

# This Week



# in Topeka

Overland Park Chamber

*Business, Economic Development & Local Government News  
from the 2016 Legislative Veto Session*

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Finally! I am certain everyone has been waiting with bated breath for this summary of what happened, and didn't happen, during the recently concluded veto session that wrapped up the short 72-day 2106 legislative session. I would like to say that this report is filled with good news, but it's not. There was some good work that came out of the veto session; however, the best is probably that it only lasted five days and relatively little mischief took place with most of the work being focused on what had to be done; e.g., the budget.

Before getting into the legislative summary, however, I want to extend a belated "thank you" to the members of our Johnson County Delegation who participated on the panel at the Johnson County Public Policy Council's legislative breakfast on the Saturday morning right before the legislature reconvened for the veto session – Speaker Ray Merrick, Rep. Erin Davis, Rep. Jerry Lunn, Rep. Melissa Rooker, and Sen. Jim Denning. Special mention goes to Rep. Davis who made time for our event even though she also had a required continuing legal education session in Lawrence that morning that required her to leave the breakfast shortly after her comments. Thanks, again, to all of you, and to all of you who attended the breakfast for the update.

Now, here is what happened, or didn't happen, during the veto session (and since).

**The Budget.** After a lot of hard work in both the House Appropriations and Senate Ways and Means Committees, a compromise was worked out by a conference committee, and the committee's report on Sub for SB249 was sent to the full House for consideration. As the roll was closed and the final vote tallied, the bill received the minimum number of votes needed for passage, 63-59. The bill was then sent to the Senate where the vote initially stood at 18-21, but one absent member arrived and cast a "yes" vote and three other senators changed from "no" to "yes" making the final tally in the Senate at 22-18, sending the bill on to the Governor.

Interestingly, Sub for SB249 did not provide the constitutionally required balanced budget, instead leaving it to the Governor to make almost \$100 million of additional allotments (cuts) for the budget to balance. Included in the bill was some expanded authority for the Governor to make additional cuts and adjustments. There was a question of how the Governor would respond to this very unusual situation. Would he veto the bill, sending it back to the Legislature to rework it and return a balanced budget as required by the state constitution? Or would he make the additional allotments needed to balance the budget. The Governor chose option 2, making approximately \$97 million of allotments bringing the budget into balance and then signing the budget bill into law.

Highlights of Sub for SB249 include:

- Provides ending balances of approximately \$27M (FY2016) and \$81M (FY2017)
- Required the Governor to make additional allotments of \$97 million with KanCare (approximately \$56 million) and higher education (approximately \$30 million) suffering the bulk of the cuts
- Sweeps a total of nearly \$185M from the state's highway fund (KDOT confirming that this sweep will delay as many as 25 new modernization and expansion projects around the state, a total of over \$500 million)
- Allows the delay of the \$92 million fourth quarter FY2016 payment to KPERS; the payment must be repaid in FY2018 at 8% interest (the Governor line item vetoed the provision that would have required tobacco money settlement fund payment amounts in excess of amount appropriated for children's programs to be used to make the delayed payment)
- The bill contains a new provision that changes the simple across-the-board allocation of cuts to higher education to one that is based on each state university's "all funds budget," meaning that the large amount of research grant moneys received primarily by KU and KSU must be figured in, meaning that the loss to each school's main campus will be about \$1M more than originally anticipated. It also includes language that removes the restrictions on tuition increases for state universities that were imposed by the 2015 Legislature for FY2017
- The bill contains a proviso that prohibited any funding cuts to K-12 education in order to balance this budget
- Prohibits the privatization of Osawatomie and Larned State Hospitals without legislative approval, but adds about \$17M more money, including additional funds for pay increases for hospital employees in an attempt to combat the continuing staffing

shortages (those employees are underpaid relative to other institutions and they have not had raises for years), but more than half of the additional funds will probably be needed to offset loss of federal funds.

**STAR Bonds.** This session the Legislature expressed concern that the STAR bond district that includes development in Wyandotte County around the Kansas Speedway, the bonds for which are due to be paid off at the end of this year, five years ahead of schedule, was going to be expanded in an attempt lead by the Governor to lure the American Royal across the state line from Kansas City, Missouri to Kansas City, Kansas. Such a move, it was suspected, would deprive the state of an estimated \$42 million in sales tax revenue. In response, the Legislature included a provision in its first budget bill early in the session that would have prohibited any new or expanded STAR bond districts in Wyandotte County for two years. The bill passed, but the Governor used his line item veto authority to veto that provision, and the veto was sustained.

HB2632 was then introduced to address the concerns of the Legislature regarding STAR bonds by tightening the controls of their use and expanding legislative oversight. The bill also contains language that authorizes the State Finance Council to proceed with the sale of the assets of the Kansas Bioscience Authority which is projected to result in \$25 million to the state. HB2632 passed the House 89-32 and the Senate 40-0 and was recently signed into law by the Governor.

Included in the new law are provisions that do the following:

- Prohibits STAR bond districts approved by the Secretary of Commerce after March 1, 2016 from including property that was part of a previous STAR bond project
- Prohibits STAR bond districts approved after January 1, 2017 from using sales tax revenues received from retail automobile dealers to finance the bonds
- Includes a provision that states if area is added to a STAR bond district, the base tax year for that new area will be the 12-month period immediately preceding its addition to the district
- Requires the Secretary of Commerce to provide an annual report to the Legislature by January 31 on the status of all then current STAR bond districts.

**Angel Investor Tax Credits.** As the session began, current law allowed a tax credit of up to 50% of an investor's cash investment in a qualified Kansas business, a program that is very important to economic development efforts in Kansas. The amount was capped at \$50,000 for a single business or a total of \$250,000 of tax credits in a single year per investor. However, the law allowing these tax credits was to sunset at the end of 2016.

H Sub for SB149, easily passed in both the House and Senate and was signed by the Governor, extends the sunset of the tax credits available to Angel Investors for five years, from 2017 through 2021.

**Property Tax Lid.** As you know, the 2015 Legislature included a provision in its final tax package that included a requirement for local units of government to submit to a popular vote any proposed property tax increase in an amount that exceeded the CPI over the previous year. That requirement was to go into effect on January 1, 2018. In this session, the Senate passed a law that would amend that property tax lid by accelerating the effective date to July 1, 2016 and exempting some sources of the property tax revenue that would be considered in determining the cap requirement; e.g., resulting from the expiration of property tax abatements, expiration of a tax increment financing district or other property tax rebate programs; all making a bad law even worse.

After much negotiation led by the League of Kansas Municipalities and the Kansas Association of Counties (along with the Chamber, opponents of the lid and the proposed Senate modifications) and the Kansas Association of Realtors (along with the Kansas Chamber, supporters of the lid and the proposed Senate modifications), a compromise was reached and presented in S Sub for HB2088. The compromise easily passed both the Senate, 37-3, and the House, 112-5, and was signed into law by the Governor.

The final bill includes provisions that:

- Accelerates the effective date of the requirement of a popular vote under current law from January 1, 2018 to January 1, 2017
- Changes the determination of the lid from the previous year's CPI to a rolling 5-year average CPI
- Clarifies that when a popular vote is required to permit a property tax increase in excess of the CPI, that vote may be conducted at any regular, special or mail ballot election

- Retains the exemptions for expiration of property tax abatements and for expiration of a tax increment financing district, rural housing incentive district, neighborhood revitalization area or other property tax abatement program
- Adds an exemption for increases in public safety expenditures
- Adds an exemption for expenses relating to a federal, state or local disaster or a federal, state or local emergency as declared by a federal or state official or municipal governing body
- Adds an exemption for property taxes levied by a subordinate government if the city or county does not have the authority to modify the tax levy of the subordinate body
- Retains the exemption for bond and interest payments.

**Economic Development Incentives.** HB2509 gives the Secretary of Commerce the discretionary authority to collect so-called administrative fees for certain economic development programs as follows:

- Up to \$750 for applications to the Kansas Industrial Training program, the Kansas Industrial Retraining program, PEAK, and the Job Creation Fund
- Up to 1% of the amount of STAR bonds or private activity bonds issues, not to exceed \$200,000 for any single issuance, plus any actual administrative costs that exceed the allowable fee; payable from the bond proceeds
- Up to 2% of funds transferred to the State Affordable Air Fare Fund
- Revenue collected under the new law would be deposited in administrative funds created for the respective programs.

**Budget Process and Budget Stabilization Fund.** HB2739 was introduced in the House Appropriations stemming from a recommendation contained in the Alvaraz & Marsal *Kansas Statewide Efficiency Review*. The bill would make changes to the State's budget process by moving to a performance based budget with the goal of aiding and improving decisions regarding budget priorities and maximizing the State's return on investment. Also included in the final bill were provisions that would establish a risk-based reserve fund in the State treasury, the Budget Stabilization Fund, as recommended in the *Kansas Statewide Efficiency Review*.

The bill, unanimously passed both the Senate and the House and was signed by the Governor, does the following:

- Requires the Secretary of Administration together with the Division of the Budget, the Revisor’s Office, and the Legislative Research Department to prepare a program service inventory by January 9, 2017
- Requires a revised performance based budget process to be implemented by January 14, 2019
- Establishes the Budget Stabilization Fund within the State Treasury by July 1, 2017
- Requires the Legislative Budget Committee to meet for up to 10 days before the 2017 Legislative Session to study and review policies relating to the Budget Stabilization Fund, including the big challenge, identifying sources of funding.

**Guns.** What would a legislative session be without more state mandates to local governments regarding what they can and cannot do within their respective jurisdictions regarding the regulation of guns? HB2502, generally referred to this past session as the “omnibus gun bill,” passed the Senate and House by 32-6 and 92-28 votes, respectively, and was signed by the Governor.

This new bill:

- Prohibits public employers from implementing personnel policies that restrict or prohibit any employee otherwise legally qualified to carry a concealed weapon from doing so while engaged in the employee’s duties outside their place of business, including while in any means of conveyance. School districts are specifically excluded from the definition of “public employer”
- Amends the definition of “adequate security measures” in current law to specify that personnel used at public entrances of buildings where concealed carry is prohibited have to be armed
- Specifically permits air guns in schools when used as part of sponsor supervised activity.

**The “LLC Loophole”.** In what we consider to be a major disappointment for the 2016 session was the failure of the Legislature to address the so-called LLC Loophole, the provision in the 2012 tax cut package that exempted all pass-through income generated by LLC’s, Sub-S Corporations, partnerships and sole proprietorships from the payment of state income tax. This provision has resulted in approximately 330,000 business owners in the state of Kansas paying no state income tax, not just on the non-wage income of their businesses, but on all income generated by those businesses, even what would be (or should be) deemed to be personal income. While not entirely responsible for the huge revenue shortfalls that the state has experienced since that law took effect starting with the 2013 tax year, it does represent an

estimated \$250 to \$300 million annually, approximately 30% of the income tax revenue “lost” as a result of the 2012 tax cuts.

During the 2016 session, two primary bills were introduced to address this unfair and irresponsible exemption. HB2444 proposed to repeal the LLC Loophole, but it also called for using all of the new revenue to reduce the state sales tax on food from its current 6.5% to 2.6%. This bill had two days of standing room only hearings in the House Taxation Committee. As previously reported, supporters of the bill included an impressive group of business owners who personally benefitted from the 2012 tax exemption but were there to ask the legislature to change current law and require them to again pay their share of income taxes. Other supporters included a number of local chambers of commerce (including the OP Chamber, although our support was predicated on a much more modest, if any, food sales tax cut) representing their member businesses and the Tax Foundation (a nationally recognized organization that studies tax policy), who argued that Governor Brownback’s 2012 tax plan has failed to live up to the promise that it would provide a quick and strong boost to the Kansas economy while actually encouraging tax avoidance rather than job growth. In fact, however, Kansas is lagging behind the region and nation in many, if not most, job growth, personal income growth and gross state product measures. The supporters also point to the continuing revenue shortfalls and growing budget deficits that force the legislature to sweep money from funds dedicated to key government services and use other one-time revenue sources in its efforts to balance the budget.

Opponents of this bill, and probably about any bill that would reinstate income taxes on business owners, countered that the “tax plan is working,” notwithstanding the dreary numbers and lack of performance that indicate otherwise, and that it will only take a little more time.

In the Senate, SB508 was introduced by its primary sponsors, Sens. Jeff King, Jim Denning, and Greg Smith. This bill would have modified the LLC Loophole by subjecting 70% of the pass-through income to state income tax, while retaining the exemption for the remaining 30%. The percentages were based on a benchmark developed at the federal level that bases economic output on 70% labor and 30% investment. SB508 was given a hearing in the Senate Assessment and Taxation Committee.

As the session wound down, it appeared that neither bill would be worked in its respective committee and make it to the floor of either chamber, so a Tax Conference Committee used SB63 as the vehicle in a “gut and go,” replacing the original language of that bill with a simple, straightforward repeal of the LLC Loophole and sent it to the full House for consideration where it failed on a 45-74 vote. There were reasons galore offered by many of those who voted against the bill; you have obviously read and/or heard some of them,

because many of you have asked about them. I offer the following challenges to most, if not all, of them.

“It was just an election year trap. They just wanted us on record casting a futile vote for a tax increase, great campaign postcard material. The Senate was not going to debate the bill and, even if it did and passed it, the Governor was going to veto it.” Maybe, maybe not, but is that a really good reason for not trying to take an incremental step to begin fixing a serious revenue problem, the folly and irresponsibility of which has been the subject of many speeches, articles, interviews and the like? Put the pressure on the Senate by sending them a bill that makes a significant move in the right direction; let them face the opportunity to vote on a responsible measure in light of the budget problems and likely budget cuts. And if it passed, let the Governor own it if he chooses to follow through on his earlier threats of a veto (a threat that at least some believed that he had backed away from).

“It does not fix the entire problem created by the 2012 tax cuts. We have to repeal the entire tax cut package – ‘all or nothing’.” As mentioned above, no one disputes that this piece of the 2012 package is not wholly responsible for the revenue shortages currently faced by the state, nor that a repeal of the Loophole would not totally solve the our revenue shortfalls. However, it is a material step in the right direction, a significant step that would be expected to generate \$250 to \$300 million annually that we otherwise would not have. Further, contrary to some statements, since business owners would have to begin making estimated income tax payments in 2017, there would be some new, additional revenue realized in FY2017, probably as much as \$50-60 million, enough to possibly avoid the need for some of the additional cuts to higher education or Medicaid/KanCare provider reimbursements, or reducing the amount of funds swept from the state highway fund, or be available as one possible option for responding to last week’s Supreme Court’s decision on equity in K-12 school funding. An all or nothing approach is just not realistic or responsible. It ignores the fact that a change in the make-up of the Legislature as a result of this fall’s elections that is significant enough to garner the votes to fully repeal the 2012 tax cuts is just not realistic. And, even if such a repeal effort could find the votes to squeak through a newly constituted Legislature, there will be no change in the occupant of the Governor’s office, and is there really any chance that he will sign a bill that completely razes the signature effort of his administration? With this approach, we slog through at least two more years of revenue shortfalls and budget cuts, waiting to see who our next Governor is and what happens to the House membership in the 2018 elections.

“The bill we were asked to vote on did not go through the committee process, it did not get a hearing.” True. But two other bills that addressed the very same subject (i.e., the LLC

Loophole) were vetted by the House Taxation Committee (HB2444) and the Senate Assessment and Taxation Committee (SB508), and while not the exact same bill that the Tax Conference Committee sent to the House floor, the concept of the LLC Loophole and its impact on the state of Kansas was considered and debated prior to H Sub for SB63 appearing before the full House.

“Because of the procedure used to get the bill to the House floor, we were limited to an “up or down” vote; we had no ability to amend the proposal.” Again, true. But, again, is that a sufficient reason to decide to reject a bill that contained only a straightforward repeal of the hated LLC Loophole? Like it or not, this procedure is used every single legislative session, and, admit it or not, I bet that there is not a legislator that has not at some time previously been happy that some legislation that he or she supported made its way through the process as a result of this very same procedural move.

“Current law contains the 2.5% trigger that says tax revenue realized that is more than 2.5% in excess of what was taken in by the state in the previous year must be used to even further reduce the individual income tax rates; it’s just like throwing gasoline on the fire.” What this rationale fails to mention is that the 2.5% trigger does not go into effect until the 2019 tax year. If the LLC Loophole had been repealed, the additional tax revenue realized as a result of that repeal would fully show up in tax year 2018; thus, it would be part of and increase the base amount to which the 2.5% trigger would be applied. And, if you believe that the Legislature will be able to successfully change tax policy over the next two sessions following the 2016 elections, then it is also reasonable to assume that the trigger could likewise be modified or eliminated.

That ends this newsletter’s sermon. It is time to head back to Topeka for *sine die*, the official end of the 2016 session. Instead of the usually perfunctory and not particularly well attended meeting to adjourn the House and Senate and to hear farewell remarks from those legislators that have decided to retire, it could be an interesting day (or days) this year. There is the possibility of dealing with transgender bathrooms and veto overrides. And there is the certainty that the Legislature will have to respond in some way to last Friday’s decision by the Supreme Court in *Gannon*, declaring that the Legislature’s attempt earlier in this session to meet the constitutional equity requirements for funding K-12 education failed and that the pending June 30 deadline imposed by the Court for doing so remains in place. It seems likely that it will take some time for the Legislature to digest the Court’s opinion (the release of which was puzzlingly and disappointingly withheld by the Court until almost 5:00 pm on Friday, the day before a long holiday weekend and only one “work day” before the Legislature was to convene for *sine die*), so it looks like we are in for a special session of the Legislature in June.