

SESSION OF 2015

**SUPPLEMENTAL NOTE ON SENATE SUBSTITUTE FOR
HOUSE BILL NO. 2109**

As Passed Without Recommendation by Senate
Committee on Assessment and Taxation

Brief*

Senate Sub. for HB 2109, as advanced without recommendation, would make a number of changes in individual income tax laws, sales and compensating use tax provisions, motor fuel taxes, motor vehicle taxes, and taxes on cigarettes and tobacco products, and would enact a tax amnesty for a number of tax sources.

Amnesty Provisions

The bill would authorize a tax amnesty for penalties and interest relative to certain delinquent taxes provided such taxes are paid in full from September 1, 2015, to October 15, 2015. The amnesty would apply to privilege, income, estate, cigarette, tobacco products, liquor enforcement, liquor drink, severance, state sales, state use, local sales, and local use taxes. The amnesty would be limited to penalties and interest applied to liabilities associated with tax periods ending on or before December 31, 2013.

The amnesty would not apply to any matter for which, on or after September 1, 2015, taxpayers have received notices of assessment or for which an audit had previously been initiated. Any fraud or intentional misrepresentation in connection with an amnesty application would void the application and waiver of any penalties and interest.

*Supplemental notes are prepared by the Legislative Research Department and do not express legislative intent. The supplemental note and fiscal note for this bill may be accessed on the Internet at <http://www.kslegislature.org>

Sales and Use Tax Provisions

The statewide sales tax and use rate for most purchases would be increased from 6.15 percent to 6.50 percent on July 1, 2015. A second rate of 6.00 percent would apply to certain purchases of food or food ingredients sold for ingestion or chewing by humans and consumed for their taste or nutritional value. Sales of certain items would be excluded from the lower rate, including candy, dietary supplements, food sold through vending machines, prepared food, and soft drinks.

Statutory disposition-of-revenue percentages would be adjusted for both taxes to provide the entire estimated amount of new revenue associated with the changes would flow to the State General Fund (SGF) while maintaining the current estimated level of receipts flowing to the State Highway Fund (SHF).

Motor Fuel Tax Provisions

Additional provisions of the bill would increase the motor fuel tax rates by \$0.05 per gallon. Associated trip permits would be increased by a commensurate amount.

Statutory disposition-of-revenue percentages would be further adjusted for both the statewide sales tax and compensating use tax to provide that the entire estimated amount of new revenue associated with the changes to the motor fuel tax would flow to the SGF while maintaining the current estimated level of receipts flowing to the SHF.

Cigarette and Tobacco Products Provisions

The bill would increase the state's cigarette tax by \$0.50 per pack to \$1.29 per pack and would increase the state's tobacco products tax from 10.0 percent of wholesale price to 15.0 percent of wholesale price. The cigarette and tobacco

products tax changes would be effective beginning July 1, 2015.

The bill also would establish an inventory tax for all cigarette and tobacco products on hand as of July 1, 2015. The inventory tax would be \$0.50 per pack for cigarettes and 5.0 percent on the wholesale sales price for tobacco products on hand as of July 1, 2015. The inventory tax would be due on July 31, 2015.

Motor Vehicle Tax Provisions

Changes to the motor vehicle tax (an in-lieu-of property tax system that has been utilized for most cars since the late 1970s) would include:

- Increasing the minimum tax for most motorcycles from \$12 to \$18; and the minimum tax for most passenger vehicles from \$24 to \$36. A grandfather clause would provide that any vehicles below the current minimum levels not be subject to a tax increase.
- Decelerating the current annual 15 percent depreciation rate such that the 15 percent level of depreciation would remain effective for only the first three model years; and would then be followed by 12 percent depreciation in years four through six; and by 10 percent depreciation for all subsequent years.
- Reducing the current 20 percent assessment rate to 18 percent in tax year 2016; 16 percent in tax year 2017; 14 percent in tax year 2018; and 12 percent in tax year 2019 and thereafter.
- Increasing, beginning in tax year 2017, the countywide average mill levy rates applied to the vehicles by phasing in the 20-mill school finance

property tax levy (which had been excluded from the motor vehicle tax formula since 2000). The tax rate would be increased by 5 mills for tax year 2017 (with the money distributed to school district general funds); 10 mills for tax year 2018; 15 mills for tax year 2019; and the full 20 mills for tax year 2020 and thereafter.

Individual Income Tax Provisions

Rate Freeze

Individual income tax rate reductions scheduled for future years would be repealed, and the tax year 2015 rates of 2.70 percent for the bottom tax bracket and 4.60 percent for the top tax bracket would become the tax rates for all future years. However, a provision that could provide future formulaic income tax rate relief under certain circumstances, based on the extent to which a specified group of SGF tax sources has increased over the previous fiscal year, would remain in statute and could go into effect beginning in tax year 2019.

Itemized Deductions Modification Acceleration

A number of changes would be enacted for Kansas itemized deductions retroactive to January 1 (the start of tax year 2015). With the exception of charitable contributions, mortgage interest, and property taxes paid, all Kansas itemized deductions would be repealed. The current changes in the percentage that could be deducted (“haircuts”) being phased in for mortgage interest and property taxes paid relative to the amount that otherwise is allowed for federal income tax purposes would be accelerated such that the final 50 percent haircut currently scheduled for tax year 2017 would be effective immediately. (Charitable contributions would remain fully deductible for Kansas taxpayers able to itemize at the state level, as under current law.)

Business Income Exemption Temporary Repeal

The bill would repeal, for tax years 2015 and 2016, a provision enacted during the 2012 legislative session that totally exempts certain non-wage business income from the individual income tax (income reported by LLC's, Subchapter-S Corporations, partnerships and sole proprietorships on lines 12, 17, and 18 of federal form 1040). The exemption would be reinstated for tax year 2017.

Payroll Tax Credit

The bill would create a new tax credit for taxpayers who are owners of LLC's, Subchapter-S Corporations, partnerships, associations, joint ventures, sole proprietorships, or other similar forms of business organization. The credit would allow the taxpayer to deduct from the taxpayer's individual income tax liability an amount equal to 1 percent of the business entity's payroll, proportionate to the taxpayer's share of the business organization's income or loss, for tax year 2015. The credit would expand to 2 percent of the business entity's payroll for tax year 2016. The credit would be non-refundable and could not be carried forward by the taxpayer. The credit would be scheduled to sunset after tax year 2016, at which time the exemption for certain non-wage business income would be reinstated.

Background

The original bill would have amended the Kansas Probate Code concerning transfer-on-death deeds. In a series of meetings beginning May 12, the Senate Assessment and Taxation Committee struck the original provisions of HB 2109, recommended a substitute bill be created, inserted all the other provisions described above and, on May 19, advanced the new substitute bill for further consideration, without recommendation.

The Kansas Department of Revenue indicated the total amount of additional tax receipts collected as a result of the tax amnesty would be \$36.088 million, \$30.000 million of which would be deposited in the SGF, \$2.471 million of which would be deposited in the SHF, and \$3.618 million of which would be returned to local units levying sales and use taxes. The latest estimated disaggregation of the amnesty receipts by tax source is as follows:

	(\$ in millions)			
	SGF	SHF	Local	Total
Sales	\$ 10.000	\$ 2.059	\$ 3.015	\$ 15.073
Use	2.000	0.412	0.603	3.015
Individual Income	12.000	0.000	0.000	12.000
Corporate Income	5.000	0.000	0.000	5.000
Cigarette	0.500	0.000	0.000	.500
Liquor Enforcement	0.500	0.000	0.000	.500
TOTAL	\$ 30.000	\$ 2.471	\$ 3.618	\$ 36.088

The multiple changes to the motor vehicle tax, which would begin affecting revenues in FY 2017, would have slightly negative impacts on the amount of receipts distributed to the 1.5 mills in state building funds; produce additional receipts for school district general funds; and reduce receipts for all other property tax levying subdivisions (including school districts levies other than general funds). The multiple changes to the motor vehicle tax also would be expected to increase state sales tax collections by \$8 million per year and local collections by \$2 million per year.

The following table summarizes the fiscal impacts estimated by the Department of Revenue with regard to the changes to the motor vehicle tax:

	(Dollars in Thousands)				
	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
EBF	\$	\$ (693)	\$ (1,047)	\$ (1,420)	\$ (1,440)
SIBF		(347)	(523)	(710)	(720)
USD Gen Funds		13,800	24,490	31,930	43,160
All Other Local Unit Levies (a)		(80,290)	(123,800)	(169,690)	(174,440)
SGF (sales/use tax)	6,634	6,634	6,634	6,634	6,634
SHF (sales/use tax)	1,366	1,366	1,366	1,366	1,366
Local Units (sales/use tax) (b)	2,000	2,000	2,000	2,000	2,000
Total	\$ 10,000	\$ (57,530)	\$ (90,880)	\$ (129,890)	\$ (123,440)
State and Local Aggregate:					
State Impact (incl. 20 mills)	\$ 8,000	\$ 20,760	\$ 30,920	\$ 37,800	\$ 49,000
Local Impact	\$ 2,000	\$ (78,290)	\$ (121,800)	\$ (167,690)	\$ (172,440)

(a) includes all levies by local taxing subdivisions; and all other levies by USDs, except for the 20 mills.

(b) local units levying sales taxes, primarily cities and counties.

Relative to the combined provisions of the bill for the SGF, the following table provides a disaggregation through FY 2018:

	(\$ in millions)		
	<u>FY 2016</u>	<u>FY 2017</u>	<u>FY 2018</u>
Non-wage business income			
exemption repeal/payroll credit	\$ 81.900	\$ 66.400	\$ 69.700
Sales and Use Tax (Food at 6.00%; Other at 6.5%)	134.000	152.400	158.100
Itemized Deduction Changes	97.000	78.600	78.700
Tax Amnesty	30.000	0.000	0.000
Motor Vehicle Tax Changes	8.000	21.800	32.500
50 cent cigarette tax increase	40.390	36.400	36.000
Tobacco Products to 15%	2.847	3.620	3.718
5 cent Motor fuel tax increase	81.955	89.700	89.900
Ind. Inc. Tax Rate Freeze	19.900	69.700	195.900
TOTAL	<u>\$ 495.992</u>	<u>\$ 518.620</u>	<u>\$ 664.518</u>