

March 12, 2014

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

Dear Representative Carlson:

SUBJECT: Fiscal Note for HB 2672 by House Committee on Health and Human Services

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2672 is respectfully submitted to your committee.

HB 2672 would increase the state's cigarette and tobacco products taxes. The bill would increase the cigarette tax to \$2.29 a pack (from \$0.79 a pack) on January 1, 2015 and would raise the tobacco products tax to 78.0 percent of the wholesale price (from 10.0 percent) on July 1, 2014. The bill would establish an inventory tax for all cigarette and tobacco products on hand as of January 1, 2015. The inventory tax would be \$1.50 per pack for cigarettes and would be due in three equal installments: January 31, April 30, and July 30, 2015. The inventory tax on tobacco products would be 68.0 percent of the wholesale sales price for tobacco products and would be due on January 31, 2015. The bill would reduce the compensation rates that distributors receive for collecting cigarette and tobacco products taxes from 4.0 percent to 0.5 percent of the tax liability to coincide with the increase in the tobacco products tax.

Estimated State Fiscal Effect				
	FY 2014 SGF	FY 2014 All Funds	FY 2015 SGF	FY 2015 All Funds
Revenue	--	--	\$77,170,000	\$77,170,000
Expenditure	--	--	\$340,142	\$340,142
FTE Pos.	--	--	--	4.00

The Department of Revenue estimates that HB 2672 would increase State General Fund revenues by \$77,170,000 in FY 2015. The increase in revenues and how the November 6, 2013 consensus revenue estimate for FY 2015 would be affected are shown in the following table:

Effect on FY 2015 Consensus Revenue Estimates
 (Dollars in Thousands)

Receipt Description	Consensus Revenue Estimates (Nov. 6, 2013)	Change in Revenue FY 2015	Proposed Adjusted CRE FY 2015
Motor Carrier	\$ 24,000	\$ --	\$ 24,000
Income Taxes:			
Individual	2,525,000	--	2,525,000
Corporate	380,000	--	380,000
Financial Institutions	34,500	--	34,500
Excise Taxes:			
Retail Sales	2,160,000	--	2,160,000
Compensating Use	355,000	--	355,000
Cigarette	89,000	50,340	139,340
Severance	135,000	--	135,000
All Other Excise Taxes	111,000	26,830	137,830
Other Taxes	<u>161,700</u>	<u>--</u>	<u>161,700</u>
Total Taxes	\$5,975,200	\$ 77,170	\$6,052,370
Other Revenues:			
Interest	\$ 10,000	\$ --	\$ 10,000
Transfers	(118,000)	--	(118,000)
Agency Earnings	<u>49,900</u>	<u>--</u>	<u>49,900</u>
Total Other Revenues	(\$ 58,100)	\$ --	(\$ 58,100)
Total Receipts	\$5,917,100	\$ 77,170	\$5,994,270

The fiscal effect to state revenues during subsequent years would be as follows:

	<u>FY 2016</u>	<u>FY 2017</u>	<u>FY 2018</u>	<u>FY 2019</u>
State General Fund	\$115,150,000	\$108,780,000	\$108,440,000	\$108,110,000

The bill would result in the collection of \$77,170,000 in additional cigarette and tobacco products taxes in FY 2015 that would be deposited into the State General Fund. The tobacco products tax would go into effect beginning July 1, 2014 and the cigarette tax rate increase would go into effect January 1, 2015. The estimate includes the collection of the inventory tax for cigarettes, but not for tobacco products because there would not be any remaining inventory of the lower taxed products when the inventory tax is calculated as of January 1, 2015. The Department of Revenue notes that if the bill is amended to change the tobacco products tax to be effective on January 1, 2015 to coincide with the collection of the inventory tax, then the collection of additional cigarette and tobacco products taxes would decrease to \$63,760,000 in FY 2015.

The Honorable Richard Carlson, Chairperson

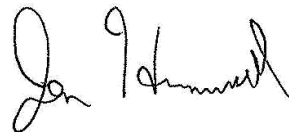
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To formulate these estimates, the Department of Revenue reviewed data on cigarette and tobacco product tax receipts, including data from 2002 when the taxes on cigarette and tobacco products were last increased. In computing the amount of cigarette and tobacco products taxes that would be generated, the Department reviewed data on cost avoidance and purchasing habit changes (lag factor). This methodology was used in 2002 when the cigarette tax was increased in from \$0.24 to \$0.79 per pack, which resulted in a 20.0 percent reduction in the number of cigarette packs sold the year after the rate change and an additional 5.0 percent reduction in the following year. This time, with the cigarette tax changing from \$0.79 to \$2.29 a pack, the impact on purchasing habits would presumably be greater. Additionally, Kansas would have significantly higher taxes than neighboring states which would lead to more cost avoidance. The tax rates for a pack of cigarettes for bordering states are: Missouri \$0.17, Nebraska \$0.64, Colorado \$0.84, and Oklahoma \$1.03. With a large Kansas population on the Missouri border, the increase of the Kansas tax rate would result in more people crossing state lines to purchase cigarettes. Other Kansas residents would likely use other tax avoidance methods, such as Internet purchases or purchasing on Indian reservations.

The Department of Revenue indicates the bill would require \$340,142 from the State General Fund in FY 2015 for administrative costs to implement the bill, including changes to forms and instructions, and modifications to the Department's computer processing system to collect and process the inventory taxes on cigarettes and tobacco products. 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, expenditures for outside contract programmer services beyond the Department's current budget may be required. The Department indicates the bill would require it to hire 4.00 additional FTE positions on a temporary basis to administer the inventory tax and monitor and inspect retail stores to ensure Kansas tax stamps have been applied to the cigarettes. Any fiscal effect associated with HB 2672 is not reflected in *The FY 2015 Governor's Budget Report*.

Sincerely,

A handwritten signature in black ink, appearing to read "Jon Hummell". The signature is fluid and cursive, with the first name "Jon" being more prominent.

Jon Hummell,
Interim Director of the Budget

cc: Steve Neske, Department of Revenue
Aaron Dunkel, Health & Environment
Jackie Aubert, Children & Families