

Kansas Senate

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Senator Greg Smith

21st District

Senate Corrections and Juvenile Justice Committee – Chairman
Senate Judiciary Committee – Vice Chairman

Written Testimony for the Kansas Senate

Senate Standing Committee on Assessment & Taxation

SB 508 - Limiting the subtraction modification on business income for certain individuals who have materially participated in the operation of the business for income tax purposes.

April 28, 2016

Chairman Donovan, Vice Chairman Tyson, Ranking Member Holland, and honorable committee members:

Thank you for allowing me to submit written testimony in support of SB 508 – “Closing the LLC Tax Loophole Bill.” As I talked to many constituents over the First Adjournment break there has been one common theme across District 21 - close the tax loophole. It is a position I support and have supported for the last two years. The Governor’s proposals to close the current budget deficit include selling off our tobacco settlement payments, sweeping more highway funds, and delaying KPERS payments to make ends meet. I do not agree with any of these positions. These are not long-term solutions. These are not fiscally conservative solutions. These are the options of desperation.

This bill corrects the legislative intent of the 2012 Tax Bill. The 2012 bill had as its goal to “broaden the base and lower the rate” of income tax by reducing all tax rates and eliminating the exemptions, deductions and credits that made our tax code unfair and hard to manage. The 2012 tax bill succeeded in lowering income tax rates from the highest in the region at 6.45% to the lowest at 4.6%. It eliminated many tax exemptions, deductions, and credits to ensure that all Kansans paid at the lowest rate possible while still funding core functions of state government.

The LLC loophole, as interpreted by the Kansas Department of Revenue exempted LLCs, subchapter S corporations, and sole proprietorships from ALL state income tax. A review of the testimony in the committee hearing as well as the debate on the House floor (I was in the House in 2012) shows that was not the expectation or the intent of

the 2012 bill. If it had been I would not have voted for the 2012 bill. The chaos on the Senate side in 2012 – the deliberate attempt to “Christmas Tree” the bill to death – was a contributing factor to the current situation.

The state deficit emerged for many different reasons. Falling prices have dramatically cut tax revenue from oil and gas production. E-commerce, which largely avoids state sales tax, has increased tremendously, and the LLC loophole are all causes of our revenue shortfall. Of all of these factors, the LLC loophole can be directly addressed most quickly to provide stability.

Senate Bill 508 was introduced to close the loophole by taxing all wage income earned by business owners exactly the same as wages earned by employees. It would exempt only non-wage (or investment) income - the original intent of the 2012 tax plan.

SB 508 will face strong opposition. The governor continues to threaten to veto the bill if it passes. That threat will influence some in the Legislature. Many who call for elimination of the LLC loophole have refused to close it because “they didn’t create the problem so they aren’t responsible for solving it.” That is an unacceptable claim. Failing to act is being part of the problem.

This is not a political decision for me - in fact, many in my party will not support this position. This is about governing our state with fiscal responsibility instead of desperation. The 2012 tax plan as proposed was sound. The interpretation of holding all income harmless was a mistake - never the intent of the bill that I voted for.

Passage of SB 508, or a similar bill in the Kansas House, is the only option to provide a fiscally sound fix to the Kansas Budget this session.

I would ask the committee to recommend SB 508, as is, favorable for passage.

Respectfully Submitted,

Greg Smith