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January 20, 2021

The Honorable Caryn Tyson, Chairperson
Senate Committee on Assessment and Taxation
Statehouse, Room 123-E
Topeka, Kansas 66612

Dear Senator Tyson:

SUBJECT: Fiscal Note for SB 22 by Senate Committee on Assessment and Taxation

In accordance with KSA 75-3715a, the following fiscal note concerning SB 22 is respectfully submitted to your committee.

SB 22 would exclude unemployment compensation benefits from gross income if the benefits were secured with a fraudulent identity and the taxpayer did not receive the benefits. These benefits would not be subject to Kansas income taxes after the Department of Revenue determines the benefits were obtained fraudulently by another individual.

Calculations for Kansas income taxes are based on the Kansas adjusted gross income, which is calculated by adding or subtracting certain types of income from the federal adjusted gross income. The bill would allow the amount of disallowed business interest expenses to be subtracted from income for Kansas income tax purposes beginning retroactively in tax year 2020. Additionally, all deductions from the carry forward amount of disallowed business interest would be added back for Kansas income tax purposes beginning retroactively in tax year 2020. This would allow state taxpayers to claim the full amount of business interest expenses on state income tax returns.

The bill would allow 100.0 percent of global intangible low-taxed income (GILTI), before allowable deductions, to be subtracted from income for Kansas income tax purposes beginning retroactively in tax year 2020. This would exempt this income from state income taxes. For all tax years prior to 2020, income from foreign dividends would also include GILTI income and would qualify for the 80.0 percent deduction. Since GILTI income is excluded from state income taxes beginning in tax year 2020, it would no longer be classified as foreign dividends going forward.

The bill would allow the amount of disallowed meal expenses to be subtracted from income for Kansas income tax purposes beginning retroactively in tax year 2020. This would allow state taxpayers to claim the full amount of meal expenses on state income tax returns.

The bill would allow the amounts received from the federal Paycheck Protection Program (PPP) under the CARES Act to be subtracted from income for Kansas income tax purposes beginning retroactively in tax year 2020, if these amounts were included in the taxpayer's federal adjusted gross income. All amounts included in the taxpayer's federal adjusted gross income would be exempt from state income taxes. The bill provides that the expenses from PPP loans that are not allowed as a deduction in determining federal adjusted gross income would be allowed to be subtracted from income for Kansas income tax purposes beginning retroactively in tax year 2020.

Under current law, a taxpayer is only allowed to use itemized deductions on a state income tax return if they also use itemized deductions on the federal income tax return. The bill would allow taxpayers to use itemized deductions on the state income tax return regardless if they use itemized deductions on federal income tax return beginning in tax year 2021.

Corporate taxpayers would be allowed to exclude contributions to capital from non-shareholders in the calculation of state income taxes beginning retroactively in tax year 2020. This provision would exclude contributions by a governmental entity or civic group such as the values of state and local tax incentives from the calculation of income.

Deferred foreign income (federal repatriation) would be classified as foreign dividends qualifying for the 80.0 percent deduction. The bill would allow taxpayers to deduct the costs of any disallowed Federal Deposit Insurance Corporation (FDIC) premiums beginning in tax year 2020. This would exempt this income from state income taxes. For tax years 2018, 2019 and 2020, the net operating loss (NOLs), including the calculation of any carry forward or carry back, would be calculated the same way as prescribed in the federal CARES Act.

Under current law, Kansas corporations, banks, trust companies, and savings and loans are allowed to claim the Kansas expensing deduction for investments in qualifying machinery and equipment that are placed into service in Kansas for tax year 2014 and each future tax year. The bill would also allow individual income taxpayers to claim the expensing deduction beginning in tax year 2021. All taxpayers claiming the Kansas expensing deduction would be required to offset the costs of the expensing deductions claimed on the federal return with Section 179 of the Internal Revenue Code.

Estimated State Fiscal Effect				
	FY 2021 SGF	FY 2021 All Funds	FY 2022 SGF	FY 2022 All Funds
Revenue	--	--	($329,100,000)	($329,100,000)
Expenditure	--	--	$384,693	$384,693
FTE Pos.	--	--	--	--

The Department of Revenue estimates that SB 22 would decrease State General Fund revenues by $329.1 million in FY 2022, $144.6 million in FY 2023, and $146.4 million in FY 2024. Given that the Department of Revenue does not have data to make precise estimates of some of the tax policy changes, the fiscal note of the bill is likely to be higher. The fiscal effect by specific tax policy change would be as follows:

Tax Policy Change	FY 2022	FY 2023	FY 2024
UI Fraud	$ --	$ --	$ --
Disallowed Business Interest	(56,100,000)	(37,500,000)	(38,600,000)
GILTI	(48,900,000)	(23,500,000)	(23,700,000)
GILTI-Dividend TY 2018 & TY 2019	(56,800,000)	--	--
Disallowed Meal Expenses	(5,900,000)	(3,100,000)	($3,100,000)
PPP	Unknown	Unknown	Unknown
Itemized Deductions	(60,900,000)	(61,500,000)	(62,100,000)
Capital Contributions	Negligible	Negligible	Negligible
Deferred Foreign Income	--	--	--
FDIC	(2,500,000)	(1,300,000)	(1,300,000)
Net Operating Loss Carry back	(100,300,000)	(20,100,000)	(20,100,000)
Net Operating Loss Carry forward	Unknown	Unknown	Unknown
Expensing Deduction	2,300,000	2,400,000)	2,500,000
Total	($329,100,000)	($144,600,000)	($146,400,000)

The Department of Labor and the Department of Revenue both indicate that the provision of the bill that allows taxpayers to exclude fraudulent unemployment compensation benefits from gross income would have no fiscal effect. Victims are not held accountable for taxes on unemployment compensation benefits related to identity theft.

To formulate the estimates related to decoupling from the Tax Cuts and Jobs Act of 2017 or the CARES Act, the Department of Revenue indicates that it used information from the federal Joint Commission on Taxation to estimate the impact of all federal tax policy changes on Kansas. The Department does not have any data to estimate the fiscal effect of allowing individual taxpayers the ability to deduct GILTI income before any deduction. The Department is unable to determine the impact of the PPP provisions because it is unclear the amount of the loans that will not be forgiven at the federal level. In addition, language in the bill would only apply to PPP loans provided by the CARES Act, but it would not apply to PPP loans under the Consolidated Appropriation Act, 2021. To formulate the estimates on allowing taxpayers to use itemized deductions on a state income tax return regardless if they use itemized deductions on the federal income tax return, the Department reviewed data on standard and itemized deductions from tax year 2017. Federal tax reform has enticed more federal standard deduction users through the raising of the standard deduction and the limit on itemized deductions.

To formulate the estimates on allowing expensing for individual income taxpayers and requiring the Section 179 of the Internal Revenue Code offset, the Department of Revenue reviewed data from tax year 2012, which was the last tax year that individual income taxpayers were allowed to claim the expensing deduction. The exclusion of certain contributions to capital would reduce State General Fund receipts by a negligible amount. Deferred foreign income is already treated as foreign dividends and qualifies for the 80.0 percent deduction, so this provision would have no fiscal effect. This fiscal note does not calculate any interest that may be owed to taxpayers that file amended returns that will allow the taxpayer to get refunds from taxes paid from prior tax years.

Under current law, Kansas taxpayers are allowed to carry forward NOLs for up to ten years and are not allowed to carry back any NOLs to prior tax years. The treatment of NOLs in the CARES Act for tax years 2018, 2019, and 2020 allows taxpayers the ability to carry back NOLs up to five years and carry forward NOLs from these specific tax years indefinitely. Under the provisions of the bill, these NOLs rules would now apply in Kansas and would allow the Kansas NOLs amount to equal the federal NOLs amount for tax years 2018, 2019, and 2020. The Department of Revenue indicates that the remaining NOLs (after carry back) generated in tax year 2018 would be $174.3 billion and would be carried forward to future tax years. If similar NOLs are generated in tax years 2019 and 2020, then this provision has the potential to reduce corporate income tax receipts by $36.6 billion ($174.3 billion carry forward x 3 years x 7.0 percent tax rate). While some corporations will never generate profits to offset these losses in the future; this provision of the bill has the potential to significantly reduce corporate income tax receipts long-lasting into the future. However, the fiscal note does not include an estimate of the fiscal effect of allowing corporations to carry forward NOLs indefinitely for tax year 2018, 2019, and 2020, because the Department does not have data on when or if corporations would be able to offset future profits with these NOLs. The Department is unable to estimate the fiscal effect of allowing individual taxpayers the ability to deduct net operating loss carry forwards from Kansas adjusted gross income the same way that is allowed on the federal return.

The Department of Revenue indicates that it would require a total $384,693 from the State General Fund in FY 2022 to implement the bill and to modify the automated tax system. The bill would require the Department to hire 3.00 new FTE positions to review, process, and audit additional income tax returns. 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 an estimate of the amount of additional debts setoffs that will be intercepted as a result of the bill. Any fiscal effect associated with SB 22 is not reflected in *The FY 2022 Governor's Budget Report*.

Sincerely,

Adam Proffitt
Director of the Budget

cc: Lynn Robinson, Department of Revenue
Bobbi Mariani, Insurance
Dawn Palmberg, Department of Labor
Jeff Scannell, Department of Administration