

February 26, 2020

REVISED

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

Dear Representative Johnson:

SUBJECT: Revised Fiscal Note for HB 2617 by Representative Highberger and Representative Horn

In accordance with KSA 75-3715a, the following revised fiscal note concerning HB 2617 is respectfully submitted to your committee.

HB 2617 would provide sales tax exemptions for food and food ingredients and feminine hygiene products on July 1, 2020. The bill would allow local governments to continue to charge a sales tax on food and food ingredients. Food and food ingredients would be 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, dietary supplements, tobacco, or certain prepared food. Food and food ingredients would specifically include bottled water, candy, food sold through vending machines, and soft drinks. The bill would provide specific definitions for bottled water, candy, food sold through vending machines, prepared food, soft drinks, dietary supplements, and feminine hygiene products. The bill would not adjust the distribution of state retail sales 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.

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) in tax year 2018 and in future tax years. The bill would create a seven-bracket income tax system beginning in tax year 2020. The individual income tax rates would be 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), 5.7 percent for income between \$30,000 and \$100,000 (between \$60,000 and \$200,000 for married filing jointly), 6.15 percent for income between \$100,000 and \$250,000 (between \$200,000 and \$500,000 for married filing jointly), 7.7 percent for income between \$250,000 and \$500,000 (between \$500,000 and \$1.0 million for married filing jointly), 8.7 percent for income between \$500,000 and \$1.0 million (between \$1.0 million and \$2.0 million for married filing jointly), and at 9.7 percent for income \$1.0 million and over (\$2.0 million and over for married filing jointly).

Estimated State Fiscal Effect				
	FY 2020 SGF	FY 2020 All Funds	FY 2021 SGF	FY 2021 All Funds
Revenue	--	--	\$148,300,000	\$83,700,000
Expenditure	--	--	\$876,567	\$876,567
FTE Pos.	--	--	--	6.00

The Department of Revenue estimates that HB 2617 would increase state revenues by \$83.7 million in FY 2021. Of that total, the State General Fund is estimated to increase by \$148.3 million in FY 2021, while the State Highway Fund is estimated to decrease by \$64.6 million in FY 2021. This bill also is estimated to decrease local sales tax revenues from the new sales tax exemption on feminine hygiene products; however, the specific estimate of lower local sales tax revenues was not calculated by the Department of Revenue. Local sales tax revenues from food and food ingredients are not estimated to be affected under the provisions of this bill. The fiscal effect to state revenues during subsequent years would be as follows:

	<u>FY 2022</u>	<u>FY 2023</u>
State General Fund	\$4,600,000	\$2,900,000
State Highway Fund	<u>(71,400,000)</u>	<u>(72,500,000)</u>
	(\$66,800,000)	(\$69,600,000)

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 Department estimates that exempting food and food ingredients would result in a reduction in state sales tax collections of \$398.5 million in FY 2021, \$441.2 million in FY 2022, and \$447.8 million in FY 2023. 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 subject to the local tax (similar to the current utility return) and the current return for items subject to the state and local sales tax. The Department indicates these additional requirements may be burdensome to some retailers.

To formulate the estimates of the sales tax exemption for feminine hygiene products, the Department review data from the Kansas Department of Health and Environment. According to the Kansas Department of Health and Environment, there were approximately 729,000 women in Kansas between the ages of 15 and 54 in 2018. Based on market data and exemption data from other states, this exemption is estimated to result in a reduction in state sales tax collections of \$1.3 million in FY 2021, \$1.5 million in FY 2022, and \$1.5 million in FY 2023.

To formulate the estimates of the proposed income tax rate changes, the Department of Revenue reviewed data from tax year 2018 and created a simulated tax table. The Department estimates that individual income tax collections would increase by \$483.5 million in FY 2021, \$375.9 million in FY 2022, and \$379.7 million in FY 2023. The individual income tax estimate for FY 2021 includes 100.0 percent of tax year 2020 tax liability and 30.0 percent of tax year 2021 tax liability. The individual income tax estimate for FY 2022 includes 70.0 percent of tax year 2021 tax liability and 30.0 percent of tax year 2022 tax liability.

The Department indicates that the bill would require \$876,567 from the State General Fund in FY 2021 to implement the bill and to modify the automated tax system. The bill would require the Department to hire 6.00 new FTE positions to review, process, and audit sales tax returns. 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 exemption portion of the bill on July 1, 2020. Since the original fiscal note was issued, the Department of Revenue increased its estimate on administrative costs needed to implement the bill.

The Department of Administration indicates that adjusting state income tax collections has the potential to have a fiscal effect on the amount of revenue collected from its debt setoff program. This program intercepts individual income tax refunds and homestead tax refunds and applies those amounts to debts owed to state agencies, municipalities, district courts, and state agencies in other states. Debts include, but are not limited to child support, taxes, educational expenses, fines, services provided to the debtor, and court ordered restitution. As the dollar amounts of refunds are decreased, the amount available for possible debt setoffs is also decreased. However, the Department is unable to make a precise estimate of the amount of debts setoffs that will not be intercepted as a result of the bill.

The Kansas Department of Transportation indicates that the bill would reduce state revenues to the State Highway Fund as noted above. The Kansas Department of Transportation 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 League of Kansas Municipalities and Kansas Association of Counties indicates that the state sales tax exemption on food and food ingredients while allowing local governments to continue to charge a sales tax on food and food ingredients has the potential to alter shopping habits, especially near the border, and could increase local sales tax revenues that are used in part to finance local governments. The sales tax exemption for feminine hygiene products would provide a reduction to local sales tax collections; however, the reduction is estimated to be negligible. Any fiscal effect associated with HB 2617 is not reflected in *The FY 2021 Governor's Budget Report*.

Sincerely,



Larry L. Campbell
Director of the Budget

cc: Ben Cleaves, Transportation
Jay Hall, Association of Counties
Jeff Scannell, Department of Administration
Lynn Robinson, Department of Revenue
Trey Cocking, League of Municipalities