

SESSION OF 2015

**SUPPLEMENTAL NOTE ON SENATE SUBSTITUTE FOR
HOUSE BILL NO. 2109**

As Amended by Senate Committee of the Whole

Brief*

Senate Sub. for HB 2109, as amended by the Senate Committee of the Whole, would make a number of changes in individual income tax laws, sales and compensating use tax provisions, motor fuel taxes, taxes on cigarettes and tobacco products, and would enact a tax amnesty for a number of tax sources.

Amnesty Provisions

The bill would authorize a tax amnesty for penalties and interest relative to certain delinquent taxes provided such taxes are paid in full from September 1, 2015, to October 15, 2015. The amnesty would apply to privilege, income, estate, cigarette, tobacco products, liquor enforcement, liquor drink, severance, state sales, state use, local sales, and local use taxes. The amnesty would be limited to penalties and interest applied to liabilities associated with tax periods ending on or before December 31, 2013.

The amnesty would not apply to any matter for which, on or after September 1, 2015, taxpayers have received notices of assessment or for which an audit had previously been initiated. Any fraud or intentional misrepresentation in connection with an amnesty application would void the application and waiver of any penalties and interest.

*Supplemental notes are prepared by the Legislative Research Department and do not express legislative intent. The supplemental note and fiscal note for this bill may be accessed on the Internet at <http://www.kslegislature.org>

Sales and Use Tax Provisions

The statewide sales tax and use rate for most purchases would be increased from 6.15 percent to 6.50 percent on July 1, 2015. A second rate of 5.70 percent would apply to certain purchases of food or food ingredients sold for ingestion or chewing by humans and consumed for their taste or nutritional value. Sales of certain items would be excluded from the lower rate, including candy, dietary supplements, food sold through vending machines, prepared food, and soft drinks.

Statutory disposition-of-revenue percentages would be adjusted for both taxes to provide the entire estimated amount of new revenue associated with the changes would flow to the State General Fund (SGF) while maintaining the current estimated level of receipts flowing to the State Highway Fund (SHF).

Motor Fuel Tax Provisions

Additional provisions of the bill would increase the motor fuel tax rates by \$0.05 per gallon. Associated trip permits would be increased by a commensurate amount.

Cigarette and Tobacco Products Provisions

The bill would increase the state's cigarette tax by \$0.18 per pack to \$0.97 per pack and would increase the state's tobacco products tax from 10.0 percent of wholesale price to 15.0 percent of wholesale price. The cigarette and tobacco products tax changes would be effective beginning July 1, 2015.

The bill also would establish an inventory tax for all cigarette and tobacco products on hand as of July 1, 2015.

The inventory tax would be \$0.18 per pack for cigarettes and 5.0 percent on the wholesale sales price for tobacco products on hand as of July 1, 2015. The inventory tax would be due on July 31, 2015.

The Tobacco Cessation Fund (TCF), which would be created by the bill, would begin receiving \$10.0 million annually of cigarette tax receipts. The TCF, which would be administered by the University of Kansas Medical Center, would be used to promote cessation of tobacco usage.

Individual Income Tax Provisions

Rate Freeze

Individual income tax rate reductions scheduled for future years would be repealed, and the tax year 2015 rates of 2.70 percent for the bottom tax bracket and 4.60 percent for the top tax bracket would become the tax rates for all future years. However, a provision that could provide future formulaic income tax rate relief under certain circumstances, based on the extent to which a specified group of SGF tax sources has increased over the previous fiscal year, would remain in statute and could go into effect beginning in tax year 2019.

Itemized Deductions Modification Acceleration

A number of changes would be enacted for Kansas itemized deductions retroactive to January 1 (the start of tax year 2015). With the exception of charitable contributions, mortgage interest, and property taxes paid, all Kansas itemized deductions would be repealed. The current changes in the percentage that could be deducted (“haircuts”) being phased in for mortgage interest and property taxes paid relative to the amount that otherwise is allowed for federal income tax purposes would be accelerated such that the final 50 percent haircut currently scheduled for tax year 2017

would be effective immediately. (Charitable contributions would remain fully deductible for Kansas taxpayers able to itemize at the state level, as under current law.)

Business Income Exemption Temporary Repeal

The bill would repeal, for tax years 2015 and 2016, a provision enacted during the 2012 legislative session that totally exempts certain non-wage business income from the individual income tax (income reported by LLCs, Subchapter-S Corporations, partnerships and sole proprietorships on lines 12, 17, and 18 of federal form 1040). The exemption would be reinstated for tax year 2017.

Payroll Tax Credit

The bill would create a new tax credit for taxpayers who are owners of LLCs, Subchapter-S Corporations, partnerships, associations, joint ventures, sole proprietorships, or other similar forms of business organization. The credit would allow the taxpayer to deduct from the taxpayer's individual income tax liability an amount equal to 1 percent of the business entity's payroll for persons employed in Kansas, proportionate to the taxpayer's share of the business organization's income or loss, for tax year 2015. The credit would expand to 2 percent of the business entity's payroll for tax year 2016. The credit would be non-refundable and could not be carried forward by the taxpayer. The credit would be scheduled to sunset after tax year 2016, at which time the exemption for certain non-wage business income would be reinstated.

Background

The original bill would have amended the Kansas Probate Code concerning transfer-on-death deeds. In a series of meetings beginning May 12, the Senate Assessment and Taxation Committee struck the original provisions of HB

2109, recommended a substitute bill be created, inserted many of the other provisions described above and, on May 19, advanced the new substitute bill for further consideration, without recommendation.

The Senate Committee of the Whole, on May 27, amended the bill to reduce the sales tax rate on food to 5.7 percent (the Senate Assessment and Taxation Committee version had set the food rate at 6.0 percent); to remove a number of proposed changes in the motor vehicle tax that had been included in the Senate Assessment and Taxation Committee version; to remove statutory disposition of revenue provisions that would have effectively produced an equivalent amount of receipts from the motor fuels tax increase for the SGF at the expense of the SHF; to clarify that the payroll tax credit only applies relative to persons employed in Kansas; to reduce the proposed cigarette tax increase to 18 cents per pack (had been 50 cents in the Senate Assessment and Taxation Committee version) while earmarking \$10.0 million of cigarette tax receipts for the newly created TCF; and to make a minor technical amendment.

The Kansas Department of Revenue indicated the total amount of additional tax receipts collected as a result of the tax amnesty would be \$36.088 million, \$30.000 million of which would be deposited in the SGF, \$2.471 million of which would be deposited in the SHF, and \$3.618 million of which would be returned to local units levying sales and use taxes.

The following table summarizes the fiscal impacts estimated by the Department of Revenue with regard to the Senate Committee of the Whole version of the bill:

(Dollars in Millions)

	<u>FY 2016</u>	<u>FY 2017</u>	<u>FY 2018</u>
Non-wage business income exemption repeal/payroll credit	\$ 81.900	\$ 66.400	\$ 69.700
Sales and Use Tax (Food at 5.7%; Other at 6.5%)	115.900	131.800	136.800
Itemized Deduction Changes	97.000	78.600	78.700
Tax Amnesty	30.000	--	--
18-cent Cigarette Tax Increase (SGF share only)	6.670	4.740	4.570
Tobacco Products to 15%	2.847	3.620	3.718
Ind. Inc. Tax Rate Freeze	19.900	69.700	195.900
SGF Total	\$ 354.217	\$ 354.860	\$ 489.388
State Highway Fund (5-cent motor fuel tax increase)	81.955	89.700	89.900
Tobacco Cessation Fund (Cigarette Tax earmark)	10.000	10.000	10.000
Total All Funds	<u>\$ 446.172</u>	<u>\$ 454.560</u>	<u>\$ 589.290</u>

Note: Totals may not add due to rounding.