Approved On: ________________

Minutes of the House Committee on Taxation. The meeting was called to order by E. C. Rolfs, Chairman, at 9:00 a.m. on February 24, 1988 in room 519 South at the Capitol of the State of Kansas.

The following members were absent (excused):

Representatives Pottorff and Vancrum

Committee staff present:

Tom Severn, Legislative Research
Chris Courtright, Legislative Research
Don Hayward, Reviser of Statutes
Millie Foose, Committee Secretary

Representative Roe moved, second by Representative Grotewiel, to reconsider action on HB-2905. The purpose is to free up $1.2 million of SIBF funds in FY89 for major maintenance and reroofing projects of SRS institutions; Governor's recommendation provides $1.2 million in FY90. The motion carried.

Harley Duncan, Secretary of Revenue, discussed HB-2940 - AN ACT amending and supplementing the Kansas income tax act; Secretary Duncan expressed two concerns that the Department of Revenue has: (a) Allowing a deduction for federal taxes paid adds unnecessary complexity to the individual income tax and, coupled with the rates proposed in the bill, leads to unacceptable changes in the income tax burden; and (b) Enacting long term tax reductions of the magnitude envisioned in HB-2940 threatens the fiscal integrity of the State. (Attachment 1)

Secretary Duncan then explained the tax policy and the two essential flaws in the HB-2940. He said that if spending is not held at 3%, the state cannot finance the program without extreme cuts in services.

Secretary Duncan then discussed the Corporation Income Tax Windfall Issue. (Attachment 2) He said that although some analyses suggest that Kansas could expect to receive additional revenues in excess of $100-$150 million over the next five years as a result of tax changes, he believes there is no conclusive evidence that a change of such magnitude can be expected.

Legislative Research

Richard Ryan, Director of KCRD, discussed the effect HB-2940 would have on the State General Fund - based on annual growth rates of 5%, 6%, 4%, and 3%. (Attachment 3) He said that the corporate tax is not the only variable and it would require $80,000,000 to meet the estimate. He said they are not looking beyond 1989 as there are many big ticket items that could change the total amount. He said their estimates are based on tax years - not fiscal years. The committee discussed rebates to school districts and found Shawnee Mission would lose $7.0 MM and Sedgwick County 5.8 MM in aid under HB-2940.

The Committee requested several additional runs from Mr. Ryan examining ending balances pegged to 5% of SGF expenditures and 7.5% of SGF expenditures.

The minutes of the previous meetings were approved. There being no further business, the meeting was adjourned.

Ed C Rolfs

Ed. C. Rolfs, Chairman

KANSAS DEPARTMENT OF REVENUE
Office of the Secretary
Robert B. Docking State Office Building
Topeka, Kansas 66612-1588

MEMORANDUM

TO: The Honorable Ed C. Rolfs, Chairman
House Committee on Taxation

FROM: Harley T. Duncan HTD
Secretary of Revenue

RE: HB 2940

DATE: February 23, 1988

Thank you for the opportunity to appear before you on HB 2940 which enacts significant changes and reforms in the Kansas individual and corporation income tax. Despite its many similarities to the Governor's reform proposals (SB 490), the Administration cannot support enactment of this bill. Our concerns are twofold:

(a) Allowing a deduction for federal taxes paid adds unnecessary complexity to the individual income tax and, coupled with the rates proposed in the bill, leads to unacceptable changes in the income tax burden; and

(b) Enacting long-term tax reductions of the magnitude envisioned in HB 2940 threatens the fiscal integrity of the State.

TAX POLICY

HB 2940 changes the Governor's proposal by reinstating the deduction for federal taxes paid, apparently based on a concern about "double taxation" or including income in the tax base which is required to pay other taxes. The Governor considered this issue, but felt that the arguments for repealing the deduction were more convincing. Those include:

- The deduction for federal taxes paid is a direct trade-off for lower marginal tax rates which were seen as extremely desirable by the Governor and his Task Force on Tax Reform. With repeal, top marginal rates can be reduced to the 5.5 -6.0 percent range (with a tax reduction of $20 million.) This compares to rates that must be **at least 9.0 percent** with the deduction if the projected tax reduction is to be kept at roughly $20 million or even increased to as much $40 million, or at 8.25 percent with an $80-$110 million reduction as in HB 2940.

- As interstate tax competition increases and lower federal tax rates increase the "cost" of state income taxes, a growing number of states are recognizing the desirability of lower marginal rates over maintenance of the deduction. In 1987 alone, four states repealed the deduction for federal taxes paid -- Colorado, Delaware, Minnesota and Utah. This leaves only eight of the forty income tax states with a full deduction for federal taxes paid.*

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* Steven D. Gold, "The Budding Revolution in State Income Taxes," Legislative Finance Paper #61, National Conference of State Legislatures, Denver, CO, December 1987.

Attachment 1

- Fifteen states acted in 1987 to reduce state income tax rates. When these are phased-in fully, only six states will have a nominal tax rate equal to or greater than Kansas' 9.0 percent.*

- Repealing the deduction adds significant progressivity to the income tax base. This allows tax rates to be reduced sharply without sacrificing the progressivity of the tax.

- Repealing the deduction simplifies the income tax and is the key to implementing a "short" tax form which 500,000 - 600,000 taxpayers could use. Maintaining the deduction prevents widespread use of the short form because of the proration necessary for taxpayers whose Kansas AGI is less than federal AGI. The tax deduction cannot, therefore, be worked into pre-computed tax tables.

- The logical extension of the principle that income which is not available for discretionary spending should not be included in the tax base would be to impose a tax most heavily on savings and investment. The desirable approach is to define the tax base broadly to include all money income and then through personal exemptions, deductions and graduated rates to distribute the tax burden as one sees most fit according to the "ability to pay" principle.

- No evidence has been presented that repealing the deduction and offsetting the broader tax base with reduced rates as proposed by the Governor introduces large disparities into the distribution of the tax burden or the treatment of taxpayers in similar economic circumstances.

- Reinstating the federal tax deduction but changing no features of the Governor's program other than tax rates makes it extremely difficult to devise a set of tax rates which will reduce tax burdens across the income groups so as to leave the current distribution of tax liability relatively undisturbed. Other changes in the tax base have the following effects: (a) taxable income of married taxpayers increases at a greater rate than for single filers; (b) the increased standard deductions and personal exemptions provide the greatest tax benefits to lower income households; and (c) conforming to federal itemized deductions, but not repealing the federal tax deduction, increases the taxable income of middle income taxpayers proportionately more than it does upper income taxpayers. The usual result is that a greater proportion of the tax burden is shifted to married taxpayers, particularly those with an AGI from $35,000 to $100,000. Single taxpayers, low income taxpayers and upper income taxpayers (over $100,000 AGI) commonly see significant tax reductions compared to current law.

FISCAL RESULTS OF HOUSE BILL 2940

Attachments A and B present the fiscal impact of HB 2940 by income group and filing status. Summaries are presented for each of tax years 1988 and 1989. For each year, the tables show, by income bracket, the number of taxpayers, the percentage change in liability from current law caused by the change, the total change in liability for all taxpayers in the bracket (in millions of dollars), the average dollar change per return, and the effective tax rate (liability divided by AGI). These data are presented for married resident taxpayers, single resident taxpayers and all resident taxpayers.

As shown, the bill reduces income tax liabilities by $78.7 million, or 9.7 percent, in 1988. Yet, married taxpayers with an AGI of $35,000-$100,000 receive less than a 2.5 percent cut. Despite the fact that the bill provides $56.5 million of tax reduction over and above the Governor's recommendation in 1988, married taxpayers with an AGI of $35,000-$100,000 receive only $1.6 million more from the bill than the Governor's plan. This maldistribution is reduced somewhat in 1989, but taxpayers with over $100,000 AGI still receive a larger tax cut than do middle income taxpayers.

Some other notable effects of the bill are:

- The proportion of the tax burden borne by single taxpayers decreases from 26.4 percent in 1988 under current law to 24.6 percent by 1988 under the bill.
- The proportion of the tax burden borne by all taxpayers with an AGI of $35,000 - $100,000 increases from 49.2 percent in 1988 under current law to 52.8 percent in 1988 under the bill. For married taxpayers only in this group, the increase is from 42.2 percent to 45.7 percent.
- The proportion of the burden borne by taxpayers with an AGI of less than $35,000 decreases from 33.1 percent under current law to 28.3 percent under the bill.
- The proportion of the burden borne by taxpayers with an AGI in excess of $100,000 increases from 17.7 percent under current law in 1988 to 18.6 percent.

These effects may not be intended. They are, however, the general result of restructuring the Governor's proposal in the manner outlined here. The only way to break this general pattern would be to treat married and single rates separately or decrease the proposed standard deductions and/or personal exemptions. Absent changes such as this, one should expect to see an increase in the proportion of the tax liability paid by married taxpayers generally and married taxpayers with an AGI of $35,000 -$100,000 particularly.

LONG TERM FISCAL EFFECTS

HB 2940 reduces individual income tax liabilities by $78.7 million in tax year 1988 and an additional $45 million (total of $114.4 million) in 1989. It also reduces the corporation income tax rate base rate by 0.5 percent in 1989 which reduces revenues by about $9.4 million annually.

It is my belief that tax reductions of this magnitude will endanger the ability of the State General Fund to finance essential governmental services over the near term and will destroy the fiscal integrity and stability of the state. Simply put, we cannot afford tax cuts of this magnitude without serious reductions in state services.

One way to view this is to look at a flow of reasonably expected revenues from current law and measure the ability of that revenue flow to finance some assumed level of spending as well as the tax cuts in HB 2940. That is done in Attachment C. The data in the Attachment assume that State General Fund revenues increase by 5.0 percent annually from FY 1989 to FY 1992 and that SGF expenditures increase by either 3.0 or 4.0 percent annually from FY 1989 to FY 1992. Also shown is the same analysis if revenues increase at only 4.5 percent annually.

As shown, if revenues increase 5.0 percent annually (Part 1 of Attachment C) and spending is held to 3.0 percent annually, it might be expected that the tax cuts in the bill could be financed. If, however, spending is limited only to 4.0 percent annual growth, the tax cuts would exceed available revenues by $175 million over the five years and the projected balance going into FY 1989 would have been dissipated.

Moreover, the projected costs of HB 2940 **do not reflect exempting manufacturing machinery and equipment from the sales tax**. If this reduction is considered, the total tax reductions increase by $55.5 million and the five-year cumulative shortfall at 4.0 percent growth is increased to $225 million.

The sensitivity of this analysis to assumptions is demonstrated by the fact that if revenues grow at only a 4.5 percent average (Part 2 of Attachment C), even holding spending to 3.0 percent would fail to produce sufficient revenues to finance HB 2940. Under that assumption, the five-year revenue availability would be $80 million short of the amount required to finance the bill. At 4.0 percent spending, the five-year shortfall is nearly $300 million with only 4.5 percent annual revenue growth. Neither of these figures considers the sales tax exemption for manufacturing machinery and equipment.

An important component of the above analysis is the ability of the Legislature to limit spending to relatively modest levels. Attachment D presents the history of State General Fund expenditures over the past 23 fiscal years. In only four years has the increase in State General Fund expenditures been less than 4.0 percent, and only in FY 1987 with $60 million of mid-year budget cuts was the expenditure increase less than 3.0 percent. Even from FY 1982-1986 when there were two major tax increases, two mid-year budget adjustments, and numerous one-time "rabbits" were required, expenditure increases averaged over 6.0 percent.

In short, it seems reasonable to expect that if HB 2940 is enacted into law, considerable reductions in state services and/or significant reductions in planned ending State General Fund balances will be required. Given that 80 percent of State General Fund expenditures are dedicated to elementary and secondary education, higher education and public assistance, one does not need to guess about who will bear the burden of the cuts. We should expect these cuts to be reflected in both the quality of our services as well as the level of our property tax burden.

It is apparently intended to finance a sizeable portion of HB 2940 through a reduction in planned ending balances. In my mind, this is a prescription for disaster. Financing even 50 percent of the tax cut through cutting balances would reduce them to less than 4.0 percent of expected receipts in FY 1990. Our ending balance has been that low in only three of the last 23 years. Further, given that the average variance of the original consensus estimate for a fiscal year is slightly over 5.0 percent (4.4 percent if FY 1983 is excluded), one should reasonably expect that dropping balances to that level will necessarily lead to periodic "financial crises" in which taxes must be increased and expenditures cut. It is simply too thin a margin of error on which to expect a stable financial operation.

CONCLUSION

In short, HB 2940 contains two essential flaws:

(1) Reinstatement of the deduction for federal taxes paid is undesirable in that it adds unnecessary complexity to the tax structure and detracts significantly from the ability to reduce marginal tax rates. Further, the bill appreciably alters the current distribution of the tax burden in a manner which is not desirable.

(2) The bill contains tax reductions which significantly disrupt the integrity of the State's fiscal position and jeopardize its ability to meet legitimate public demands.

Thank you for the opportunity to testify on this matter. I would be glad to attempt to answer any questions.

SIMULATION 7236 TAX YEAR 1988

Governor's Proposal
Plus The Deductibility of Federal Income Taxes
Exempt Kansas Municipal Bonds Issued After December 31, 1987
$60 Refundable Credit for Elderly and Blind Taxpayers
New Kansas Tax Rates
$1,950 Kansas Personal Exemption

Kansas Department Of Revenue

Individual Income Tax In Tax Year 1988
Resident Taxpayers

SIMULATION 7236

Liability Dollars are in Millions

K.A.G.I. Bracket	Married: No. Of Returns	Married: Percent Increase	Married: Dollar Change In Liability	Married: Dollar Change Per Return	Married: Effective Rate	Single: No. Of Returns	Single: Percent Increase	Single: Dollar Change In Liability	Single: Dollar Change Per Return	Single: Effective Rate	Total Residents: No. Of Returns	Total Residents: Percent Increase	Total Residents: Dollar Change In Liability	Total Residents: Dollar Change Per Return	Total Residents: Effective Rate
No K.A.G.I.	9,684	0.0%	($0.14)	($14.46)	0.0%	4,526	0.0%	($0.08)	($17.67)	0.0%	14,211	0.0%	($0.22)	$0.00	0.0%
$0 $5	16,947	-2321.8%	($0.58)	($34.47)	0.0%	110,421	-151.3%	($1.83)	($16.56)	0.0%	127,368	-195.6%	($2.41)	($18.94)	0.0%
$5 $15	71,895	-88.8%	($7.01)	($97.53)	0.4%	168,105	-36.7%	($11.72)	($69.71)	1.4%	240,000	-47.0%	($18.73)	($78.04)	1.1%
$15 $25	93,474	-25.8%	($8.59)	($91.87)	1.4%	95,579	-17.6%	($9.90)	($103.56)	2.6%	189,053	-20.6%	($18.49)	($97.78)	2.0%
$25 $35	97,474	-11.9%	($8.08)	($82.88)	2.1%	37,684	-11.7%	($4.46)	($118.43)	3.1%	135,158	-11.8%	($12.54)	($92.79)	2.3%
$35 $50	112,000	-2.4%	($2.99)	($26.69)	2.6%	19,895	-8.2%	($2.45)	($122.96)	3.4%	131,895	-3.5%	($5.44)	($41.21)	2.7%
$50 $100	93,474	-2.2%	($3.94)	($42.17)	2.9%	7,368	-7.4%	($1.51)	($204.66)	4.0%	100,842	-2.8%	($5.44)	($53.95)	3.0%
$100 Over	14,000	-5.0%	($5.72)	($408.73)	4.7%	1,158	-5.2%	($0.61)	($527.45)	5.0%	15,158	-5.0%	($6.33)	($417.80)	4.7%
Total	508,947	-7.0%	($37.06)	($72.81)	2.7%	444,737	-17.2%	($32.55)	($73.20)	2.5%	953,684	-9.7%	($69.60)	($72.98)	2.6%
Fiscal Impact:			($37.06)					($32.55)					($69.60)		
All Taxpayers:			($78.72)			Non-Resident:		($9.12)							

Attach. 6A

Simulation 7236

Single Taxable Income			Tax Rate	Excess Over
$0	$5,000		4.00%	$0
$5,000	$7,000	$200	5.00%	$5,000
$7,000	$10,000	$300	5.50%	$7,000
$10,000	$20,000	$465	6.00%	$10,000
$20,000	$25,000	$1,065	7.00%	$20,000
$25,000	$50,000	$1,415	8.00%	$25,000
$50,000	Over	$3,415	8.25%	$50,000

Married Taxable Income			Tax Rate	Excess Over
$0	$10,000		4.00%	$0
$10,000	$14,000	$400	5.00%	$10,000
$14,000	$20,000	$600	5.50%	$14,000
$20,000	$40,000	$930	6.00%	$20,000
$40,000	$50,000	$2,130	7.00%	$40,000
$50,000	$100,000	$2,830	8.00%	$50,000
$100,000	OVER	$6,830	8.25%	$100,000

SIMULATION 7233 TAX YEAR 1989

Governor's Proposal
Plus The Deductibility of Federal Income Taxes
Exempt Kansas Municipal Bonds Issued After December 31, 1987
New Kansas Tax Rates

$2,000 Kansas Personal Exemption

Kansas Department Of Revenue

Individual Income Tax In Tax Year 1989
Resident Taxpayers

SIMULATION 7233

Liability Dollars are in Millions

K.A.G.I. Bracket	Married: No. Of Returns	Married: Percent Increase	Married: Dollar Change In Liability	Married: Dollar Change Per Return	Married: Effective Rate	Single: No. Of Returns	Single: Percent Increase	Single: Dollar Change In Liability	Single: Dollar Change Per Return	Single: Effective Rate	Total Residents: No. Of Returns	Total Residents: Percent Increase	Total Residents: Dollar Change In Liability	Total Residents: Dollar Change Per Return	Total Residents: Effective Rate
No K.A.G.I.	9,684	0.0%	$0.00	$0.00	0.0%	4,526	0.0%	$0.00	$0.00	0.0%	14,211	0.0%	$0.00	$0.00	0.0%
$0 $5	16,947	-95.8%	($0.02)	($1.42)	0.0%	110,421	-95.9%	($1.16)	($10.50)	0.0%	127,368	-95.9%	($1.18)	($9.29)	0.0%
$5 $15	71,895	-68.6%	($5.42)	($75.34)	0.3%	168,105	-36.3%	($11.59)	($68.92)	1.3%	240,000	-42.7%	($17.00)	($70.85)	1.0%
$15 $25	93,474	-29.5%	($9.82)	($105.09)	1.2%	95,579	-22.2%	($12.52)	($130.95)	2.4%	189,053	-24.9%	($22.34)	($118.17)	1.8%
$25 $35	97,474	-18.7%	($12.74)	($130.66)	1.9%	37,684	-16.3%	($6.19)	($164.25)	2.9%	135,158	-17.8%	($18.93)	($140.02)	2.2%
$35 $50	112,000	-9.1%	($11.44)	($102.12)	2.4%	19,895	-12.5%	($3.72)	($186.96)	3.2%	131,895	-9.8%	($15.16)	($114.92)	2.6%
$50 $100	93,474	-8.1%	($14.37)	($153.75)	2.7%	7,368	-10.5%	($2.13)	($289.63)	3.8%	100,842	-8.4%	($16.51)	($163.68)	2.8%
$100 Over	14,000	-8.8%	($10.08)	($720.19)	4.5%	1,158	-8.2%	($0.97)	($840.55)	4.8%	15,158	-8.7%	($11.06)	($729.38)	4.5%
Total	508,947	-12.1%	($63.89)	($125.54)	2.5%	444,737	-20.2%	($38.28)	($86.07)	2.4%	953,684	-14.3%	($102.17)	($107.13)	2.5%
Fiscal Impact:			($63.89)					($38.28)					($102.17)		
All Taxpayers:			($114.36)			Non-Resident:		($12.19)							

Attachment B

Simulation 7233

Single Taxable Income			Tax Rate	Excess Over
$0	$5,000		3.75%	$0
$5,000	$7,000	$188	4.50%	$5,000
$7,000	$10,000	$278	5.25%	$7,000
$10,000	$20,000	$435	5.75%	$10,000
$20,000	$25,000	$1,010	6.75%	$20,000
$25,000	$50,000	$1,348	7.75%	$25,000
$50,000	Over	$3,285	8.00%	$50,000

Married Taxable Income			Tax Rate	Excess Over
$0	$10,000		3.75%	$0
$10,000	$14,000	$375	4.50%	$10,000
$14,000	$20,000	$555	5.25%	$14,000
$20,000	$40,000	$870	5.75%	$20,000
$40,000	$50,000	$2,020	6.75%	$40,000
$50,000	$100,000	$2,695	7.75%	$50,000
$100,000	OVER	$6,570	8.00%	$100,000

Attachment C
State General Fund Analysis

Part 1

Fiscal Year	General Fund Receipts 5.0% Growth	Expenditures Growth at 3.00%	Expenditures Growth at 4.00%	Difference Growth at 3.00%	Difference Growth at 4.00%
1988	$1,963	$1,897	$1,897		
1989	$2,019	$1,991*	$1,991*	$28	$28
1990	$2,120	$2,051	$2,071	$70	$50
1991	$2,226	$2,112	$2,153	$114	$73
1992	$2,338	$2,176	$2,240	$162	$98
1993	$2,455	$2,241	$2,329	$214	$125
Total				$588	$375

Part 2

Fiscal Year	General Fund Receipts 4.5% Growth	Expenditures Growth at 3.00%	Expenditures Growth at 4.00%	Difference Growth at 3.00%	Difference Growth at 4.00%
1988	$1,963	$1,897	$1,897		
1989	$2,019	$1,991*	$1,991*	$28	$28
1990	$2,110	$2,051	$2,071	$60	$40
1991	$2,205	$2,112	$2,153	$93	$52
1992	$2,304	$2,176	$2,240	$129	$65
1993	$2,408	$2,241	$2,329	$167	$79
Total				$477	$264

* As recommended in the "Governor's Budget Report".

Tax Year	House Bill 2940*
1988	$75
1989	$110
1990	$124
1991	$124
1992	$124
Total	$557

* Includes individual income and corporation income changes only.
Enactment of the sales tax exemption on manufacturing machinery and equipment, House Bill 2626, would increase the total cost by $55.5 million.

February 16, 1988

Attachment D

Kansas Department of Revenue

Percentage Increase in Expenditures
Dollars in Millions

Fiscal Year	Expenditures	Percent Increase
1966	$221.9	
1967	$239.3	7.8%
1968	$258.6	8.1%
1969	$278.3	7.6%
1970	$343.2	23.3%
1971	$354.8	**3.4%**
1972	$366.1	**3.2%**
1973	$386.4	5.5%
1974	$488.8	26.5%
1975	$597.9	22.3%
1976	$700.4	17.1%
1977	$815.7	16.5%
1978	$840.1	**3.0%**
1979	$965.4	14.9%
1980	$1,110.8	15.1%
1981	$1,258.7	13.3%
1982	$1,333.5	5.9%
1983	$1,405.9	5.4%
1984	$1,503.4	6.9%
1985	$1,634.5	8.7%
1986	$1,743.0	6.6%
1987	$1,726.5	**-0.9%**
1988	$1,897.3	9.9%
1989	$1,990.6	4.9%

KANSAS DEPARTMENT OF REVENUE
Office of the Secretary
Robert B. Docking State Office Building
Topeka, Kansas 66612-1588

MEMORANDUM

TO: Ed C. Rolfs, Chairman
House Committee on Taxation

FROM: Harley T. Duncan HTD
Secretary of Revenue

RE: The Corporation Income Tax Windfall Issue

DATE: February 23, 1988

This memorandum responds to some of the discussion that has occurred regarding the impact of federal tax changes on state corporation income tax receipts. Some analyses suggest that Kansas should expect to receive additional revenues in excess of $100-$150 million over the next five years as a result of these changes. My own belief is that no conclusive evidence has been presented that a change of such magnitude should be expected. This makes it premature, in my mind, to enact permanent tax reductions on such assumptions.

Some of the points I would make in this regard follow:

- **Current Position.** It is incorrect to say that the Department of Revenue has ignored the effects of federal tax reform on the corporate income tax. Our position (and, I think, that of the Consensus Revenue Estimating Group) is that we expect federal reform to have a "modest positive" influence on our corporate receipts. However, it is not possible to estimate with any reasonable accuracy the magnitude of that increase because of the unavailability of data and other resources. As a result, no specific amount is included in the estimate for the impact of federal reform. It should be considered, however, that the group recognized the federal impact and adjusted its estimates to some degree therefore.

- **History of Receipts.** As shown in Attachment A, corporation income tax receipts have declined from a high of $162 million in FY 1981 to a low of $104.6 million in FY 1987. This is due in large part to changes in federal tax policy which narrowed the corporation income tax base. The 1987 figure is the lowest since 1977. As a proportion of State General Fund receipts, corporate income taxes have declined from 13.7 percent in FY 1977 to under 6.0 percent in FY 1987. Estimates for FY 1988 and 1989 are $113 million each. Through January 1988, actual corporate receipts were 11.6 percent ($6.6 million) **below** the FY 1988 estimate and only 2.4 percent above FY 1987 actual receipts. It appears that receipts for March - June 1988 will need to increase by nearly 25 percent over March - June 1987 in

Attachment 2

order to make the FY 1988 estimate. Thus, any influence of federal changes on tax year 1987 payments to date is not evident, and significant improvement will be necessary to reach the current FY 1988 estimate. For all State General Fund sources, actual receipts exceeded the estimates by $2 million or 0.2 percent, with over 35 percent of our total individual income tax receipts scheduled for March - June.

- **Other State Estimates.** Attachment B presents the results of a telephone survey of 12 other states on their estimates of the impact of federal corporation tax reform on state receipts. The twelve states break down as follows:

No separate estimate	Arkansas, Nebraska, Oklahoma and Wisconsin
Less than 5% increase	Ohio, Oregon
5 - 10% increase (1988)	Illinois, Maryland, Minnesota
Over 10% increase	Colorado*, Iowa, Missouri

*An estimated 50 percent of the Colorado increase is attributable to repeal of a counterpart state investment tax credit. Absent this, the projected increase would be 8-9 percent.

It is fair to say that most states expressed a good deal of uncertainty or uneasiness with their estimates. They were, for the most part, driven from federal figures, and states were experiencing difficulty in gauging the timing of any expected receipts.

- **Accounting Firm Estimate.** One Wichita accounting firm estimated (using federal revenue figures) that Kansas could expect to receive an additional $103 million over the next five years as a result of the federal changes. That estimate, however, used gross 1987 collections in its analysis. If net (after refunds) collections are used, the projected windfall drops to about $65 million over 5 years, including some of which would be attributable to the financial institutions privilege tax.

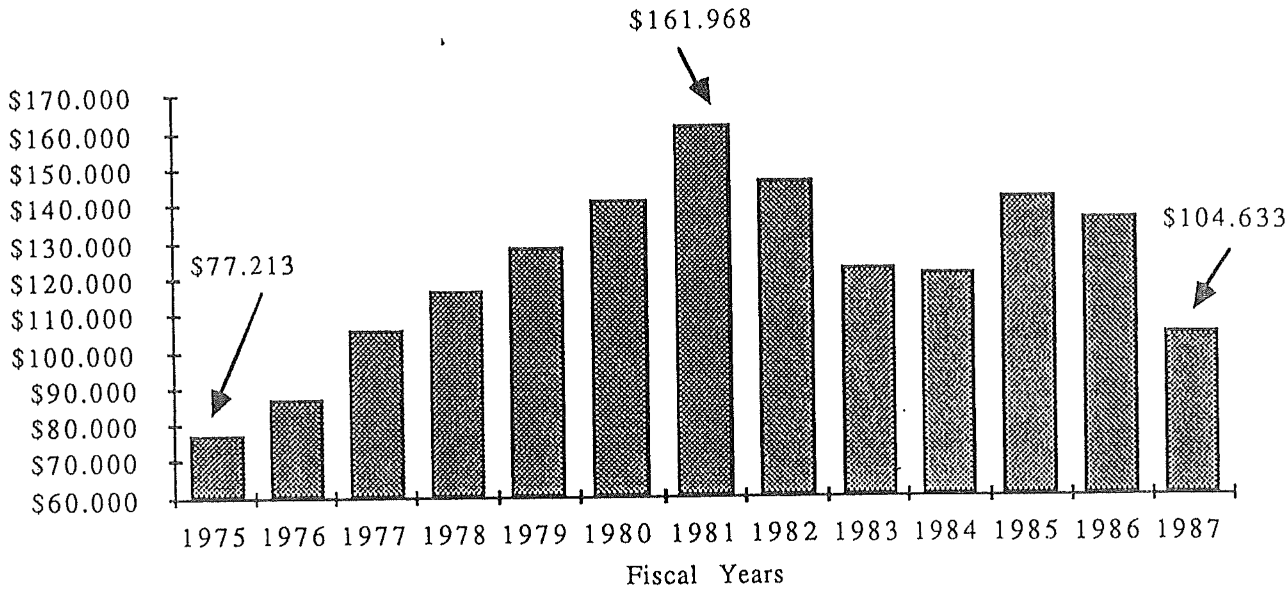
- **Reasons for Uncertainty.** Those federal reform provisions which affect state tax bases are primarily what have been termed "accounting provisions" which relate to the capitalization of certain costs, changes in inventory accounting, and changes in rules which formerly allowed the deferral of certain income. The effect of these changes will vary from state-to-state and industry-to-industry. Most of the discussion has centered on manufacturing and retailers. Yet, these two industry groups constitute only 30 percent of our corporate tax base. Fully one-third is comprised of transportation companies (trucks, railroads and pipelines) and public utility companies (gas, electric and telephone companies) while wholesale trade constitutes another 15 percent of the base. There has been little discussion of how, if at all, these types of firms will be affected.

Further, we must be concerned with what are changes in timing of receipts (which would increase receipts on a one-time basis) versus permanent tax base expansions. More recent data from the U.S. Treasury Department (July 1987) than that presented to the Committee yesterday shows that the federal revenue effects of the uniform capitalization rules are "front-end loaded" to a degree, decreasing from $9.1 billion in 1987 to $6.5 billion in 1991. A similar pattern is seen in the limits on the use of installment method of recognizing receipts, estimated at $2.1 billion in 1987 but averaging $1.4 billion annually thereafter. Of most importance is the need to recognize that limits on the use of completed contract method of accounting are simply changes in the timing of receipts and not permanent expansions in the base. That is, they require income to be recognized evenly over a several year period instead of at the end of a contract. This is most important in the defense contracting industry.

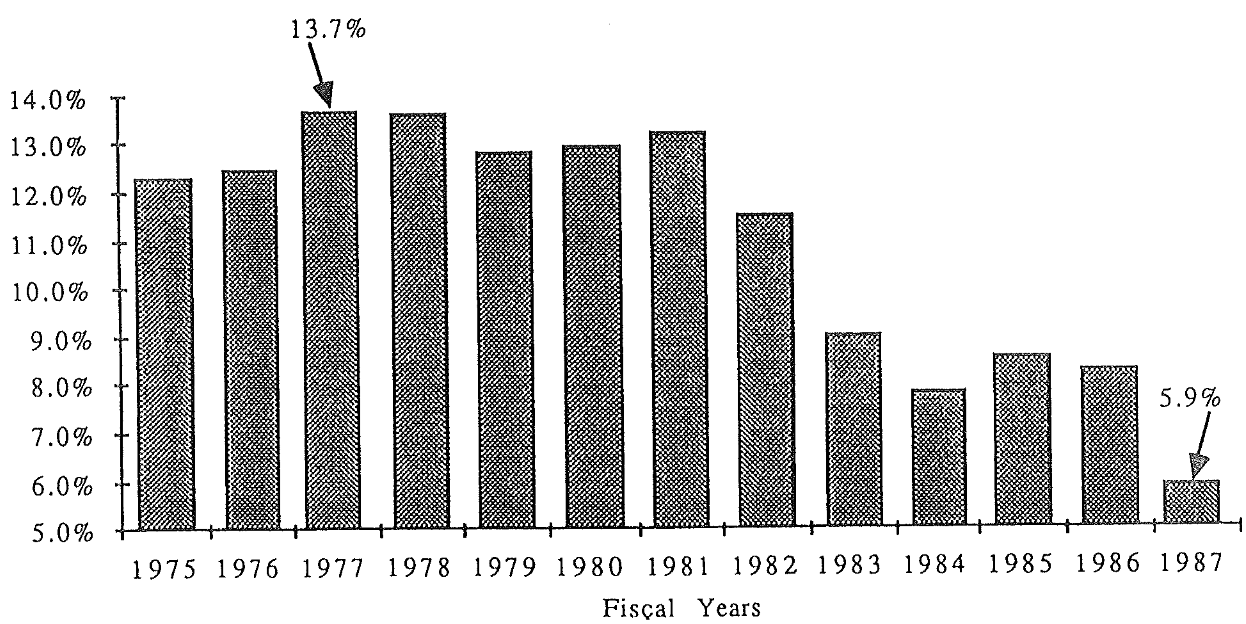
In short, there is no conclusive evidence about the magnitude of the "corporate windfall" that would provide a basis for enacting permanent tax reductions of the sort contained in SB 580 or 2940. Given the nature of the federal changes affecting the state tax base and the innumerable nuances of the corporation income tax, it seems improbable to me that such conclusive statements could be made at this time. It is simply premature to enact tax changes on the information at hand.

February 2, 1988

Kansas Department of Revenue
Corporate Income Tax
(Dollars in Millions)



Corporate Income Tax Revenue as a Percent of the State General Fund



Kansas Department of Revenue

States' Estimates of Corporate Windfall from Federal Tax Reform
(Dollars in Millions)
Telephone Survey of February 10-16, 1988

State	New Laws or Rates	FY	Windfall	Regular Corporate without Windfall	Total (all) Taxes	Windfall Percent of Corporate	Corporate Percent of Total Taxes	How Windfall Estimated	Federal Influences
Arkansas	No								

No windfall estimates. The state is now creating a detailed, corporate data base on computer, with which to make estimates.

State	New Laws or Rates	FY	Windfall	Regular Corporate without Windfall	Total (all) Taxes	Windfall Percent of Corporate	Corporate Percent of Total Taxes	How Windfall Estimated	Federal Influences
Colorado	Yes	1988	$28.0	$145.0		16.2%		Allocated fed	Investment
		1988	$32.0	$145.0		18.1%		estimates	Tax Credit

The 1988 windfall estimate is $28-$32 million. Total corporate estimated collections are up from $113 million in FY 1987 because of 7-1-1987 tax-rate increase. Estimates that half of windfall amount is from Investment Tax Credit repeal.

State	New Laws or Rates	FY	Windfall	Regular Corporate without Windfall	Total (all) Taxes	Windfall Percent of Corporate	Corporate Percent of Total Taxes	How Windfall Estimated	Federal Influences
Illinois	No	1988	$56.0	$614.0		8.4%		backed out of regular est.	

Windfall estimate done by Illinois Chamber of Commerce is $200 million (state & local). State windfall estimate of $56 million made at state level only. Regular estimate is based on before-tax corporate profit estimates; then windfall estimated as percent of that. Windfall is considered "fictitious." FY 1988 to date revenues verify lower ($56 million) windfall estimate, but it will not be returned until existence of windfall is a certainty. State estimates that it may take two years for tax reform changes to be made fully evident in Illinois.

State	New Laws or Rates	FY	Windfall	Regular Corporate without Windfall	Total (all) Taxes	Windfall Percent of Corporate	Corporate Percent of Total Taxes	How Windfall Estimated	Federal Influences
Iowa	Yes	1988	$17.5	$145.0		10.8%		Backed-out of	
		1988	$20.0	$145.0		12.1%		total windfall	

Prior to TY 1987, Iowa was non-conforming. At special session in October, 1987, Iowa became conforming for tax year 1987 only. Regular session now considering conformity as permanent.

State	New Laws or Rates	FY	Windfall	Regular Corporate without Windfall	Total (all) Taxes	Windfall Percent of Corporate	Corporate Percent of Total Taxes	How Windfall Estimated	Federal Influences
Maryland	No	1988	$20.0	$242.3		7.6%		Consultants	

Windfall was estimated by consultants on a CY basis: at $24 million for CY 1987 and $20 million for CY '88 and '89. Maryland converted to FY, with the "bulk" of the $24 million in FY 1988. Thus, the estimate is at $20 million. Windfall estimate is deemed to be "as good as can be done."

State	New Laws or Rates	FY	Windfall	Regular Corporate without Windfall	Total (all) Taxes	Windfall Percent of Corporate	Corporate Percent of Total Taxes	How Windfall Estimated	Federal Influences
Minnesota	Yes	1988	$27.4	$382.9		6.7%		Backed out of	
		1989	$48.5	$405.5		10.7%		MN tax reform	

Estimates based on law prior to 1987 changes, at old 12% rate. New law incorporates federal reforms. Additional collections from Minnesota tax reform are estimated at $46 million for FY 1988 and $68.4 million for FY 1989.

State	New Laws or Rates	FY	Windfall	Regular Corporate without Windfall	Total (all) Taxes	Windfall Percent of Corporate	Corporate Percent of Total Taxes	How Windfall Estimated	Federal Influences
Missouri	No	1988	$32.0	$224.0		12.5%		2% of federal	Accounting Provisions

FY 1988 to date collections show that windfall estimate could be on the low side, by about $8 million, making the total windfall at $40, but estimate will not be revised upward. Federal tax reform has stimulated Missouri to build a corporate file (i.e., enter corporate return information on computer file). Estimates that changed accounting provisions account for about 68% of windfall estimates.

Kansas Department of Revenue

States' Estimates of Corporate Windfall from Federal Tax Reform
(Dollars in Millions)
Telephone Survey of February 10-16, 1988

State	New Laws or Rates	FY	Windfall	Regular Corporate without Windfall	Total (all) Taxes	Windfall Percent of Corporate	Corporate Percent of Total Taxes	How Windfall Estimated	Federal Influences
Nebraska	Yes								

Currently more concerned with the fiscal effect of Legislative Bill 775 than with corporate windfall. In L.B., to promote corporate investment in plant equipment and the hiring of new employees, credits are given for sales tax paid, number employees hired and property tax. Estimated that 25 corporations would file, but over 100 have filed to date.

Ohio	Yes	1988	$40.0	$866.2		4.4%		% fed increase	

Windfall estimated by using same % increases for state as was used at federal level. Windfall estimate is "shaky," and not being monitored. Lowered top corporate rate to 8.9% from 9.7%, Fy 1988; so estimate total revenues will remain about the same as before windfall.

Oklahoma	Yes	1987		$83.7	$2,534.0		3.3%		
		1988		$87.0	$2,700.0		3.2%		

No windfall estimates made. New laws raised other taxes' rates, as sales, ABC, motor fuel. Little reliance on corporate revenue.

Oregon	Yes	1988	$0.6	$140.2		0.4%		1% of federal estimates	
		1989	$3.6	$133.3		2.6%			

Conformed to federal and decreased rate to 6.6% from 7.5% for Tax Year 1987. Estimates to be revised at end of February, 1988.

Wisconsin	Yes								

Prior to 1987, Wisconsin was non-conforming; so that windfall would be estimated to be break-even. Beginning with Tax Year 1987, Wisconsin is conforming, and saw federal tax reform as offering state the opportunity to conform.

STATE GENERAL FUND -- H.B. 2940

(in Millions)

	FY 89	FY 90	FY 91	FY 92	FY 93
Beginning Balance	$146.2	$146.2	$146.2	$146.2	$146.2
Receipts					
Consensus Est.	$2,019.4	$2,019.4	$2,019.4	$2,019.4	$2,019.4
Sales/Use Tax Ex.	(7.3)	(16.0)	(16.0)	(16.0)	(16.0)
Ind. Inc. Tax	(78.7)	(114.4)	(114.4)	(114.4)	(114.4)
Corp. Inc. Tax					
NOL Carrybacks	3.7	11.3	0.0	0.0	0.0
Apportionment	(0.8)	(1.0)	(1.0)	(1.0)	(1.0)
Rate Reductions	--	(7.1)	(9.4)	(9.4)	(9.4)
Total, FY 89 Basis	$1,936.3	$1,892.3	$1,878.6	$1,878.6	$1,878.6
Total, Current $	$1,936.3	$1,986.9	$2,071.2	$2,174.7	$2,283.5
(5% annual growth rate)					
Expenditures	$1,936.3	$1,986.9	$2,071.2	$2,174.7	$2,283.5
	2.1%	2.6%	4.2%	5.0%	5.0%
Ending Balance	$146.2	$146.2	$146.2	$146.2	$146.2
Percent of Expend.	7.6%	7.4%	7.1%	6.7%	6.4%
(6% annual growth rate)					
Expenditures	$1,936.3	$2,005.8	$2,110.8	$2,237.4	$2,371.7
	2.1%	3.6%	5.2%	6.0%	6.0%
(4% annual growth rate)					
Expenditures	$1,936.3	$1,967.9	$2,031.9	$2,113.2	$2,197.7
	2.1%	1.6%	3.2%	4.0%	4.0%
(3% annual growth rate)					
Expenditures	$1,936.3	$1,949.0	$1,993.0	$2,052.8	$2,114.4
	2.1%	0.7%	2.3%	3.0%	3.0%

KLRD
2/22/88

Attachment 3

STATE GENERAL FUND -- H.B. 2940

(in Millions)

	FY 89	FY 90	FY 91	FY 92	FY 93
Beginning Balance	$146.2	$146.2	$146.2	$146.2	$146.2
Receipts					
Consensus Est.	$2,019.4	$2,019.4	$2,019.4	$2,019.4	$2,019.4
Ind. Inc. Tax	(78.7)	(114.4)	(114.4)	(114.4)	(114.4)
Corp. Inc. Tax					
NOL Carrybacks	3.7	11.3	0.0	0.0	0.0
Apportionment	(0.8)	(1.0)	(1.0)	(1.0)	(1.0)
Rate Reductions	--	(7.1)	(9.4)	(9.4)	(9.4)
Total, FY 89 Basis	$1,943.6	$1,908.3	$1,894.6	$1,894.6	$1,894.6
Total, Current $	$1,943.6	$2,003.7	$2,088.8	$2,193.2	$2,302.9
(5% annual growth rate) Expenditures	$1,943.6	$2,003.7	$2,088.8	$2,193.2	$2,302.9
	2.4%	3.1%	4.2%	5.0%	5.0%
Ending Balance	$146.2	$146.2	$146.2	$146.2	$146.2
Percent of Expend.	7.5%	7.3%	7.0%	6.7%	6.3%
(6% annual growth rate) Expenditures	$1,943.6	$2,022.7	$2,128.8	$2,256.5	$2,391.9
	2.4%	4.1%	5.2%	6.0%	6.0%
(4% annual growth rate) Expenditures	$1,943.6	$1,984.6	$2,049.2	$2,131.2	$2,216.4
	2.4%	2.1%	3.3%	4.0%	4.0%
(3% annual growth rate) Expenditures	$1,943.6	$1,965.5	$2,010.0	$2,070.3	$2,132.4
	2.4%	1.1%	2.3%	3.0%	3.0%