



March 10, 2023

The Honorable Adam Smith, Chairperson
House Committee on Taxation
300 SW 10th Avenue, Room 346-S
Topeka, Kansas 66612

Dear Representative Smith:

SUBJECT: Fiscal Note for HB 2435 by House Committee on Taxation

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2435 is respectfully submitted to your committee.

HB 2435 would reduce the state retail sales tax and compensating use tax rate from 6.5 percent to 5.5 percent on April 1, 2023. The bill would reduce the state retail sales tax and compensating use tax rate for food and food ingredients to 0.0 percent and changes the distribution of overall state sales and compensating use tax revenue to 82.0 percent to the State General Fund and 18.0 percent to the State Highway Fund on April 1, 2023. Under current law, the state retail sales tax rates specifically on food and food ingredients and the distribution of overall state sales and compensating use tax revenue are set to be adjusted as follows:

<u>Date of Rate Change</u>	<u>Tax Rate</u>	<u>Percent to State General Fund</u>	<u>Percent to State Highway Fund</u>
Current law	4.0 %	83.0 %	17.0 %
January 1, 2024	2.0	83.0	17.0
January 1, 2025	0.0	82.0	18.0

The bill would provide a sales tax exemption for diapers and feminine hygiene products. The bill includes definitions for diapers and feminine hygiene products.

The bill would require the Secretary of Revenue to certify on a monthly basis to the Director of the Budget and the Director of Accounts and Reports at the Department of Administration the amount of revenue that would have been generated from sales of food and food ingredients in STAR bond districts if the state retail sales and compensating use tax rate remained at 6.5 percent. The Director of Accounts and Reports would certify that amount to the State Treasurer who on a monthly basis would transfer that amount from the State General Fund to the STAR Bonds Food Sales Tax Revenue Replacement Fund. The State Treasurer would then make

payments from the STAR Bonds Food Sales Tax Revenue Replacement Fund to the City Bond Finance Fund that would be used to make STAR bond payments. This provision that would hold STAR bond districts harmless from the elimination of the state sales tax on food and food ingredients would not apply to STAR bond project districts established after July 1, 2022.

Under current law, Kansas residents with qualifying income of \$30,615 or less are able to claim the non-refundable food sales tax credit through tax year 2024 if the taxpayer is 55 years of age or older, is blind or disabled, or claims an exemption for a dependent child under 18 who lived with them all year. The bill would repeal the non-refundable food sales tax credit one year earlier after tax year 2023.

The bill would become effective upon publication in the *Kansas Register*. The fiscal note assumes that the sales tax exemption for diapers and feminine hygiene products would become effective on April 1, 2023.

Estimated State Fiscal Effect				
	FY 2023 SGF	FY 2023 All Funds	FY 2024 SGF	FY 2024 All Funds
Revenue	(\$178,200,000)	(\$203,854,000)	(\$815,000,000)	(\$935,530,000)
Expenditure	\$63,236	\$63,236	--	\$8,400,000
FTE Pos.	--	--	--	--

The Department of Revenue estimates that HB 2435 would decrease state revenues by \$203,854,000 in FY 2023 and by \$935,530,000 in FY 2024. Of those totals, the State General Fund is estimated to decrease by \$178.2 million in FY 2023 and by \$815.0 million in FY 2024, while the State Highway Fund is estimated to decrease by \$25,654,000 in FY 2023 and by \$120,530,000 in FY 2024. The bill would make changes to state revenues as follows:

<u>Tax Changes (SGF)</u>	<u>FY 2023</u>	<u>FY 2024</u>	<u>FY 2025</u>	<u>FY 2026</u>
Food Sales Tax	(\$43,600,000)	(\$277,200,000)	(\$122,700,000)	\$ --
Sales Tax Rate at 5.5%	(133,900,000)	(522,000,000)	(547,300,000)	(554,700,000)
Diapers	(500,000)	(5,900,000)	(6,600,000)	(6,800,000)
Feminine Hygiene Products	(200,000)	(1,500,000)	(1,500,000)	(1,500,000)
Foods Sales Tax Credit	--	--	10,300,000	--
STAR Bond Replacement	--	(8,400,000)	(3,000,000)	--
Total SGF	(\$178,200,000)	(\$815,000,000)	(\$670,800,000)	(\$563,000,000)
<u>Tax Changes (SHF)</u>	<u>FY 2023</u>	<u>FY 2024</u>	<u>FY 2025</u>	<u>FY 2026</u>
Food Sales Tax	\$3,800,000	(\$7,200,000)	\$3,600,000	\$ --
Sales Tax Rate at 5.5%	(29,300,000)	(111,700,000)	(120,200,000)	(122,400,000)
Diapers	(110,000)	(1,300,000)	(1,400,000)	(1,500,000)
Feminine Hygiene Products	(44,000)	(330,000)	(330,000)	(330,000)
Total SHF	(\$25,654,000)	(\$120,530,000)	(\$118,330,000)	(\$124,230,000)
Total (SGF+SHF)	(\$203,854,000)	(\$935,530,000)	(\$789,130,000)	(\$687,230,000)

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 fiscal note considers the reduction of state retail sales tax and compensating use tax rate for food and food ingredients that takes place over a three-year period beginning with a 2.5 percent reduction effective on January 1, 2023, that was enacted in 2022 HB 2106. Local sales tax revenues from food and food ingredients are not estimated to be affected under this provision of the bill.

To formulate the estimates on diapers and feminine hygiene products, the Department of Revenue reviewed data from the U.S. Bureau of Labor Statistics Consumer Expenditure Survey and the Kansas Department of Health and Environment. These provisions of the bill are estimated to decrease local sales tax revenues; however, the specific estimate of lower local sales tax revenues was not calculated by the Department of Revenue. The Kansas Association of Counties and the League of Kansas Municipalities indicate that these provisions of the bill would provide a net reduction to local sales tax collections that are used in part to finance local governments.

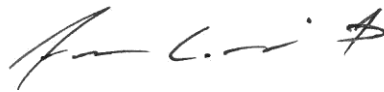
The Department of Revenue indicates that 69,307 taxpayers claimed \$9,966,464 in non-refundable food sales tax credits in tax year 2020. Under current law, \$10.3 million in non-refundable food sales tax credit would be claimed in State General Fund refunds in FY 2023, FY 2024, and FY 2025. Once the state sales tax rate becomes 0.0 percent on food and food ingredients, repealing the food sales tax credit would save approximately \$10.3 million in State General Fund refunds in tax year 2024 or FY 2025.

With pulling forward the elimination of the state sales tax rate on food and food ingredients to April 1, 2023, the bill would increase the State General Fund transfer to the STAR Bonds Food Sales Tax Revenue Replacement Fund by \$8.4 million in FY 2024, from \$7.0 million to \$15.4 million. Language that holds STAR bond districts harmless from the phase out of the state sales tax on food and food ingredients was approved in last year's Omnibus appropriations bill (2022 HB 2510). The Office of the State Treasurer indicates that the administrative costs associated with implementing the bill, including the modification of its accounting procedures, would be negligible and could be absorbed within existing resources. The bill would increase expenditures from its STAR Bonds Food Sales Tax Revenue Replacement Fund to the City Bond Finance Fund by \$8.4 million in FY 2024 and by \$3.0 million in FY 2025. It is estimated that total expenditures from the STAR Bonds Food Sales Tax Revenue Replacement Fund would be \$15.4 million in FY 2024, \$18.2 million in FY 2025, and \$18.4 million in FY 2026. The League of Kansas Municipalities indicates that this provision would provide additional revenues to help pay off STAR bonds and could aid in the financial success and viability of existing STAR bond projects. However, reducing the state retail sales tax and compensating use tax rate reduction to 5.5 percent would reduce revenues that are pledged to repay STAR bond projects. It is unknown what impact that this provision of the bill would have on the viability of STAR bond projects.

The Department indicates that the bill would require \$63,236 from the State General Fund in FY 2023 to implement the bill and to modify the automated tax system. 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. The fiscal effect associated with HB 2435 is partially reflected in *The FY 2024 Governor's Budget Report*. The Governor's tax policy recommendations did not include reducing the state retail sales tax and compensating use tax rate reduction to 5.5 percent; however, all other provisions of the bill were included in *The FY 2024 Governor's Budget Report*.

Sincerely,

A handwritten signature in black ink, appearing to read "Adam Proffitt", with a stylized flourish at the end.

Adam Proffitt
Director of the Budget

cc: Lynn Robinson, Department of Revenue
Brendan Yorkey, Department of Transportation
Wendi Stark, League of Kansas Municipalities
Jay Hall, Kansas Association of Counties
John Hedges, Office of the State Treasurer
Sherry Rentfro, Department of Commerce