



Testimony to House Taxation Committee on HB 2429

Retail Sales Taxes

May 6, 2014

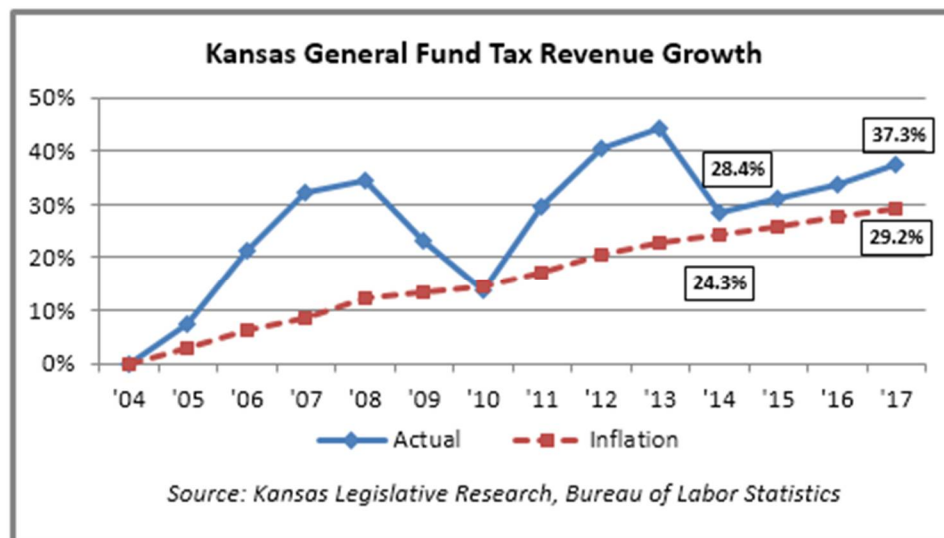
Dave Trabert, President

Chairman KleeB and members of the Committee:

We appreciate this opportunity to provide testimony on the merits of HB 2429. We oppose HB 2429 because we do not believe that any tax increase is necessary, as Kansas has a spending problem instead of a revenue problem.

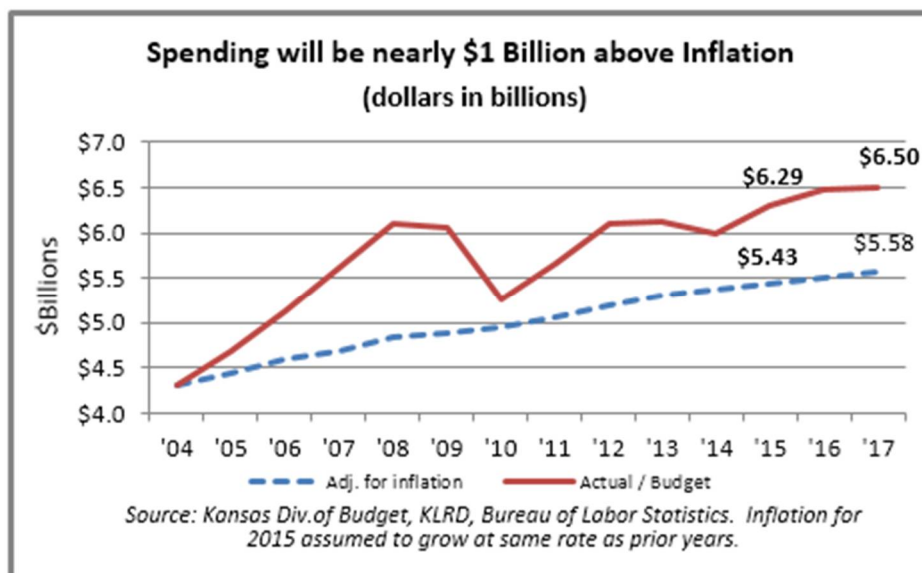
Contrary to 'sky is falling' claims, the new Kansas revenue estimates show that tax revenue will continue to be well ahead of the inflation-adjusted historic trend. Tax revenue increased by 28.4 percent over the last ten years, or 4 points more than the increase in inflation (Midwest Urban Cities calculated on a fiscal year basis). The April 2015 Consensus Revenue Estimates put total General Fund tax revenue at \$5.743 billion this year and growing to \$6.025 billion over the next two years.

Inflation would be 29.2 percent higher in FY 2017 than in FY 2004 if it continues at last year's pace, but tax revenue would be 37.3 percent higher.



The problem with the Kansas budget is that the cost of government was not reduced when tax reform was enacted.

While tax revenue has remained ahead of inflation since 2004, proposed spending in FY 2017 will be nearly \$1 billion higher than 2004 spending adjusted for inflation. But that's not the only evidence of a spending problem.



Every state provides the same basket of basic services (education, social service, etc.) but some states do so at a much lower cost and pass the savings on in the form of lower taxes. In 2012, the states that tax income spent 49 percent more per-resident providing services than the states without an income tax, and they don't do it by pushing spending to local government; the ten states with the highest combined state and local tax burden spent 43 percent more per resident than the ten states with the lowest burdens. Kansas, by the way, spent 37 percent more per resident than the states without an income tax.

Let's put that in perspective. Kansas' 2012 spending of \$6.098 billion was 37 percent higher than

2012 Actual Spending Per-Resident		
State Grouping	Amount	Variance
No Income Tax	\$2,491	
Income Tax	\$3,702	49%
Lowest State/Local Tax Burden	\$2,726	
Highest State/Local Tax Burden	\$3,901	43%
Kansas	\$3,409	

Source: National Association of State Budget Officers, Census. State spending totals exclude federal funds and bond issue proceeds.

the per-resident spending of states without an income tax. This year Kansas is expected to spend \$191.5 million more than in 2012 and the budgets under consideration in the Legislature will add another \$210.1 million in the next two years.

There may not be sufficient interest in the Legislature and the Governor's office to reduce the cost of government, but the opportunities are ample.

Here is a short list opportunities to reduce the cost of government:

- ✓ Kansas has 22% more state employees than the national average, on an employees-per-10,000-residents basis.
- ✓ State agencies spent \$17 million on overtime in the 2014 calendar year. It may not be possible to eliminate overtime but it can be controlled; state agencies spent \$10 million in 2011.
- ✓ K-12 funding will set a 4th consecutive record this year at \$6.145 billion and contrary to false statements made by some superintendents, state aid with the new block grants will increase by \$142 million this year...not counting KPERS, Bond & Interest, Special Education and a few minor funding areas.
- ✓ While K-12 funding continues to set records, every Legislative Post Audit study has found schools to be organized and operating inefficiently.
- ✓ While K-12 funding continues to set records, schools have used over \$400 million of state and local tax dollars to increase their operating cash reserves. That money was intended to operate schools, not increase bank accounts. If every district had maintained the same carryover ratio that they each had for the 2006 school year, their collective reserves would be \$320 million less this year. FYI, there is no record of school administrators complaining about not have enough cash reserves in 2006...or 2007...or 2008...or 2009.
- ✓ State agencies also have carryover reserves that have increased, including Regents universities.
- ✓ The University of Kansas spends 26% more per-student on Educational Programs than Kansas State University; KU spends 40% more per-student than Wichita State. Emporia State spends 18% more per-student than Pittsburg State and 50% more than Fort Hays State. Using Wichita State as the benchmark for research universities and Fort Hays State for the others, annual savings would total \$170 million.
- ✓ The Department of Administration often overcharges agencies for services that could be provided at lower costs in the private sector. For example:
 - The FY 2016 Budget Instructions shows agencies are charged \$19.40 per square foot for office space; that's a 27% increase over last year, which was higher than market prices. Charges to the federal government are much lower.
 - The price KPI paid to duplicate this testimony at Office Max was slightly less than the price state agencies are charged.

- ✓ The Department of Education annually forgoes about \$21 million in federal reimbursement because no invoice is submitted for the KPERS cost of school employees performing federally-funded functions. Other states do get reimbursed for these costs.
- ✓ The last time we ran the numbers (in 2010), state spending on employee insurance was \$29 million higher than it would be if employees were paying the same portion as the national average. Kansas was paying 94% of the cost of single coverage and averaged 77% for non-single coverage; the national average was 81% and 70%.

Proposals to raise taxes while ignoring these and other glaring inefficiencies is effectively telling citizens that many legislators prefer to raise their taxes than to deal with the backlash from the bureaucracy and special interests that profit from excess government spending.

That said, if raising taxes is the preferred method of balancing the budget, the lesson of the last recession is that the State is better able to fund necessary services with a steady revenue stream from consumption taxes rather than income taxes.

Tax revenue declined in FY 2009 and FY 2010 but the magnitude of the decline was much greater for income taxes, which dropped 21% over two years or about \$702 million. Retail sales tax was fairly steady, dropping just \$59 million or 3% over the same period. Imagine how differently the budget processes of those two years would have been if Kansas had had more reliance on consumption taxes and less on income taxes. The income leg of

Decline in Income and Retail Sales Tax During Last Recession				
Tax Type	2008	2009	2010	2-Year Chg.
Income	3,361,891	2,948,450	2,659,663	-21%
Retail Sales	1,711,398	1,689,516	1,652,037	-3%

Source: Kansas Legislative Research

the so-called 3-legged stool may satisfy the political / social desire of those who want to tax income but it is not is government's best interest of having a steady tax stream to fund necessary services.

Some of the justification for raising income taxes is being couched in terms of fairness, as in, 'why should one group be exempt from income tax but others must pay tax.' The focus of those discussions are the businesses organized as Limited Liability Corporations (LLCs), partnerships and other business entities that are taxed as Individuals instead of Corporations.

There is another group, however, that has been exempt from state income tax for decades – state and local government retirees' pensions. As explained in our 2011 publication of A Comprehensive Reform of the Kansas Public Employees' Retirement System ...

"KPERS benefits are not taxable for state income tax purposes. Employee contributions to the plan are after tax, so it's appropriate that distributions from employee contributions would be not be taxable to avoid double taxation. However, KPERS members never have to pay state income tax on the majority of their pension benefits, which come from employer contributions and earnings on employer contributions.

The cost to taxpayers of providing government retirees with these tax-free benefits is substantial. The exact amount of pension distributions from employer contributions and the applicable tax rate for each recipient would have to be identified to accurately calculate the benefit, but we can make a reasonable estimate. As noted in Table 4, in order to fully fund the state/school plan based on the market value of plan assets, the employer contribution rate would be 15.26% and the total employer and employee contribution rate would be 19.33%; the employer rate is therefore 78.9% of the total. For the KP&F plan, the employer rate would be 75% of the total (19.8% for the employer, 26.32% in total). The following estimate of a \$52 million income tax benefit to KPERS retirees is based on the lower employer rate of 75%.¹

Table 12 - Retirement Benefit Estimate for 2010 (millions of dollars)	
Total KPERS distributions - Calendar 2010	\$ 1,108.6
Estimated portion from Employers	75%
Estimated employer funds distributed	\$ 831.5
Assumed state income tax rate (middle bracket)	6.25%
Estimated state income tax benefit to KPERS retirees	\$ 52.0
<i>Source: KPERS, 2010 distributions as listed at KansasOpenGov.org; Kansas Dept. of Revenue</i>	

Then-KPERS executive director Glenn Deck said our estimation of the tax benefit was reasonable. The current tax benefit should be similar; marginal tax rates have declined but pension distributions were \$1.329 billion in 2013. But regardless of the actual amount, state and local government retirees are exempt from paying income tax on the portion of their pensions funded by taxpayers.

There is certainly a discussion to be had about fairness in taxation, but anyone proposing to increase or charge a tax based on fairness should be supportive of taxing government retirees the same as private sector retirees. Otherwise, proposals to raise income taxes may be a matter of political expediency but not about 'fairness.'

While we believe the cost of providing services should be reduced rather than increase any tax, the sales tax increase is preferable to an income tax increase.

¹ <http://www.kansaspolicy.org/ResearchCenters/BudgetandSpending/BudgetandSpendingStudies/71799.aspx>