancock amendment, making it very difficult to increase the tax in times of rapid economic adjustment.[7]

Equity or fairness: People with higher incomes pay a lower percentage of their income in sales tax. Hence, the sales tax is regressive with regard to income (Table 2), a pattern that is consistent with that found in other states.

Corporate Income Tax

The corporate income tax can be found in Chapter 143, RSMo.

Efficiency: The complexity of the federal tax code provides incentives for firms to make decisions with an eye to minimizing their taxes. Additional provisions of the state code further encourage firms to change decisions in order to minimize taxes. Consequently, the tax, as currently instituted, is not efficient.

Competitiveness: The Missouri corporate income tax burden is relatively lowest in the nation for states that have a corporate income tax and thus, the lowest among the state's neighbors. The competitive impact on incorporated businesses will be influenced by the combination of the corporate franchise tax and the corporate income tax. Missouri ranks low nationally on the combination of the two taxes, with Iowa and Oklahoma ranking just below it and Nebraska ranking lowest of the neighboring states. The tax should not affect the ability of businesses to compete with those in other states.

Administrative Simplicity: The federal corporate income tax code is very complex. Because the state code follows the federal, the additional administrative burdens for both the taxpayer and the state are lower than they would be if the state did not follow the federal code. Additional provisions in the state code do increase the administrative complexity for business and for the state.

Adequacy: Changes in both the federal and state corporate income tax code have reduced the amount of revenue generated by the tax.

Equity or fairness: Even though this tax is directly paid by corporations, all taxes are ultimately indirectly paid by individuals who own corporations through the stocks they hold and in the form of lower dividends. Corporate income taxes are progressive. That is, higher income families pay a higher percentage of their income in corporate income taxes than do lower income families (Table 2).[8]

[7] Article X, Section 18 (c) of the Missouri Constitution requires voter approval for tax increases greater than $50 Million, adjusted for inflation. Currently that threshold is approximately $75 M.
[8] Stallmann, J. I. (2004). *Evaluating Tax Systems,* Report 17-2004. Retrieved [Month, Day, Year], from University of Missouri System, Missouri Legislative Academy Web site: http://www.truman.missouri.edu/ipp/mla/publications/publications.htm and Phares, D. (1980). Who Pays State and Local Taxes? Cambridge, MA: Oelgaschlager, Gunn & Huin.

Motor Fuels Tax

The Missouri motor fuels tax is an excise tax as are taxes on liquor and tobacco.[9] Missouri's tax on motor fuels is currently seventeen cents per gallon, and has been in effect since 1996.[10]

Economic efficiency: This tax applies to all businesses and individuals who use gasoline and/or diesel. Increases in price due to taxes have little effect on fuel consumption in the short term because alternatives to fossil fuel-burning vehicles are currently limited. In the longer run, people decrease fuel consumption by buying smaller or more fuel efficient cars and traveling less. Higher fuel prices caused by taxes may create incentives for the development and use of alternative fuels. Thus the tax might have the indirect effect of reducing pollution from the use of fossil fuels.

Economic competitiveness: Among Missouri's neighbors, only Kentucky has a lower tax on gasoline. As a result, individuals and businesses are not likely to cross state lines to avoid the tax. Missouri also ranks low in the nation on this tax, so the state should be competitive for business.

Administrative simplicity: The consumer is aware of and understands the tax, but most consumers are not aware of the tax per gallon nor the annual total taxes paid. The tax is relatively easy to administer.

Adequacy: Tax revenues do not vary greatly in the short run because of inelastic demand, but the tax rate is a fixed amount per gallon, so that it does not keep pace with inflation. The tax rate can be increased only with voter approval, as provided in the Hancock amendment.

Equity or fairness: In general, those with less income pay a higher percentage of their income in motor fuels tax than do those with higher incomes. The motor fuels tax is regressive as are excise taxes in general (Table 2).

Missouri's Tax System

Table 1 summarizes the narrative information presented above to provide an overview of how Missouri's various taxes perform on each of the five measures. It should be noted that no state performs well on all measures and no tax meets all of the criteria used here. Missouri does best with measures of competitiveness because its taxes are comparatively low. The state does least well with respect to adequacy because all revenue sources are responsive to economic downturns. The state tax system also does not do well on equity.

[9] An excise tax is a tax based on the production, sale or consumption of a commodity.
[10] See Chapter 142, Revised Statutes of Missouri for provisions of law pertaining to gasoline taxes.

Table 1

Summary Evaluation of Major Missouri State Taxes

	Efficiency	Competitiveness	Administrative	Adequacy	Equity
Sales and Use Tax	Generally efficient on consumer goods Inefficent for firms	Little negative impact for consumer goods	Simple for consumers more complex for business Use tax difficult	No—follows business cycle and does not capture changing purchase patterns	Regressive
Motor Fuels, Alcohol & Tobacco	Efficient	No negative impact	Simple	Falls behind in times of inflation	Regressive
Corporate Income	Inefficient	Little negative impact	Complexity added by state provisions	Not in downturn	Progressive
Individual Income	Inefficient	No negative impact	Complexity added by state provisions	Not in downturn, especially due to fall in unearned incomes	Limited progressive

Table 2 shows the incidence of Missouri sales and income taxes on five family income categories. The sales tax is regressive in that those in the lower income brackets pay a higher proportion of their income in taxes than those in the upper income brackets. The Missouri individual income tax is progressive for all income brackets except the very highest. The top 20% of Missouri families pay slightly less in income taxes, proportionally, than the next highest 20%, but more than those in the three lowest income categories. When all state taxes are added together, the lowest income families pay a higher percentage of their income in taxes than do the higher income families.

Table 2

Percentage of Missouri Income Paid in State Taxes by Family Income Level

Family Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Top 20%
Income Range	Less than $15,000	$15,000-25,000	$25,000-41,000	$41,000-67,000	$67,000 or more
Average Income in Group	$8,900	$19,900	$32,900	$52,800	$132,755
Total Sales & Excise Taxes	7.1	6	4.9	4.2	2.8
General Sales—Individuals	4.1	3.7	3.2	2.7	1.8
Other Sales & Excise—Ind.	1	0.7	0.5	0.4	0.3
Sales & Excise on Business	2	1.6	1.3	1.1	0.7
Total Income Taxes	0.5	1.4	2.1	2.7	2.6
Personal Income Tax	0.5	1.5	2.3	3.2	3.9
Federal Deduction Offset*	0	-0.1	-0.2	-0.5	-1.3
Total State Taxes	7.6	7.4	7	6.9	5.4

* A taxpayer can deduct, from their income, the amount that they paid in federal income taxes for that year.

Source: Adapted from McIntyre, Robert S., Robert Denk, Norton Francis, Matthew Gardner, Will Gomaa, Fiona Hsu, and Richard Sims. “Who Pays? A Distributional Analysis of the Tax System in All 50 States.” Washington, D.C.: Institute on Taxation and Economic Policy. January, 2003. www.itepnet.org

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