SESSION OF 2012

CONFERENCE COMMITTEE REPORT BRIEF
SENATE SUBSTITUTE FOR HOUSE BILL NO. 2117

As Agreed to May 3, 2012

Brief*

Senate Sub. for HB 2117 would implement a number of major changes in income taxes effective for tax year 2013; repeal a severance tax exemption; remove renters from the Homestead Property Tax Refund program while expanding the program for the remaining participants; reinstate transfers to the Local Ad Valorem Tax Reduction Fund (LAVTRF) program; expand the definition of a retailer doing business in the state for purposes of collecting sales and use taxes; and make changes to the administration of the Oil and Gas Valuation Depletion Trust Fund (OGVDTF) program.


Rate Reduction and Restructuring

One major part of the bill would take the current three-bracket structure for individual income taxes (3.5, 6.25, and 6.45 percent) and collapse it into a two-bracket system. The rates would permanently be set at 3.0 and 4.9 percent beginning in tax year 2017. The top rate would be temporarily higher than 4.9 percent and would be set at 5.5 percent in tax years 2013-2014; 5.3 percent in tax year 2015; and 5.1 percent in tax year 2016.

*Conference committee report briefs are prepared by the Legislative Research Department and do not express legislative intent. No summary is prepared when the report is an agreement to disagree. Conference committee report briefs may be accessed on the Internet at http://www.kslegislature.org/klrd
Business Income Exemption

The bill would totally exempt certain non-wage business income that under current law is subject to individual income tax (income reported by LLC’s, Subchapter S corporations, and sole proprietorships on lines 12, 17, and 18 of federal form 1040. The exemption would be applicable to the first $100,000 of qualifying non-wage business income for tax years 2013-2014; the first $250,000 for tax years 2015-2016; and all qualifying non-wage business income beginning in tax year 2017. Effective tax year 2013, an additional modification would apply for business losses claimed as part of federal adjusted gross income, and Kansas net operating losses would be repealed.

Tax Credits

Additional sections would repeal tax credits beginning in tax year 2013 currently allowed to individuals for abandoned well plugging; adoption expenses; agritourism; alternative fuel equipment expenditures; assistive technology; child and dependent care expenses; disabled access expenditures; environmental compliance expenditures; law enforcement training center contributions; national guard health insurance expenditures; swine facility improvement expenditures; research and development expenditures; port authority contributions; small employer health benefit plan contributions; telecommunications property tax payments; venture capital contributions; and certain assistance to family contributors.

Other language would clarify that a business and job development tax credit would be repealed effective for tax year 2012.

Taxpayers also would no longer be able to claim both the earned income tax credit (EITC) and the food sales tax rebate credit but would have the option of choosing between the two programs.
The sunset on an existing tax credit for certain historic site preservation contributions would be repealed, effectively extending the programs indefinitely.

Two additional tax credit programs would have sunsets extended but not repealed. The sunset would be extended by three years (from tax year 2012 to tax year 2015) for certain tax credits that may be claimed for contributions earmarked for community college capital improvements, technical college purchase of equipment or deferred maintenance, or general deferred maintenance at postsecondary educational institutions. A statewide cap on the total amount of credits that may be claimed for any tax year would be set at $10 million through tax year 2015. The sunset on a tax credit for renewable electric cogeneration facilities would be extended by five years (from tax year 2011 to tax year 2016). Finally the sunset on another credit for certain regional foundations would be extended by five years (from tax year 2012 to tax year 2017).

An additional provision relating to High Performance Incentive Program (HPIP) credits would allow the sharing of credits under certain circumstances between and among members of a unitary group of corporations. To qualify for the tax-credit-sharing authorization, a taxpayer would have had to file a certificate of intent prior to June 30, 2013, to place in service a qualified business facility investment of at least $10 million and create a minimum of 50 new jobs that meet certain average wage requirements. A second HPIP provision would repeal a change in law enacted in 2011 that had increased the HPIP minimum investment threshold in five urban counties.

Other language would clarify the Department of Revenue's current interpretation that incarcerated persons are not eligible for either the food sales tax rebate or homestead refunds. The bill also would bar any food sales tax rebate or homestead refund claims filed by incarcerated persons on or after July 1, 2012.
Deductions

The ability of individual income taxpayers to claim most itemized deductions would be repealed for state income tax purposes. Itemized deductions could be claimed only if taxpayers have itemized at the federal level and if the sum of the deductions for mortgage interest and charitable contributions exceeds the Kansas standard deduction amount. Under such circumstances, only the sum of these two deductions could be claimed as an alternative to the Kansas standard deduction.

Corporation Income Tax Apportionment

The legislation further would authorize an optional single-factor (sales) income tax apportionment formula beginning in tax year 2013 as an exception to the normal three-factor (property, payroll, and sales) formula for certain corporations relocating to Kansas which employ ten or more full-time employees. To qualify, a taxpayer must have had no employees, nor owned or rented any real or tangible personal property in Kansas prior to January 1, 2013.

Taxpayers making the election would be prohibited from also claiming certain tax benefits pursuant to the Promoting Employment Across Kansas (PEAK) program and the HPIP program. A decision to use the sales-only apportionment formula would be required to remain in effect for ten tax years.

ROZ Expansion

The bill would add an additional 24 counties (Allen, Anderson, Bourbon, Brown, Chase, Cherokee, Clay, Coffey, Doniphan, Ellsworth, Grant, Haskell, Labette, Linn, Marshall, Meade, Morris, Nemaha, Neosho, Osage, Ottawa, Rice, Sumner, and Wabaunsee) to the ROZ program, (bringing the total number of eligible counties to 74) which effectively
provides an income tax exemption for certain out-of-state taxpayers who relocate to those counties. The program also authorizes counties to participate in a state-matching program to repay student loans of up to $15,000 for certain students who establish domicile in ROZ counties.

**Severance Tax Provisions**

The two-year new pool severance tax exemption would be repealed relative to all oil production from any pool producing in excess of 100 barrels per well per day, provided the initial production occurs on and after July 1, 2012.

The bill also would clarify that the definition of gas for severance tax purposes includes "all other raw, unrefined gases, all constituent parts of any such gas or gases and refined products derived from any such gas or gases, including, but not limited to, methane, ethane, propane, butane, and helium." That section of the bill also would retroactively eliminate all refund claims associated with the claim that any constituent part of gas and any refined products derived from gas were not taxable under the 1983 severance tax imposition.

**Homestead Program**

Beginning in tax year 2013, renters would no longer be eligible to participate in the Homestead Property Tax Refund program. The balance of the program would be expanded by increasing the maximum allowable refund from $700 under current law to $800.

**LAVTRF**

The bill also would provide for transfers from the State General Fund to the Local Ad Valorem Tax Reduction Fund (LAVTRF) for FY 2013, 2014, 2015, 2016, and all subsequent
years in the amount of $45 million for each year. Current law calls for a $27 million transfer to the LAVTRF in FY 2014, a $40.5 million transfer to the LAVTRF in FY 2015, and a $54.0 million transfer to the LAVTRF in FY 2016 and all subsequent years. Additional provisions would change the nature of the FY 2014 transfer from a revenue transfer to a demand transfer, and would attempt to ensure that local units generally use the transfers to reduce property taxes as a condition of accepting the funds.

**Sales and Use Tax "Click-Thru" Nexus**

Other sections of the bill would enact "click-thru" nexus provisions to expand the definition of a retailer doing business in this state for purposes of sales and use tax collection to include those retailers who enter into certain agreements with Kansas residents. Such agreements would include those entered into with one or more residents of Kansas under which the resident, in exchange for some consideration, directly or indirectly refers potential customers from Kansas so long as the cumulative gross receipts stemming from transactions generated by such references exceed $10,000 during the preceding 12 months. The bill also would create provisions of law by which retailers could submit proof they do not meet the requirements established in the expanded definition.

**OGVDTF**

Another section of the bill relating to the Oil and Gas Valuation Depletion Trust Fund (OGVDTF) would provide for the annual transfer to each county eligible to participate in a current program wherein certain severance tax receipts are held in trust by the state prior to certain criteria having been met for the ultimate release of those funds to the counties. The bill establishes county-specific trust funds where the money will be housed until such time as the statutory criteria for release has been met.
Conference Committee Action

The Conference Committee on May 3 agreed to adopt a phased-in approach to the business income exemption that is similar but not identical to the approach used in House Sub. for SB 177; eliminate the ability of taxpayers to claim both the EITC and food sales tax rebate credits; remove the proposed repeal of a tax credit for individual development account contributions; remove the proposed repeal of a tax credit for certain child day care expenses; repeal the sunset on historic site contribution and regional foundation contribution tax credits; remove the proposed repeal of a subtraction modification for certain long term care insurance expenditures; remove provisions that would have increased standard deductions for individuals; add the repeal of most itemized deductions; add 24 counties to the ROZ program; expand the remaining Homestead program by an amount roughly equivalent to the dollar amount of its contraction associated with eliminating the participation of renters; insert the provisions of HB 2624 relating to the OGVDTF; insert the provisions of HB 2157 relating to single-factor apportionment and HPIP; include the LAVTRF transfer amounts from HB 2241 with some modification to language relating to acceptance of the funds by local units; include the provisions of SB 267 relating to higher education and electric cogeneration tax credits; include SB 369 clarifying the inability of incarcerated individuals to claim certain tax benefits; add the provisions of SB 371 relating to "click-thru" nexus; add HB 2481 clarifying a definition within the severance tax law; and add the repeal of a business and job development income tax credit in SB 386.

Background

The subject matter of the House Committee of the Whole version of the bill (repeal of defunct language in sales tax statutes and allowing certain employers to retain employee withholding taxes), approved in 2011, was addressed in other legislation adopted during the 2011
session. The Senate Assessment and Taxation Committee on March 14 voted to remove all of these provisions; recommend that a substitute bill be created; and insert various tax reform provisions, many of which were contained originally in SB 339, a proposal recommended by the Governor at the outset of the 2012 Session.

Among features of the Governor's plan which the Senate Committee removed were the proposed repeal of the earned income tax credit; proposed repeal of additional credits relating to historic preservation, angel investor contributions, and community service; proposed elimination of the subtraction modification associated with Learning Quest program contributions; and a mechanism that would have provided for formulaic tax reductions in future years based on growth in selected SGF receipts.

The Senate Committee of the Whole amended the bill to remove that part of the Governor's recommendation that would have maintained the sales tax rate at 6.3 percent on and after July 1, 2013, when it is currently scheduled to be reduced to 5.7 percent. A second Senate Committee of the Whole amendment removed the proposed repeal of itemized deductions. A third Senate floor amendment increased the standard deduction for joint filers.

The latest fiscal information available from the Department of Revenue indicates that the Conference Committee agreement would be expected to have the following impact on SGF receipts (dollars in millions):

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### SGF RECEIPTS

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<th>Individual Income</th>
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<th>LAVTRF Transfers</th>
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