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March 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 2763 by House Committee on Taxation

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2763 is respectfully submitted to your committee.

HB 2763 would implement the Kansas Economic Freedom Act of 2014. The bill would eliminate the individual income, corporate income, financial institutions income, retail sales, and compensating use taxes beginning on January 1, 2014. The bill would impose a consumption tax at the rate of 5.7 percent on new personally consumed goods and services beginning on January 1, 2014. 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 member 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 books and records of transactions and 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 in the efficient payment, collection, accounting of the tax, and the direct payment of the tax by businesses.

The bill would require that 88.767 percent of the amount collected from the consumption tax be deposited in the State General Fund and 11.233 percent be deposited in the State Highway Fund. 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 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, 2013.

The bill would also expand the definition of nexus to include "click-thru" provisions in which a retailer would be responsible for collecting and remitting consumption tax. Such retailer would be someone who enters into an agreement with one or more Kansas residents for a commission or other consideration, directly or indirectly, refers potential customers by a link on an internet website, by telemarketing, by an in-person or oral presentation. The bill specifies that gross receipts from such sales within Kansas must exceed $10,000 during the prior 12 months. Provisions are included in the bill for the retailer to submit proof that they do not have nexus.

The bill also provides that any ruling, agreement or contract between a retailer and the state's executive branch or state agency agreeing that a retailer is not required to collect the consumption tax in this state despite the presence of a warehouse, distribution center or fulfillment center is null and void unless specifically approved by a majority vote in each of the houses of the Legislature. The bill further provides that any vendor selling or leasing tangible personal property to the state is required to register as a retailer for consumption tax purposes.

The Department of Revenue indicates HB 2763 would not be implemented until January 1, 2014 and therefore would not have a fiscal effect until FY 2014. The Department estimates that the bill would decrease state revenues by $1,001.0 million in FY 2014. Of that total, the State General Fund is estimated to decrease by $957.0 million in FY 2014, while the State Highway Fund is estimated to decrease by $44.0 million in FY 2014. The fiscal effect to state revenues during subsequent years would be as follows:

	FY 2015	FY 2016
State General Fund	($2,536,000,000)	($2,609,000,000)
State Highway Fund	(78,000,000)	(81,000,000)
	($2,614,000,000)	($2,690,000,000)

To formulate these estimates, the Department of Revenue reviewed data on the individual income, corporate income, financial institutions income, retail sales, and compensating use taxes.

For FY 2014, the Department estimates that corporate income tax receipts would be reduced by $90.0 million, individual income tax receipts would be reduced by $1,245.0 million, retail sales and compensating use tax collections would be reduced be a total of $1,127.0 million. The FY 2014 reductions in corporate and individual income tax are from the lower remittance of estimated tax and withholding payments. Retail sales and compensating use tax collections would be based on seven months of collections. The Department of Revenue estimates that $1,461.0 million would be collected from the new consumption tax in the last five months of FY 2014. The Department indicates that the amount of consumption tax receipts generated would exceed the amount of retail sales and compensating use tax revenue that is lost due to the repeal of consumer, government, and nonprofit exemptions; and the taxing of professional and personal services purchased by end consumers, insurance premiums, rental of real estate, and digital goods. The fiscal note was calculated with the assumption that all used goods and all business-to-business transactions would be exempt from the consumption tax. Therefore, the net fiscal effect of HB 2763 would be a reduction of state revenues in FY 2014 of $1,001.0 million ($1,461.0 in new revenues from the consumption tax minus $90.0 million in lower corporate income tax receipts minus $1,245.0 million in lower individual income tax receipts minus $1,127.0 million in lower retail sales and compensating use tax receipts). The Department of Revenue estimates that the reduction in state revenues in FY 2015 would increase to $2,536.0 million when the fiscal effect of the bill would be accounted for the entire fiscal year.

The Department of Revenue indicates that the bill would require a total of $629,820 from the State General Fund in FY 2014 for administrative costs to implement the bill. The Department indicates that $622,975 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 remaining $6,875 of costs would be necessary to issue new on-line publications, news releases, retailer help guides, and getting new taxpayers registered.

The Department indicates that the proposal would not have an immediate impact on is staffing levels. The consumption tax would increase the number of retailers filing reports to 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 2013 income tax returns are processed in 2014 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 function 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 the bill would reduce sales tax revenue dedicated to the State Highway Fund by $44.0 million in FY 2014. It is estimated that sales tax revenue dedicated to the State Highway Fund would be reduced by a total of $203.0 million between FY 2014 and FY 2016. Any fiscal effect associated with HB 2763 is not reflected in *The FY 2013 Governor's Budget Report*.

The League of Kansas Municipalities indicates that the bill would eliminate the ability for local governments to collect local sales tax revenues. The League indicates that because the bill repeals the state retail sales and compensating use tax laws, this would eliminate the ability of local governments from having a local option retail sales and compensating use tax because it is linked to the state retail sales and compensating use tax laws. The League indicates that the bill does not have a provision to allow local governments to collect local option consumption taxes. The loss of local option sales and use taxes to local governments would amount to approximately $841,447,000, including $434,594,000 to counties; $363,399,000 to cities; and $43,454,000 to special districts.

Sincerely,

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

cc: Steve Neske, Revenue
Ben Cleeves, Transportation
Melissa Wangemann, Kansas Association of Counties
Larry Baer, League of Kansas Municipalities