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Shawn Sullivan, Director of the Budget

Sam Brownback, Governor

May 11, 2017

CORRECTED

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

Dear Representative Johnson:

SUBJECT: Corrected Fiscal Note for HB 2420 by House Committee on Taxation

In accordance with KSA 75-3715a, the following corrected fiscal note concerning HB 2420 is respectfully submitted to your committee.

Under current law, individual income tax rates are set at 2.7 percent for income under $15,000 ($30,000 for married filing jointly) and at 4.6 percent for income $15,000 and over ($30,000 for married filing jointly) in tax year 2017 and the bottom rate is set to be lowered to 2.6 percent beginning in tax year 2018. HB 2420 would create a four bracket income tax beginning in tax year 2017 and in all future tax years. The individual income tax rates would be set at 2.7 percent for income under $15,000 ($30,000 for married filing jointly), 4.9 percent for income between $15,000 and $50,000 (between $30,000 and $100,000 for married filing jointly), 5.75 percent for income between $50,000 and $125,000 (between $100,000 and $250,000 for married filing jointly), and 6.45 percent for income $125,000 and over ($250,000 for married filing jointly). The bill would eliminate the automatic income tax rate reduction procedure that has the potential to reduce individual income tax rates beginning in tax year 2021. The bill would also allow taxpayers to claim 100.0 percent of the total amount of medical care expenses as an itemized deduction. The bill would prohibit any penalties or interest from the underpayment of taxes from the tax rate changes in tax year 2017, as long as the taxes are paid by April 15, 2018.

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. The bill would require non-wage business income to be included as income for Kansas income tax purposes beginning in tax year 2017. The bill would also allow all non-wage business losses to be claimed for Kansas income tax purposes; however, losses from previous tax years could not be claimed. Income from the sale of qualified livestock and Christmas trees would be included as taxable income.

The bill would phase out the retail sales tax imposed by the state on food and food ingredients over a six-year period. Food and food ingredients are defined as substances, whether in liquid, concentrated, solid, frozen, dried, or dehydrated form, that are sold for ingestion or chewing by humans and are consumed for their taste or nutritional value. Food and food ingredients would not include alcoholic beverages, tobacco, or food sold through vending machines. Food and food ingredients would specifically include bottled water, candy, dietary supplements, or soft drinks. In the original fiscal note issued, an incorrect definition of food and food ingredients was used. The bill provides specific definitions for bottled water, candy, food sold through vending machines, prepared food, soft drinks, and dietary supplements. The bill would adjust the state retail sales tax rates specifically on food and food ingredients and change the distribution of overall state sales tax revenue collected as follows:

Date of Rate Change	Tax Rate	Percent to State General Fund	Percent to State Highway Fund
Current law	6.5 %	83.846 %	16.154 %
January 1, 2019	5.5	83.712	16.288
January 1, 2020	4.5	83.383	16.617
January 1, 2021	3.5	83.040	16.960
January 1, 2022	2.5	82.683	17.317
January 1, 2023	1.5	82.310	17.690
January 1, 2024	--	81.837	18.163
January 1, 2025	--	81.479	18.521

Once the state sales tax is eliminated on food and food ingredients on January 1, 2024, local governments would no longer be able to charge a local sales tax on food and food ingredients.

Estimated State Fiscal Effect				
	FY 2018 SGF	FY 2018 All Funds	FY 2019 SGF	FY 2019 All Funds
Revenue	$673,200,000	$673,200,000	$491,900,000	$487,700,000
Expenditure	$260,105	$260,105	--	--
FTE Pos.	--	--	--	---

The Department of Revenue estimates that HB 2420 would increase state revenues by $673.2 million in FY 2018 and by $487.7 million in FY 2019. Of those totals, the State General Fund is estimated to increase by $673.2 million in FY 2018 and by $491.9 million in FY 2019, while the State Highway Fund is estimated to decrease by $4.2 million in FY 2019. The fiscal effect to state revenues during subsequent years would be as follows:

	FY 2020	FY 2021	FY 2022
State General Fund	$425,100,000	$250,100,000	$188,500,000
State Highway Fund	(18,500,000)	(55,400,000)	(70,600,000)
	$406,600,000	$194,700,000	$117,900,000

This bill would not have a fiscal effect on local sales tax revenues until after January 1, 2024, when local governments would no longer be able to charge a local sales tax on food and food ingredients; however, the specific estimate of lower local sales tax revenues was not calculated by the Department of Revenue. The Streamlined Sales Tax Agreement requires once a taxable item is fully exempt from state sales taxes, it would also be exempt from local sales taxes. The estimate assumes that 15.0 percent of all current sales tax collections are collected on food and food ingredients.

The bill is retroactive and the fiscal effect is based on changing the income tax rates, taxing non-wage business income, and allowing itemized deductions on medical care expenses beginning on January 1, 2017. The estimate for FY 2018 includes 100.0 percent of tax year 2017 tax liability and 30.0 percent of tax year 2018 tax liability. The estimate for FY 2019 includes 70.0 percent of tax year 2018 tax liability and 30.0 percent of tax year 2019 tax liability.

The Department indicates that the bill would require $260,105 from the State General Fund in FY 2018 to implement the bill and make changes to the 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, additional 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 an estimate of the amount of debt setoffs that will no longer be intercepted as a result of the bill.

The Kansas Department of Transportation (KDOT) indicates that the bill would reduce state revenues to the State Highway Fund as noted above. KDOT indicates that when the state receives lower State Highway Fund dollars it may be required to make corresponding reductions to 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 would provide a net decrease to local sales tax collections that are used in part to finance local governments beginning on January 1, 2024. Any fiscal effect associated with HB 2420 is not reflected in *The FY 2018 Governor's Budget Report*.

Sincerely,

Shawn Sullivan,
Director of the Budget

cc: Lynn Robinson, Department of Revenue
Ben Cleeves, Transportation
Larry Baer, League of Municipalities
Melissa Wangemann, Association of Counties
Colleen Becker, Department of Administration