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Shawn Sullivan, Director of the Budget

Sam Brownback, Governor

March 11, 2016

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

Dear Representative Kleeb:

SUBJECT: Fiscal Note for HB 2444 by Representative Hutton

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2444 is respectfully submitted to your committee.

Calculations for Kansas income taxes are based on the Kansas adjusted gross income, which is calculated by adding or subtracting certain types of income from the federal adjusted gross income. HB 2444 would require non-wage business income to be included as income for Kansas income tax purposes beginning in tax year 2016. The bill would also allow all non-wage business losses to be claimed for Kansas income tax purposes, except the federal net operating loss deduction. The bill would prohibit any penalties or interest from the underpayment of taxes from calculating non-wage business income in tax year 2016, as long as the taxes are paid by April 15, 2017.

The bill would reduce the state retail sales tax and consumer use tax rate for food and food ingredients from 6.5 percent to 2.6 percent beginning on July 1, 2016. Food and food ingredients would not include alcoholic beverages, candy, dietary supplements, food sold through vending machines, prepared food, soft drinks, and tobacco. The bill would change the amount of state retail sales and compensating use tax to be deposited in the State General Fund from 83.846 percent to 82.413 percent and the State Highway Fund from 16.154 percent to 17.587 percent.

Estimated State Fiscal Effect				
	FY 2016 SGF	FY 2016 All Funds	FY 2017 SGF	FY 2017 All Funds
Revenue	--	--	$26,800,000	$26,800,000
Expenditure	--	--	$306,400	$306,400
FTE Pos.	--	--	--	--

The Department of Revenue estimates that HB 2444 would increase State General Fund revenues by $26.8 million in FY 2017. The increase in State General Fund revenues and how the November 6, 2015 consensus revenue estimate for FY 2017 would be affected are shown in the following table:

Effect on FY 2017 Consensus Revenue Estimates
(Dollars in Thousands)

Receipt Description	Consensus Revenue Estimates (Nov. 6, 2015)	Change in Revenue FY 2017	Proposed Adjusted CRE FY 2017
Income Taxes:			
Individual	$2,485,000	$ 260,900	$2,745,900
Corporate	420,000	--	420,000
Financial Institutions	47,000	--	47,000
Excise Taxes:			
Retail Sales	2,380,000	(234,100)	2,145,900
Compensating Use	395,000	--	395,000
Cigarette	135,000	--	135,000
Severance	58,200	--	58,200
All Other Excise Taxes	116,400	--	116,400
Other Taxes	173,300	--	173,300
Total Taxes	$6,209,900	$ 26,800	$6,236,700
Other Revenues:			
Interest	$ 9,200	$ --	$ 9,200
Transfers	17,600	--	17,600
Agency Earnings	49,000	--	49,000
Total Other Revenues	$ 75,800	$ --	$ 75,800
Total Receipts	$6,285,700	$ 26,800	$6,312,500

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

	FY 2018	FY 2019	FY 2020	FY 2021
State General Fund	($60,000,000)	($65,900,000)	($72,000,000)	($78,400,000)

To formulate these estimates, the Department of Revenue reviewed data from tax year 2014. The bill is estimated to increase individual income tax liability by $260.9 million FY 2017 based on taxing all non-wage business income and allowing business losses to be claimed by the taxpayer beginning in tax year 2017. Because the bill is retroactive to the start of tax year 2016 and assuming a 2.0 percent growth rate, the bill is expected generate all of tax year 2016 liabilities and a portion of tax year 2017 liabilities in fiscal year 2017.

The Department of Revenue also reviewed data on retail sales and compensating use taxes. The Department indicates that with previous changes to the state retail sales and compensating use tax rates and distribution formulas, there is a one month lag from the time that the rate and distribution changes become effective and when the revenues are collected. The Department indicates that FY 2017 would include one month of revenue at the current rate for food and food ingredients and distribution formula effective in FY 2016 and 11 months of revenue at the proposed new rate for food and food ingredients and the new distribution formula. The bill is estimated to reduce state retail sales and compensating use taxes collections by $234.1 million from the State General Fund in FY 2017. Because of the changes in the distribution formula, the bill would have no fiscal effect on revenues to the State Highway Fund.

The Department of Revenue indicates the bill would require $306,400 from the State General Fund in FY 2017 for administrative costs to implement the bill, including changes to forms and publications, and modifications to the Department's 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 Department of Administration indicates that adjusting state income tax collections has the potential to have a fiscal effect on the amount of revenue collected from its debt setoff program. This program intercepts individual income tax refunds and homestead tax refunds and applies those amounts to debts owed to state agencies, municipalities, district courts, and state agencies in other states. Debts include, but are not limited to child support, taxes, educational expenses, fines, services provided to the debtor, and court ordered restitution. As the dollar amounts of refunds are decreased, the amount available for possible debt setoffs is also reduced. However, the Department is unable to make a precise estimate of the amount of debt setoff that will no longer be intercepted as a result of the bill.

The Kansas Department of Transportation (KDOT) indicates that the bill would have no fiscal effect on the State Highway Fund or the planned expenditures for projects funded under the comprehensive transportation plan, known as T-WORKS.

The Kansas Association of Counties and the League of Kansas Municipalities indicate that the bill has the potential to reduce that amount of state sales tax revenues from food and food ingredients that are collected in a STAR bond district. However, the Kansas Association of Counties and the League of Kansas Municipalities do not have data on the amount of state sales taxes that are collected from food or food ingredients in STAR bond districts to provide an estimate of the reduction in revenue or if the reduction would alter the STAR bond payment schedule for any STAR bond district.

Retailers that sell food and food ingredients would be required to break out the amount of food and non-food sales tax collections to ensure that amounts are reported correctly. Retailers would also be required to reprogram cash registers to accommodate the lower sales tax rate for food and food ingredients. Any fiscal effect associated with HB 2444 is not reflected in *The FY 2017 Governor's Budget Report*.

Sincerely,

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