

July 22, 2015

The Honorable Marvin Kleeb, Chairperson
House Committee on Taxation
Statehouse, Room 185-N
Topeka, Kansas 66612

Dear Representative Kleeb:

SUBJECT: Fiscal Note for HB 2435 by House Committee on Taxation

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2435 is respectfully submitted to your committee.

Under current law, political subdivisions, nonprofit hospitals, blood and organ banks, schools, and educational institutions receive a sales tax exemption for the purchase of supplies and materials, either directly or indirectly, for the purpose of constructing, equipping, reconstructing, maintaining, repairing, enlarging, furnishing, or remodeling facilities. HB 2435 would remove this sales tax exemption beginning on July 1, 2015. The bill includes a grandfather clause for projects started prior to July 1, 2015.

The Department of Revenue estimates that HB 2435 would increase state revenues by \$96.9 million in FY 2016. Of that total, the State General Fund is estimated to increase by \$80,360,000 in FY 2016, while the State Highway Fund is estimated to increase by \$16,540,000 in FY 2016. This bill also is estimated to increase local revenues by \$22,550,000 in FY 2016. The increase in revenues and how the April 20, 2015 consensus revenue estimate for FY 2016 would be affected are shown in the following table:

Effect on FY 2016 Consensus Revenue Estimates
(Dollars in Thousands)

| Receipt Description | Consensus Revenue Estimates (April 20, 2015) | Change in Revenue FY 2016 | Proposed Adjusted CRE FY 2016 |
|------------------------|--|---------------------------------|-------------------------------------|
| Motor Carrier | \$ 11,000 | \$ -- | \$ 11,000 |
| Income Taxes: | | | |
| Individual | 2,300,000 | -- | 2,300,000 |
| Corporate | 440,000 | -- | 440,000 |
| Financial Institutions | 44,000 | -- | 44,000 |
| Excise Taxes: | | | |
| Retail Sales | 2,240,000 | 80,360 | 2,320,360 |
| Compensating Use | 370,000 | -- | 370,000 |
| Cigarette | 88,000 | -- | 88,000 |
| Severance | 73,800 | -- | 73,800 |
| All Other Excise Taxes | 113,700 | -- | 113,700 |
| Other Taxes | <u>190,500</u> | <u>--</u> | <u>190,500</u> |
| Total Taxes | \$5,871,000 | \$ 80,360 | \$5,951,360 |
| Other Revenues: | | | |
| Interest | \$ 17,800 | \$ -- | \$ 17,500 |
| Transfers | (232,680) | -- | (232,680) |
| Agency Earnings | <u>57,100</u> | <u>--</u> | <u>57,100</u> |
| Total Other Revenues | (\$ 157,780) | \$ -- | (\$ 157,780) |
| Total Receipts | \$5,713,220 | \$ 80,360 | \$5,793,580 |

To formulate these estimates, the Department of Revenue reviewed data on the purchase of materials for renovation and construction projects for state and local governments, schools, and non-profit hospitals that are currently exempt from sales taxation. For FY 2016, it is estimated that local governments, schools, and non-profit hospitals would pay a total of \$95.2 million in sales taxes on purchases of materials for renovation and construction projects. The sales taxes would be distributed as follows: \$64,270,000 to the State General Fund, \$13,230,000 to the State Highway Fund, and \$17.7 million for local governments. The combined \$77.5 million (\$64,270,000 from the State General Fund and \$13,230,000 from the State Highway Fund) would represent new money to the State of Kansas that it does not currently receive. Cities and counties would be able to retain their portion of the local government sales tax charged on purchases of materials for renovation and construction projects.

The Department of Revenue estimates that state government agencies would pay a total of \$24,250,000 in sales taxes on purchases of materials for renovation and construction projects, including, \$16,090,000 for the State General Fund, \$3,310,000 for the State Highway Fund, and

\$4,850,000 for local governments. The combined \$19.4 million (\$16,090,000 from the State General Fund and \$3,310,000 from the State Highway Fund) would represent the State of Kansas retaining these state resources regardless of the original state revenue source for these purchases. The \$4,850,000 would represent new money for local governments, which they do not currently receive, and money that would be lost from the State of Kansas. According to the Department of Revenue, reissuing sales tax publications and issuing new notices on the change to the exemption status would cost \$4,000 from the State General Fund in FY 2016.

The Kansas Department of Transportation (KDOT) indicates that the bill would increase state revenues to the State Highway Fund as noted above. The agency is unable to estimate the additional expenditures that would be incurred if the bill were implemented, because it is unclear on the scope of the tax.

The Department of Administration indicates the bill would lead to higher costs for materials for renovations and construction projects for state agencies. Contractors currently are informed through the bid process when a construction project is to be exempt from sales tax. The bidder is informed that sales tax is not to be included as part of any bid. With the removal of the exemption, contractors will be charged sales tax for these supplies and building materials. This will lead to the increased costs through these sales taxes to be included in bids. These costs will ultimately be the responsibility of the state and by extension the taxpayer. In addition, removal of the tax exemption will take away an incentive for the contractor to buy their supplies and building materials within the State of Kansas. Currently, by purchasing within the State of Kansas, the contractor can utilize the tax exempt status. Purchasing materials out of state would potentially put the contractor at a disadvantage versus a contractor basing their bid on purchasing in the State of Kansas and utilizing the exemption. Once this incentive is removed, the contractor will no longer receive any advantage to purchasing local materials. The contractor will seek to acquire supplies and materials wherever is most advantageous for the contractor and to include any sales taxes incurred through the use of out of state vendors.

The Board of Regents indicate that the bill the would result in higher costs of construction and renovation projects at the state universities, because it would increase the direct costs of construction to cover the additional sales tax expense and interest costs for bonded projects. The state universities, on average, annually spend \$80.0 million on deferred maintenance projects and \$162.0 million on other capital improvement projects, for a total of \$242.0 million spent annually on construction and renovation projects. Construction materials cost typically range from 40.0 percent to 60.0 percent of the total construction cost of the project. With an estimated \$242.0 million spent annually, the materials cost would range from \$96.8 million to \$145.2 million that would now be subject to state and local sales taxes.

The Department of Education indicates that the bill would increase remodeling and constructing costs for schools district facilities. The Department of Education does not have material costs for remodeling or construction projects to make a precise estimate of the sales tax costs that would be incurred by school districts for the 2015-16 and 2016-17 school years.

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The Adjutant General indicates the bill would increase State General Fund expenditures by \$600,000 to \$890,000 per fiscal year to maintain National Guard facilities as required by federal and state cooperative agreements. The Adjutant General indicates that the sales expenses for materials for renovations and construction would not be reimbursed by the federal government. Any fiscal effect associated with HB 2435 is not reflected in *The FY 2016 Governor's Budget Report*.

The Kansas Association of Counties and the League of Kansas Municipalities indicate that the bill would increase costs for the purchase of materials for constructing or remodeling of local government facilities; however, the Association and the League are unable to calculate the precise estimate of the additional costs. The bill would also increase sales taxes for local governments, but the additional local sales collections would not be sufficient to offset the additional costs because local governments would be required to pay the state sales tax on the purchase of materials for local government construction or remodeling projects.

Sincerely,

A handwritten signature in black ink, appearing to read "Shawn Sullivan", with a horizontal line extending to the right.

Shawn Sullivan,
Director of the Budget

cc: Jack Smith, Department of Revenue
Ben Cleeves, Transportation
Larry Baer, League of Municipalities
Melissa Wangemann, Association of Counties
Colleen Becker, Department of Administration
Kelly Oliver, Board of Regents
Dale Dennis, Education
Adam Phannenstiel, Corrections
Dawn Palmberg, Department of Labor
Chris Tymeson, Wildlife, Parks & Tourism
Denny Stoecklein, State Fair
Cheri Froetschner, Adjutant General's Office
Brad Ridley, Aging & Disability Services