FY19 Revenue Update

Interim Joint Committee on Appropriations and Revenue

October 25, 2018

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Governor's Office for Economic Analysis

Overview

- Introduction
- Fiscal Year 2018 General Fund Year-End
- Fiscal Year 2019 New Projections
- HB 487 Impacts for Fiscal Year 2019
- Tax-by-Tax Analysis
- Q & A

FY 2018 General Fund Receipts

Actual Receipts	$10,838,200,000
December 2017 Official CFG Estimate	10,718,400,000
FY 2018 General Fund Revenue Surplus	**$ 119,800,000**

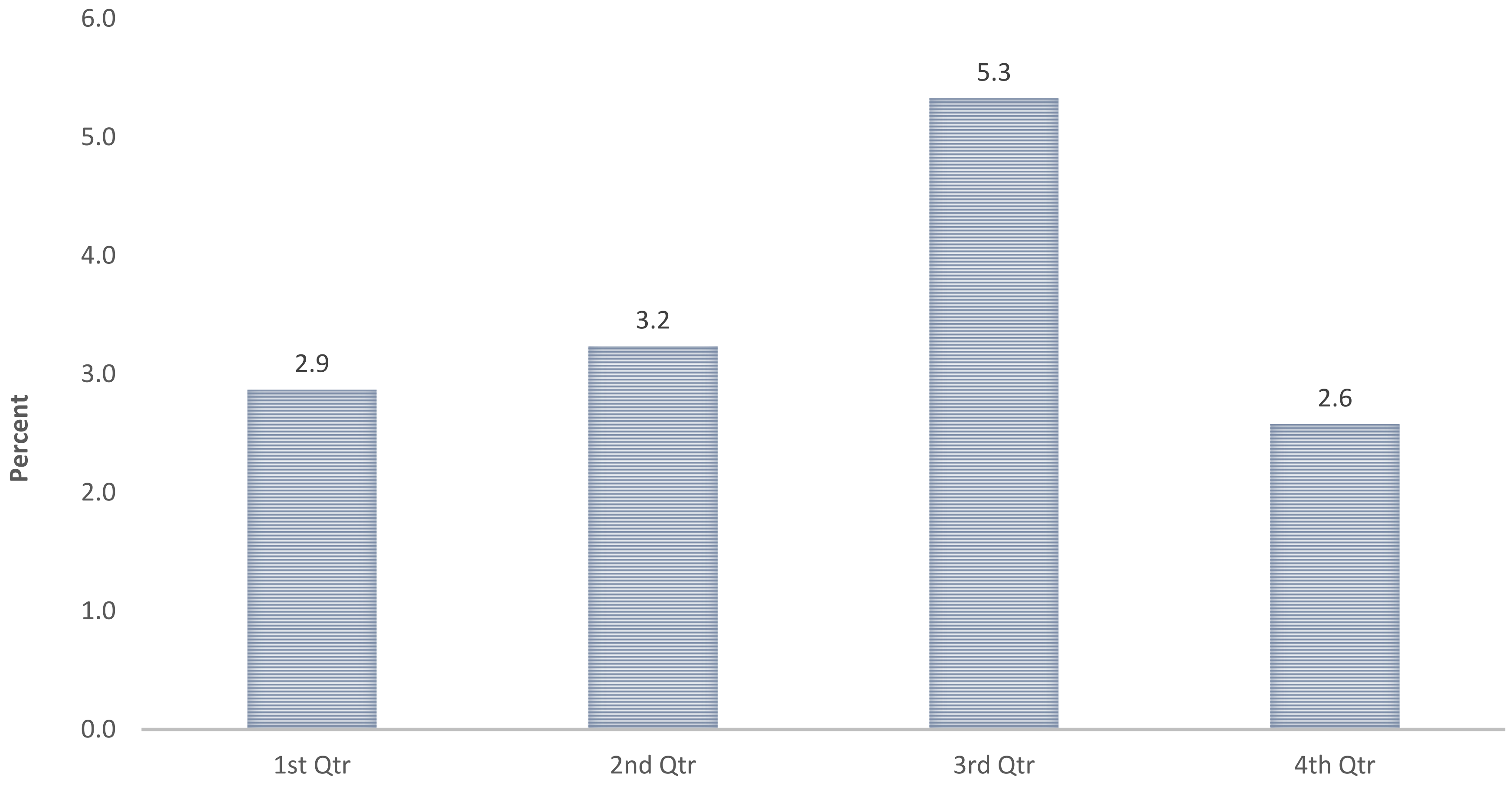
FY18 General Fund Receipts vs. Official Estimate ($ millions)

	Actual	Estimate	Diff ($)	Diff (%)
Sales and Use	3,605.7	3,611.9	-6.2	-0.2%
Individual Income	4,603.6	4,509.0	94.6	2.1%
Corporation Income	511.4	558.6	-47.2	-8.5%
LLET	238.1	186.2	51.9	27.9%
Coal Severance	89.6	88.5	1.1	1.3%
Cigarette Tax	211.8	214.3	-2.5	-1.2%
Property	621.3	607.9	13.4	2.2%
Lottery	253.0	243.0	10.0	4.1%
Other	703.7	699.0	4.7	0.7%
TOTAL	10,838.2	10,718.4	119.8	1.1%

A Surplus in FY18 Does not Imply a Surplus in FY19

- FY18 included some extraordinary payments in certain accounts
  - Lottery transferred an extra $10 million in dividends
  - Individual Income tax had unusually strong estimated payments in the 2nd and 3rd quarters of FY18
  - While unexpected money is good from a revenue collection standpoint, it makes it difficult to post growth in the following year
- Tax reform adds uncertainty to forecasting collections
  - Makes it difficult to tease out economic impacts from tax law impacts
  - Complicates the modeling process by changing the relationship between historical collections and future collections
  - As collections in FY19 mature, some of the fiscal impacts of HB 487 will be re-evaluated

FY18 Quarterly Growth Pattern



FY19 Unofficial Interim Estimate

General Fund Interim Forecast (October 2018)
$ millions

	FY19						FY19	
	Q1		Q2, Q3, & Q4		Full Year		Official CFG	
	Actual	% Chg	Estimate	% Chg	Estimate	% Chg	Estimate	$ Diff
Individual	1,115.9	-0.7	3,421.8	-1.7	4,537.7	-1.4	4,531.2	6.5
Sales & Use	977.3	8.2	2,925.3	8.2	3,902.6	8.2	3,907.6	-5.0
Corporate	145.8	-5.1	350.6	-2.0	496.4	-2.9	573.0	-76.6
Property	48.6	-9.5	580.1	2.2	628.7	1.2	620.7	8.0
LLET	49.0	12.7	182.1	-6.4	231.1	-3.0	200.2	30.9
Lottery	56.5	2.7	195.7	-1.2	252.2	-0.3	249.0	3.2
Cigarettes	111.9	103.1	226.9	44.8	338.8	59.9	337.9	0.9
Coal Severance	20.0	-21.1	56.7	-11.9	76.6	-14.5	77.9	-1.3
Other	142.4	0.9	567.2	0.8	709.6	0.8	700.7	8.9
General Fund	**2,667.4**	**4.5**	**8,506.3**	**2.7**	**11,173.7**	**3.1**	**11,198.2**	**-24.5**

Fiscal Impact of House Bill 487 SCS

There was no official score for FY18 due to the effective date of HB 487 being in July. However, there may have been some minor changes in FY18:

- Withholding tables technically changed May 1st
- Estimated income tax payments in June (FY18)

FY19 fiscal impact was +192.3 million

- Sales Tax +$208.2 million
- Corporate income -$27.6 million
- Individual income -$118.3 million
- Tobacco Taxes +$130 million

House Bill 487 Key Effective Dates

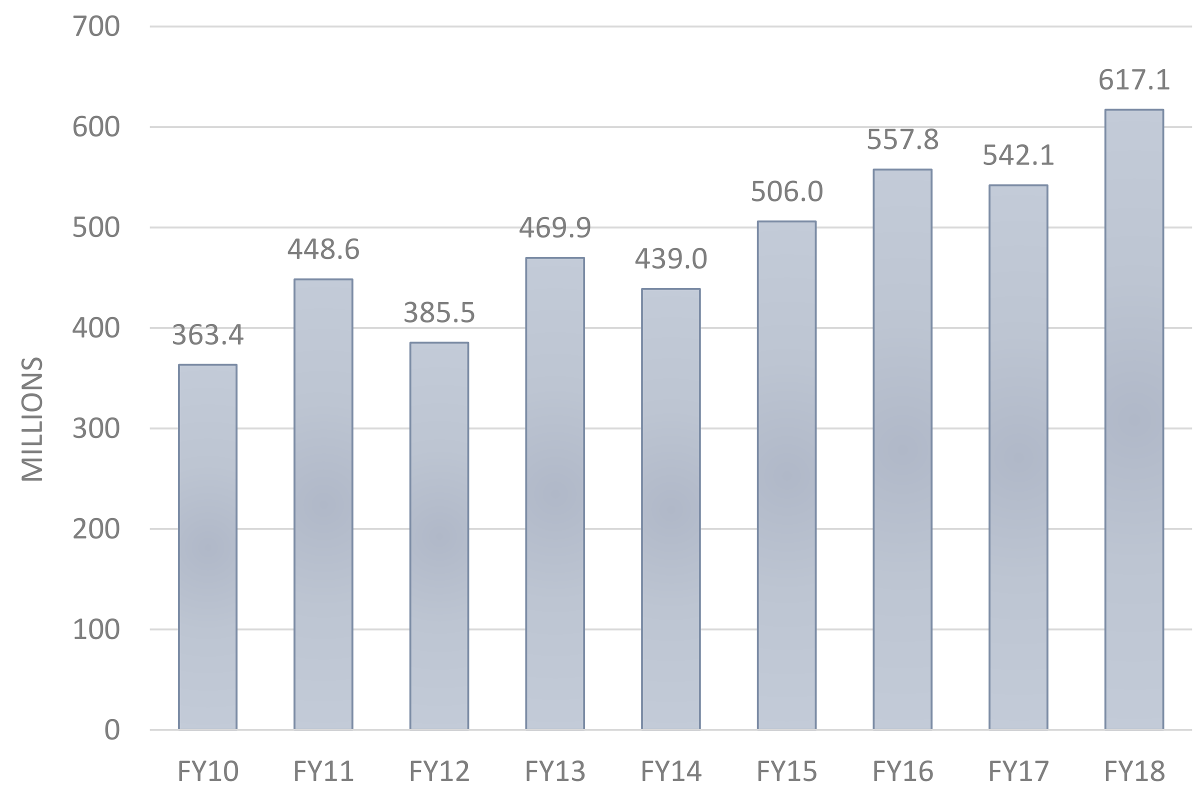
- **For tax years beginning on or after January 1, 2018**
  - Flat tax rate of 5% for individuals and corporations
  - Elimination of many Individual Income Tax deductions
  - IRC Conformity for Income Tax updated to December 31, 2017
  - Single Sales Factor & Market Based Sourcing
- **Sales after July 1, 2018:**
  - Sales Tax on various services, participatory admissions, extended warranties, installation with purchase of tangible personal property
  - Cigarette Tax Increase
- **For tax years beginning on or after January 1, 2019**
  - Unitary Combined & Elective Consolidated Group Filing

A Look at the Major Taxes

- **Individual Income Tax**
  - Still tracking very close to the official estimate in FY19
  - FY19 affected by one-time declaration payments in FY18
  - A lot going on with Tax Reform
    - Flat tax rate of 5% for individuals and corporations, beginning on and after 1/1/18
    - Base was broadened (many deductions, credits, and exemptions eliminated)
    - Federal conformity provisions were updated to December 31, 2017. The update adopted many provisions in the Tax Cuts and Jobs Act on the effective dates specified in that Act
    - Removed $10 personal tax credit (retained for blind, aged, and National Guard)
  - Uncertainty on refunds and estimated payments heading into the winter and spring months

Individual Income Estimated Payments ($ mil)

(FY18 May Include One-time Nonrecurring Payments due to Federal Tax Reform)



Details on HB 487 – Individual Income Tax

For tax years beginning on or after January 1, 2018:

- **Maintained deductions for:**
  - Home mortgage interest, points, and qualified mortgage insurance premiums
  - Charitable contributions, and
  - Some miscellaneous deductions
    - Amortizable premium on taxable bonds (IRC Sec. 171)
    - Federal estate tax on income in respect of a decedent (IRC Sec. 691)
    - Repayments of more than $3,000 under a claim of right (IRC Sec. 1341)
    - Unrecovered investment in an annuity (IRC Sec. 72)
    - Loss from other activities from Schedule K-1 (Form 1065-B), box 2
- **Several Itemized Deductions *Eliminated***
  - Investment interest (IRC Sec. 163)
  - Taxes (IRC Sec. 164)
  - Casualty or theft losses and gambling losses (IRC Sec. 165)
  - Medical and dental care expenses (IRC Sec. 213)
  - Moving Expenses (IRC Sec. 217)
  - Other miscellaneous deductions subject to the 2% of AGI limitation (IRC Sec. 67)

A Look at the Major Taxes FY19

- **Sales Tax**
  - Tracking very close to the official estimate
  - FY19 has grown 8.2% year-to-date
  - Implementation issues with Tax Reform
    - Expansion of the Sales Tax base to include many services and admissions
    - Extensive taxpayer outreach has occurred with the DOR
    - Expect revenue growth to accelerate somewhat as more and more retailers adjust to the new tax laws
  - Wayfair Case

South Dakota v. Wayfair

- The United States Supreme Court ruled in South Dakota v. Wayfair on June 21, 2018, that states can require sellers to collect and remit sales or use tax on sales delivered to locations within their state regardless of physical presence
- HB 487, effective July 1, 2018, requires remote retailers with 200 or more sales into the state or $100,000 or more in gross receipts from sales into the state to register and collect Kentucky sales and use tax
- House Bill 487 defines remote retailers as those with no physical presence in Kentucky
- Affected retailers should be registered and collecting Kentucky sales and use tax by October 1, 2018
- A small amount of revenue was booked as part of the score in HB 487

Expansion of the Sales Tax Base

- Participatory admissions, membership fees – Bowling centers; skating rinks; health spas; swimming pools; tennis courts; weight training facilities; fitness & recreational sports centers; golf courses, both public and private;
- Transient Accommodations - Campsites, campgrounds, RV parks;
- Landscaping services (lawn care/maintenance; tree trimming, pruning or removal; landscape design and installation; landscape care/maintenance; snow plowing or removal services);
- Janitorial services - residential/commercial cleaning, carpet, upholstery, window cleaning;
- Small animal veterinary services, pet care (grooming, boarding, pet sitting, pet obedience training);
- Industrial laundry and linen supply services;
- Non-coin-operated laundry and dry cleaning services;
- Indoor tanning services;
- Non-medical diet and weight reducing services;
- Limousine services with a driver; and
- Extended warranty services sold on or after July 1, 2018 for tangible personal property or digital property that is taxable to the warranty holder.

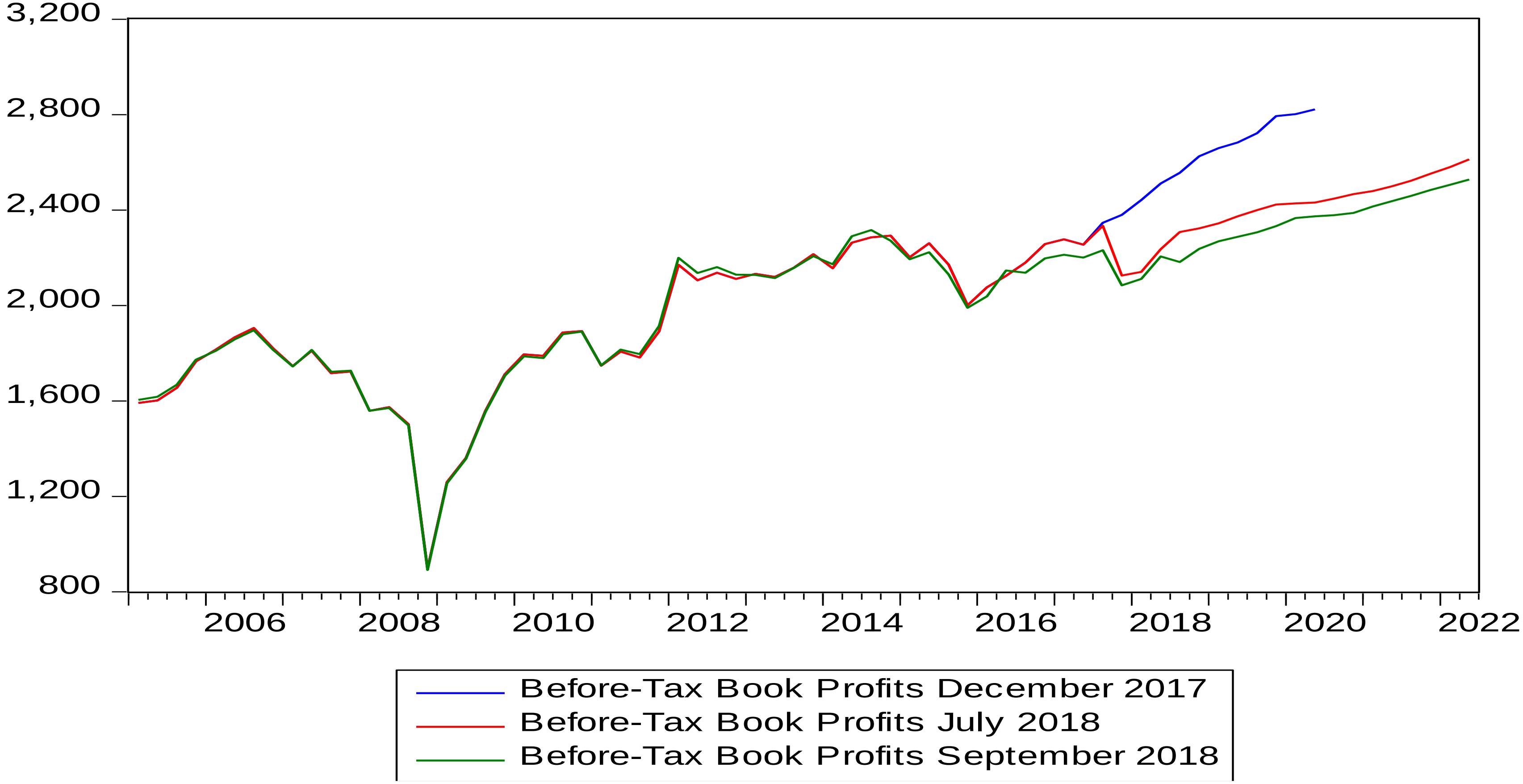
Expansion of the Sales Tax Base

- Gross receipts subject to sales tax will include installation/repair labor associated with the sale of taxable tangible personal property, digital property, or services. This labor component becomes taxable if part of a taxable retail sale.
- Charges for the installation of fixtures to real property or for labor to repair fixtures to real property are not part of gross receipts subject to sales tax. See 103 KAR 26:070 for more information on fixtures and building materials used in construction contracting.
- There is an exemption for charges for repair or installation labor for taxable tangible personal property used directly within the manufacturing process.
- This law change does not affect contractors involved in building construction or repairs to real property.

Corporation Income Tax

- **Corporation Income tax**
  - As shown above, the corporation income tax internal estimates have been lowered for FY19
  - The first quarter of FY19 saw receipts fall 5.1 percent
  - Corporate income tax receipts are linked to the expectations for corporate profits, which have moderated since the official estimates were formed
  - Corporation income tax was also affected by tax reform
    - The rate was lowered to a flat 5% (Down from a top marginal rate of 6%)
    - The Corporation Income Apportionment Factor was changed to Single Sales Factor with Market Based Sourcing, beginning on and after 1/1/18.
    - Mandatory Unitary Combined or Elective Consolidated Group Filing is effective for tax years beginning on or after 1/1/19.

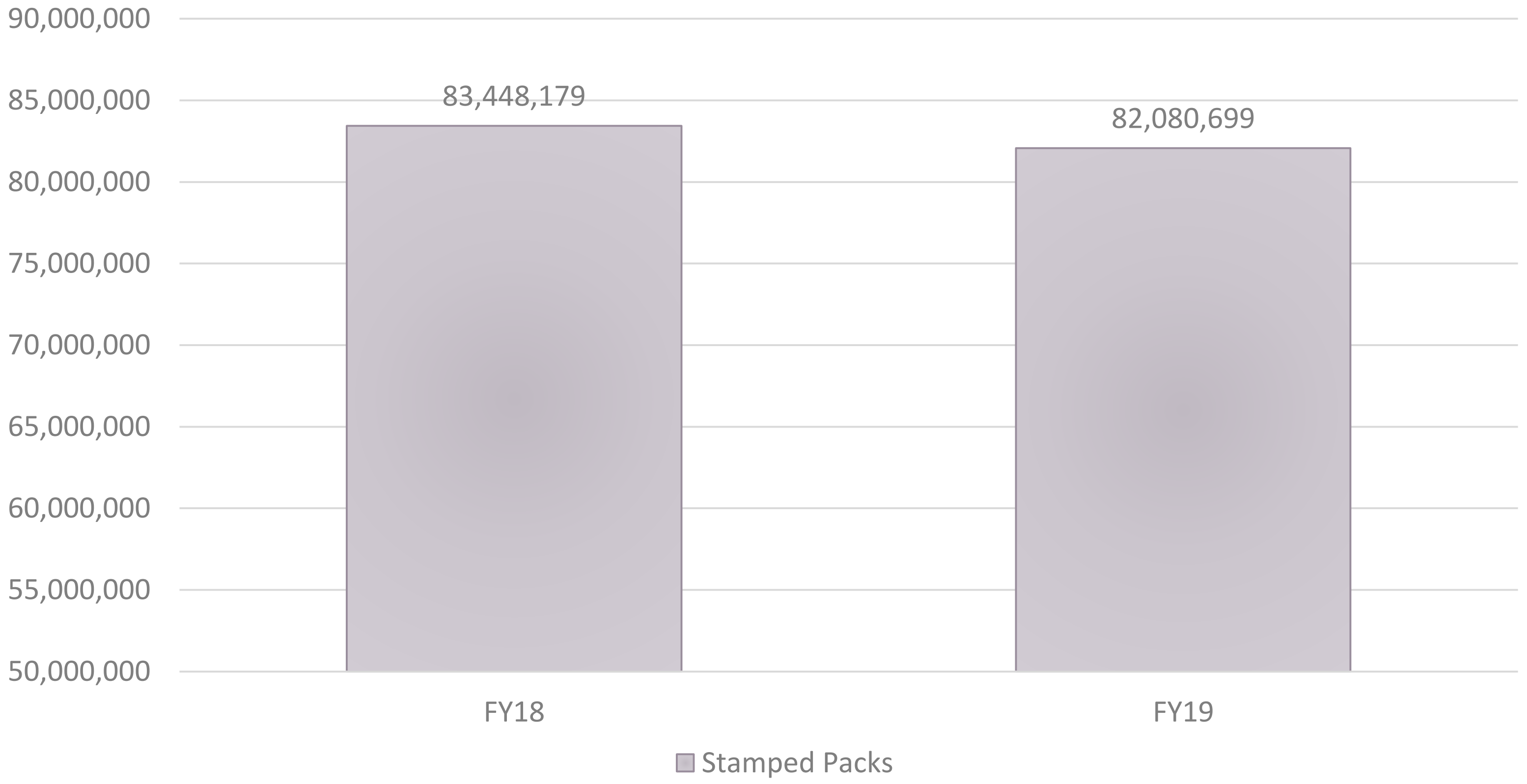
The Forecast for Profits has been Revised Downward (Source: IHS Global Insight)



Cigarette Taxes

- HB 487 raised the tax on a pack of cigarettes from $0.60 to $1.10 effective July 1, 2018
- A floor stocks tax was also imposed to prevent hoarding of stamped cigarettes before the tax increase took place
- Both the surtax increase and the floor stocks tax have slightly exceeded expectations so far in FY19
- First quarter receipts are up 85.3 % compared to the first quarter of FY18
- The floor stocks tax yielded $21.2 million to date

Quarter 1: FY19 vs. FY18



Take-Away Messages

- Year-to-date receipts have shown encouraging growth of 4.5%
- The interim estimates are running very close to the enacted budget estimates, including the effects of HB 487
- The revenue surplus from FY18 seems less likely to replicate itself in FY19
- Tax reform significantly affects the ability to forecast revenues
- Expect the remainder of FY19 to be similar to the first quarter receipts pattern:
  - Strong growth in the sales and excise taxes
  - A slight decline in both income taxes
  - No significant growth in the remainder of the taxes

Questions

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