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Laura Kelly, Governor

March 20, 2024

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 2844 by House Committee on Taxation

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2844 is respectfully submitted to your committee.

Under current law, the standard deduction for the calculation of Kansas income taxes is set at $3,500 for single individual taxpayers, $8,000 for married filing jointly, and $6,000 for head of household. HB 2844 would increase the standard deduction to $3,605 for single individual taxpayers, $8,240 for married filing joint status, and $6,180 for head of household beginning in tax year 2024. The bill would increase the standard deduction for all taxpayers by the cost-of-living adjustment published in the Internal Revenue Code for tax years 2025 and 2026.

Under current law, taxpayers are allowed to claim $2,250 for each personal exemption. The bill would increase the personal exemption to $2,320 in tax year 2024. The bill would allow the personal exemption amount to be increased for tax years 2025 and 2026 by the cost-of-living adjustment published in the Internal Revenue Code.

Under current law, individual income tax rates are set at 3.1 percent for income under $15,000 ($30,000 for married filing jointly), 5.25 percent for income between $15,000 and $30,000 (between $30,000 and $60,000 for married filing jointly), and at 5.7 percent for income $30,000 and over ($60,000 and over for married filing jointly). The bill would create a new three-bracket income tax system beginning in tax year 2024. The individual income tax rates would be set at 0.0 percent for income under $7,000 (under $14,000 for married filing jointly), 5.2 percent for income between $7,000 and $30,000 (between $14,000 and $60,000 for married filing jointly), and 5.65 percent for income $30,000 and over ($60,000 and over for married filing jointly). The bill would also remove outdated language from previous tax years.

Under current law, taxpayers filing as single, head of household, married filing separate, or married filing jointly are allowed to subtract the full amount of Social Security benefits from federal adjusted gross income for Kansas income tax purposes, if the taxpayer has income of $75,000 or less. The bill would exempt Social Security benefits from Kansas income taxes if the taxpayer's income is $75,000 or less. For all taxpayers, the bill would reduce the subtraction modification of Social Security benefits from federal adjusted gross income by a mathematical formula for incomes above the $75,000 threshold but below $125,000 for tax year 2024, for incomes above the $75,000 threshold but below $175,000 for tax year 2025, and for incomes above the $75,000 threshold but below $275,000 for tax year 2026. This would allow taxpayers with income above $75,000 and below the threshold amount to subtract a portion of Social Security benefits from federal adjusted gross income. The bill would exempt all Social Security benefits from the individual income tax beginning in tax year 2027.

The bill would reduce the privilege normal tax rate for banks from 2.25 to 1.63 percent in tax year 2025. The bill would reduce the privilege normal tax rate for trust companies and savings and loan associations from 2.25 percent to 1.61 percent in tax year 2025.

Under current law, the statewide mill rate to fund public education is set at 20-mills for school years 2023-2024 and 2024-2025. The bill would set the statewide mill rate to fund public education at 18-mills for school years 2024-2025 and 2025-2026. The bill would remove specific references to the 20-mills statewide mill rate to fund public education.

Under current law, $42,049 of a residential property's appraised valuation is exempt from the state's 20-mill property tax for public schools in tax year 2023, with a statutory increase of the exemption in tax year 2024 based upon the ten-year average percentage change in statewide valuation of all residential real property. The bill would increase the exemption to $80,000 beginning in tax year 2024 and would allow for future exemption increases based on the ten-year average change in residential property values beginning in tax year 2025.

Under current law, State General Fund transfers to the Local Ad Valorem Tax Reduction Fund (LAVTRF) are suspended in the appropriations bill for both FY 2024 and FY 2025 and are capped at $54.0 million when the transfer is set to resume in FY 2026. The bill would eliminate the transfer to this fund from the State General Fund, transfer the balance of the fund to the State General Fund on July 1, 2024, abolish the fund, and transfer the liabilities of the fund to the State General Fund. The bill would also remove statutory references to the LAVTRF. Specifically, the LAVTRF would no longer be used for loan repayments if a municipality fails to repay a water or sewer loan from the State Revolving Fund of the Kansas Department of Health and Environment (KDHE). The bill would remove the ability for a municipality to use LAVTRF distributions to fund a water pollution control project; remove LAVTRF distributions as a factor in the State Library's grant-in-aid to local public libraries; and remove language that allows LAVTRF distributions to counties be withheld under certain circumstances.

Under current law, State General Fund transfers to the County and City Revenue Sharing Fund (CCRSF) are suspended in the appropriations bill for both FY 2024 and FY 2025 and the transfer is set to resume in FY 2026. The bill would eliminate the transfer to this fund from the State General Fund, transfer the balance of the fund to the State General Fund on July 1, 2024, abolish the fund, and transfer the liabilities of the fund to the State General Fund. The bill would also remove statutory references to the CCRSF.

Estimated State Fiscal Effect			
	FY 2024	FY 2025	FY 2026
Expenditures			
State General Fund	--	$147,000,000	$154,100,000
Fee Fund(s)	--	--	--
Federal Fund	--	--	--
Total Expenditures	--	$147,000,000	$154,100,000
Revenues			
State General Fund	--	($265,000,000)	($250,000,000)
State Highway Fund	--	--	--
School District Finance	--	(147,000,000)	(154,100,000)
Total Revenues	--	($412,000,000)	($404,100,000)
FTE Positions	--	--	--

The Department of Revenue estimates that HB 2844 would decrease state revenues by $412.0 million in FY 2025, including reducing State General Fund (SGF) revenues by an estimated $265.0 million and reducing State School District Finance Fund revenues by an estimated $147.0 million. The estimated fiscal effect by specific tax policy change would be as follows:

Tax Changes (SGF)	FY 2025	FY 2026	FY 2027
Standard Deduction, Exemption, Rate	($211,500,000)	($177,200,000)	($187,500,000)
Social Security Four-Year Phase Out	(50,900,000)	(65,400,000)	(96,200,000)
Privilege Tax Rate Reduction	(2,600,000)	(7,400,000)	(7,400,000)
Total SGF	($265,000,000)	($250,000,000)	($291,100,000)
Tax Changes (Property Taxes)			
School Levy Decrease & Exemption	($147,000,000)	($154,100,000)	($161,600,000)
Total (SGF+Property Taxes)	($412,000,000)	($404,100,000)	($452,700,000)

To formulate the estimates of the increased standard deduction amounts, increased personal exemption amounts, and changes to the individual income tax rate brackets, the Department simulated this tax policy change based on actual tax return data from tax year 2021. The Department estimates that the number of tax returns would grow by approximately 1.0 percent each year and the standard deduction and personal exemption amount are assumed to increase by 2.5 percent each year for the cost-of-living adjustment.

To formulate the estimates of the four-year phase out exemption of Social Security benefits from individual income, the Department reviewed data on Social Security benefits from tax year 2020. The Department adjusted the amount of Social Security benefits to account for cost-of-living adjustments that have occurred since tax year 2020. The Department created a simulated tax table for all taxpayers that receive Social Security benefits and considered the $75,000 Social Security benefits exemption that is currently allowed for each tax filing type.

To formulate the estimates of the privilege normal tax rate reduction for banks, trust companies, and savings and loan associations, the Department reviewed financial institutions privilege tax data from tax year 2021.

Reducing the statewide mill rate to fund public education and increasing the residential exemption would result in a reduction of property tax revenues totaling $147.0 million in FY 2025, $154.1 million in FY 2026, and $161.6 million in FY 2027. The Division of the Budget notes that the estimated reduction in revenues from the school levy would require an offsetting appropriation for State Foundation Aid from the State General Fund to keep the Base Aid for Student Excellence (BASE) in the school finance formula at $5,381 for FY 2025, as included in *The FY 2025 Governor's Budget Report*. If this provision of the bill would be enacted without a corresponding increase to the State General Fund appropriation for State Foundation Aid, the Department of Education would have to prorate the BASE by reducing state aid to school districts in FY 2025.

The bill would increase State General Fund revenues by $156.0 million in FY 2026 and by $158.0 million in FY 2027 by eliminating the State General Fund transfers to the LAVTRF and CCRSF. For FY 2026 when these transfers are set to resume under current law, the LAVTRF would receive $54.0 million and CCRSF would receive $102.0 million. The last State General Fund transfer to these funds occurred in FY 2003; since then, transfers have routinely been suspended in appropriations bills and have been excluded from long-term budget profiles. Since these transfers have routinely been suspended in appropriations bills, the fiscal effects were not included in the tables above.

The Department of Revenue indicates that the bill would require additional expenditures from the State General Fund in FY 2025 to implement the bill and to modify the automated tax system; however, an estimate of the additional expenditures needed to implement the bill were not available before the bill hearing. 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 bill would have no fiscal effect on the operations of the Office of the State Bank Commissioner; however, it has the potential to adjust certain assessment rates. The agency's budget is funded from assessments paid through its licensees and chartered institutions. Its assessments are based on the budgetary needs of the applicable division. For state banks and trust companies, the agency assesses a percentage of each entity's total assets necessary in order to regulate these institutions. The percentage of total assets assessed changes each fiscal year in order to ensure the agency's budgetary needs are met. It is expected that all state banks and trust companies will have an increase in total assets due to lower privilege taxes. If each bank and trust company have an increase in total assets, the agency will lower its percentage of total asset assessment of each state bank and trust company to cover the agency expenses.

The State Treasurer indicates the bill would require it to perform minor accounting procedures to abolish the LAVTRF and CCRSF. The State Treasurer indicates that the administrative costs to implement the bill are estimated to be negligible and could be absorbed within existing resources.

KDHE indicates the bill would have no fiscal effect on the operations of the State Revolving Fund programs. The bill would remove a mechanism for expedited repayment of loans from municipalities that have missed a payment by using distributions from the LAVTRF, but the revenue generating streams a municipality may use for loan repayment remain in place. Eliminating that mechanism, which has never been used, would not threaten the financial backing of revenue or general obligation bonds for the State Revolving Fund programs. State statutes would retain the use of service charges, connection fees, special assessments, property taxes, grants, or other sources of revenue available to the municipality to make loan repayments.

KDHE indicates removing the ability for a municipality to use LAVTRF distributions to fund a water pollution control project would have no fiscal effect on its operations. KDHE indicates that this provision was used in the early years of the Clean Water Act and associated construction grant program but is no longer used.

The State Library indicates since the LAVTRF has not been funded in two decades, it has not been a factor for grant-in-aid for some time. Removing this as a factor will not have a noticeable impact on the eligibility requirements.

The fiscal effects associated with increasing the standard deduction amounts, increasing the income limitation allowing additional Social Security benefits to be exempt from Kansas income taxes, and the residential school levy exemption increase are partially reflected in *The FY 2025 Governor's Budget Report,* which included higher increases to each standard deduction amount, allowed all Social Security benefits to be exempt from Kansas income taxes, reduces privilege tax rates beginning in tax year 2024, and increased the residential school levy exemption to $100,000, but would have eliminated future exemption increases based on the ten-year average change in residential property values. *The FY 2025 Governor's Budget Report* included resuming funding the LAVTRF with a $54.0 million transfer from the State General Fund beginning in FY 2025. No other provisions of HB 2844 are reflected in *The FY 2025 Governor's Budget Report*.

The League of Kansas Municipalities and the Kansas Association of Counties indicate that the bill would eliminate the statutory transfers from the State General Fund to the LAVTRF and CCRSF that could provide additional resources to local governments. By lowering the statewide mill rate to fund public education and increasing the residential exemption, the bill has the potential to reduce revenues that are pledged to repay tax increment financing projects such as redevelopment districts or bioscience development districts; however, it is unknown what impact the bill would have on the viability of those projects.

Sincerely,

Adam C. Proffitt
Director of the Budget

cc: Lynn Robinson, Department of Revenue
Wendi Stark, League of Kansas Municipalities
Jay Hall, Kansas Association of Counties
John Hedges, Office of the State Treasurer
Amy Penrod, Department of Health & Environment
Ray Walling, State Library
Gabrielle Hull, Department of Education
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Barbara Albright, Office of the State Bank Commissioner