LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
http://www.in.gov/legislative

FISCAL IMPACT STATEMENT

LS 6861 **NOTE PREPARED:** Feb 21, 2006
BILL NUMBER: SB 258 **BILL AMENDED:** Feb 16, 2006

SUBJECT: Taxation and State and Local Finance.

FIRST AUTHOR: Sen. Kenley **BILL STATUS:** 2nd Reading - 2nd House
FIRST SPONSOR: Rep. Espich

FUNDS AFFECTED: X GENERAL **IMPACT:** State & Local
X DEDICATED
FEDERAL

Summary of Legislation: (Amended) ***IRC Reference Update:*** The bill provides that for taxable years beginning after December 31, 2005, references in Indiana law to the Internal Revenue Code (IRC) and related regulations refer to the law and regulations in effect on January 1, 2006.

Dependent Child Deduction: The bill corrects an obsolete reference to the Internal Revenue Code related to a state Income Tax deduction for dependents. For taxable years beginning after December 31, 2005, the bill expands the class of dependents that permit a taxpayer to take an additional $1,500 dependent state Income Tax deduction from "son, stepson, daughter, or stepdaughter who is not more than 19 years of age or a student" to any "son, stepson, daughter, stepdaughter, or foster child of the taxpayer, descendant of a son, stepson, daughter, stepdaughter, or foster child of the taxpayer, brother, sister, stepbrother, or stepsister of the taxpayer or a descendant of any such relative who is not more than 19 years of age, a student, or permanently and totally disabled".

Streamlined Sales Tax: This bill specifies that tobacco products are not food and food ingredients. It defines the terms "direct mail" and "bundled transaction". The bill also provides that a person is a retail merchant making a retail transaction when the person sells tangible personal property as part of a bundled transaction.

The bill provides that a person who: (1) voluntarily registers as a seller under the Streamlined Sales and Use Tax Agreement; (2) is not a Model 1, Model 2, or Model 3 seller (as defined under the Streamlined Sales and Use Tax Agreement); and (3) had a liability for collection of State Gross Retail and Use Tax for the preceding calendar year that did not exceed $1,000; is not required to file a monthly State Gross Retail and Use Tax return.

The bill also provides that a transaction in which a florist that takes a floral order from a purchaser and transmits the floral order to another florist for delivery is sourced to the location of the florist who originally took the floral order from the purchaser.

Government Accounting: The bill specifies that the Governor, with the assistance of the Budget Director, is responsible for establishing and maintaining internal controls on the collection, recording, and reporting of accounting and financial information in all state agencies in the executive department of state government. It also requires the Budget Director and the Governor to certify that: (1) certain statements with financial information fairly represent the financial condition and results of operation of the state; and (2) the state's accounting internal controls in the executive department of state government are effective.

Validation of Bonds: The bill changes the date for validation of all outstanding bonds issued or lease agreements executed by various governmental entities from March 15, 2000, to March 15, 2006.

<u>**Effective Date:**</u> (Amended) Upon passage; January 1, 2005 (retroactive); January 1, 2006 (retroactive); March 15, 2006 (retroactive); July 1, 2006.

<u>**Explanation of State Expenditures:**</u> (Revised) ***Government Accounting:*** The bill specifies that the Governor and Budget Director are responsible for establishing and maintaining internal controls on the collection, recording, and reporting of accounting and financial information in all state agencies in the executive department of state government.

The bill requires the Budget Director and the Governor to certify that the following documents fairly represent the financial condition and results of operation of the state:

1. Year-end closing statements that include financial information about the state cash or fund balances, revenues, or expenditures;
2. Other interim or biennial statements about state cash or state fund balances, or expenditures;
3. A comprehensive annual financial report prepared by the Auditor of State; or
4. Budget reports and surplus statements that forecast the effect of appropriations or expenditures on cash or fund balances in a future period.

The impact would depend on the cost of reviewing the current control collection, recording, and reporting of accounting and financial information. If the review is done by the Budget Agency and the State Board of Accounts staff, there would be minor fiscal impact. If the decision is to have an independent accounting firm perform the review of the controls, then the cost of the consulting contract could be about $100,000.

Background: The review of the internal controls on the collection, recording, and reporting of accounting and financial information in all state agencies in the executive department could be time-consuming and require a high level of knowledge and experience by a consulting firm. The executive branch has about 120 agencies ranging from the Family and Social Services Administration to the Port Commission with budgets ranging from hundreds of thousands to billions of dollars. The estimated cost of the consulting contract is based on an average hourly rate of $300 per hour for about 333 billable hours.

(Revised) ***Validation of Bonds:*** Under existing law, all bonds, notes, evidences of indebtedness, leases, or other written obligations issued by or in the name of any state agency, county, township, city, incorporated town, school corporation, state educational institution, state-supported institution of higher learning, political subdivision, joint agency created under IC 8-1-2.2 (which involves municipal electric utility programs), leasing body, or any other political, municipal, public or quasi-public corporation or in the name of any special assessment or taxing district; or in the name of any commission, authority, or authorized body of any such entity; and any pledge, dedication or designation of revenues, conveyance, or mortgage securing these bonds, notes, evidences of indebtedness, leases, or other written obligations are hereby legalized and declared valid if these bonds, notes, evidences of indebtedness, leases, or other written obligations have been executed before March 15, 2000.

The bill provides that in addition to the above-listed debt instruments, swap agreements and other agreements are legalized. Additionally, the bill includes "boards" with respect to entities to which the provisions apply. The bill further extends the deadline before which the debt instrument must have been executed, from March 15, 2000, to March 15, 2005.

Essentially, these provisions legalize the above-mentioned products. Without the provision, if, for example, a bond was issued without providing the appropriate notice, the bond could be invalidated. The above provisions make the issuer or the entities involved not liable. For example, IC4-4-11-17 provides that the Indiana Finance Authority must hold a public hearing on the proposed financing agreement for an industrial development project after giving notice by publication in one newspaper of general circulation in the city, town, or county where the industrial development project is to be located at least ten days in advance of this public hearing. Under the bill, if the notice was given only six days in advance of the public hearing, the Authority could not be held liable and the bond would not be invalidated.

(Revised) ***Department of State Revenue (DOR):***The DOR will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the changes contained in this bill. The impact attributable to the Sales Tax changes is expected to be offset by the savings realized by allowing sellers who meet the requirements in the bill to file Sales Tax returns annually rather than monthly. Otherwise, the DOR's current level of resources should be sufficient to implement these changes.

Explanation of State Revenues: (Revised) ***Summary**:* The bill makes the following changes:

(1) Updates the reference in state statute to the Internal Revenue Code (IRC) from January 1, 2005, to January 1, 2006 for purposes of the Adjusted Gross Income (AGI) Tax.

(2) Expands the coverage of the dependent child deduction under the individual AGI Tax to include certain dependents other than a taxpayer's son, stepson, daughter, stepdaughter, or foster child who are currently covered.

(3) Makes changes to conform Indiana's Sales Tax laws to the Streamlined Sales Tax Agreement (SSTA).

The estimated revenue impact of the state AGI Tax changes is summarized in the table below. The impact of the Sales Tax changes is indeterminable. Detailed discussions of the changes follow the table.

Provisions (Revenue Impact in $M)	FY 2006	FY 2007	FY 2008
IRC Reference Update	(1.28)	(1.41)	(1.87)
Expansion of Dependent Child Deduction	0	(2.9)	(3.0)
Total	**(1.28)**	**(4.31)**	**(4.87)**

(Revised) ***IRC Reference Update:*** The bill updates the reference to the IRC to incorporate all the federal changes made up to January 1, 2006. The current reference to the IRC pertains to all IRC provisions amended and in effect on January 1, 2005. The update would include changes affecting tax years 2005 and after as a result of the following federal acts:

(1) The Energy Tax Incentives Act of 2005 (P.L. 109-58);
(2) The Katrina Emergency Tax Relief Act of 2005 (P.L. 109-73);
(3) The Gulf Opportunity Zone Act of 2005 (P.L. 109-135).

The Energy Tax Incentives Act includes provisions relating to: (1) depreciation and expensing of natural gas distribution property, electricity transmission and distribution property, and certain refinery investments; (2) amortization of certain air pollution control facilities installed by electric generating companies; and (3) deduction for construction of energy-efficient commercial buildings.

The Katrina Emergency Tax Relief Act and the Gulf Opportunity Zone Act include provisions: (1) increasing corporate charitable contribution limits; (2) excluding from gross income charitable mileage reimbursements for volunteers; and (3) expanding the deduction for corporate contributions of food inventory to noncorporate entities, and extending the deduction to donations of books to public schools. A summary of the estimated revenue impact of these federal acts is outlined in the table below.

Provisions (Revenue Impact in $M)	FY 2006	FY 2007	FY 2008
Energy Tax Incentives Act			
(1) Depreciation and expensing provisions.	(0.13)	(0.44)	(1.17)
(2) Amortization provisions.	(0.05)	(0.14)	(0.29)
(3) Deduction for energy-efficient commercial buildings.	(0.17)	(0.36)	(0.20)
(4) Other provisions.	(0.44)	(0.32)	(0.21)
Subtotal	**(0.79)**	**(1.26)**	**(1.87)**
Katrina Emergency Tax Relief Act/Gulf Opportunity Zone Act			
Charitable contribution provisions.	(0.49)	(0.15)	0.0
Total Impact on State Revenue	**(1.28)**	**(1.41)**	**(1.87)**

Revenue from the corporate AGI Tax is distributed to the state General Fund. The revenue from the individual AGI Tax is deposited in the state General Fund (86%) and the Property Tax Replacement Fund (14%).

(Revised) ***Dependent Child Deduction:*** The bill would reduce state Adjusted Gross Income (AGI) Tax liabilities for individual taxpayers who have dependents that currently do not qualify for the dependent child deduction. The revenue loss due to this change could potentially total about $2.9 M in FY 2007, with annual growth thereafter estimated to be about 1.5% annually. Since the deduction is effective beginning in tax year 2006, the fiscal impact would begin in FY 2007.

Under current law, a taxpayer may reduce his or her state taxable income by $1,500 per dependent child. For a taxpayer to claim the dependent child deduction, the dependent child must be (1) the taxpayer's son, stepson, daughter, stepdaughter, or foster child, and (2) either be under the age of 19 or a full-time student who is under the age of 24. The bill would expand the deduction to apply to: (1) a dependent grandchild, sibling, nephew, or niece of a taxpayer who meets the age requirements stated in (2) above; or (2) a dependent of a taxpayer who is permanently and totally disabled regardless of age.

The estimates of grandchildren and other qualifying dependents are based on: (1) analysis of the state taxpayer data relating to the federal dependent exemption and the state's dependent child deduction; and (2) survey research by the U.S. Census Bureau relating to cohabitation of grandchildren with grandparents, and adult children with parents.

Streamlined Sales Tax: This bill's impact on Sale Tax revenue is indeterminable. The provisions in the bill are changes to conform Indiana's Sales Tax laws to the Streamlined Sales Tax Agreement (SSTA) as amended on October 1, 2005, and re-adopted on November 12, 2005.

Tobacco Products: The bill specifies that tobacco products are not food and food ingredients. Food and food ingredients for human consumption are exempt from the Sales Tax. Therefore, this provision could increase Sales Tax collections to the extent that retailers currently classify tobacco products as food or food ingredients. It is estimated that any increase in revenue would be minimal.

Direct Mail: The bill defines the term "direct mail" in conformance with the SSTA. This term was already used in IC 6-2.5-13-3, but was not defined. This provision of the bill is not expected to have a fiscal impact.

Bundled Transactions: This provision could decrease Sales Tax revenue to the extent that items that are taxable under current law become exempt under this new definition of bundled transactions. The amount of Sales Tax revenue that could be lost is indeterminable, but is anticipated to be minimal.

The bill defines a "bundled transaction" as a retail sale of two or more products, except real property and services to real property, that are:

(1) distinct;
(2) identifiable; and
(3) sold for one non-itemized price.

The bill also provides that a person is a retail merchant making a retail transaction when the person sells tangible personal property as part of a bundled transaction. Therefore, tangible personal property that is sold in a bundled transaction will be subject to Sales Tax.

The bill specifies that the term bundled transaction does NOT include a retail sale:

(1) which the sales price of a product varies, or is negotiable, based on the purchasers selections;

(2) where a service is the true object of the transactions and tangible personal property is only provided because it is essential to the use of the service;
(3) where taxable and nontaxable products are bundled and the price of the taxable products make up less than 10% of the total purchase price;
(4) where the transaction involves taxable products and exempt products and any of these items:
(A) food and food ingredients;
(B) drugs;
(C) durable medical equipment;
(D) mobility enhancing equipment;
(E) over-the-counter drugs;
(F) prosthetic devices; or
(G) medical supplies; and
the taxable products make up 50% or less of the total purchase price.

Under current law, Sales Tax would be applied to all of these sales, except item (3), which DOR has already classified as an exempt transaction in 45 IAC 2.2-4-2.

Under the bill, Sales Tax would not be applied to any of the sales transactions listed above.

Florist Sourcing Rule: This provision of the bill is not expected to have a fiscal impact. The bill does not change the way Sales Tax is currently applied to a transaction in which a florist that takes a floral order from a purchaser and transmits the floral order to another florist for delivery. Currently, this transaction would be taxed by the florist who takes the original purchase order.

The bill changes the date on which these transactions will be taxed as if the transaction took place solely in the location where the flowers were delivered. The bill says that this sourcing rule change will take place beginning in 2008, while the previous version of the SSTA stated that this change in sourcing rules would take place in 2006.

Sales Tax revenue is deposited in the Property Tax Replacement Fund (50%), the state General Fund (49.192%), the Public Mass Transportation Fund (0.635%), the Commuter Rail Service Fund (0.14%), and the Industrial Rail Service Fund (0.033%).

The Streamlined Sales Tax Project addresses the problem of collecting Sales and Use Taxes on goods purchased via the internet, catalogs, and other remote sellers. The project seeks to remove the burden of collecting Sales Taxes from remote sellers through a simplification of state Sales and Use Tax structures, which would be applied in a more uniform way. As of February 21, 2005, 45 states had participated in the Streamlined Sales Tax Project through legislative enactments, executive orders, or negotiations.

Explanation of Local Expenditures:

Explanation of Local Revenues: (Revised) The IRC update and the expansion of the dependent child deduction could potentially affect taxable income of individual taxpayers. However, the impact on counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) is likely to be minimal.

State Agencies Affected: Governor; State Budget Agency; Auditor of State; Department of State Revenue.

Local Agencies Affected: Counties with local option income taxes.

Information Sources: Tom Conley, Department of State Revenue, (317) 232-2107; Bob Lain, State Budget Agency, (317) 232-3471. OFMA Income Tax Databases: 2002-2003. U.S. Congress, Joint Committee on Taxation, http://www.house.gov/jct/tableofcnts.html. U.S. Census Bureau, Current Population Reports: *Children's Living Arrangements and Characteristics: March 2002*, (P20-547), June 2003; *Coresident Grandparents and Grandchildren (P23-198)*, May 1999; *The Population 14 to 24 Years Old by College Enrollment*, June 1, 2001. U. S. Census Bureau, Census 2000, *Profile of General Demographic Characteristics (Indiana)*. U. S. Census Bureau, Current Population Survey, *Family Households, by Type, Age of Own Children, Age of Family Members, and Age, Race and Hispanic Origin of Householder: 2004*, June 29, 2005. Streamlined Sales Tax Agreement (10/1/05); http://www.streamlinedsalestax.org/agreement.htm.

Fiscal Analyst: Adam Brown, 317-232-9854. Jim Landers, 317-232-9869. Chuck Mayfield, 317-232-4825.