INTERIM JOINT COMMITTEE ON APPROPRIATIONS AND REVENUE

Minutes of the 5th Meeting
of the 2018 Interim

October 25, 2018

Call to Order and Roll Call

The 5th meeting of the Interim Joint Committee on Appropriations and Revenue was held on Thursday, October 25, 2018, at 1:00 PM, in Room 102/104 of the Health Innovation Center on the campus of Northern Kentucky University, Highland Heights, Kentucky. Senator Christian McDaniel, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Christian McDaniel, Co-Chair; Representative Steven Rudy, Co-Chair; Senators Danny Carroll, David P. Givens, Morgan McGarvey, Gerald A. Neal, Dennis Parrett, Wil Schroder, Brandon Smith, Robin L. Webb, Stephen West, and Max Wise; Representatives Rocky Adkins, Tim Couch, Myron Dossett, Ken Fleming, Jason Nemes, Sal Santoro, Arnold Simpson, Jim Stewart III, James Tipton, Russell Webber, and Susan Westrom.

Guests: Dr. Ashish Vaidya, President, Northern Kentucky University; John Chilton, State Budget Director, Office of State Budget Director; Greg Harkenrider, Deputy Executive Director, Office of State Budget Director; John Cooper, Governmental Affairs Consultant, Kentucky Bankers Association; Debra Stamper, Executive Vice President and General Counsel, Kentucky Bankers Association; Ballard Cassady, President and Chief Executive Officer, Kentucky Bankers Association; Dave Eager, Executive Director, Kentucky Retirement Systems; Kathy Rupinen, General Counsel Advocacy; Jennifer Hays, Committee Staff Administrator, LRC Appropriations and Revenue Committee.

LRC Staff: Jennifer Hays, Cynthia Brown, and Chase O'Dell.

Welcome from NKU

Dr. Ashish Vaidya welcomed members to Northern Kentucky University.

Approval of Minutes

Senator Schroder moved that the minutes of the August 30, 2018 meeting and September 27, 2018 meeting be approved. Representative Santoro seconded the motion, and the minutes were approved by voice vote.

Discussion of Budgeted Receipts versus Actual Receipts

John Chilton, State Budget Director, Office of State Budget Director; and Greg Harkenrider, Deputy Executive Director, Office of State Budget Director; discussed Budgeted Receipts versus Actual Receipts.

Greg Harkenrider testified that there was a general fund revenue surplus of $119,800,000 for Fiscal Year (FY) 2018. Of the $119,800,000 revenue surplus, $94,600,000 came from the individual income tax. Sales and use tax receipts were $6,200,000 lower than estimated. Corporate income and LLET receipts were $4,700,000 above the estimate. Property tax receipts were $13,400,000 over the estimate.

Greg Harkenrider stated that a surplus in FY18 does not imply a surplus in FY19. He explained that some money received in FY18 is not expected for FY19. An extra $10,000,000 from dividends was received from the lottery in FY18. In addition, there were really strong estimated payments from the individual income tax in the second and third quarters of FY18. He testified that unexpected money makes it difficult to post growth in the following year. He continued to say that tax reform adds uncertainty to the forecasting process. Mr. Harkenrider stated that growth will be slower in FY19 because of the one-time money received in the third quarter of FY18.

Receipts for FY19 are expected to be $24,500,000 below the official Consensus Forecasting Group (CFG) estimate. Individual income tax receipts are projected to fall 1.4 percent in FY19. Sales tax receipts are projected to grow 8.2 percent in FY19. Mr. Harkenrider testified that the decline in the corporate income tax is the main reason behind the $24,500,000 shortfall in FY19.

The changes in House Bill (HB) 487 SCS are expected to bring in an extra $208.2 million in sales tax receipts. The changes are also expected to cause a loss of $118.3 million in individual income tax receipts. Tobacco taxes are expected to bring in an additional $130 million because of HB 487.

Greg Harkenrider testified that the individual income tax receipts are close to the estimate so far this year. He stated that moving from a graduated rate to a flat rate is showing up in withholding. Year-to-date withholding is down 2.5 percent in the current year. Mr. Harkenrider stated that the effects of broadening the tax base will not show up until 2018 returns are filed. He continued to say that there is uncertainty surrounding what the situation with refunds and estimated payments will be in the spring. Growth is projected to occur in those areas.

Mr. Harkenrider said that it will be hard to replicate the individual income estimated payments from FY18.

The sales tax receipts thus far are close to the estimate for FY19. Of the projected 8.2 percent growth in sales and use tax receipts, it is projected that 5.3 percent will be the result of base broadening and tax reform. The remaining 2.9 percent is projected to result from economic growth.

Greg Harkenrider testified that estimates have been lowered for the corporate tax. He explained that the corporate taxes are one of the main reasons that receipts will be lower than estimated. Last year there was relatively flat growth in the corporation income tax. Corporate tax receipts were up two percent and Limited Liability Entity Tax (LLET) receipts were down three percent. Mr. Harkenrider stated that the first quarter of FY19 saw corporate receipts fall 5.1 percent.

Mr. Harkenrider testified that the cigarette tax and floor stock tax both exceeded expectations. First quarter receipts for the taxes are up 85.3 percent compared to last year. The floor stock tax brought in $21.2 million in receipts in the first quarter of FY19, exceeding the official estimate of $19 million. Greg Harkenrider stated that the 50 cent tax increase on packs of cigarettes only led to a 1.64 percent decrease in first quarter sales in FY 19 compared to FY18.

Mr. Harkenrider testified that year-to-date receipts have shown encouraging growth of 4.5 percent. He continued to say that interim estimates are running close to the enacted budget estimates. He also stated that the revenue surplus of FY18 is unlikely to repeat in FY19. The remainder of FY19 is expected to be similar to the first quarter receipt patterns.

In response to a question from Representative Rudy, Greg Harkenrider stated that there will be more certainty concerning receipts received by the end of the third quarter of FY19.

In response to a question from Senator Carroll, Greg Harkenrider stated that non-profit admissions were not factored in receipt estimates, therefore exempting them would not have an effect on the estimates. In response to a follow-up question from Senator Carroll, Mr. Harkenrider said that the sale of taxable tangible property by non-profits should have been taxed all-along. In response to another question from Senator Carroll, he explained that there was a misunderstanding of the law that led to under-compliance in the taxation of non-profits.

Discussion on the Bank Franchise Tax

John Cooper, Governmental Affairs Consultant, Kentucky Bankers Association; Debra Stamper, Executive Vice President and General Counsel, Kentucky Bankers Association; and Ballard Cassady, President and Chief Executive Officer, Kentucky Bankers Association; discussed the Bank Franchise Tax in Kentucky.

Ballard Cassady testified that Kentucky is taxing banks at a rate that is 92 percent higher on average than any other corporation or business in the state. He stated that corporate tax reform enacted by the General Assembly in 2018 expanded the gap.

The Bank Franchise Tax was enacted in 1996. Mr. Cassady testified that Dodd-Frank increased the gap between the bank franchise tax and taxes on every other corporation.

Mr. Cassady testified that Kentucky's chartered banks have the highest capital of any state in the region. He continued to say that having some of the best capitalized banks in the country kept them from failing during the recession in 2008. Mr. Cassady also testified that because of the bank franchise tax, Kentucky banks' high capital rate contributes to the imbalance between bank tax rates and tax rates on all other corporations. In addition, he stated that it is part of the reason that Kentucky's bank tax rate is higher than all of the states surrounding it.

Ballard Cassady testified that Kentucky taxes its banks higher than any other state in the country. He said that the 92 percent tax gap between banks and other corporations in the state is an average, and that the gap is much higher for small banks.

Kentucky banks have an average effective tax rate of 13.3 percent, which is the highest rate in the nation. Kentucky is one of five states in the country that has a bank franchise tax.

As a result of out-of-state bank acquisitions, Kentucky has lost control of over $665 million in capital in the last five years. Mr. Cassady testified that the trend will accelerate if the bank tax gap is not closed quickly.

In response to a question from Representative Adkins, Ballard Cassady said that banks are being acquired in locations across the state.

In response to a question from Senator Givens, Ballard Cassady stated that the bank franchise tax was used by 30 or more states at one time. In response to a follow-up question from Senator Givens, Mr. Cassady said that the consumer and corporate mind work differently. In response to another follow-up, he stated that three significant events contributed to the current situation. He cited those events as being the lowering of the corporate tax rate in 2005, the passage of Dodd-Frank, and the lowering of the corporate tax rate again in 2018. In response to another question from Senator Givens, Mr. Cassady stated that adding the local deposit tax on top of the bank tax creates an effective tax rate of 13.3 percent.

Discussion of KRS Exit Strategies for Quasi Government Agencies

Dave Eager, Executive Director, Kentucky Retirement Systems; and Kathy Rupinen, General Counsel Advocacy; discussed KRS exit strategies for quasi government agencies.

Dave Eager testified that the Kentucky Retirement System (KRS) could not be left until 2015. 2015 House Bill 62 defined a process by which agencies could leave the retirement system. Dave Eager said that KRS had some issues with HB 62.

2017 HB 351 allowed for lump sum payments only.

2018 HB 362 froze the Kentucky Employee Retirement Systems (KERS) Quasi rate at 49.43 percent for FY 2019.

Dave Eager testified that most Quasi agencies cannot afford higher contributions in FY 2020. He continued to say that most of the agencies cannot afford to withdraw from the system.

KERS has $15.6 billion in actuarial liability. Mr. Eager testified that KERS has $13.5 billion in unfunded liability. He continued to say that 71 percent of the actuarial liability is comprised of retirees. In addition, he stated that there are 0.83 active employees making contributions for every retiree receiving payments.

State Police Retirement Systems (SPRS) has $967 million in actuarial liability. Retirees make up 79 percent of the liability.

Dave Eager stated that retirements will most likely continue to accelerate for the next 10 years. He also stated that KRS has a fiduciary responsibility to its systems and members.

Kathy Rupinen testified that some agencies are not replacing employees as they leave. She continued to say that some agencies are attempting to outsource their employees. KERS has seen a drop of 10,000 active employees in the last eight years. Kathy Rupinen stated that KRS has an obligation to determine who are employees of participating employers.

In response to a question from Representative St. Onge, Dave Eager testified that statute does not explain what a Quasi agency is. He continued to say that KRS does not decide what agencies are critical to the state.

In response to a question from Representative Westrom, Kathy Rupinen stated that there are Area Development Districts (ADD) participating in KRS. Mr. Eager said that 14 of them are participating.

House Bill 487 Impact on Individual Income Tax

Jennifer Hays, Committee Staff Administrator, LRC Appropriations and Revenue Committee, discussed House Bill 487's impact on the individual income tax.

In response to a question from Representative St. Onge, Jennifer Hays stated that generalizations cannot be made from specific returns.

In response to a question from Senator McGarvey, Jennifer Hays testified that the Legislative Research Commission (LRC) has very little data pertaining to the effects of HB 487.