

February 14, 2012

The Honorable Richard Carlson, Chairperson
House Committee on Taxation
Statehouse, Room 274-W
Topeka, Kansas 66612

Dear Representative Carlson:

SUBJECT: Fiscal Note for HB 2560 by House Committee on Taxation

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2560 is respectfully submitted to your committee.

HB 2560 is a comprehensive tax bill that lowers individual income rates, eliminates individual income tax credits and deductions, and makes changes to the severance tax, homestead property tax, retail sales tax, and compensating use tax. Beginning in tax year 2013, the bill would lower the state's individual income tax rates for all taxpayers. Rather than the current three tax brackets, the bill would create two brackets: a 3.0 percent rate for income under \$15,000 (\$30,000 for married filing jointly) and a 4.9 percent rate for income \$15,000 and over (\$30,000 for married filing jointly).

The bill would also create a procedure that would allow individual and corporate income tax rates to decrease in future tax years. Beginning in FY 2015, if actual State General Fund receipts from the fiscal year exceed actual State General Fund receipts from the preceding fiscal year by more than 2.0 percent and the State General Fund ending balance exceeds 7.5 percent, the Secretary of Revenue would estimate the individual and corporate tax rate reductions that would decrease receipts by that amount. Rate reductions would be applied to the highest marginal rates.

The bill would make the following changes to simplify and streamline the state's tax code:

1. Eliminate all itemized deductions and tax credits for the individual income tax, except for the High Performance Incentive Program Tax Credit and Community Entrepreneurship Tax Credit;
2. Eliminate the Learning Quest and Long Term Care subtraction modifications;
3. Increase the standard deduction for head of household filers from \$4,500 to \$9,000;
4. Prohibit renters from qualifying for the Homestead Property Tax Refund Program;

5. Eliminate the Food Sales Tax Rebate Program;
6. Maintain the state retail sales and compensating use tax rates at 6.3 percent instead of allowing it to reduce to 5.7 percent on July 1, 2013 as required by current law, and adjust the transfer percentage to allow the same amount to go to the State Highway Fund as under current law;
7. Repeal the current two-year severance tax exemption on new pool oil and gas wells, except for oil wells generating 50 barrels or fewer per day; and
8. Exempt all non-wage business income that businesses would otherwise report from state individual income taxes (*as reported by LLCs, S-Corps, and sole proprietorships on lines 12, 17, and 18 of the federal form 1040 individual income tax return*).

Estimated State Fiscal Effect				
	FY 2012 SGF	FY 2012 All Funds	FY 2013 SGF	FY 2013 All Funds
Revenue	--	--	(\$89,900,000)	(\$89,900,000)
Expenditure	--	--	--	--
FTE Pos.	--	--	--	--

The Department of Revenue estimates that HB 2560 would decrease State General Fund revenues by \$89.9 million in FY 2013. The decrease in revenues and how the November 4, 2011 consensus revenue estimate for FY 2013 would be affected are shown in the following table:

Effect on FY 2013 Consensus Revenue Estimates
(Dollars in Thousands)

Receipt Description	Consensus Revenue Estimates (Nov. 4, 2011)	Change in Revenue FY 2013	Proposed Adjusted CRE FY 2013
Motor Carrier	\$ 21,000	\$ --	\$ 21,000
Income Taxes:			
Individual	3,065,000	(106,000)	2,959,000
Corporate	240,000	--	240,000
Financial Institutions	24,000	--	24,000
Excise Taxes:			
Retail Sales	2,200,000	--	2,200,000
Compensating Use	335,000	--	335,000
Cigarette	92,000	--	92,000
Corporate Franchise	6,000	--	6,000
Severance	102,800	16,100	118,900
All Other Excise Taxes	96,000	--	96,000
Other Taxes	<u>141,000</u>	<u>--</u>	<u>141,000</u>
Total Taxes	\$6,322,800	(\$ 89,900)	\$6,232,900

Other Revenues:

Interest	\$ 7,400	\$ --	\$ 7,400
Transfers	(90,300)	--	(90,300)
Agency Earnings	<u>51,500</u>	<u>--</u>	<u>51,500</u>
Total Other Revenues	(\$ 31,400)	\$ --	(\$ 31,400)
Total Receipts	\$6,291,400	(\$ 89,900)	\$6,201,500

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

	<u>FY 2014</u>	<u>FY 2015</u>	<u>FY 2016</u>	<u>FY 2017</u>
State General Fund	(\$99,000,000)	(\$60,800,000)	(\$52,600,000)	(\$49,900,000)

To formulate these estimates, the Department of Revenue reviewed data on current income tax collections, tax credits, and deductions. The Department estimates that reducing individual income tax rates and eliminating most individual income tax credits and deductions, which would begin in tax year 2013, would reduce State General Fund revenues by \$106.0 million in the last part of FY 2013 and would reduce State General Fund revenues by \$368.8 million in FY 2014. Eliminating the current two-year severance tax exemption on new pool oil and gas wells is estimated to generate \$16.1 million in FY 2013 and \$18.8 million in FY 2014. The changes to the retail sales and compensating use tax rates are estimated to provide an additional \$251.0 million in FY 2014. The Department estimates that the bill would reduce State General Fund revenues by \$89.9 million in FY 2013 (\$16.1 million in additional severance taxes minus \$106.0 million lower individual income taxes) and by \$99.0 million in FY 2014 (\$251.0 million in additional retail sales and compensating use taxes plus \$18.8 million in additional severance taxes minus \$368.8 million in lower individual income taxes).

The Department indicates that the administrative costs associated with implementing the bill would not be needed until FY 2014. The Department indicates that the bill would require \$52,500 from the State General Fund in FY 2014 to implement the bill and to modify the automated tax system. The bill would create \$238,000 in savings by eliminating salaries and wages associated with 5.00 FTE positions that would no longer be needed to administer, process, and track the Food Sales Tax Credit and the Homestead Property Tax Credit for renters in FY 2014. These savings would be offset in FY 2014 by the costs associated with one-time computer programming costs in the same amount. The required programming for this bill by itself (3,800 hours in in-house programming and implementation) 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 Kansas Historical Society indicates that the bill would no longer allow the Historical Preservation Tax Credit to be claimed by individual income taxpayers. The Historical Society is responsible for administering this tax credit program and indicates that if the tax credit would only be able to be claimed by corporate taxpayers, then the demand for this program would be greatly reduced. The agency indicates that there were 119 approved projects in FY 2011 and estimates that applications for new projects would be reduced by approximately 90.0 percent under the provisions of this bill. The agency indicates that expenses for administering this

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program are paid through application fees. With the anticipated reduction in fee revenues, the agency indicates it would either reduce the number of positions that are used to administer this program from 2.00 FTE positions to 1.00 FTE position or raise its application fees to make up the anticipated shortfall of \$29,050.

The Department of Commerce is responsible for managing a number of individual income tax credits which would be eliminated under the bill. However, the savings realized from no longer managing these tax credit programs would be negligible.

It should be noted that while the Kansas Earned Income Tax Credit (EITC) is eliminated in this bill, *The FY 2013 Governor's Budget Report* provides an additional \$60.0 million that will be devoted to state child welfare and poverty programs through the budget process with accompanying legislative oversight. Because the current EITC is used as the state match for the federal Temporary Assistance for Needy Families (TANF) Program, the additional funding through the budget process is designed to count toward the state maintenance of effort requirements and avoid any federal TANF penalties. The fiscal effect associated with HB 2560 is reflected in *The FY 2013 Governor's Budget Report*.

Sincerely,

A handwritten signature in black ink, appearing to read "Steven J. Anderson", written in a cursive style.

Steven J. Anderson, CPA, MBA
Director of the Budget

cc: Steve Neske, Revenue
Zac Anshutz, Insurance Department
Jason Glasrud, Commerce
Tom Day, KCC
Debbie White, Historical Society
Jackie Aubert, SRS