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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 2747 by House Committee on Taxation

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2747 is respectfully submitted to your committee.

HB 2747 would require that beginning in FY 2012, in any fiscal year in which the amount of selected actual State General Fund receipts exceeds the actual State General Fund receipts from the preceding year by more than 2.0 percent, then the Director of Legislative Research would certify the amount of excess to the Secretary of Revenue and Director of the Budget. Based on the excess percentage, the Secretary of Revenue would be required to calculate the income tax rate reductions that would go into effect for the next tax year that would reduce revenues in the following year by the amount certified. The rate reductions would be applied to reduce the middle rate by the excess percentage, the upper rate by the excess percentage less 0.5 percent, and the lower rate by the excess percentage plus 0.5 percent. In any calculation by the Secretary of Revenue in which an individual or corporation income tax rate for any income tax category or bracket is below 0.4 percent, then the rate would be zero. After the individual rates are reduced to zero, then the rate reductions would be applied to the following taxes in the following order until each rate is reduced to zero: surtax on corporations; normal tax on corporations; surtax on national banking associations, state banks, trust companies, and savings and loan associations; and normal tax on national banking associations, state banks, trust companies, and savings and loan association.

In any fiscal year when the amount of selected actual State General Fund receipts are 102.0 percent or less than the previous fiscal year, the Director of Legislative Research would be required to certify that amount to the Secretary of Revenue and the Director of the Budget; however, the Secretary of Revenue would not make any adjustment to income tax rates for that tax year. The selected State General Fund tax receipts include, individual and corporate income taxes, financial institutions privilege taxes, retail sales taxes, compensating use taxes, cigarette and tobacco products taxes, cereal malt beverage and liquor gallonage taxes, liquor enforcement taxes, liquor drink taxes, corporation franchise taxes and annual franchise fees, and mineral severance taxes.

The bill would add an additional 21 counties to the list of counties that are designated as Rural Opportunity Zones. The Rural Opportunity Zones Program was approved by the 2011 Legislature to help attract financial investment, business development, and job growth in rural areas of the state. The program offers individuals who relocate from outside the state to a county that has been designated as a Rural Opportunity Zone the opportunity to participate in a student loan forgiveness program and receive a 100.0 percent state income tax credit through tax year 2015. The additional counties designated in the bill include: Allen, Anderson, Bourbon, Brown, Chase, Cherokee, Clay, Coffey, Doniphan, Ellsworth, Grant, Haskell, Labette, Marshall, Meade, Morris, Nemaha, Neosho, Osage, Ottawa, and Rice.

The bill would phase out an exemption for all non-wage business income that businesses would otherwise report from state individual income taxes (as reported by LLCs, S-Corps, and sole proprietorships on lines 12, 17, and 18 of the federal form 1040 individual income tax return). The bill would allow the taxpayer to exempt up to $100,000 in non-wage business income for tax years 2013, 2014, and 2015; up to $250,000 for tax years 2016 and 2017; and would be exempt for tax year 2018 and each future tax year.

The bill would increase the standard deduction for head of household filers from $4,500 to $9,000. For residents who are in the state for only part of the year, the credit for taxes paid to another state would be allowed only for income that is included in Kansas adjusted gross income. The bill would reduce the Earned Income Tax Credit from 17.0 percent to 9.0 percent beginning in tax year 2014 and each future tax year. The bill would repeal the current two-year severance tax exemption on new pool oil and gas wells, except for oil wells generating 50 barrels or fewer per day.

The bill would make the following adjustments to the state retail sales and compensating use tax rates and distributions:

Date of Rate Change	Tax Rate	Percent to State General Fund	Percent to State Highway Fund
Current law	6.3 %	88.740 %	11.260 %
July 1, 2012	6.3	88.767	11.233
July 1, 2013	5.7	88.074	11.926
July 1, 2014	5.7	88.465	11.535
July 1, 2015	5.7	79.841	20.159
July 1, 2016	5.7	79.904	20.096
July 1, 2017	5.7	79.996	20.004
July 1, 2018	5.7	80.023	19.977
July 1, 2019	5.7	80.079	19.921
July 1, 2020	5.7	80.133	19.867
July 1, 2021	5.7	80.186	19.814
July 1, 2022	5.7	81.579	18.421

Under current law, the state retail sales and compensating use tax rates and distributions are set to be adjusted as follows:

Date of Rate Change	Tax Rate	Percent to State General Fund	Percent to State Highway Fund
Current law	6.3 %	88.740 %	11.260 %
July 1, 2012	6.3	88.767	11.233
July 1, 2013	5.7	81.579	18.421

Estimated State Fiscal Effect				
	FY 2012 SGF	FY 2012 All Funds	FY 2013 SGF	FY 2013 All Funds
Revenue	--	--	($41,700,000)	($41,700,000)
Expenditure	--	--	--	--
FTE Pos.	--	--	--	--

The Department of Revenue estimates that HB 2747 would decrease State General Fund revenues by $41.7 million in FY 2013. The decrease 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	(57,800)	3,007,200
Corporate	240,000	--	240,000
Financial Institutions	24,000	--	24,000
Excise Taxes:			
Retail Sales	2,200,000	--	2,200,000
Compensating Use	335,000	--	335,000
Cigarette	92,000	--	92,000
Corporate Franchise	6,000	--	6,000
Severance	102,800	16,100	118,900
All Other Excise Taxes	96,000	--	96,000
Other Taxes	141,000	--	141,000
Total Taxes	$6,322,800	($ 41,700)	$6,281,100
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	$6,291,400	($ 41,700)	$6,249,700

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

	FY 2014	FY 2015	FY 2016	FY 2017
State General Fund	($ 35,900,000)	($ 42,400,000)	($310,900,000)	($378,400,000)
State Highway Fund	(159,600,000)	(191,500,000)	50,200,000	50,200,000
	($195,500,000)	($233,900,000)	($260,700,000)	($328,200,000)

To formulate these estimates, the Department of Revenue reviewed data on current individual and corporate income tax collections, the amount of Earned Income Tax Credits claimed, sales and use tax collections, and severance tax collections. The Department estimates that reducing individual income tax rates, lowering the Earned Income Tax Credit, expanding the number of Rural Opportunity Zone counties, eliminating business income for taxpayers with federal adjusted gross income under $100,000, and increasing the head of household standard deduction beginning in tax year 2013 would reduce individual income tax liability by $57.8 million in the last part of FY 2013 and by $214.3 million in FY 2014. Eliminating the current two-year severance tax exemption on new pool oil and gas wells is estimated to generate $16.1 million in FY 2013 and $18.8 million in FY 2014.

The bill would not affect the current rates for the state retail sales and compensating use tax, but it would change how this money is distributed beginning in FY 2014. The State General Fund would receive an additional $159.6 million in FY 2014 and an additional $191.5 million in FY 2015. The State Highway Fund would receive corresponding reductions of the same amount for FY 2014 and FY 2015. Transfers to the State Highway Fund would increase by approximately $50.2 million in FY 2016 through FY 2022 in order to pay back the State Highway Funds by FY 2022 for the funds that were diverted in FY 2014 and FY 2015. The Department estimates that the bill would reduce State General Fund revenues by $41.7 million in FY 2013 ($16.1 million in additional severance taxes minus $57.8 million lower individual income taxes) and by $35.9 million in FY 2014 ($159.6 million in additional retail sales and compensating use taxes plus $18.8 million in additional severance taxes minus $214.3 million in lower individual income taxes).

The Department indicates that the administrative costs associated with implementing the bill would not occur until FY 2014. The Department indicates that the bill would require $156,240 from the State General Fund in FY 2014 to implement the bill and to modify the automated tax system. The required programming for this bill by itself (2,808 hours of in-house programming and 2,480 hours of implementation) 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 $159.6 million in FY 2013 and by $191.5 million in FY 2014. It is estimated that sales tax revenue dedicated to the State Highway Fund would be reduced by a total of $218.7 million between FY 2013 and FY 2017. KDOT indicates that the T-WORKS is planned to be completed in FY 2020; however, the bill continues to pay back State Highway Funds through FY 2022. KDOT also indicates that the bill would provide a total of $1,075,000 in lower dedicated sales tax revenue to the State Highway Fund from FY 2013 through FY 2022.

The Department of Commerce indicates that it is currently responsible for administering the Rural Opportunity Zones Program. The Department indicates that the administrative costs associated with reviewing additional applications from individuals that are proposing to move to a new Rural Opportunity Zone proposed in the bill would be negligible and could be absorbed within existing staff levels and resources.

The Insurance Department indicates the bill would have no fiscal effect on its operations.

The Earned Income Tax Credit Program is used as the primary state match for the federal Temporary Assistance for Needy Families (TANF) Program. Reducing the amount that taxpayers receive from this credit in tax year 2014 from 17.0 percent to 9.0 percent has the potential to require additional state matching funds devoted to state child welfare and poverty programs through the budget process to count toward the state maintenance of effort requirements and avoid any federal TANF penalties. The Department of Social and Rehabilitation Services estimates that it would require $14.5 million in additional state matching funds from the State General Fund in FY 2015 to avoid any penalties. Any fiscal effect associated with HB 2747 is not reflected in *The FY 2013 Governor's Budget Report*.

Sincerely,

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

cc: Steve Neske, Revenue
Zac Anshutz, Insurance Department
Jason Glasrud, Commerce
Ben Cleeves, KDOT
Jackie Aubert, SRS