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Sam Brownback, Governor

May 3, 2013

The Honorable Richard Carlson, Chairperson
House Committee on Taxation
Statehouse, Room 285-N
Topeka, Kansas 66612

Dear Representative Carlson:

SUBJECT: Fiscal Note for HB 2355 by House Committee on Taxation

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2355 is respectfully submitted to your committee.

HB 2355 would implement the Kansas Fair Tax Act of 2013. The bill would eliminate the corporate income, financial institutions income, retail sales, and compensating use taxes beginning on July 1, 2013. For tax year 2014, the bill would lower the individual income tax rate from 3.0 percent to 1.5 percent for income under $15,000 ($30,000 for married filing jointly) and lower the individual income tax rate from 4.9 percent to 2.45 percent for income $15,000 and over ($30,000 and over for married filing jointly). For tax year 2015, the bill would eliminate the individual income tax and any unused income tax credits.

The bill would impose a consumption tax at the rate of 6.3 percent on new personally consumed goods and services beginning on July 1, 2013 with all of the receipts deposited in the State General Fund. Beginning on January 1, 2014 the bill would require that 88.767 percent of the amount collected from the consumption tax be deposited in the State General Fund and 11.233 percent be deposited in the State Highway Fund. The bill would define the goods and services that the consumption tax would be imposed on and the goods and services that would be exempted. The consumption tax would be paid by the consumer and the retailer would be responsible for collecting the tax. If the retailer does not collect all of the tax that is due, then the Director of Taxation would be allowed to collect the remaining tax that is due directly from the consumer. The bill would provide retailers with 0.25 percent of the amount of the consumption taxes that they have collected to compensate retailers for collecting and remitting the tax to the State of Kansas. Local governments would also be allowed to collect a consumption tax to replace the local retail sales tax and compensating use tax.

The bill would provide a family consumption allowance for each Kansas resident taxpayer. The allowance is determined annually and would be equal to the product of the rate of consumption tax and 1/12th of the annual poverty guidelines established in the *Federal Register* by the U.S. Department of Health and Human Services. The allowance would be bundled as a single payment to each household to include all eligible Kansas residents who share the same dwelling and would be deposited electronically. The bill would require the taxpayer to electronically file a yearly report to the Department of Revenue by September 30th that certifies the name and valid Social Security numbers of each member residing at the same dwelling unit. When there is a change in the household, the taxpayer is required to file a change with the Department of Revenue within two weeks of the change.

The bill would not allow a retailer to assume or absorb the tax. All retailers would be required to be registered with the Department of Revenue. The bill would provide the Secretary of Revenue with the authority to revoke or suspend the registration certificate of a retailer under certain conditions. Retailers would be required to maintain books and records of transactions and would set a three-year statute of limitations for any refund claims. The Department of Revenue would have the authority to audit retailers. The Department would be authorized to charge interest and penalties for any unpaid taxes and could seize property of the retailer for any nonpayment of taxes. The Department would be required to work with retailers and associations of retailers in the efficient payment, collection, accounting of the tax, and the direct payment of the tax by businesses. The bill would create the Consumption Tax Refund Fund at the Department of Revenue and would provide procedures for consumers to file for a refund. The bill would allow for the continuation of payments from the consumption tax for STAR bond projects and for the intermodal facility in Johnson County. The provisions of the Streamlined Sales Tax Agreement would apply to the consumption tax.

The bill would create the Consumption Tax Transition Committee that will make a report on recommendations for necessary procedures, administrative processes, and legislation to improve the implementation of this new tax. The committee would comprise members of the Legislature, the Secretary of Revenue, the State Treasurer, and the Secretary of State. The report would be due prior to January 1, 2014.

The bill would expand the definition of nexus to include “click-thru” provisions in which a retailer would be responsible for collecting and remitting consumption tax. Such retailer would be someone who enters into an agreement with one or more Kansas residents for a commission or other consideration, directly or indirectly, refers potential customers by a link on an internet website, by telemarketing, by an in-person or oral presentation. The bill specifies that gross receipts from such sales within Kansas must exceed $10,000 during the prior 12 months. Provisions are included in the bill for the retailer to submit proof that they do not have nexus.

The bill also provides that any ruling, agreement or contract between a retailer and the state’s executive branch or state agency agreeing that a retailer is not required to collect the consumption tax in this state despite the presence of a warehouse, distribution center or fulfillment center is null and void unless specifically approved by a majority vote in each of the houses of the Legislature. The bill further provides that any vendor selling or leasing tangible personal property to the state is required to register as a retailer for consumption tax purposes.

Estimated State Fiscal Effect				
	FY 2013 SGF	FY 2013 All Funds	FY 2014 SGF	FY 2014 All Funds
Revenue	--	--	$988,000,000	$768,000,000
Expenditure	--	--	$508,020	$508,020
FTE Pos.	--	--	--	--

The Department of Revenue estimates that HB 2355 would increase state revenues by $768.0 million in FY 2014. Of that total, the State General Fund is estimated to increase by $988.0 million in FY 2014, while the State Highway Fund is estimated to decrease by $220.0 million in FY 2014. This bill is also estimated to increase local revenues by $374.0 million in FY 2014. The increase in revenues and how the April 19, 2013 consensus revenue estimate for FY 2014 would be affected are shown in the following table:

Effect on FY 2014 Consensus Revenue Estimates
(Dollars in Thousands)

Receipt Description	Consensus Revenue Estimates (April 19, 2013)	Change in Revenue FY 2014	Proposed Adjusted CRE FY 2014
Motor Carrier	$ 41,000	$ --	$ 41,000
Income Taxes:			
Individual	2,400,000	(369,000)	2,031,000
Corporate	370,000	(370,000)	--
Financial Institutions	31,000	--	31,000
Excise Taxes:			
Retail Sales	1,920,000	(1,920,000)	--
Compensating Use	295,000	(295,000)	--
Cigarette	90,000	--	90,000
Corporate Franchise	6,000	--	6,000
Severance	132,800	--	132,800
All Other Excise Taxes	100,000	--	100,000
Other Taxes	162,000	3,942,000	4,104,000
Total Taxes	$5,547,800	$ 988,000	$6,535,800
Other Revenues:			
Interest	$ 10,400	$ --	$ 10,400
Transfers	(159,930)	--	(159,930)
Agency Earnings	56,000	--	56,000
Total Other Revenues	($ 93,530)	$ --	($ 93,530)
Total Receipts	$5,454,270	$ 988,000	$6,442,270

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

	FY 2015	FY 2016	FY 2017	FY 2018
State General Fund	($398,000,000)	($1,445,000,000)	($1,485,000,000)	($1,527,000,000)
State Highway Fund	(5,000,000)	(5,000,000)	(5,000,000)	(5,000,000)
Local Governments	411,000,000	427,000,000	443,000,000	459,000,000
	($8,000,000)	($1,073,000,000)	($1,047,000,000)	($1,073,000,000)

To formulate these estimates, the Department of Revenue reviewed data on the individual income, corporate income, financial institutions income, retail sales, and compensating use taxes.

For FY 2014, individual income tax receipts would be reduced by $369.0 million, corporate income tax receipts would be reduced by $370.0 million, retail sales and compensating use tax collections would be reduced by a total of $2,215.0 million. The FY 2014 reductions in corporate and individual income tax are from the lower remittance of estimated tax and withholding payments. The Department of Revenue estimates that the new consumption tax would collect $3,942.0 million for the State General Fund. The Department indicates that the amount of consumption tax receipts generated would exceed the amount of retail sales and compensating use tax revenue that is lost due to the repeal of exemptions and the taxing of professional and personal services purchased by end consumers, insurance premiums, rental of real estate, and digital goods. The fiscal note was calculated with the assumption that all used goods and all business-to-business transactions would be exempt from the consumption tax. Therefore, the net fiscal effect of HB 2355 would be an increase of state revenues in FY 2014 of $988.0 million ($3,942.0 million in new revenues from the consumption tax minus $369.0 million in lower individual income tax receipts minus $370.0 million from eliminating the corporate income tax minus $2,215.0 million from eliminating the retail sales and compensating use taxes). The Department of Revenue estimates that the bill would reduce state revenues by $1,450.0 million in FY 2015 when the fiscal effect of the bill would be accounted for the entire fiscal year.

The Department of Revenue indicates that the bill would require a total of $508,020 from the State General Fund in FY 2014 for administrative costs to implement the bill. The Department indicates that $501,175 would be required to develop the taxpayer consumption allowance database to provide the family consumption allowance to each Kansas resident taxpayer on a monthly basis. The Department would be required to develop a process to issue the family consumption allowances, which would require programming, testing, and maintenance. An on-line process would need to be developed for taxpayers to file their annual return and to make changes when the household population changes. The Department would also need to develop a system to electronically remit the family consumption allowance to potentially thousands of banks on a monthly basis. The remaining $6,845 of costs would be necessary to issue new on-line publications, news releases, retailer help guides, and getting new taxpayers registered.

The Department indicates that the proposal would not have an immediate impact on is staffing levels. The consumption tax would increase the number of retailers filing reports to include the service industries, insurance and real estate rental companies. Through a reallocation of existing staff, the Department would be able to absorb the additional workload associated with the consumption tax by using income tax processing staff. After the 2013 income tax returns are processed in 2014 the Department may be able to reduce staff associated with the processing of income tax returns. The overall impact of the consumption tax on collections and auditing function is unknown and decisions on staffing would be determined once the Department has had experience administering and enforcing the new tax.

The Kansas Department of Transportation (KDOT) indicates that the bill would reduce state revenues to the State Highway Fund as noted above. KDOT indicates the reduction in revenues would require reductions and/or delays to planned expenditures for projects funded under the comprehensive transportation plan, known as T-WORKS. KDOT also indicates that the reduction in revenue may require it to increase the amount of bonds that it plans to issue under its current bonding authority in order to complete planned projects. Any fiscal effect associated with HB 2355 is not reflected in *The FY 2014 Governor's Budget Report*.

The League of Kansas Municipalities indicates that the bill would eliminate local retail sales and compensating use taxes and would replace them with a local option consumption tax beginning on July 1, 2013. Because the consumption tax base appears to be larger than the retail sales and compensating use tax bases, the bill has the potential to provide additional revenue to local governments.

Sincerely,

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Director of the Budget

cc: Steve Neske, Revenue
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