

April 13, 2021

The Honorable Adam Smith, Chairperson
House Committee on Taxation
Statehouse, Room 185A-N
Topeka, Kansas 66612

Dear Representative Smith:

SUBJECT: Fiscal Note for HB 2428 by House Committee on Taxation

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2428 is respectfully submitted to your committee.

HB 2428 would increase the state's cigarette and tobacco products taxes on July 1, 2021. The bill would increase the cigarette tax to \$2.79 a pack (from \$1.29 a pack) and increase the tobacco products tax to 54.0 percent of the wholesale price (from 10.0 percent). The bill would establish an inventory tax for all cigarette and tobacco products on hand as of July 1, 2021. The inventory tax would be \$1.50 per pack for cigarettes and would be due on October 31, 2021. The inventory tax would be 44.0 percent of the wholesale sales price for tobacco products on hand as of July 1, 2021, and the inventory tax would be due on July 31, 2021. Under current law, a wholesale dealer in good standing can receive a 0.55 percent cigarette stamp discount for the costs to affix the stamp to each package of cigarettes indicating that the cigarette tax has been paid. The bill would reduce the cigarette stamp discount to 0.25 percent. The tobacco products discount for a distributor's expenses to file the tobacco products tax return would be reduced from 4.0 percent to 0.6 percent.

The bill would also create the Cigarette and Tobacco Cessation Fund to be administered by the Kansas Department of Health and Environment (KDHE) to promote the cessation of cigarette and tobacco usage. The first \$1.0 million in cigarette and tobacco products tax revenue collected each year would be deposited in the Cigarette and Tobacco Products Cessation Fund.

The bill would reduce the state retail sales tax and compensating use tax rate for food and food ingredients from 6.5 percent to 5.0 percent on July 1, 2021. 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, candy, dietary supplements, food sold through vending machines, soft drinks, tobacco, or certain prepared foods. Food and food ingredients would specifically include bottled water. The bill provides specific definitions for bottled water, candy, food sold through vending machines, prepared food, soft drinks, and dietary supplements. The bill would 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.

Estimated State Fiscal Effect				
	FY 2021 SGF	FY 2021 All Funds	FY 2022 SGF	FY 2022 All Funds
Revenue	--	--	\$18,630,000	\$5,030,000
Expenditure	--	--	--	\$1,804,739
FTE Pos.	--	--	--	8.00

The Department of Revenue estimates that HB 2428 would increase state revenues by \$5,030,000 in FY 2022. Of that total, the State General Fund is estimated to increase by \$18,630,000 in FY 2022, the State Highway Fund is estimated to decrease by \$14.6 million in FY 2022, and the Cigarette and Tobacco Products Cessation Fund is estimated to increase by \$1.0 million in FY 2022. This bill also is 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 fiscal effect to state revenues during subsequent years would be as follows:

	<u>FY 2023</u>	<u>FY 2024</u>	<u>FY 2025</u>	<u>FY 2026</u>
State General Fund	\$11,260,000	\$8,440,000	\$ 3,990,000	\$ 3,090,000
State Highway Fund	(16,200,000)	(16,300,000)	(16,500,000)	(16,600,000)
C&T Cessation Fund	<u>1,000,000</u>	<u>1,000,000</u>	<u>1,000,000</u>	<u>1,000,000</u>
	(\$ 3,940,000)	(\$6,860,000)	(\$11,510,000)	(\$12,510,000)

The specific changes in revenues from the tax law changes for FY 2022 and FY 2023 are shown in the following table:

	<u>FY 2022</u>	<u>FY 2023</u>
Cigarette Tax to \$2.79 per pack	\$55,220,000	\$ 63,730,000
Cigarette Inventory Tax	13,320,000	--
Tobacco Products Tax to 54.0 Percent	26,190,000	32,430,000
Tobacco Products Inventory Tax	1,100,000	--
Food Sales Tax to 5.0 percent	<u>(90,800,000)</u>	<u>(100,100,000)</u>
Total Tax Law Changes	\$ 5,030,000	(\$ 3,940,000)

The estimate assumes that 15.0 percent of all current sales tax collections are collected on food and food ingredients. 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. Sales tax, cigarette tax, and tobacco products tax estimates are based on the November 2020 Consensus Revenue Estimate.

The Department of Revenue indicates that it would require a total \$804,739 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.

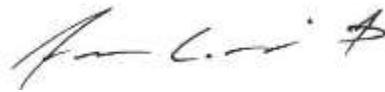
The Department estimates that ongoing expenses for salary and wages for the 7.00 FTE positions and overhead expenses would total \$448,124 from the State General Fund in FY 2023. The current composite jurisdiction sales tax system does not accommodate a second state sales tax rate. This bill would require modifications to 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. 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 July 1, 2021.

KDHE indicates that the bill would provide \$1.0 million in cigarette and tobacco products tax revenue to promote the cessation of cigarette and tobacco usage. KDHE indicates that it would use the additional money to hire 1.00 new FTE position to work with KDHE media vendors to promote the cessation of cigarette and tobacco usage with paid television, radio, print, or digital advertising at the state and local levels. The additional funding would also allow KDHE to work with health care professionals and other partners to fund tobacco cessation and prevention programs.

The Attorney General's Office indicates that the bill would have no fiscal effect on its operations. The Office indicates that the bill would likely reduce sales of cigarettes in the state, which has the potential to decrease payments to Kansas under the Master Settlement Agreement.

The Kansas Department of Transportation (KDOT) indicates that the bill would reduce state revenues to the State Highway Fund as noted above. KDOT 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 Kansas Association of Counties and the League of Kansas Municipalities indicate that the bill would provide a net reduction to local sales tax collections that are used in part to finance local governments. Any fiscal effect associated with HB 2428 is not reflected in *The FY 2022 Governor's Budget Report*.

Sincerely,



Adam Proffitt
Director of the Budget

cc: Ben Cleeves, Transportation
Jay Hall, Association of Counties
Lynn Robinson, Department of Revenue
Dan Thimmesch, Health & Environment
Willie Prescott, Office of the Attorney General
Lauren Tice Miller, Office of the Treasurer
Wendi Stark, League of Municipalities