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The Impact of Imposing a "Flat Tax" on Missouri Personal Income

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The Missouri personal income tax currently applies a graduated rate structure with tax rates ranging from 1.5 percent to 6 percent of income. This rate structure is applied to a tax base that starts with federal adjusted gross income, but allows a series of special deductions and exemptions that allow some Missourians to reduce their taxable income. One proposal for simplifying the Missouri income tax, Senate Bill 27, would eliminate almost all exemptions and deductions and conform more closely to federal adjusted gross income, and would apply a flat rate of 4 percent to all Missouri taxable income. This analysis estimates the distributional impact of this proposal.

Senate Bill 27 would eliminate a host of Missouri tax exemptions, including:

- The state's deduction for federal income taxes paid, which is currently capped at $5,000 per taxpayer.
- The exclusion for pension benefits, currently capped at $6,000.
- All itemized deductions.

The bill would also replace the current standard deduction and personal exemption with a single deduction of $10,000 for single taxpayers, $15,000 for heads of household and $20,000 for married couples. The following chart shows the distributional impact of these provisions.

Impact of SB 27 "Flat Tax" on Missouri Personal Income Tax Burdens By Income Level

All Missouri Taxpayers, 2002

2002 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%	**ADDENDUM**
Income Range	Less Than $14,000	$14,000 – $25,000	$25,000 – $42,000	$42,000 – $67,000	$67,000 – $123,000	$123,000 – $282,000	$282,000 – Or More	Total Tax Change 2002
Average Income in Group	$9,000	$19,700	$33,200	$53,100	$87,000	$171,400	$773,900	
State Tax Change Only								
Tax Change as a % of Income	–0.1%	–0.2%	–0.4%	–0.6%	–0.8%	–1.0%	–1.4%	
$ Average Tax Change	$ –9	$ –46	$ –122	$ –345	$ –654	$ –1,666	$ –10,971	$ –994,000,000
% of Total Tax Cut	0.5%	2.3%	6.5%	17.9%	25.7%	17.5%	29.7%	

SOURCE: *Institute on Taxation and Economic Policy Microsimulation Tax Model, January 2003*

The analysis shows that:

- The largest benefits from this proposal would accrue to the wealthiest Missourians, both in absolute dollar amounts and as a share of income. The wealthiest 1 percent of Missourians—those earning over $282,000 in 2002—would realize an average state tax cut of almost $11,000 from this proposal.

- The wealthiest 1 percent would collectively realize almost 30 percent of the benefits from this proposal.
- The lowest-income Missourians—those earning less than $14,000 in 2002—would receive an average tax cut of $9 from the proposal, and would collectively receive just 0.5% of the benefits from the proposal.

This proposal would also have a substantial impact on the *federal* income taxes paid by Missourians. This is because Missouri taxpayers who itemize their federal income tax returns are allowed to write off their state income taxes. Any cut in state income taxes that affects itemizers will therefore reduce the amount of itemized deductions Missourians can claim on their federal return—and will increase the overall federal tax burden on Missourians. ITEP estimates that this "federal offset" effect would increase federal taxes paid by Missourians by about $200 million if this proposal were implemented in 2002—meaning that roughly 20 percent of the tax cuts under this proposal would never be realized by Missourians, but would be collected directly by the federal government in the form of higher federal income taxes for Missourians. This effect is especially pronounced for wealthier Missourians who are more likely to itemize their federal income taxes and who pay at higher marginal tax rates. For the wealthiest 1 percent of Missouri taxpayers, more than 38 percent of the Missouri tax cuts from this proposal would be immediately offset by federal income tax hikes.

About ITEP: *ITEP is one of the leading research and education organizations in the country working on government taxation and spending policy. Since its founding in 1980, ITEP's work has played a key role in educating the public and informing federal and state tax policy. ITEP's website is http://www.itepnet.org*

The analysis presented here was conducted using the ITEP microsimulation tax model. Since 1996 ITEP has used this model to conduct research on federal, state, and local tax systems. A microsimulation model uses a large sample of tax returns and other data that is extrapolated to the year being analyzed. This is the type of tax model used by the U.S. Treasury Department, the Congressional Joint Committee on Taxation, the Congressional Budget Office, and many state revenue departments. A properly constructed microsimulation model can provide accurate estimates of revenue yield and tax incidence by income group.

ITEP's microsimulation model relies on one of the largest databases of tax returns and supplementary data in existence, encompassing close to 750,000 records. Included in the sample are federal tax returns, with statistically valid samples from every state and the District of Columbia. A sampling of records from the U.S. Decennial Census five percent sample (which contains a random sample of five percent of all census forms received by the Census Bureau) are also included, and statistically matched with the tax return records. Other data sets are used to impute detailed expenditures for each record and other information. The data on the records is extrapolated to subsequent years using federal tax micro and tabular data, Census Bureau Current Population Survey micro and tabular data, and government and other widely respected macro data sources.(A complete description and methodology for the ITEP model is available on request.)