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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 2457 by House Committee on Taxation

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2457 is respectfully submitted to your committee.

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 5.7 percent for income $30,000 and over ($60,000 and over for married filing jointly). HB 2457 would eliminate the individual income tax for taxpayers with income under $5,624 ($11,250 for married filing jointly) and set the individual income tax rate to 4.95 percent for income over $5,624 ($11,250 for married filing jointly) beginning in tax year 2024.

Under current law, corporation tax rates are set at 4.0 percent of taxable income (normal tax) and an additional tax of 3.0 percent of taxable income (surtax) applies to taxable income in excess of $50,000 in tax year 2023. The Attracting Powerful Economic Expansion (APEX) Program at the Department of Commerce allows two 0.5 percent normal tax rate reductions for signed APEX projects after construction has commenced. The bill would reduce the normal tax rate to 3.0 percent beginning in tax year 2023 and remove APEX language that requires future corporate income tax rate reduction with signed APEX agreements. The bill would also remove outdated language from prior tax years.

The bill would reduce the privilege normal tax rate for banks from 2.25 percent to 1.625 percent beginning in tax year 2023. The bill would reduce the privilege normal tax rate for trust companies and savings and loan associations from 2.25 percent to 1.61 percent beginning in tax year 2023.

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 phase out the income tax on social security income over a four-year period by allowing the subtraction modification of Social Security benefits from federal adjusted gross income by a mathematical formula for incomes above the $75,000 and below certain income thresholds. The bill would allow taxpayers with income of $75,000 up to $125,000 to subtract a portion of Social Security benefits from federal adjusted gross income in tax year 2023. The upper limit in this calculation would be increased to $175,000 in tax year 2024 and to $275,000 in tax year 2025, before allowing all Social Security income to be exempt from Kansas income taxes beginning in tax year 2026.

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 status, and $6,000 for head of household. The bill would increase the standard deduction for single individual taxpayers to $4,000 in tax year 2023 and would increase the standard deduction for all taxpayers by the amount adjusted by the cost-of-living adjustment published in the Internal Revenue Code beginning in tax year 2024 and annually thereafter.

Under current law, Kansas residents with qualifying income of $30,615 or less are able to claim the non-refundable food sales tax credit through tax year 2024 if the taxpayer is 55 years of age or older, is blind or disabled, or claims an exemption for a dependent child under 18 who lived with them all year. The bill would repeal the non-refundable food sales tax credit two years earlier, after tax year 2022.

Under current law, $40,000 of a residential property's appraised valuation is exempt from the state's 20-mill property tax for public schools in tax year 2022, with a statutory increase of the exemption in tax year 2023 based upon the average percentage change in statewide valuation of all residential real property for the preceding ten years. The bill would increase the exemption to $65,000, beginning in Tax Year 2023, with a statutory increase in subsequent tax years based upon the 10-year average percentage change in the statewide valuation of all residential real property.

The bill would reduce the state retail sales tax and compensating use tax rate for food and food ingredients to 0.0 percent and 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 July 1, 2023. 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:

Date of Rate Change	Tax Rate	Percent to State General Fund	Percent to State Highway Fund
Current law	4.0 %	83.0 %	17.0 %
January 1, 2024	2.0	83.0	17.0
January 1, 2025	0.0	82.0	18.0

Estimated State Fiscal Effect				
	FY 2023 SGF	FY 2023 All Funds	FY 2024 SGF	FY 2024 All Funds
Revenue	--	--	($579,500,000)	($641,700,000)
Expenditure	--	--	$55,761,605	$161,605
FTE Pos.	--	--	--	--

The Department of Revenue estimates that HB 2457 would decrease state revenues by $641.7 million in FY 2024, including reducing State General Fund (SGF) revenues by an estimated $579.5 million, reducing State Highway Fund (SHF) revenues by an estimated $6.6 million, and reducing property tax revenues to support K-12 education by an estimated $55.6 million. The estimated fiscal effect by specific tax policy change would be as follows:

Tax Changes (SGF)	FY 2024	FY 2025	FY 2026
Individual Income Flat Rate	($132,900,000)	($444,300,000)	($448,700,000)
Corporate Income Rate Reduction	(124,000,000)	(40,600,000)	(41,400,000)
Privilege Tax Rate Reduction	(9,600,000)	(7,300,000)	(7,500,000)
Social Security Phase Out	(49,400,000)	(63,500,000)	(93,400,000)
Standard Deduction COLA	(19,800,000)	(28,600,000)	(38,300,000)
Foods Sales Tax Credit	10,300,000	10,300,000	--
State Food Sales Tax Changes	(254,100,000)	(122,700,000)	--
Total SGF	($579,500,000)	($696,700,000)	($629,300,000)
Tax Changes (SHF)	FY 2024	FY 2025	FY 2026
State Food Sales Tax Changes	($6,600,000)	$3,600,000	$ --
Tax Changes (Property Taxes)			
20-mill School Levy Exemption	($55,600,000)	($58,800,000)	($62,300,000)
Total (SGF+SHF+Property Taxes)	($641,700,000)	($751,900,000)	($691,600,000)

To formulate the estimates that set the individual income tax rate to a flat 4.95 percent, the Department of Revenue simulated this tax policy change based on actual tax return data from tax year 2020. The estimate for FY 2024 includes 30.0 percent of tax year 2024 tax liability. The estimate for FY 2025 includes 70.0 percent of tax year 2024 tax liability and 30.0 percent of tax year 2025 tax liability.

To formulate the estimates that reduce corporate income tax rates, the Department of Revenue simulated this tax policy change based on actual tax return data from tax year 2020. The estimate takes into account the that the Department of Commerce has certified that construction has commenced for the first APEX project which triggered a 0.5 percent reduction to the normal tax rate to 3.5 percent beginning in tax year 2024. While a second APEX project has been signed, the Department of Commerce has not certified that construction has commenced on that project to officially trigger another 0.5 percent rate reduction to the normal rate that has the potential to reduce the normal rate to 3.0 percent no earlier than tax year 2025.

To formulate the estimates that reduce privilege normal tax rate for banks, trust companies, and savings and loan associations, the Department of Revenue reviewed financial institutions privilege tax data from tax year 2020.

To formulate the estimates that phase out the Social Security Cliff, 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 2.0 percent for future years. The Department created a simulated tax table for all taxpayers that receive Social Security benefits. The Department estimates that the number of tax returns grows approximately 1.0 percent each year. The fiscal effect associated with this provision of HB 2457 is partially reflected in *The FY 2024 Governor's Budget Report*. In *The FY 2024 Governor's Budget Report*, the Governor recommends smoothing out the social security cliff, so no Kansan making under $100,000 pays full taxes on Social Security income, which is estimated to reduce State General Fund revenue by $20.5 million in FY 2024, $16.0 million in FY 2025, and $16.1 million in FY 2026.

To formulate the estimates that increase each standard deduction amount, the Department of Revenue simulated this tax policy change based on actual tax return data from tax year 2020. The Department increased the standard deduction amounts by 4.0 percent in tax year 2024, 3.0 percent in tax year 2025, and 2.0 percent in tax year 2026. The standard deduction amounts used to calculate the fiscal note are as follows:

Filing Status	Current Law	TY 2023	TY 2024	TY 2025	TY 2026
Married Filing Jointly	$8,000	$8,000	$8,320	$8,570	$8,741
Single	$3,500	$4,000	$4,160	$4,285	$4,370
Head of Household	$6,000	$6,000	$6,240	$6,427	$6,556
Married Filing Separately	$4,000	$4,000	$4,160	$4,285	$4,370

The Department of Revenue indicates that 69,307 taxpayers claimed $9,966,464 in non-refundable food sales tax credits in tax year 2020. Under current law, $10.3 million in non-refundable food sales tax credit would be claimed in State General Fund refunds in both FY 2024 and FY 2025. Repealing the food sales tax credit would save approximately $10.3 million in State General Fund refunds in tax year 2023 (FY 2024) and tax year 2024 (FY 2025).

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 fiscal note considers the reduction of state retail sales tax and compensating use tax rate for food and food ingredients that takes place over a three-year period beginning with a 2.5 percent reduction effective on January 1, 2023, that was enacted in 2022 HB 2106.

The Kansas Department of Transportation indicates that the bill would make net adjustments of state revenues to the State Highway Fund, as noted above. The fiscal effect associated with the 0.0 percent state food sales tax rate and revenue distribution changes included in HB 2457 is partially reflected in *The FY 2024 Governor's Budget Report*. The Governor's tax policy recommendation would reduce the state retail sales tax and compensating use tax rate for all food and food ingredients to 0.0 percent and 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, 2023.

Language that holds STAR bond districts harmless from the phase out of the state sales tax on food and food ingredients for FY 2024 was approved in last year's Omnibus Appropriations Bill (2022 HB 2510). This bill has the potential to reduce revenues that are pledged to repay STAR bond projects beginning in FY 2025; however, it is unknown what impact the bill would have on the viability of those projects.

The Department of Revenue estimates that the residential exemption would be $42,049 in tax year 2023 (FY 2024). Increasing the exemption from $42,049 to $65,000 would result in a reduction of revenues generated from the 20-mill school levy totaling $55.6 million in FY 2024, $58.8 million in FY 2025 and $62.3 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 $5,103 for FY 2024, as included in *The FY 2024 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 by approximately $82 per weighted FTE student, using an estimated 680,000 weighted FTE students (excluding weighting for special education FTE students) in FY 2024.

The Department of Revenue indicates that the bill would require $161,605 from the State General Fund in FY 2024 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 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 increased, the amount available for possible debt setoffs is also increased. However, the

Department is unable to make a precise estimate of the number of debts setoffs that will be intercepted as a result of the bill.

Sincerely,

Adam Proffitt
Director of the Budget

cc: Lynn Robinson, Department of Revenue
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