

LEGISLATIVE UPDATE



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2016 PRE-VETO SESSION



The Kansas Legislature has been on a month-long break since March 25 and will return to Topeka today, April 27, for the 2016 Veto Session. Due to this year's shortened legislative calendar, many conference committees ran out of time to meet and negotiate bills prior to the first adjournment. Several key issues still need resolution during the Veto Session, including the budget, school finance and taxes.

While conference committees will meet where they left off before first adjournment, the main focus of the Veto Session will be balancing the budget and ensuring that the Legislature's fix for equitable education funding is enough to satisfy the Supreme Court. Wednesday marks the 69th day of the legislative session. The goal is to adjourn before using the statutorily approved full 90-day session.

General Fund Tax Revenue Change			
Tax Type	FY2015	FY2016	FY2017
Motor Carrier	-68.8%	3.2%	4.3%
Individual Income	2.7%	2.1%	2.2%
Corporate Income	4.5%	-6.6%	1.5%
Financial Institutions	25.0%	-8.7%	8.1%
Retail Sales & Use	1.6%	6.8%	3.8%
Oil & Gas Severance	-25.9%	-74.3%	41.3%
Other Excise	1.8%	23.7%	-0.2%
Other	8.4%	-9.9%	2.1%
Total taxes	1.5%	2.6%	3.0%

Source: April 2016 Consensus Revenue Estimate

Budget Facts

- Even though the consensus revenue estimates were revised down, the State of Kansas brought in more money this fiscal year than last fiscal year.
- The amount of revenue coming into the state continues to grow each year.
- State spending increased in FY 2016 and will increase again in FY 2017, even though revenue estimates were revised down.

Tax Facts

- The 2012 tax cuts included both an exemption for business income as well as a reduction in individual income tax rates.
- The first year of the tax cuts' income tax collections declined \$741 million.
- The decline in tax collections were attributed to:
 - Rate Reduction—\$498 million
 - Non-wage business income exemptions—\$209 million
 - Other—\$34 million

CONSENSUS REVENUE ESTIMATES



The Consensus Revenue Estimating Group met on April 20 to revise the November 2015 State General Fund (SGF) estimates for the Governor's two-year budget. They announced significant revenue shortfalls totaling \$228.6 million for fiscal years 2016 and 2017.

For FY 2016, the estimate was decreased by \$93.9 million, or 1.5% below the November estimate. Total taxes were decreased by \$177.1 million, while other revenues were increased by \$83.2 million. The overall revised estimate for receipts is \$6.1 billion, which is 2.4% above FY 2015 actuals.

For FY 2017, the estimate was decreased by \$134.7 million. Total taxes were decreased by \$170.7 million, while other revenues were increased by \$36 million. The overall revised estimate for receipts is \$6.15 billion, which is 1.3% above the new FY 2016 estimate.

During a joint committee of the House Appropriations and Senate Ways and Means Committees on April 21, Kansas Budget Director Shawn Sullivan cited a decrease in sales tax receipts as a contributing factor to the shortfall due to the deflation of durable goods, an increase in online sales, and a depressed oil and gas industry.

STATE BUDGET

Based on the revised estimates, the total adjustments needed to maintain a zero balance in the SGF for FY 2016 is \$140.1 million and \$151.3 million in FY 2017. The Governor's Budget Amendment (GBA) includes 19 adjustments to revenues and expenditures from this year's already-passed budget bill. Both the House Appropriations and Senate Ways and Means Committees have approved the GBA to be included in this year's final Omnibus appropriations bill to be taken up during the Veto Session.

Also included in the GBA are three options presented to the Legislature to balance the budgets for FY 2016 and 2017. All three options include moving \$70 million in sales tax revenues from KDOT into the SGF in the remaining months of this fiscal year and \$115 million in FY 2017. This would delay all new TWORKS projects planned for FY 2016 and FY 2017.

Option one—preferred by the Governor—includes a carry-over of the 3% reduction made to Universities in FY 2016 into 2017, which results in \$17.7 million in reduced expenditures. It also requests legislative approval to securitize future tobacco settlement payments in excess of \$42 million for a one-time gain of \$158 million in FY 2017. Children's programs currently funded through the Children's Initiative Fund would continue to receive funding of \$42 million per year.

Option two also includes the 3% cut to Universities in FY 2017, and adds \$25 million in targeted efficiency savings. Most importantly, option two would delay the FY 2016 fourth quarter KPERS payment and push repayment back to FY 2018, instead of October 2017 as approved in the budget bill.



(Continued on page 3)

STATE BUDGET (CONT.)

(Continued from page 2)

Option three—least desired by the Governor—includes a 3% to 5% cut to most state agencies for FY 2017 that would total \$139.3 million in expenditures. Among the agencies that would see a 3% reduction include the Kansas Department of Education via general state aid for K-12 education. Lawmakers are concerned that such a cut would be problematic given that the Kansas Supreme Court has not yet ruled on the adequacy portion of the school finance lawsuit case.

Options one and two are one-time fixes to balance the two-year budget and rely on efficiencies found through the Alvarez & Marsal government efficiency study to solve the state's long term budget shortfall. The decision leaves the Legislature to make some tough decisions, especially in an election year, during the Veto Session.

NON-WAGE BUSINESS INCOME



Over the last year, there has been growing scrutiny of the non-wage business income exemption passed as part of the 2012 tax reform. The reform, which allows for small business owners and other LCC's to take distributions (non-wage income) without paying income tax on those earnings. When passed, many legislators felt the exemption would only apply to active income and would help stimulate growth. However, the application of the exemption has been applied to passive income, which has increased the cost of the exemption. In addition, several businesses have reorganized in order to qualify for the exemption, which has also increased the cost of the exemption.

During regular session, the House held a hearing on HB 2444, which requires non-wage business income to be included as income for Kansas income tax purposes beginning in tax year 2016, and dedicated this revenue to buy down the food sales tax rate. The bill drew both proponents and opponents, but no additional action has been taken on the measure. The Senate has scheduled a hearing on Thursday, April 28 at 9 a.m. for SB 508. This bill would subject 70% of the income of an LLC, partnership or sub-chapter S corporation to Kansas income tax with the revenue going to the state general fund. The authors of the bill, Senators Jeff King, R-Independence, Greg Smith, R-Overland Park and Jim Denning, R-Overland Park, believe this more accurately reflects the legislature's original intent that only non-wage income was meant to be exempt from income tax.

Several attempts were made during last session's veto to pass a "fix" for the non-wage business income, but the proposal only got 27 votes in the House and further negotiations broke down when the Governor threatened to veto any measure which made changes to the exemption. This year, there have been recent reports that if a non-wage business income amendment made it to the Governor's desk, he would not veto the measure this year.

So as the veto session begins, we expect this issue to be part of the discussion as legislators begin to grapple with closing the budget gaps during an election year.

TAXES

High Performance Incentive Program (HPIP)

Senate Bill 506 was introduced in the Senate Taxation Committee on March 9 based upon a recommendation from the Alvarez & Marsal government efficiency study. The bill would amend current statute, removing the training program components for HPIP eligibility and includes a 10% haircut to the value of credits for tax years 2016 and 2017. HPIP provides tax incentives to employers for capital investment in facilities, technology and employee training and education. No hearings have been held on SB 506, but the Administration has expressed a desire to modify HPIP during the Veto Session in an attempt to limit claims during these tight financial times.

Angel Investor Tax Credits

Senate Bill 149 (including contents of House Bill 2405) passed the House by a vote of 122-3 before Spring break. SB 149 extends the sunset of the Angel Investor Tax Credit program – which offers qualified investors transferable state income tax credits of 50 percent – by five years, from tax year 2017 to 2022. SB 149 includes several other amendments to income tax law and sits in Tax conference committee to be finalized during the Veto Session.



PROPERTY TAX REFORM



Tax Lid/Public Vote Requirement

Senate Substitute for House Bill 2088 passed the Senate by a vote of 24-16 after five hours of debate on the floor and just days before the Legislature broke for Spring break. The bill modifies portions of a property tax reform package that was passed last year, including moving up the effective date from 2018 to January 1, 2017. Before property taxes can be raised higher than the rate of inflation, a vote of the public must take place. It also gives local governments more flexibility on timing, allowing the vote to be held as either part of primary and general elections, special elections, or mail ballots.

Cities and counties have been negotiating a compromise with the Kansas Association of Realtors and Kansas Chamber regarding a number of exemptions in the bill. However, talks were stalled in the Tax conference committee right before first adjournment after disagreement over several issues. Negotiators will hammer out differences during the Veto Session.

Valuation Appeals Process

House Substitute for Senate Bill 280 (including contents of House Bill 2714) passed the House by a vote of 123-0 prior to first adjournment. SB 280 requires that property must be valued based on the fair market value by the Board of Tax Appeals and not solely on a mass appraisal of the property, requires counties to follow valuation methods developed by the Property Valuation Division and clarifies that counties cannot take matters into consideration that occur after January 1 when establishing property tax valuation. SB 280 remains in Tax conference committee and will be taken up during the Veto Session.

EQUITABLE SCHOOL FUNDING



Senate Substitute for House Bill 2655 passed by a vote of 93-31 in the House and 32-5 in the Senate the morning of first adjournment. In less than 48 hours, both the Senate and House introduced, heard and debated the bill in an attempt to address equity in K-12 school funding.

The bill only spends \$2 million in additional money on schools, but rather shifts distribution and equalizes the capital outlay and local option budget formulas. Proponents of the measure boast that the plan creates a similar property taxing effort across the state, narrowing the gap between the wealthiest and poorest districts through their local option budget. The bill also includes a hold harmless provision that ensures no district loses funding for school year 2016-2017, giving the Kansas Department of Education and the Legislature time to craft a new school finance formula moving forward.

The rushed process was in response to the Kansas Supreme Court's ruling in February that the funding passed last year in the block grant bill was constitutionally unequal. In the court's opinion was a deadline of July 1, 2016 before schools could potentially close. Kansas Attorney General Derek Schmidt recently filed a brief with the court on behalf of the state, defending the Legislature's fix as adequate to meet constitutional requirements. The four school district plaintiffs in the *Gannon v. Kansas* lawsuit have until April 28 to file their briefs before the scheduled hearing of arguments on May 10.

HUMAN RESOURCES

Workers Compensation

House Bill 2617 passed the Senate before first adjournment by a vote of 40-0. However, the House motion to concur to the Senate changes was withdrawn, and the bill was sent to Commerce conference committee for further review. HB 2617 allows workers compensation claims to be filed electronically and eliminates the requirement for the Department of Labor to maintain a licensed physician on staff.

The Senate made two amendments that address the intent from the workers compensation reform package of 2011. The first requires that if a chemical test is used to determine whether an employee's injury should be disallowed for compensation due to alcohol or drug use, the employee would have access to a split sample within 48 hours of a positive test, but only if the sample is collected by the employer. The second amendment clarifies in cases where there is a preexisting functional impairment, the combined impairment for the injury and preexisting impairment must be equal to or greater than 10 percent whole person impairment in determining whether an employee is eligible to receive benefits. It appears the confusion on the Senate's changes has been clarified, and we expect the House to concur during the Veto Session.

Employee Scheduling Mandates

House Bill 2576 passed the House by a vote of 90-33 during the regular Session. The bill is a preemptive measure that prohibits cities, counties and local units of government from adopting "fair scheduling mandates" that affect the work schedules of private sector employees. HB 2576 is expected to pass out of Commerce conference committee during the Veto Session.

TRANSPORTATION

Governor Brownback has proposed a sweep of \$185 million of sales tax revenues from the Kansas Department of Transportation (KDOT) in his plans to help fill the state budget shortfall for fiscal years 2016 and 2017.

In a news release issued last week, KDOT announced that this cut will delay 25 planned modernization and expansion T-WORKS projects through 2019 at an estimated cost of \$553 million. Modernization jobs include the addition of shoulders, passing lanes and remediation of hills and curves. Expansion projects add capacity to the highway system. Preservation projects – which include pavement and bridge repair, resurfacing and replacement – will not be affected.

A large number of organizations are strongly opposing the cut to the state highway fund and are urging the Legislature to find other ways to balance the budget during the Veto Session. They argue that the T-WORKS program provides hundreds of jobs, spurs economic activity, and ensures safe roads for all Kansans.

NEW SECRETARY OF COMMERCE



Appointed by Governor Sam Brownback, Antonio J. Soave of Overland Park began his service as Kansas Secretary of Commerce in December 2015, following Pat George's retirement in July.

Prior to his role as Commerce Secretary, Soave was the chairman and CEO of Capistrano Global Advisory Services (CGA). He has also served as an adjunct professor of international economics and finance at the Walsh College of Business in Troy, Mich. and was an intern in the White House Office of Public Liaison's Department of Foreign Policy and Defense under President Ronald Reagan.

"Antonio's experience working with businesses in a wide range of industries including rail, construction, oil and gas, biotech and manufacturing gives him an excellent understanding of industry needs and how Kansas can help those companies grow and create jobs," said Governor Brownback.

Soave is active on a number of boards and organizations. He is an International Advisory Council member of the United States Institute of Peace and served as the Executive Director of the School of Business at Benedictine College. He has a Bachelor's degree in international studies from The American University in Washington, D.C., a Juris Doctor from the Detroit College of Law at Michigan State University and a Masters of Law in International Law from the University of San Diego.

The Kansas Department of Commerce is the state's lead economic development agency that oversees the programs and services that create jobs, attract new investment, provide workforce training and encourage community development in the state.

Legislative Deadlines

April 27, 2016—Veto Session begins

Sine Die to be announced

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