

January 30, 2024

The Honorable Adam Smith, Chairperson
House Committee on Taxation
300 SW 10th Avenue, Room 346-S
Topeka, Kansas 66612

Dear Representative Smith:

SUBJECT: Fiscal Note for HB 2586 by House Committee on Taxation

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2586 is respectfully submitted to your committee.

HB 2586 is a comprehensive tax bill that reduces retail sales, compensating use, individual income, financial institutions privilege, and property taxes. The bill would reduce the state retail sales tax and compensating use tax rate for food and food ingredients to 0.0 percent and would change the distribution of overall state sales and compensating use tax revenue to 82.0 percent to the State General Fund and 18.0 percent to the State Highway Fund on April 1, 2024. Under current law, the state retail sales tax rates specifically on food and food ingredients and the distribution of overall state sales and compensating use tax revenue are set to be adjusted as follows:

<u>Date of Rate Change</u>	<u>Tax Rate</u>	<u>Percent to State General Fund</u>	<u>Percent to State Highway Fund</u>
Current law	2.0	83.0	17.0
January 1, 2025	0.0	82.0	18.0

The bill would provide a sales tax exemption for diapers and feminine hygiene products beginning on April 1, 2024. The bill includes definitions for diapers and feminine hygiene products.

The bill would create a sales tax holiday for back-to-school related sales of certain items. The sales tax holiday would begin on the first Thursday in August at 12:01 a.m. and end at midnight on the following Sunday. The bill would exempt all back-to-school related sales of:

1. Any article of clothing or clothing accessories with a sales price of \$300 or less per item;
2. All school supplies, school instructional materials, or school art supplies with a sales price of \$100 or less per item;
3. All prewritten computer software with a sales price of \$300 or less per item; and
4. All computers or school computer supplies with a sales price of \$2,000 or less per item.

The bill provides definitions for clothing, clothing accessories or equipment, school supplies, school instructional materials, school art supplies, school computer supplies, and other items used to implement the back-to-school sales tax holiday. The first back-to-school sales tax holiday would occur in August 2024.

Under current law, taxpayers filing as single, head of household, married filing separate, or married filing jointly are allowed to subtract the full amount of Social Security benefits from federal adjusted gross income for Kansas income tax purposes, if the taxpayer has income of \$75,000 or less. The bill would exempt all Social Security benefits from the individual income tax regardless of income amounts beginning in tax year 2024.

Under current law, the standard deduction for the calculation of Kansas income taxes is set at \$3,500 for single individual taxpayers, \$8,000 for married filing joint status, and \$6,000 for head of household. The bill would increase the standard deduction to \$5,000 for single individual taxpayers, \$10,000 for married filing joint status, and \$7,500 for head of household beginning in tax year 2024 and annually thereafter.

Under current law, the non-refundable income tax credit for expenses for household and dependent care services necessary for gainful employment (more commonly referred to as the Child and Dependent Care Tax Credit) is set at 25.0 percent of the credit claimed against the taxpayer's federal income tax liability under Section 21 of the federal Internal Revenue Code in tax year 2024 and in all future tax years. The bill would set the tax credit at 50.0 percent in tax year 2024 and in all future tax years.

The bill would reduce the privilege normal tax rate for banks from 2.25 percent to 1.94 percent in tax year 2024 and 1.63 percent in tax year 2025. The bill would reduce the privilege normal tax rate for trust companies and savings and loan associations from 2.25 percent to 1.93 percent in tax year 2024 and 1.61 percent in tax year 2025.

Under current law, \$42,049 of a residential property's appraised valuation is exempt from the state's 20-mill property tax for public schools in tax year 2023, with a statutory increase of the exemption in tax year 2024 based upon the ten-year average percentage change in statewide valuation of all residential real property. The bill would increase the exemption to \$100,000 beginning in tax year 2024 and would eliminate future exemption increases based on the ten-year average change in residential property values. The bill would take effect upon publication in the *Kansas Register*.

Estimated State Fiscal Effect			
	FY 2024	FY 2025	FY 2026
Expenditures			
State General Fund	--	(\$84,852,347)	(\$81,300,000)
Fee Fund(s)	--	--	--
Federal Fund	--	--	--
Total Expenditures	--	(\$84,852,347)	(\$81,300,000)
Revenues			
State General Fund	(\$22,000,000)	(\$346,100,000)	(\$216,500,000)
State Highway Fund	(4,500,000)	(17,600,000)	(2,600,000)
School District Finance	--	(84,800,000)	(81,300,000)
Total Revenues	(\$26,500,000)	(\$448,500,000)	(\$300,400,000)
FTE Positions	--	--	--

The Department of Revenue estimates that HB 2586 would decrease state revenues by \$26.5 million in FY 2024, including an estimated \$22.0 million reduction of State General Fund (SGF) revenues and a \$4.5 million reduction of State Highway Fund (SHF) revenues. For FY 2025, the bill is estimated to decrease state revenues by \$448.5 million, including an estimated \$346.1 million reduction of SGF revenues, a \$17.6 million reduction of SHF revenues, and an \$84.8 million reduction of State School District Finance Fund revenues. The estimated fiscal effect by specific tax policy change would be as follows:

<u>Tax Changes (SGF)</u>	<u>FY 2024</u>	<u>FY 2025</u>	<u>FY 2026</u>
State Food Sales Tax Changes	(\$20,800,000)	(\$72,600,000)	\$ --
Diapers Exemption	(800,000)	(4,800,000)	(4,800,000)
Feminine Hygiene Prod. Exemp.	(400,000)	(2,300,000)	(2,300,000)
Back-to-School Sales Tax Holiday	--	(4,800,000)	(4,900,000)
Social Security Exemption	--	(152,100,000)	(120,700,000)
Standard Deduction Increase	--	(90,500,000)	(70,400,000)
Child & Dependent Care Credit	--	(6,000,000)	(6,000,000)
Privilege Tax Rate Reduction	--	<u>(13,000,000)</u>	<u>(7,400,000)</u>
Total SGF	(\$22,000,000)	(\$346,100,000)	(\$216,500,000)
<u>Tax Changes (SHF)</u>			
State Food Sales Tax Changes	(\$4,200,000)	(\$15,000,000)	\$ --
Diapers Exemption	(200,000)	(1,000,000)	(1,100,000)
Feminine Hygiene Exemption	(100,000)	(500,000)	(500,000)
Back-to-School Sales Tax Holiday	--	<u>(1,100,000)</u>	<u>(1,000,000)</u>
Total SHF	(\$4,500,000)	(\$17,600,000)	(\$2,600,000)
<u>Tax Changes (Property Taxes)</u>			
20-mill School Levy Exemption	\$ --	(\$84,800,000)	(\$81,300,000)
Total (SGF+SHF+Property Taxes)	(\$26,500,000)	(\$448,500,000)	(\$300,400,000)

To formulate the estimates of the sales tax exemption for food and food ingredients, the Department assumes that expenditures on food and food ingredients will be comparable to expenditures observed during calendar year 2023, the first year of the rate reduction. The fiscal note considers the three-year phase-out of state retail sales tax and compensating use tax rate for food and food ingredients that was enacted in 2022 HB 2106.

To formulate the estimates of the sales tax exemption for diapers and feminine hygiene products, the Department of Revenue reviewed data from the U.S. Bureau of Labor Statistics Consumer Expenditure Survey and the Kansas Department of Health and Environment. These provisions of the bill are 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.

To formulate the estimates of a back-to-school sales tax holiday, the Department reviewed data on state sales tax collections and consumer expenditure data. Data from other states indicate there is an increase in purchases during a sales tax holiday that ranges from “slight” to a five-fold increase in purchases and corresponding decreases in sales volume before and after the holiday period as shoppers shift their purchases to take advantage of the sales tax holiday. For the Kansas sales tax holiday, it is assumed that sales during the four-day period would be at least triple the normal purchases, with corresponding decreases in sales volume before and after the sales tax holiday period. This provision of the bill 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.

To formulate the estimates of the exemption of Social Security benefits from individual income, the Department reviewed data on Social Security benefits from tax year 2020. The Department adjusted the amount of Social Security benefits to account for cost-of-living adjustments that have occurred since tax year 2020 and used an average growth rate of 3.0 percent for future years. The Department created a simulated tax table for all taxpayers that receive Social Security benefits and considered the \$75,000 Social Security benefits exemption that is currently allowed for each tax filing type.

To formulate the estimates of the increased standard deduction amounts, the Department simulated this tax policy change based on actual tax return data from tax year 2021. The Department estimates that the number of tax returns would grow by approximately 1.0 percent each year.

To formulate the estimates of the larger Child and Dependent Care Tax Credits, the Department reviewed recent data from the Internal Revenue Service on the amount of federal Child and Dependent Care Tax Credits that were claimed by individual income taxpayers. The Department indicates that approximately \$6.0 million in tax credits would be claimed by individual taxpayers in tax year 2024 under current law that allows taxpayers to claim 25.0 percent of the federal credit. Allowing taxpayers to receive 50.0 percent of the federal credit in tax year 2024 would allow taxpayers to claim an additional \$6.0 million, or a total of \$12.0 million in tax credits in tax year 2024 or FY 2025.

To formulate the estimates of the privilege normal tax rate reduction for banks, trust companies, and savings and loan associations, the Department reviewed financial institutions privilege tax data from tax year 2021.

The Department of Revenue estimates that the residential appraised value exemption would be \$44,702 in tax year 2024 (FY 2025) and under current law will increase in future tax years by the ten-year average percentage change in statewide valuation of all residential real property. Increasing the exemption from \$44,702 to \$100,000 would result in a reduction of property tax revenues generated from the 20-mill school levy totaling \$84.8 million in FY 2025 and \$81.3 million in FY 2026.

The Division of the Budget notes that the estimated reduction in revenues from the 20-mill school levy would require an offsetting appropriation for State Foundation Aid from the State General Fund to keep the Base Aid for Student Excellence (BASE) in the school finance formula at \$5,381 for FY 2025, as included in *The FY 2025 Governor's Budget Report*. If this provision of the bill would be enacted without a corresponding increase to the State General Fund appropriation for State Foundation Aid, the Department of Education would have to prorate the BASE by reducing state aid to school districts in FY 2025.

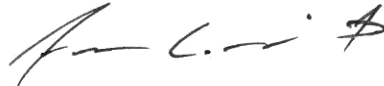
The Department of Revenue indicates that the bill would require \$52,347 from the State General Fund in FY 2025 to implement the bill and to modify the automated tax system. The required programming for this bill by itself would be performed by existing staff of the Department of Revenue. In addition, 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.

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 the bill would provide a net reduction to local sales tax collections that are used in part to finance local governments. This bill has the potential to reduce revenues that are pledged to repay STAR bond projects; however, it is unknown what impact the bill would have on the viability of those projects.

The bill would have no fiscal effect on the operations of the Office of the State Bank Commissioner; however, it has the potential to adjust certain assessment rates. The agency's budget is funded from assessments paid through its licensees and chartered institutions. Its assessments are based on the budgetary needs of the applicable division. For state banks and trust companies, the agency assesses a percentage of each entity's total assets necessary in order to regulate these institutions. The percentage of total assets assessed changes each fiscal year in order to ensure the agency's budgetary needs are met. It is expected that all state banks and trust companies will have an increase in total assets due to lower privilege taxes. If each bank and trust company have an increase in total assets, the agency will lower its percentage of total asset assessment of each state bank and trust company to cover the agency expenses.

The fiscal effect associated with HB 2586 is reflected in *The FY 2025 Governor's Budget Report*. After *The FY 2025 Governor's Budget Report* was issued, the Department of Revenue updated its property tax valuation model which changed the fiscal note for exempting the first \$100,000 from the state's 20-mill property tax for public schools than was previously reported.

Sincerely,

A handwritten signature in black ink, appearing to read "Adam C. Proffitt", with a stylized flourish at the end.

Adam C. Proffitt
Director of the Budget

cc: Lynn Robinson, Department of Revenue
Wendi Stark, League of Kansas Municipalities
Jay Hall, Kansas Association of Counties
Brendan Yorkey, Department of Transportation
Barbara Albright, Office of the State Bank Commissioner
Gabrielle Hull, Department of Education