

April 24, 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 2625 by Representative Rubin, et al.

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2625 is respectfully submitted to your committee.

HB 2625 would implement the Kansas Fair Tax Act of 2013 Revised. The bill would eliminate the individual income, corporate income, financial institutions income, retail sales, and compensating use taxes beginning on January 1, 2015. All outstanding taxes owed to the state before January 1, 2015 would remain an obligation of the taxpayer. All income tax credits that remain outstanding after January 1, 2015 would be determined by an audit conducted by the transition committee.

The bill would impose a consumption tax at the rate of 5.7 percent on new personally consumed goods and services beginning on July 1, 2014 with all of the receipts deposited in the State General Fund. Beginning on January 1, 2014 the bill would require that 81.579 percent of the amount collected from the consumption tax be deposited in the State General Fund and 18.421 percent be deposited in the State Highway Fund. The bill would define the goods and services that the consumption tax would be imposed on and the goods and services that would be exempted. The consumption tax would be paid by the consumer and the retailer would be responsible for collecting the tax. If the retailer does not collect all of the tax that is due, then the Director of Taxation would be allowed to collect the remaining tax that is due directly from the consumer. The bill would provide retailers with 0.25 percent of the amount of the consumption taxes that they have collected to compensate retailers for collecting and remitting the tax to the State of Kansas.

The bill would provide a family consumption allowance for each Kansas resident taxpayer. The allowance is determined annually and would be equal to the product of the rate of consumption tax and 1/12th of the annual poverty guidelines established in the *Federal Register* by the U.S. Department of Health and Human Services. The allowance would be bundled as a single payment to each household to include all eligible Kansas residents who share the same dwelling and would be deposited electronically. The bill would require the taxpayer to

electronically file a yearly report to the Department of Revenue by September 30th that certifies the name and valid Social Security numbers of each person residing at the same dwelling unit. When there is a change in the household, the taxpayer is required to file a change with the Department of Revenue within two weeks of the change.

The bill would not allow a retailer to assume or absorb the tax. All retailers would be required to be registered with the Department of Revenue. The bill would provide the Secretary of Revenue with the authority to revoke or suspend the registration certificate of a retailer under certain conditions. Retailers would be required to maintain records of transactions for at least three years and the bill would set a three-year statute of limitations for any refund claims. The Department of Revenue would have the authority to audit retailers. The Department would be authorized to charge interest and penalties for any unpaid taxes and could seize property of the retailer for any nonpayment of taxes. The Department would be required to work with retailers and associations of retailers regarding the efficient payment, collection, accounting of the tax, and the direct payment of the tax by businesses. The bill would create the Consumption Tax Refund Fund at the Department of Revenue and would provide procedures for consumers to file for a refund. The bill would allow for the continuation of payments from the consumption tax for STAR bond projects and for the intermodal facility in Johnson County. The provisions of the Streamlined Sales Tax Agreement would apply to the consumption tax.

The bill would impose a compensating consumption tax at the rate of 5.7 percent on goods purchased outside of Kansas and that are used, stored, or consumed in Kansas beginning on July 1, 2014, with all of the receipts deposited in the State General Fund. Beginning on January 1, 2014, the bill would require that 88.767 percent of the amount collected from the compensating consumption tax be deposited in the State General Fund and 11.233 percent be deposited in the State Highway Fund. Cities and counties would not be able to continue to charge local retail sales and compensating use taxes and would not be authorized to charge a local consumption tax or local compensating consumption tax.

The bill would create the Consumption Tax Transition Committee that will make a report on recommendations for necessary procedures, administrative processes, and legislation to improve the implementation of this new tax. The committee would comprise members of the Legislature, the Secretary of Revenue, the State Treasurer, and the Secretary of State. The report would be due prior to January 1, 2015.

Estimated State Fiscal Effect				
	FY 2014 SGF	FY 2014 All Funds	FY 2015 SGF	FY 2015 All Funds
Revenue	--	--	(\$226,000,000)	\$210,000,000
Expenditure	--	--	\$600,000	\$600,000
FTE Pos.	--	--	--	--

The Department of Revenue estimates that HB 2625 would increase state revenues by \$210.0 million in FY 2015. Of that total, the State General Fund is estimated to decrease by \$226.0 million in FY 2015, while the State Highway Fund is estimated to increase by \$436.0 million in FY 2015. This bill is also estimated to eliminate local retail sales and compensating use tax revenues of \$695.0 million in FY 2015. The fiscal effect to 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	(\$1,280,000,000)	(\$1,187,000,000)	(\$1,118,000,000)	(\$1,048,000,000)
State Highway Fund	(44,000,000)	(46,000,000)	(47,000,000)	(49,000,000)
Local Governments	<u>(787,000,000)</u>	<u>(816,000,000)</u>	<u>(847,000,000)</u>	<u>(878,000,000)</u>
	(\$2,111,000,000)	(\$2,049,000,000)	(\$2,012,000,000)	(\$1,975,000,000)

To formulate these estimates, the Department of Revenue reviewed data on insurance accounts, rental units and average month rent, loss of used merchandise sales, loss of business sales, increased revenues due to the repeal of existing sales tax exemptions, and the addition of taxation on personal services, including professional and technical services, health care, and other personal services. The Department estimates that corporate and individual income tax receipts would decrease by nearly 50.0 percent in FY 2015 due to the loss of withholding and estimated payments. The consumption tax would generate more than the current sales tax to yield a positive revenue balance for FY 2015. However, in FY 2016 and future fiscal years, the consumption tax does not replace the loss of revenues from the retail sales and income taxes, resulting in significantly less revenue each year.

The bill provides for retailers to retain 0.25 percent as compensation for filing the tax returns, which is estimated to reduce revenues by approximately \$11.5 million annually. Providing a family consumption allowance for each Kansas resident taxpayer is estimated to reduce revenues by \$107.0 million each year.

The Department of Revenue estimates that the bill would require a total of \$600,000 from the State General Fund in FY 2014 for administrative costs to implement the bill. The Department indicates that would be required to develop the taxpayer consumption allowance database to provide the family consumption allowance to each Kansas resident taxpayer on a monthly basis. The Department would be required to develop a process to issue the family consumption allowances, which would require programming, testing, and maintenance. An on-line process would need to be developed for taxpayers to file their annual return and to make changes when the household population changes. The Department would also need to develop a system to electronically remit the family consumption allowance to potentially thousands of banks on a monthly basis. The Department would also be required to issue new on-line publications, news releases, retailer help guides, and provide assistance to get new taxpayers registered.

The Department indicates that the proposal would not have an immediate impact on its staffing levels. The consumption tax would increase the number of retailers filing reports to

The Honorable Richard Carlson, Chairperson

April 24, 2014

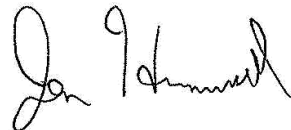
Page 4—HB 2625

include the service industries, insurance and real estate rental companies. Through a reallocation of existing staff, the Department would be able to absorb the additional workload associated with the consumption tax by using income tax processing staff. After the 2014 income tax returns are processed in 2015, the Department may be able to reduce staff associated with the processing of income tax returns. The overall impact of the consumption tax on collections and auditing functions is unknown and decisions on staffing would be determined once the Department has had experience administering and enforcing the new tax.

The Kansas Department of Transportation (KDOT) indicates that the bill would make changes to the amount of revenue distributed to the State Highway Fund in FY 2015 and future fiscal years as noted above. KDOT indicates that the bill would increase revenues to the State Highway Fund by a total of \$199.0 million over the next six years, which represents the remainder of the current comprehensive transportation plan known as T-WORKS. Any fiscal effect associated with HB 2625 is not reflected in *The FY 2015 Governor's Budget Report*.

The League of Kansas Municipalities and Kansas Association of Counties indicate that the bill would eliminate local retail sales and compensating use taxes beginning on January 1, 2015. Because the bill does not replace local retail sales and compensating use taxes with a local option consumption tax, the bill would significantly decrease revenues that are used to finance local governments. In addition, cities and counties that have imposed a community improvement or transportation develop district sales tax would lose that revenue as well.

Sincerely,

A handwritten signature in black ink, appearing to read "Jon Hummell", written in a cursive style.

Jon Hummell,
Interim Director of the Budget

cc: Steve Neske, Revenue
Melissa Wangemann, KAC
Larry Baer, LKM
Ben Cleeves, KDOT
Zac Anshutz, Insurance Department