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Sam Brownback, Governor

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

Dear Representative Johnson:

SUBJECT: Fiscal Note for HB 2431 by House Committee on Taxation

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2431 is respectfully submitted to your committee.

HB 2431 is a comprehensive tax bill that deals with income taxes, retail sales and compensating use taxes, cigarette, and motor fuel taxes. The bill would create a five bracket income tax beginning in tax year 2017. For tax year 2017, the individual income tax rates would be set at 2.83 percent for income under $15,000 ($30,000 for married filing jointly); 5.28 percent for income between $15,000 and $50,000 (between $30,000 and $100,000 for married filing jointly); 5.53 percent for income between $50,000 and $125,000 (between $100,000 and $250,000 for married filing jointly); 6.05 percent for income between $125,000 and $500,000 (between $250,000 and $1.0 million for married filing jointly); and 7.3 percent for income over $500,000 ($1.0 million for married filing jointly). For tax year 2018 through tax year 2022, the individual income tax rates would be set at 2.95 percent for income under $15,000 ($30,000 for married filing jointly); 5.95 percent for income between $15,000 and $50,000 (between $30,000 and $100,000 for married filing jointly); 6.45 percent for income between $50,000 and $125,000 (between $100,000 and $250,000 for married filing jointly); 7.5 percent for income between $125,000 and $500,000 (between $250,000 and $1.0 million for married filing jointly); and 10.0 percent for income over $500,000 ($1.0 million for married filing jointly).

The bill creates a four bracket income tax beginning in tax year 2023. For tax year 2023 and all future tax years, the individual income tax rates would be set at 2.95 percent for income under $15,000 ($30,000 for married filing jointly); 5.95 percent for income between $15,000 and $50,000 (between $30,000 and $100,000 for married filing jointly); 6.45 percent for income between $50,000 and $125,000 (between $100,000 and $250,000 for married filing jointly); and 7.5 percent for income over $125,000 ($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.

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 prohibit any penalties or interest from the underpayment of taxes from the tax rate changes and calculating non-wage business income in tax year 2017, as long as the taxes are paid by April 17, 2018.

The bill would allow 100.0 percent of the medical care expenses claimed on federal income tax returns as an itemized deduction on state income tax returns beginning in tax year 2017. The mortgage interest and property tax deductions would be increased from 50.0 percent to 100.0 percent beginning in tax year 2017. The bill would make the current Food Sales Tax Credit Program refundable beginning in tax year 2017. The bill would allow renters to claim the Homestead Property Tax Refund for tax year 2017 and in each future tax year.

The bill would allow a non-refundable income tax credit for expenses for household and dependent care services necessary for gainful employment. This tax credit is more commonly referred to as the Child and Dependent Care Tax Credit. The state tax credit for tax year 2017 would be 25.0 percent of the credit claimed against the taxpayer's federal income tax liability under Section 21 of the federal Internal Revenue Code, which authorizes the federal household and dependent care tax credit. The bill requires any taxpayer claiming the credit to provide a valid Social Security number.

The bill would lower the normal tax rate for corporate income tax filers from 4.00 percent to 3.75 percent beginning in tax year 2017.

The bill would reduce the state retail sales tax and compensating use tax rate for food and food ingredients from 6.5 percent to 4.5 percent beginning on July 1, 2017. Food and food ingredients would not include alcoholic beverages, tobacco, candy, dietary supplements, soft drinks, or food sold through vending machines. Food and food ingredients would specifically include bottled water. The 4.5 percent retail sales tax and compensating use tax on food and food ingredients would be distributed the same as the current 6.5 percent distribution: 83.846 percent to the State General Fund and 16.154 percent to the State Highway Fund. The bill would provide a formula that allows additional reductions in the sales tax rate on food and food ingredients when certain State General Fund receipts exceed the 7.5 percent ending balance requirement. Once the state sales tax is eliminated on food and food ingredients, local governments would no longer be able to charge a local sales tax on food and food ingredients.

The bill would increase the cigarette tax from \$1.29 a pack to \$2.29 a pack on July 1, 2017. The bill would establish a \$1.00 inventory tax for all cigarettes on hand as of July 1, 2017 and the inventory tax would be due on October 31, 2017.

The bill would increase most motor fuel fees and taxes beginning on July 1, 2017. The bill would increase the special LP gas permit fee for each weight and mile category. The 24-hour motor fuel permit would be increased from $13.00 to $15.50, and the 72-hour motor fuel permit would increase from $25.00 to $30.00. The bill would increase the following motor fuel tax rates:

Motor Fuel Type	Current Tax Rate	New Tax Rate
Motor-vehicle fuels (not including E85)	$0.24	$0.29
E85 fuel	$0.17	$0.22
Special fuels (diesel)	$0.26	$0.31
LP-gas	$0.23	$0.28
Compressed natural gas	$0.24	$0.29
Liquefied natural gas	$0.26	$0.31

The bill would change the distribution of motor fuel tax revenue as follows:

Time Period of Tax Change	State Highway Fund	Special City & County Highway Fund
Current Law	66.37 %	33.63 %
July 1, 2017 & Prior to January 1, 2018	71.70 %	28.30 %
After January 1, 2018	72.06 %	27.94 %

Estimated State Fiscal Effect				
	FY 2018 SGF	FY 2018 All Funds	FY 2019 SGF	FY 2019 All Funds
Revenue	$774,500,000	$840,500,000	$816,500,000	$881,100,000
Expenditure	$458,153	$458,153	$134,495	$134,495
FTE Pos.	--	2.00	--	2.00

The Department of Revenue estimates that HB 2431 would increase state revenues by $840.5 million in FY 2018 and by $881.1 million in FY 2019. Of those totals, the State General Fund is estimated to increase by $774.5 million in FY 2018 and by $816.5 million in FY 2019, while the State Highway Fund is estimated to increase by $66.0 million in FY 2018 and by $71.6 million in FY 2019.

The Department of Revenue indicates that State General Fund estimates for FY 2018 and FY 2019 are based on the Consensus Revenue Estimate. The individual income tax 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 individual income tax 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 estimate assumes that 15.0 percent of all current sales tax collections are collected on food and food ingredients. The proposed motor fuel tax rate increases and the change in the distribution of those revenues would provide additional revenues to the State Highway Fund and would have no fiscal effect on the Special City and County Highway Fund.

The Department indicates that the bill would require $458,153 from the State General Fund in FY 2018 to implement the bill and to modify the automated tax system. The bill would require the Department to hire 2.00 new Customer Service Representatives to review and process Homestead Property Tax Refund claims from renters. The Department estimates that ongoing expenses for salary and wages for the 2.00 FTE positions and overhead expenses would total $134,495 from the State General Fund in FY 2019. 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 Kansas Department of Transportation indicates that the bill would provide a net increase in state revenue to the State Highway Fund as noted above. The additional revenues would fund additional expenditures for projects funded under the comprehensive transportation plan, known as T-WORKS.

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 would no longer be intercepted as a result of the bill.

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. When the state sales tax is eliminated on food and food ingredients, local governments would no longer be able to charge a local sales tax on food and food ingredients. Any fiscal effect associated with HB 2431 is not reflected in *The FY 2018 Governor's Budget Report*.

Sincerely,

Shawn Sullivan,
Director of the Budget