

Approved

1/27/87

Minutes of the House Committee on Taxation. The meeting was called to order by E. C. Rolfs, Chairman, at 9:00 a.m. on January 22, in room 519-S of the Capitol of the State of Kansas.

All members of the Committee were present except: Representatives  
Crowell and Pottorff  
(excused)

Committee Staff Present: Tom Severn, Legislative research  
Chris Courtright, Legislative Research  
Don Hayward, Revisor of Statutes  
Millie Foose, Committee Secretary

Richard Ryan, Legislative Research Department, gave a presentation on the health of the state economy. (Attachment 1)

Mr. Ryan said the figures and comparisons were as nearly correct as possible, but he emphasized that there are many reasons why the figures may be changed in March when they will again be reviewed by the Division of the Budget and Kansas Legislative Research Department.

Several members of the committee questioned Mr. Ryan about the accuracy of the figures and asked him why they could not be more accurate. He explained that it is not always possible to accurately predict economic growth or a recession.

Mr. Ryan said that the Consensus Estimating Group does not believe that tax reform will have a large positive or negative effect on the economy, but there is disagreement among some economists as to how the new federal law will impact the economy in general.

Mr. Ryan also emphasized that the estimates of additional revenues to Kansas resulting from federal tax reform should be viewed only as approximations and used very cautiously during the 1987 legislative session when considering General Fund Finances.

The Consensus Estimating Group will meet again in March 1987 and will review all the economic forecasts outlined in Mr. Ryan's presentation, as well as the trend of actual receipts to the General Fund in FY 1987. The revenue estimates will then be raised or lowered if there have been significant changes in the economic outlook. Mr. Ryan said he would give the Committee additional information at that time if requested.

There being no further business to come before the committee, the meeting was adjourned.

  
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Ed C. Rolfs, Chairman

MEMORANDUM

November 7, 1986

TO: Governor John Carlin, Governor-Elect Mike Hayden,  
and Legislative Budget Committee

FROM: Division of the Budget and Kansas Legislative  
Research Department

RE: State General Fund Receipts

ESTIMATES FOR FY 1987 (REVISED) AND FY 1988

For the 13th consecutive year, the Division of the Budget and its consulting economists,\* the Department of Revenue, and the Legislative Research Department have cooperated in the preparation of estimated receipts to the State General Fund. The economists and staff members of the three agencies met on November 6, 1986 to discuss estimates that each of them had prepared independently for FY 1987 (revised estimates) and FY 1988. The "consensus estimates" agreed upon at that meeting are presented in Table I along with actual receipts in FY 1986. Table II compares the last preceding estimates and the current revised estimates for FY 1987.

To provide some perspective concerning the consensus estimates, tabulated on the following page are the original and revised estimates and actual receipts in the 12 preceding fiscal years, 1975-1986. The current estimating procedure began in the Fall of 1974 with the revised estimate for FY 1975.

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\* Dr. Darwin Daicoff from KU, Dr. Jarvin Emerson from KSU, and Dr. Glenn Fisher from WSU. In addition, Fred Rice of the Department of Human Resources, Moe Johnson of the U.S. Department of Agriculture, and Lyell Ocobock of the Pooled Money Investment Board staff were consultants regarding employment, farm income, and short-term interest rate trends, respectively.

STATE GENERAL FUND REVENUE ESTIMATES

Dollar Amounts are in Millions

Fiscal Year	Adj. Original Estimate <sup>1</sup>	Final Estimate <sup>2</sup>	Actual Receipts	Difference Between Actual Receipts and Adj. Original Est.		Difference Between Actual Receipts and Final Estimate	
				Amount	Percent	Amount	Percent
1975	--	\$ 614.9 <sup>a</sup>	\$ 627.6	--	--	\$ 12.7	2.1%
1976	676.3	699.7	701.2	\$ 24.9	3.7%	1.4	0.2
1977	760.2	760.7	776.5	16.3	2.1	15.8	2.1
1978	830.1	861.2	854.6	24.5	3.0	(6.5)	(0.8)
1979	945.2	1,019.3	1,006.8	61.6	6.5	(12.5)	(1.2)
1980	1,019.3	1,095.9	1,097.8	78.5	7.7	1.9	0.2
1981	1,197.1	1,226.4	1,226.5	29.4	2.5	0.1	0.01
1982	1,351.3	1,320.0	1,273.0	(78.3)	(5.8)	(47.0)	(3.6)
1983	1,599.2	1,366.9	1,363.6	(235.6)	(14.7)	(3.2)	(0.24)
1984	1,596.7	1,539.0	1,546.9	(49.8)	(3.1)	7.9	0.5
1985	1,697.7	1,679.7	1,658.5	(39.2)	(2.3)	(21.3)	(1.3)
1986	1,731.2	1,666.4	1,641.4	(89.8)	(5.2)	(25.0)	(1.5)

1. The original estimate made in November or December prior to the start of the next fiscal year in July was adjusted to account for legislation enacted which affected receipts to the General Fund.
2. The adjusted original estimate plus or minus changes subsequently made by the Consensus Estimating Group. The final estimate also includes the estimated impact of legislation on receipts.
  - a) The first estimate of the Consensus Estimating Group was the revised estimate for FY 1975.

Except for the last five fiscal years, actual receipts were always higher than the original estimate, ranging from 2.1 percent to 7.7 percent. Receipts in FYs 1982-1986 ranged between 2.3 percent and 14.7 percent lower than the original estimate. As might be expected, there has been a smaller difference between actual receipts and the final estimate, ranging from only one-hundredth of one percent to 3.6 percent. Also, it will be noted that in half of the 12 fiscal years, including four of the last five, actual receipts were below the final estimate.

Economic Forecasts

Listed below are certain economic forecasts which, among other things such as actual receipts in FY 1986 and in FY 1987 through October, were considered in making the revenue estimates.

1. Kansas personal income (growth rate)	Actual CY 1985 5.9%	Est. CY 1986 4.0%	Est. CY 1987 3.9%
2. Rate of inflation (CPI-U)	Actual CY 1985 3.6%	Est. CY 1986 2.0%	Est. CY 1987 3.5%
3. Kansas unemployment rate	Actual FY 1986 5.2%	Est. FY 1987 5.4%	Est. FY 1988 5.4%
4. Kansas total employment (growth rate)	Actual FY 1986 1.3%	Est. FY 1987 0.4%	Est. FY 1988 0.9%
5. Short-term interest rates (avg.) 91-day Treasury bills Federal Funds	Actual CY 1985 7.48% 8.10%	Est. CY 1986 6.0% 6.7%	Est. CY 1987 5.3% 5.7%
6. Crude Oil and Natural Gas	Actual FY 1986	Est. FY 1987	Est. FY 1988
Oil prices (avg. per bbl.)	\$ 22.87	\$ 13.00	\$ 13.50
Oil production (taxable bbls.)	59,314,000	51,500,000	50,000,000
Gas prices (avg. per mcf)	\$ 1.23	\$ 1.15	\$ 1.10
Gas taxable value	\$600,195,000	\$516,868,000	\$491,618,000

In summary, the Consensus Estimating Group believes that there will be no national recession in FYs 1987 and 1988, but economic growth will be modest. The forecasts of Kansas personal income would be the lowest growth rates since 1969 except for a 3.6 percent increase in 1983; the next lowest increase was 5.9 percent in 1985. Inflation, as measured by the CPI-U, is expected to average 3.5 percent in CY 1987 after declining to 2.0 percent in CY 1986. The Kansas unemployment rate is estimated at 5.4 percent in both FYs 1987 and 1988, up slightly from FY 1986, while total employment in Kansas will grow only slightly in the current and next fiscal years, with the increases being less than in FY 1986. The forecast of short-term interest rates (annual averages) is that they will continue to decline in CYs 1986 and 1987, but this forecast hinges on the estimates of modest economic growth and relatively low inflation.

With respect to the outlook for Kansas crude oil and natural gas prices and production, the situation remains confusing and uncertain. Much will depend on what OPEC does. In October it extended its temporary production controls through December. No one knows what will happen when representatives of OPEC meet again in December of this year. There are both

gloomy and relatively optimistic forecasts, but several knowledgeable people in the Kansas industry contacted by the Consensus Estimating Group suggested a cautious approach in forecasting prices and production from now through FY 1988.

For oil, the revised forecast is that prices will average \$13.00 per barrel in FY 1987 and \$13.50 in FY 1988, down substantially from the FY 1986 average of \$22.87. Taxable production will decline from 59.3 million barrels in FY 1986 to 51.5 million in FY 1987 and 50.0 million in FY 1988, a decrease of about 16 percent over the two years. The price of gas, which is competitive with oil, also is estimated to decline -- from an average of \$1.23 per mcf in FY 1986 to \$1.15 in FY 1987 and \$1.10 in FY 1988. The taxable value of gas is estimated to drop from \$600.2 million in FY 1986 to \$516.9 million in FY 1987 and \$491.6 million in FY 1988, a decrease of 18.0 percent over the two years.

### Fiscal Year 1987

The current revised estimate of General Fund receipts in FY 1987 is \$1.765 billion, which is \$93.6 million, or 5.0 percent, less than the last revised estimate. Table II shows the details of the current and last estimates. Receipts from most of the big revenue producers (individual and corporation income taxes, sales and use taxes, and the severance tax) have been reduced significantly.

The individual income tax estimate includes \$12.0 million as a result of federal tax reform. The estimate for the financial institutions privilege tax includes a one-time payment of \$8.0 million which will be offset as an operating loss in FY 1988. Revenue from the insurance premium taxes is only slightly more than actual collections in FY 1986, but in that year there was an unusually large amount of retaliatory tax collected.

### Fiscal Year 1988

The estimate of receipts in FY 1988 is \$1.947 billion, which is \$182.1 million, or 10.3 percent, more than the current revised estimate for FY 1987. However, the estimate for FY 1988 includes \$143.0 million in additional individual income tax receipts as a consequence of federal tax reform. Ignoring the estimated effects of tax reform in both FYs 1987 and 1988, General Fund receipts in FY 1988 would be \$51.1 million, or 2.9 percent, over FY 1987.

It will be noted that the estimate for the privilege tax on financial institutions is much less than the revised estimate for FY 1987. As noted above, there was a large, one-time payment in FY 1987 and it is assumed that a corresponding amount will have to be refunded in FY 1988.

### Impact of Federal Tax Reform

As usual, the Consensus Estimating Group made its estimates based on current federal and state tax laws. Because the Kansas individual and corporation income tax statutes conform with the federal law in many particulars, the new federal "tax reform" legislation will have a positive impact on

Kansas revenue. The amount of that impact, however, is very difficult to estimate, for at least the following reasons:

1. While the Consensus Estimating Group does not believe that tax reform will have a large positive or negative effect on the economy, there is nonetheless disagreement among some prominent economists as to how the new federal law will impact the economy in general, particularly business investment, to say nothing about what the impact might be in any one state.

2. It is not known how taxpayer behavior will be affected by the new law. For instance, what will the effect be of repealing the investment tax credit and tightening depreciation allowances on business investment, of changing taxation of capital gains to the earned income or normal tax rate, of restricting the deduction of the annual deposits in individual retirement accounts, and of eliminating or curtailing certain tax shelters but not others?

3. The Department of Revenue has made estimates of the impact of the federal legislation on Kansas individual income tax revenue based on a simulation model consisting of a random sample of 10,000 (about one percent) 1983 Kansas returns filed in 1984. The 1983 data were inflated to 1986 levels by estimating what the growth in items of income and expenses was between 1983 and 1986, but it is recognized that those estimates could be off the mark. Furthermore, while the model itself makes no adjustment for taxpayer behavioral changes that might result from federal tax reform or that have occurred since 1983, the Department made adjustments based on assumptions which might or might not be valid concerning taxpayer actions with respect to capital gains and tax sheltering, e.g., IRAs. Due to lack of data, some significant changes in the federal law, such as limitations on passive losses, could not be included in the model.

4. The Department of Revenue's model projected the impact of federal tax reform for tax years 1987 and 1988. Then, the estimates had to be translated into the state's fiscal year which presents the problem of determining how much net additional revenue will be received in the period July 1-June 30.

5. For the corporation income tax, the Department of Revenue has no model corresponding to the one for the individual income tax.

For the above reasons, and undoubtedly more, the estimates of additional revenue to Kansas resulting from federal tax reform should be viewed only as approximations and used very cautiously during the 1987 legislative session when considering General Fund finances.

Individual Income Tax. The Department of Revenue's model, using assumptions about growth rates in income and expenses since 1983 and as adjusted as noted above, projects additional individual income tax revenue for tax year 1987 at \$105 million, and for tax year 1988 at \$125 million. On a fiscal year basis, the projections are \$12.0 million for 1987 and \$143 million for 1988, and these amounts are included in the consensus estimates to reflect the impact of federal tax reform.

Corporation Income Tax. The consensus estimates of corporation income taxes include no revenue due to federal tax reform. As previously noted, the Department of Revenue has no corporation income tax model. Estimates

based on Congressional projections of the increase in federal corporation income tax liability indicate that the impact on Kansas would be relatively small. Moreover, the timing of any increase in Kansas revenue on a fiscal year basis is very difficult to determine.

Concluding Comment

When the Consensus Estimating Group meets again in March 1987, it will review all of the economic forecasts discussed herein as well as the trend of actual receipts to the General Fund in FY 1987. The revenue estimates will then be raised or lowered if there have been significant changes in the economic outlook and revenue expectations since the estimates were made in November to warrant a revision.

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TABLE I

## STATE GENERAL FUND RECEIPTS

In Thousands

	Actual FY 1986		Consensus Estimates, November 6, 1986			
			FY 1987 (Revised)		FY 1988	
	Amount	% Increase	Amount	% Increase	Amount	% Increase
Property Tax:						
Motor Carriers	\$ 8,060	21.3%	\$10,300	27.8%	\$ 9,500	(7.8)%
Income and Privilege Taxes:						
Individual	582,158	(3.5) <sup>a</sup>	612,000	5.1%	773,000	26.3
Corporation	135,818	(4.3)	110,000	(19.0)	130,000	18.2
Financial Institutions	17,105	23.0	26,000	52.0	10,000	(61.5)
Domestic Insurance Cos.	321	47.9	275	(14.3)	350	27.3
Total	<u>735,402</u>	<u>(3.2)</u>	<u>748,275</u>	<u>1.8</u>	<u>913,350</u>	<u>22.1</u>
Inheritance Tax	32,360	8.5	33,000	2.0	32,000	(3.0)
Excise Taxes:						
Retail Sales	489,592	2.3	633,000	29.3	655,000	3.5
Compensating Use	71,126	4.3	93,000	30.8	96,000	3.2
Cigarette	58,059	33.1 <sup>b</sup>	61,000	5.1	59,000	(3.3)
Tobacco Products	1,289	3.6	1,400	8.6	1,400	0.0
Cereal Malt Bev.	4,622	(8.9)	4,100	(11.3)	3,800	(7.3)
Liquor Gallonage	11,248	(1.9)	11,200	(0.4)	11,200	0.0
Liquor Enforcement	17,743	4.3	18,500	4.3	19,000	2.7
Private Clubs	2,619	18.7	2,700	3.1	2,700	0.0
Corporation Franchise	8,342	4.5	8,800	5.5	9,200	4.5
Severance	92,010	(9.2)	61,600	(33.1)	60,200	(2.3)
Total	<u>756,651</u>	<u>2.7</u>	<u>895,300</u>	<u>18.3</u>	<u>917,500</u>	<u>2.5</u>
Other Taxes:						
Insurance Premium	60,679	(14.1)	61,000	0.5	66,500	9.0
Bingo Enforcement	247	(8.5)	265	7.3	260	(1.9)
Miscellaneous	1,109	(9.0)	1,100	(0.8)	1,100	0.0
Total	<u>62,036</u>	<u>(13.9)</u>	<u>62,365</u>	<u>0.5</u>	<u>67,860</u>	<u>8.8</u>
Total Taxes	<u>1,594,510</u>	<u>(0.6)</u>	<u>1,749,240</u>	<u>9.7</u>	<u>1,940,210</u>	<u>10.9</u>
Other Revenue:						
Interest	42,168	(16.3)	33,000	(21.7)	28,100	(14.8)
Transfers (net)	(29,255)	6.5	(50,375)	(72.2)	(55,844)	(10.9)
Agency Earnings and Miscellaneous	34,006	(1.2)	33,000	(3.0)	34,500	4.5
Total	<u>46,919</u>	<u>(12.3)</u>	<u>15,625</u>	<u>(66.7)</u>	<u>6,756</u>	<u>(56.8)</u>
GRAND TOTAL	\$1,641,429	(1.0)%	\$1,764,865	7.5%	\$1,946,966	10.3%

a) Temporary limitation on deductibility of federal income tax expired in tax year 1984 (FY 1985).

b) Tax rate was increased by 50 percent, effective 10/1/85.



TABLE II

GENERAL FUND RECEIPTS -- COMPARISON OF THE LAST PRECEDING  
AND THE CURRENT REVISED ESTIMATES, FY 1987

	<u>In Thousands</u>		
	<u>Last Estimate*</u>	<u>Current Revised Estimate</u>	<u>Difference</u>
Property Tax:			
Motor Carriers	\$ 8,700	\$ 10,300	\$ 1,800
Income and Privilege Taxes:			
Individual	644,125	612,000	(32,125)
Corporation	137,000	110,000	(27,000)
Financial Institutions	15,375	26,000	10,625
Domestic Insurance Cos.	400	275	(125)
Total	<u>796,900</u>	<u>748,275</u>	<u>(48,625)</u>
Inheritance Tax	31,000	33,000	2,000
Excise Taxes:			
Retail Sales	666,120	633,000	(33,120)
Compensating Use	95,810	93,000	(2,810)
Cigarette	59,000	61,000	2,000
Tobacco Products	1,400	1,400	0
Cereal Malt Bev.	4,000	4,100	100
Liquor Gallonage	11,200	11,200	0
Liquor Enforcement	18,500	18,500	0
Private Clubs	2,600	2,700	100
Corporation Franchise	8,700	8,800	100
Severance	70,600	61,600	(9,000)
Total	<u>937,930</u>	<u>895,300</u>	<u>(42,630)</u>
Other Taxes:			
Insurance Premium	64,200	61,000	(3,200)
Bingo Enforcement	265	265	0
Miscellaneous	1,325	1,100	(225)
Total	<u>65,790</u>	<u>62,365</u>	<u>(3,425)</u>
Total Taxes	<u>1,840,320</u>	<u>1,749,240</u>	<u>(91,080)</u>
Other Revenue:			
Interest	34,000	33,000	(1,000)
Transfers (net)	(49,846)	(50,375)	(529)
Agency Earnings and Miscellaneous	33,995	33,000	(995)
Total	<u>18,149</u>	<u>15,625</u>	<u>(2,524)</u>
GRAND TOTAL	<u>\$ 1,858,469</u>	<u>\$ 1,764,865</u>	<u>\$ (93,604)</u>

\* Estimates made on March 31, 1986, adjusted after the 1986 legislative session to account for the effect on receipts of legislation enacted.

NOTE: Details may not add to totals due to rounding.