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Laura Kelly, Governor

March 22, 2021

The Honorable Caryn Tyson, Chairperson
Senate Committee on Assessment and Taxation
Statehouse, Room 123-E
Topeka, Kansas 66612

Dear Senator Tyson:

SUBJECT: Fiscal Note for SB 296 by Senate Committee on Federal and State Affairs

In accordance with KSA 75-3715a, the following fiscal note concerning SB 296 is respectfully submitted to your committee.

SB 296 would reduce the state retail sales tax and compensating use tax rate for food and food ingredients based on a formula. 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, dietary supplements, tobacco, or certain prepared foods. Food and food ingredients would specifically include bottled water, candy, food sold through vending machines, and soft drinks. The bill provides specific definitions for bottled water, candy, food sold through vending machines, prepared food, soft drinks, and dietary supplements. The bill does not adjust the distribution of state retail sales tax and compensating use tax revenue, which would remain the same as current law: 83.846 percent to the State General Fund and 16.154 percent to the State Highway Fund.

The formula to adjust the state retail sales tax and compensating use tax rate for food and food ingredients is based on the amount of compensating use tax receipts collected each fiscal year above 3.0 percent from the base year of FY 2018. That amount would be certified by the Director of Legislative Research and the Secretary of Revenue would be required to calculate the rate reduction based on the certified amount reduced to the nearest 0.1 percent. The first rate reduction would occur on January 1, 2022, and subsequent rate reductions would occur on January 1st in future years after the new rate is published by October 1st of the previous year. 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.

Estimated State Fiscal Effect				
	FY 2021 SGF	FY 2021 All Funds	FY 2022 SGF	FY 2022 All Funds
Revenue	--	--	($57,600,000)	($68,800,000)
Expenditure	--	--	$777,505	$777,505
FTE Pos.	--	--	--	7.00

The Department of Revenue estimates that SB 296 would decrease state revenues by $68.8 million in FY 2022. Of that total, the State General Fund is estimated to decrease by $57.6 million in FY 2022, while the State Highway Fund is estimated to decrease by $11.2 million in FY 2022. The fiscal effect to state revenues during subsequent years would be as follows:

	FY 2023	FY 2024	FY 2025	FY 2026
State General Fund	($213,000,000)	($335,700,000)	($370,600,000)	($376,000,000)
State Highway Fund	(41,000,000)	(64,700,000)	(71,400,000)	(72,500,000)
	($254,000,000)	($400,400,000)	($442,000,000)	($448,500,000)

This bill would not have a fiscal effect on local sales tax revenues until after state sales tax is eliminated, 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.

To formulate the estimates of the sales tax exemption for food and food ingredients, the Department assumes that 15.0 percent of all current sales tax collections are collected on food and food ingredients. The Department indicates that State General Fund estimates for FY 2022 are based on the November 2020 Consensus Revenue Estimate. The Department estimates that the sales tax rate on food and food ingredients would be reduced to 4.0 percent on January 1, 2022, 0.9 percent on January 1, 2023, and 0.0 percent on January 1, 2024. Retailers would be required to collect sales or compensating use tax at two different rates depending on the products sold. The bill would also require food retailers to file two returns each month, one for food sales only and one for other items. The Department indicates these additional requirements may be burdensome to some retailers.

The Department of Revenue indicates that it would require a total $777,505 from the State General Fund in FY 2022 to implement the bill and to modify the sales tax system. The bill would require the Department to hire 7.00 new FTE positions to review, process, and audit sales tax returns. The Department estimates that ongoing expenses for salary and wages for the 7.00 FTE positions and overhead expenses would total $451,816 from the State General Fund in FY 2023. The current composite jurisdiction sales tax system does not accommodate a second state sales tax rate. The required programming for this bill by itself would be performed by existing staff of the Department of Revenue. In addition, 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. Due to the required programming necessary to implement the bill, the Department may not be able to implement the food sales tax rate reduction on January 1, 2022.

A provision in the federal American Rescue Plan Act of 2021 (ARP) prohibits states or territories from using the federal funds appropriated from ARP "to either directly or indirectly offset a reduction in the net tax revenue of such State or territory resulting from a change in law, regulation, or administrative interpretation during the covered period that reduces any tax (by providing for a reduction in a rate, a rebate, a deduction, a credit, or otherwise) or delays the imposition of any tax or tax increase." If the state fails to comply with this provision by implementing a reduction of net tax revenue through tax year 2024, the U.S. Treasury would be required to recoup ARP funds in the amount of the net tax revenue reduction. If ARP funds are not available, it is presumed that the State General Fund would be used to reimburse the U.S. Treasury.

The Kansas Department of Transportation indicates that the bill would reduce state revenues to the State Highway Fund as noted above. The Kansas Department of Transportation 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. The League of Kansas Municipalities and the Kansas Association of Counties indicate the bill would have no fiscal effect on local governments until the state eliminates the sales tax on food and food ingredients. Once that occurs, the bill would provide a significant net reduction to local sales tax collections that are used in part to finance local governments. Any fiscal effect associated with SB 296 is not reflected in *The FY 2022 Governor's Budget Report*.

Sincerely,

Adam Proffitt
Director of the Budget

cc: Lynn Robinson, Department of Revenue
Ben Cleeves, Transportation
Wendi Stark, League of Municipalities
Jay Hall, Association of Counties