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Steven J. Anderson, CPA, MBA, Director

Sam Brownback, Governor

March 7, 2012

The Honorable Richard Carlson, Chairperson
House Committee on Taxation
Statehouse, Room 274-W
Topeka, Kansas 66612

Dear Representative Carlson:

SUBJECT: Fiscal Note for HB 2667 by House Committee on Taxation

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2667 is respectfully submitted to your committee.

HB 2667 is a comprehensive tax proposal that would affect retail sales, individual income, and corporate income taxes. Specifically, the bill would make the following tax policy changes:

1. Lower the individual income tax rates each year in tax years 2012 and 2014;

2. Lower the corporate normal income tax rates in each year in tax years 2012 and 2013;

3. Raise slightly the corporate surtax income tax rate in tax year 2011 and then lower the rates in tax years 2012 and 2013;

4. Begin collecting state and local retail sales and compensating use taxes on digital products and most services, except for services purchased by a business, on January 1, 2013;

5. Lower the state retail sales and compensating use tax rates to 5.3 percent effective January 1, 2013, and adjust the distribution of revenue between the State General Fund and the State Highway Fund;

6. Lower the state retail sales and compensating use tax rate to 3.15 percent effective January 1, 2013 for all sales of food and food ingredients. All sales of food and food ingredients would be exempt from all sales taxes beginning on January 1, 2014 and the Food Sales Tax Refund Program would be repealed as of January 1, 2013;

7. Remove a number of specific sales tax exemptions that exist in current law. Some of the exemptions that would be removed include: coin operated laundry services; customized computer software; labor services for construction; residential utilities; bingo cards;

charitable organizations that are listed by name; and purchases made by the federal government, State of Kansas, local governments, schools, and educational institutions; and

8. Require the Secretary of Revenue to certify the amount of additional retail sales tax and compensating use taxes that are collected by local governments as a result of this bill. The bill requires that at least 30.0 percent of the additional revenues would be used to reduce local property taxes.

The Department of Revenue estimates that HB 2667 would increase state revenues by a net of $19,740,000 in FY 2013. Of that total, the State General Fund is estimated to increase by $2,450,000 in FY 2013, while the State Highway Fund is estimated to increase by $17,290,000 in FY 2013. This bill is estimated to increase local sales tax revenues in FY 2013. The increase in revenues and how the November 4, 2011 consensus revenue estimate for FY 2013 would be affected are shown in the following table:

Effect on FY 2013 Consensus Revenue Estimates
(Dollars in Thousands)

Receipt Description	Consensus Revenue Estimates (Nov. 4, 2011)	Change in Revenue FY 2013	Proposed Adjusted CRE FY 2013
Motor Carrier	$ 21,000	$ --	$ 21,000
Income Taxes:			
Individual	3,065,000	(124,400)	2,940,600
Corporate	240,000	(60,000)	180,000
Financial Institutions	24,000	--	24,000
Excise Taxes:			
Retail Sales	2,200,000	162,158	2,362,158
Compensating Use	335,000	24,692	359,692
Cigarette	92,000	--	92,000
Corporate Franchise	6,000	--	6,000
Severance	102,800	--	102,800
All Other Excise Taxes	96,000	--	96,000
Other Taxes	141,000	--	141,000
Total Taxes	$6,322,800	$ 2,450	$6,325,250
Other Revenues:			
Interest	$ 7,400	$ --	$ 7,400
Transfers	(90,300)	--	(90,300)
Agency Earnings	51,500	--	51,500
Total Other Revenues	($ 31,400)	$ --	($ 31,400)
Total Receipts	$6,291,400	$ 2,450	$6,293,850

The fiscal effect to state revenues during subsequent years would be as follows:

	FY 2014	FY 2015	FY 2016	FY 2017
State General Fund	$102,350,000	$105,960,000	$100,490,000	$117,340,000
State Highway Fund	36,130,000	53,840,000	55,810,000	57,960,000
	$138,480,000	$159,800,000	$156,300,000	$175,300,000

To formulate these estimates, the Department of Revenue reviewed data on retail sales and compensating use tax collections, sales tax exemptions, individual income tax collections, and corporate income tax collections. The Department of Revenue indicates that the bill would increase retail sales and compensating use tax collections by a total of $204,140,000 in FY 2013, including $186,850,000 to the State General Fund and $17,290,000 to the State Highway Fund by collecting additional revenue from repealing certain sales tax exemptions, imposing the retail sales tax on certain services, and by reducing the state sales tax rate. Lowering the individual income tax rates is estimated to decrease revenues by $177.4 million in FY 2013, which would partially be offset by a $53.0 million increase in individual income tax revenue from eliminating the Food Sales Tax Refund program that is administered through the income tax. Lowering the corporate income tax rate in FY 2013 is estimated to reduce receipts by $60.0 million. In FY 2014, the bill is estimated to increase retail sales and compensating use tax collections by a total of $426,780,000, including $390,650,000 to the State General Fund and $36,130,000 to the State Highway Fund. The bill would also decrease individual income tax collections by $163.3 million and decrease corporate income tax by $125.0 million in FY 2014.

The Department of Revenue indicates the bill would require $770,650 from the State General Fund in FY 2013 for administrative costs to implement the bill, including changes to forms and instructions, salaries and wages for 2.00 new FTE positions that would assist taxpayers with the changes that are being proposed, and to modify the automated tax system. The required programming for this bill by itself would be performed by existing staff of the Department of Revenue. However, if the combined effect of implementing this bill and other enacted legislation exceeds the Department's programming resources, or if the time for implementing the changes is too short, expenditures for outside contract programmer services beyond the Department's current budget may be required.

The Kansas Department of Transportation (KDOT) indicates the bill would reduce sales tax revenue dedicated to the State Highway Fund by $17,290,000 in FY 2013 and by $36,130,000 in FY 2014. It is estimated that sales tax revenue dedicated to the State Highway Fund would be increased, however, by a total of $412.6 million between FY 2013 and FY 2020. KDOT also indicates the bill would remove a sales tax exemption that it currently uses when purchasing contractual services, commodities, capital outlay, and capital improvements. KDOT indicates that removing the sales tax exemption would require it to pay sales tax on building materials, maintenance contracts, and engineering and drafting services. KDOT estimates that it would spend an additional $51.3 million from the State Highway Fund in FY 2013 for the additional costs associated with the removal of its current sales tax exemptions. The total increase in additional State Highway Fund expenditures for sales taxes between FY 2013 and FY

2020 is estimated to be $442.4 million. Offsetting the estimated increase in State Highway Fund revenues, the net fiscal effect would be a reduction to the State Highway Fund of approximately $29.8 million between FY 2013 and FY 2020.

The bill would increase costs for state agencies, local governments, schools, certain nonprofits groups, and other individuals and groups by removing current sales tax exemptions. The potential fiscal effect of requiring additional state expenditures to pay state and local retail sales taxes or providing reduced state services as a result of now being required to pay state and local retail sales taxes is not accounted for in this fiscal note. Any fiscal effect associated with HB 2667 is not reflected in *The FY 2013 Governor's Budget Report*.

The Kansas Association of Counties and the League of Kansas Municipalities indicate that the bill would increase expenditures by local governments by removing the sales tax exemption on all purchases of property and services made by local governments. The bill would also increase local sales tax revenue by collecting local sales taxes on sales of certain property and services that under current law is exempt from paying state and local retail sales taxes. However, the Kansas Association of Counties and the League of Kansas Municipalities are unable to estimate the net fiscal effect of this bill on local governments.

Sincerely,

Steven J. Anderson, CPA, MBA
Director of the Budget

cc: Steve Neske, Revenue
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