Approved: March 14, 2006
Date

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE

The meeting was called to order by Chairman Barbara Allen at 10:45 A.M. on March 8, 2006 in Room 519-S of the Capitol.

All members were present.

Committee staff present:
- Chris Courtwright, Kansas Legislative Research
- Gordon Self, Revisor of Statutes Office
- Judy Swanson, Secretary

Conferees appearing before the committee:
- Bill Waters, KDOR
- Mark Beck, KDOR
- Senator Jim Barnett
- Professor Art Hall

Others attending:
- See attached list.

Senator Schmidt moved to amend **SB 585** by changing the effective date to publication in the statutes book, then recommend it favorably for passage. Senator Apple seconded the motion, and the motion carried.

KDOR Secretary Joan Wagnon led discussion on:

HB 2619--Property tax exemption for certain commercial and industrial machinery and equipment, materials and supplies

Sub HB 2525--Property tax exemption for certain telecommunications machinery and equipment and railroad machinery and equipment.

KDOR General Counsel Bill Waters said these bills, in his opinion, pass the constitutional test of being uniform and equal. (Attachment 1) Discrimination is based on a taxpayer characteristic, and he felt this type of discrimination does not apply to these bills. There will be certain types of businesses that will benefit much more rapidly than others, such as technology-based businesses, because of the nature of their business. He cited several cases which were upheld by the Kansas Supreme Court. He said the language in the EDX amendment gives the legislature the right to exempt property. There is no similar language in the classification amendment. He concurred with Senator Schmidt the Supreme Court would interpret the amendments as to what the people thought at the time they voted on the amendments.

Mark Beck provided information concerning which other states do not tax CI/ME, and the cost of increasing the exemption from $400 to $1000. (Attachment 2) He also provided a chart concerning CI/ME new investment for 2004. (Attachment 3) Senator Allen requested KDOR to provide a percentage figure column corresponding to the dollar value figures representing CI/ME new investment for 2004. Senator Lee expressed concern the fiscal note will be much higher than anticipated. Senator Schmidt said for counties using tax abatements, they will never get the benefit of the CI/ME exemption because certain property which has been abated locally will not come back on the tax rolls. Also, the tax base year (2005) is artificially low because it fails to account for locally abated property and growth in the economy.

Senator Jim Barnett presented an overview of his proposal for economic growth in Kansas, "Prescription for Growth". (Attachment 4) He compared trends in economic growth, comparing Kansas with other plains states, and with the United States. The Kansas population is aging, and it is growing slowly. However, the Kansas budget is growing quickly. Art Hall, Kansas University Professor, testified to the relationship of mill rates to the property valuation in 112 Kansas localities. Mr. Hall assured the Committee he was not representing Kansas University and was on vacation from the University to testify with Senator Barnett.

Being no further business, the Committee adjourned at 11:55 a.m.

SENATE
ASSESSMENT & TAXATION COMMITTEE

GUEST LIST

DATE: 3-18-06

NAME	REPRESENTING
Sheila Frahm	KACCT
Jim Rea	KACCT
Brad Harrelson	KFB
Charles Nicolay	Capitol City Oil Co.
David Cunningham	KASB
Kiel Bronner	intern
Bernie Koch	Wichita Metro Chamber of Commerce
Jeanne Goodvin	City of Wichita
Hal Hudson	NFIB
Pat Hubbell	KSRR
Doug Smith	Pinegar, Smith & Associates
John Frederick	Boeing
Larry R Baer	LKM
Bill Thompson	Dept of Commerce
Ann Durkes	Division of Budget
Steve Stotts	KDOR
KEN DANIEL	KSSMALLBIZ.COM
Tony Folsom	KDOR

SENATE
ASSESSMENT & TAXATION COMMITTEE

GUEST LIST

DATE: 03-08-06

NAME	REPRESENTING
Estelle Montgomery	Hein Law Firm
Roger Hamm	KDOR
Mike Murray	Sprint
Jackie Clark	Hallmark Cards
Judy Gann	SPRINT
Lucky DeFries	Coleman, DeFries & Northern
Robt J. Fasl	AT&T Services, Inc.
Kristi Wyatt	Greater KC Chamber of Commerce
Caty Bennett	" " "
Bob Vancrum	" " "
Harriet Lange	Ks Assn of Broadcasters
Mike Reecht	Gaches Braden
Michael Smith	Kansas Ass'n of Counties
Blaise Plummer	Emporia, Kansas
Ken Gudenkauf	KDOT
TERRY FORSYTH	KNEA
Bill Brady	Capitol Strategies
Erik Sartorius	City of Overland Park
Marlee Carpenter	KS Chamber

K A N S A S

JOAN WAGNON, SECRETARY

KATHLEEN SEBELIUS, GOVERNOR

DEPARTMENT OF REVENUE
DIVISION OF PROPERTY VALUATION

During House floor debate a question was raised as to the constitutionality of H.B. 2619. Although one can never say with absolute certainty how a court might rule in any given case, it would appear that H.B. 2619 is well within the legislature's authority to exempt property from taxation. Although several property tax exemptions are provided in the Kansas Constitution (art. 11, § 1[b]), "the legislature has the general power to confer additional exemptions, or exemptions that are broader in scope through the enactment of legislation, unless constitutionally prohibited from doing so." *In re Tax Application of Leitz Constr. Co.,* 273 Kan. 890, 903, 47 P.3d 1275 (2002). "The standard under article 11, § 1, is that the legislature may provide statutory exemptions if such exemptions have a public purpose and promote the general welfare." *Von Ruden v. Miller,* 231 Kan. 1, 14, 642 P.2d 91 (1982). The legislature is the judge of what exemptions are in the public interest and will be conductive to the public welfare. *Lario Enterprises, Inc. v. State Bd. of Tax Appeals,* 22 Kan. App. 2d 857, 860, 925 P.2d 440, *rev. denied* 261 Kan. 1083 (1996). The Kansas Supreme Court has stated that it will "follow a policy of judicial restraint unless [it] find[s] the judgment of the legislature was 'entirely devoid of a rational basis.'" *State ex rel. Tomasic v. City of Kansas City,* 237 Kan. 572, 579, 701 P.2d 1314 (1985). In the *Tomasic* case, cited above, the Kansas Supreme Court held that the Industrial Revenue Bond ("IRB") exemption statute (K.S.A. 79-201a, *Second*) encouraged industrial development and promoted the general welfare and served a public purpose. 237 Kan. at 580. Therefore, the exemption of newly purchased or leased commercial and industrial machinery and equipment to encourage industrial development and business expansion, would likely be held to be constitutional.

A question was also raised whether H.B. 2619 violates the rule set down by the Kansas Supreme Court in *State ex rel. Stephan v. Parrish,* 257 Kan. 294, 891 P.2d 445 (1995). At issue in *Parrish* was a retroactive amnesty from property taxation to taxpayers who did not timely list their property for taxation. Those taxpayers who timely listed their property for taxation were not granted an amnesty. The Court, having first noted that the classification was based on a characteristic or status of the taxpayer rather than upon an appropriate classification of the property, found such a distinction arbitrary and without a rational basis and, therefore, a violation of equal protection.

Assessment & Taxation
Date 3-8-06
Attachment # 1

DOCKING STATE OFFICE BUILDING, 915 SW HARRISON ST., ROOM 400, TOPEKA, KS 66612-1585
Voice 785-296-2365 Fax 785-296-2320 http://www.ksrevenue.org/

H.B. 2619, as distinguished from the situation in *Parrish,* is based on the status of the property rather than the status of the taxpayer. It distinguishes between property acquired or leased prior to July 1, 2006, and property acquired or leased after June 30, 2006. This is a common distinction in property tax statutes. *See, e.g.,* K.S.A. 2005 Supp. 79-201d, which exempts from taxation farm storage facilities designed for the storage of hay *newly constructed or first assembled after December 31, 2004. See also* K.S.A. 2005 Supp. 79-259, which exempts from taxation electric transmission lines and appurtenances *constructed after December 31, 2000.*

KANSAS

JOAN WAGNON, SECRETARY

KATHLEEN SEBELIUS, GOVERNOR

DEPARTMENT OF REVENUE
DIVISION OF PROPERTY VALUATION

March 8, 2006

Two questions arising from the March 7, 2006 briefing:

1) What is the value of increasing the exemption from $400 to $1000?

   Answer: The estimated assessed value of CI/ME with a retail cost when new of between $400 and $1000 is $47 million or 2.5% of the $1.8 billion total CI/ME. The impact to the school general fund is estimated at $940,000 and the state building fund $70,500. <u>These estimates are included in the fiscal note.</u>

2) Which states do not tax CI/ME?

   Delaware
   Hawaii
   Illinois
   Iowa
   Minnesota
   New Hampshire
   New Jersey
   New York
   North Dakota
   Ohio
   Pennsylvania
   South Dakota

Assessment & Taxation
Date 3-8-06
Attachment # 2

DOCKING STATE OFFICE BUILDING, 915 SW HARRISON ST., ROOM 400, TOPEKA, KS 66612-1585
Voice 785-296-2365 Fax 785-296-2320 http://www.ksrevenue.org/

Commercial & Industrial Machinery & Equipment New Investment

	Assessed Value			
	2004	2005	Change	Assessed Value of New Purchased in 2004
Cowley	20,155,784	22,949,708	2,793,924	4,802,305
Douglas	56,243,155	60,909,205	4,666,050	13,566,404
Ellis	12,055,602	12,971,587	915,985	4,072,264
Johnson	459,641,270	476,361,443	16,720,173	94,706,926
McPherson	34,111,437	35,708,175	1,596,738	2,135,091
Miami	10,828,352	9,341,510	-1,486,842	1,403,127
Montgomery	35,142,596	29,195,391	-5,947,205	2,998,538
Reno	38,254,547	38,567,727	313,180	7,043,708
Russell	2,748,871	2,563,072	-185,799	280,954
Saline	49,210,630	51,926,310	2,715,680	10,683,355
Sedgwick	349,660,903	367,524,139	17,863,236	102,474,008
Shawnee	115,754,027	128,512,317	12,758,290	30,649,904
Smith	766,980	778,510	11,530	142,155
Sumner	9,985,869	10,207,979	222,110	1,625,186
Wyandotte	176,984,376	181,113,621	4,129,245	38,207,615

THE CENTER FOR
APPLIED ECONOMICS

Supporting Regional Economic Development through Analysis and Education

Arthur P. Hall, Ph.D.
Executive Driector

January 18, 2006

Senator Jim Barnett
1400 Lincoln
Emporia, KS 66801

Dear Sen. Barnett:

Per our meeting on October 29, 2005, and your subsequent letter of request, the Center for Applied Economics has compiled an analysis of the various features of a budget plan that will help promote economic growth in the State of Kansas. Your letter contemplated several policy changes. The enclosed attachment provides a high-level summary of my analysis. I believe my analysis provides a reliable "proof of concept" of the policy changes that you have proposed. I stand ready to help you revisit and refine the estimates as time and circumstance dictates.

To conduct my analysis, I have relied on several sources and tools. As you and I have discussed, budget estimation—particularly revenue estimation—is not an exact science; it requires assumptions about the future path of many interrelated economic variables. To assure that the analysis accounts for the many complexities associated with the laws and procedures that guide expenditure policy within the Budget of the State of Kansas, I have relied on the best estimates made by Alan Conroy, Director of the Kansas Legislative Research Department. To produce estimates related to changes in revenue policy, I have relied on my own microsimulation model, which is grounded in Kansas-specific historical data gathered from the U.S. Internal Revenue Service and the Kansas Department of Revenue. A key assumption built into my microsimulation model is a five percent annual growth rate of nominal Kansas Gross State Product (i.e., the Kansas economy). This assumption is within the bounds of Kansas experience: The Kansas economy has experienced a nominal average annual growth rate of 6.03 percent over the past quarter century, and a 4.90 percent growth rate over the past decade. Thus, unless the Kansas economic growth rate accelerates its secular decline, the assumption of five percent nominal annual economic growth provides a realistic benchmark.

Sincerely,

Arthur P. Hall
Executive Director

Enclosure

School of Business • University of Kansas • Summerfield Hall • 1300 Sunnyside Ave. • Lawrence, KS 66045-7585
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Assessment & Taxation
Date 3-8-06
Attachment # 4

Analysis of Proposed Budget Policy Changes
Prepared for Senator Jim Barnett
Center for Applied Economics, KU School of Business

- A global spending freeze that excludes only K-12 education, Regents, and Medicaid. To obtain accurate figures that reflect the control of State expenditures, I have relied on the estimates produced, at your request, by Alan Conroy.

- Improve the investment tax credit component of the High Performance Incentive Program [KSA 79-32,160a(e), and guided by KSA 79-32,154]. Capital investment is a business activity directly associated with economic growth. Policy makers can promote capital investment by implementing policies that improve the rate of return on capital employed. Investment tax credits offer one approach for improving the rate of return on capital employed, and making a wider range of investments economically viable.

  The current administration of the HPIP (10 percent) investment tax credit is unnecessarily constraining its potential for promoting capital investment in Kansas. The intent of the proposed policy change is to make the HPIP investment tax credit universally available to any enterprise making a business-related capital investment within Kansas. You can accomplish this intent in practice by:

  1. Reducing the current $50,000 minimum investment threshold to $0.01.
  2. Allowing for unlimited carry forward of unused credit amounts. (The credit is not a refundable credit.)
  3. Eliminating the Kansas Department of Commerce certification requirement, and any other form of "permission" required to use the credit. (Standard tax return reporting and compliance procedures would still apply.)
  4. Provide access to the credit for businesses not currently eligible: SIC codes 01-17 and 52-59—Agriculture, Mining, Construction, Retail. Payers of the Privilege Tax (financial institutions) would also qualify for the credit.

  My estimated budget impact from expanding the application of the HPIP investment tax credit derives from using IRS corporate tax return data to assess average levels of capital investment and, correspondingly, the expected value of the credit relative to business taxable income and business income tax liability. It is important to understand that the estimated value of the annual tax relief embodied in my analysis is incremental to the relief already offered by current law. Current law grants relief equal to about seven percent of tax liability. My estimates add tax relief equal to about 11 percent of tax liability. The combined total of 18 percent is consistent with average investment patterns nationwide. (For non-corporate businesses, the HPIP investment tax credit interacts with the individual income tax changes discussed below.)

- Increase of the tax exemption for dependents and reduction of marginal income tax rates for individuals. Economic theory and my reading of economic history suggest that lowering marginal income tax rates helps to promote economic growth—either by providing an incentive for greater labor force participation or increasing the return to personal investment (like starting a new business). As a demonstration of your commitment to provide direct tax relief to families, you requested that the proposed changes in revenue policy also increase the exemption for the dependents of individual income tax filers.

  The specific individual income tax policy changes made possible by your expressed expenditure policy and the other revenue policy changes are shown on the summary page below. The analysis allows for two scenarios. Scenario 1 assumes an exemption increase of $250 per dependent. Scenario 2 assumes an exemption increase of $500 per dependent. The rate reduction schedules made possible by the alternative exemption increases are listed on the summary page below. Note that each scenario requires a gradual phase down of marginal income tax rates. The phase down is required to allow your spending control to provide budget capacity and to accommodate the new education-related expenditures mandated by the Kansas Supreme Court. The listed rate reductions are merely a guide based on budget capacity, the promotion of economic growth, and your stated goal of tax relief for all taxpayers. Other combinations of exemption amounts and tax rate levels are possible.

- Elimination of the Kansas estate tax. House Bill 2005, enacted in the 2003 Legislative session, links the Kansas estate/inheritance tax to the federal estate-tax phase out as of January 1, 2007. My analysis relies on data received (at your request) from the Kansas Legislative Research Department. I made no separate estimates of the budget implications of eliminating the Kansas estate tax.

Scenario 1

(Dollars in Millions)

Kansas Fiscal Year	**2009**	**2010**	**2011**	**2012**
Year of Income Tax Base for Revenue Estimation	*2008*	*2009*	*2010*	*2011*
Budget Capacity Available (per Kansas Legislative Research)	$165	$175	$460	$650
Estate tax elimination (assuming federal link) (per Kansas Legislative Research)	-32	-15	-5	0
ITC + **2,500** Dependent Exemption + Rate Reduction (per Center for Applied Economics)	-129	-157	-458	-621
Total Tax Reduction	-161	-172	-463	-621
Budget Capacity Remaining After Tax Reduction	$4	$3	($3)	$29

Scenario 1 Tax Rate Schedule:

Low Rate	3.40	3.30	3.25	3.00
Middle Rate	6.10	6.00	5.25	5.00
High Rate	6.30	6.35	5.25	5.00

Scenario 2

(Dollars in Millions)

Kansas Fiscal Year	**2009**	**2010**	**2011**	**2012**
Year of Income Tax Base for Revenue Estimation	*2008*	*2009*	*2010*	*2011*
Budget Capacity Available (per Kansas Legislative Research)	$165	$175	$460	$650
Estate tax elimination (assuming federal link) (per Kansas Legislative Research)	-32	-15	-5	0
ITC + **2,750** Dependent Exemption + Rate Reduction (per Center for Applied Economics)	-131	-162	-455	-644
Total Tax Reduction	-163	-177	-460	-644
Budget Capacity Remaining After Tax Reduction	$2	($2)	($0)	$6

Scenario 2 Tax Rate Schedule:

Low Rate	3.40	3.40	3.00	3.00
Middle Rate	6.20	6.10	5.50	5.00
High Rate	6.40	6.30	5.50	5.00

STATE OF KANSAS

JIM BARNETT
SENATOR, 17TH DISTRICT
CHASE, COFFEY, GREENWOOD
LYON, MARION, MORRIS, AND OSAGE
COUNTIES

COMMITTEE ASSIGNMENTS
CHAIR: PUBIC HEALTH AND WELFARE
MEMBER: FEDERAL AND STATE AFFAIRS
FINANCIAL INSTITUTIONS AND INSURANCE
GOVERNOR'S HEALTH CARE COST CONTAINMENT COMMISSION
HEALTH CARE STABILIZATION FUND

TOPEKA

SENATE CHAMBER

October 29, 2005

Arthur P. Hall, Ph.D.
Executive Director, Center for Applied Economics
University of Kansas School of Business
Summerfield Hall
1300 Sunnyside Avenue
Lawrence, KS 66045

Dear Dr. Hall:

As per our conversation today, I am hopeful that the Center for Applied Economics will be able to assist me in developing a plan for the State of Kansas that will grow the economy and make Kansas a more attractive State in which to raise a family and locate a business. I have seen as a State Senator our debt grow to where we have the greatest debt per capita of any State in the Nation. I have also seen our budget commitments grow to the point where they exceed our income and the State of Kansas is set on a path to increase taxes every three to four years in order to meet our financial obligations.

As a candidate for Governor, I am considering several tax cuts that I believe will stimulate the economy. I also believe a one year freeze in most budget items would provide the capital necessary to enact the cuts. I am hopeful that you will be able to analyze a financial plan for Kansas that would involve the following:

1) Increase dependent exemptions for income tax purposes at least $1,000. per person
2) Eliminate or phase out the Death Tax
3) Lower Income Tax and phase in a two tier system
4) Improve the HPIP Investment Tax Credit program by making it easier to access and make it applicable to any business related capital investment
5) Freeze all state spending for one year, except for K – 12 Education and Higher Education, which would increase at a rate close to the cost of living. I would also like to exempt Medicaid from the spending freeze at its current rate of inflation

I enjoyed our conversation and I look forward to your analysis of a tax and spending program of the nature I have specified.

Sincerely,

Jim

Senator Jim Barnett

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Illustration of the HPIP Investment Tax Credit

- The tables below demonstrate the positive influence of the HPIP ITC on hypothetical investment returns, given different investment amounts and tax credit carry-forward assumptions. As is typical in investment analysis, the ITC has more investment value the sooner the taxpayer can use it.
- The different investment sizes matter under current law because the HPIP ITC specifies a $50,000 minimum investment threshold. The threshold reduces the value of the credit for smaller investment amounts. Eliminating the threshold will provide equal taxpayer value to all qualifying investments.
- To understand the bias against smaller-dollar investments, observe, under each scenario, the rates of returns when the hypothetical net income equals 10% of the investment amount: Under the "No Credit" scenario, both investments yield a zero percent return. Under the ITC scenarios, the returns turn positive. However, the rates of return are uniformly higher for the larger investment; the difference is the measure of the bias imposed by the minimum-investment threshold.

$1 Million Investment (10-Yr Lifetime)

Net Income from Investment	No Credit	Years to Deplete HPIP Credit: 1	3	5	10	Net Income % of Investment
95,000	-0.92%	0.88%	0.86%	0.84%	0.81%	9.5%
100,000	0.00%	1.82%	1.79%	1.76%	1.69%	10.0%
105,000	0.90%	2.74%	2.69%	2.65%	2.54%	10.5%
110,000	1.77%	3.64%	3.57%	3.51%	3.38%	11.0%
115,000	2.63%	4.52%	4.44%	4.36%	4.20%	11.5%
120,000	3.46%	5.38%	5.28%	5.19%	5.00%	12.0%
125,000	4.28%	6.22%	6.10%	6.00%	5.79%	12.5%
130,000	5.08%	7.04%	6.91%	6.80%	6.56%	13.0%
135,000	5.86%	7.85%	7.71%	7.58%	7.32%	13.5%
140,000	6.64%	8.65%	8.49%	8.35%	8.07%	14.0%
145,000	7.40%	9.43%	9.26%	9.10%	8.81%	14.5%
150,000	8.14%	10.20%	10.01%	9.85%	9.53%	15.0%
155,000	8.88%	10.96%	10.76%	10.58%	10.25%	15.5%
160,000	9.61%	11.71%	11.49%	11.31%	10.96%	16.0%
165,000	10.32%	12.45%	12.21%	12.02%	11.66%	16.5%

$100,000 Investment (10-Yr Lifetime)

Net Income from Investment	No Credit	Years to Deplete HPIP Credit: 1	3	5	10	Net Income % of Investment
9,500	-0.92%	0.00%	0.00%	0.00%	0.00%	9.5%
10,000	0.00%	0.93%	0.93%	0.92%	0.90%	10.0%
10,500	0.90%	1.84%	1.83%	1.81%	1.77%	10.5%
11,000	1.77%	2.73%	2.71%	2.68%	2.63%	11.0%
11,500	2.63%	3.60%	3.56%	3.53%	3.46%	11.5%
12,000	3.46%	4.44%	4.40%	4.36%	4.28%	12.0%
12,500	4.28%	5.27%	5.22%	5.18%	5.08%	12.5%
13,000	5.08%	6.09%	6.03%	5.98%	5.86%	13.0%
13,500	5.86%	6.89%	6.82%	6.76%	6.64%	13.5%
14,000	6.64%	7.67%	7.60%	7.53%	7.40%	14.0%
14,500	7.40%	8.44%	8.36%	8.29%	8.14%	14.5%
15,000	8.14%	9.20%	9.11%	9.04%	8.88%	15.0%
15,500	8.88%	9.95%	9.85%	9.77%	9.61%	15.5%
16,000	9.61%	10.69%	10.58%	10.50%	10.32%	16.0%
16,500	10.32%	11.41%	11.30%	11.21%	11.03%	16.5%

Source: Center for Applied Economics, KU School of Business

K-59
(Rev. 9/05)

KANSAS
HIGH PERFORMANCE INCENTIVE PROGRAM CREDITS

For the taxable year beginning ______________, 20____, ending ______________, 20____.

Name of taxpayer (as shown on return)	Social Security Number
If partner, shareholder or member, enter name of partnership, S corporation, LLC or LLP	Employer Identification Number (EIN)

PART A – GENERAL INFORMATION

1. Enter the period for which you were HPIP certified by the Secretary of Commerce. .... 1. __/__/__ through __/__/__ month/day/year
2. Enter your HPIP certification number. .... 2. ____________

PART B – HPIP TRAINING AND EDUCATION CREDIT

3. Total qualified cash investment in training and education. .... 3. ____________
4. Total amount expended for payroll during the period specified. .... 4. ____________
5. Multiply line 4 by 2%. .... 5. ____________
6. Amount of credit subject to limitation (subtract line 5 from line 3). .... 6. ____________
7. Total credit for amount invested (the lesser of line 6 or $50,000). .... 7. ____________
8. Enter your ownership percentage. .... 8. ____________
9. Amount of credit allowable for training and education. .... 9. ____________

PART C – HPIP INVESTMENT CREDIT

10. Address location of qualified business facility:

______________________ Street Address ______________________ City

11. Complete the following investment schedule for the 1st qualifying year:

INVESTMENT SCHEDULE FOR 1ST QUALIFYING YEAR			
	(1) Enter Business Entity Tax Filing Period By Month	(2) Base Year: _ _ _ _ Monthly Base Investment	(3) 1st Qualifying Year: _ _ _ _ Monthly Qualifying Investment
a.			
b.			
c.			
d.			
e.			
f.			
g.			
h.			
i.			
j.			
k.			
l.			
m.	TOTAL		
n.	Average Investment		
o.	Capitalized Rents		
p.	TOTAL		
q.	Base		
r.	Average Qualified Investment		
s.	Minimum Investment Allowed		$50,000
t.	Qualified Business Facility Investment		
u.	INVESTMENT CREDIT (10% of line t.)		

12. Enter your ownership percentage. See instructions .... 12. ____________ %
13. Amount of credit available this tax year (multiply line 11u by 12) .... 13. ____________
14. Amount of tax liability for current year after all previous claimed credits .... 14. ____________
15. Amount of credit used .... 15. ____________
16. Amount of carry forward for next year's Schedule K-59 .... 16. ____________

4-7

PART D – CARRY FORWARD SCHEDULE

17. **First Year** Carry Forward:
    a. Tax Year ______________
    b. Certification No. ______________
    c. Date of Certification ______________
    d. Carry Forward Amount ______________
    e. Credit Used ______________
    f. Credit Forward Available ______________

18. **Second Year** Carry Forward:
    a. Tax Year ______________
    b. Certification No. ______________
    c. Date of Certification ______________
    d. Carry Forward Amount ______________
    e. Credit Used ______________
    f. Credit Forward Available ______________

19. **Third Year** Carry Forward:
    a. Tax Year ______________
    b. Certification No. ______________
    c. Date of Certification ______________
    d. Carry Forward Amount ______________
    e. Credit Used ______________
    f. Credit Forward Available ______________

20. **Fourth Year** Carry Forward:
    a. Tax Year ______________
    b. Certification No. ______________
    c. Date of Certification ______________
    d. Carry Forward Amount ______________
    e. Credit Used ______________
    f. Credit Forward Available ______________

21. **Fifth Year** Carry Forward:
    a. Tax Year ______________
    b. Certification No. ______________
    c. Date of Certification ______________
    d. Carry Forward Amount ______________
    e. Credit Used ______________
    f. Credit Forward Available ______________

22. **Sixth Year** Carry Forward:
    a. Tax Year ______________
    b. Certification No. ______________
    c. Date of Certification ______________
    d. Carry Forward Amount ______________
    e. Credit Used ______________
    f. Credit Forward Available ______________

23. **Seventh Year** Carry Forward:
    a. Tax Year ______________
    b. Certification No. ______________
    c. Date of Certification ______________
    d. Carry Forward Amount ______________
    e. Credit Used ______________
    f. Credit Forward Available ______________

24. **Eighth Year** Carry Forward:
    a. Tax Year ______________
    b. Certification No. ______________
    c. Date of Certification ______________
    d. Carry Forward Amount ______________
    e. Credit Used ______________
    f. Credit Forward Available ______________

25. **Ninth Year** Carry Forward:
    a. Tax Year ______________
    b. Certification No. ______________
    c. Date of Certification ______________
    d. Carry Forward Amount ______________
    e. Credit Used ______________
    f. Credit Forward Available ______________

26. **Tenth Year** Carry Forward:
    a. Tax Year ______________
    b. Certification No. ______________
    c. Date of Certification ______________
    d. Carry Forward Amount ______________
    e. Credit Used ______________

INSTRUCTIONS FOR SCHEDULE K-59

GENERAL INFORMATION

The K-59 Schedule has been redesigned for 2006 to provide for an investment schedule and a carry forward schedule. Please review and read all directions before completing the K-59 form.

The High Performance Incentive Program (HPIP) provides for two types of credits:

- Training and Education Credit (K.S.A. 74-50,132); and
- Investment Tax Credit (K.S.A. 79-32,160a(e)).

Certification from the Kansas Department of Commerce is the initial requirement for either of the credits and must be maintained with your records.

Training and Education Credit. A qualified firm that invests in the training and education of its employees and pays higher than average wages is eligible to receive a tax credit. The credit is the amount of training and education expenditures that exceed 2% of the wages, limited to $50,000. The credit must be used in the tax year it is earned. There is no carry forward provision for this credit.

Investment Tax Credit. A qualified firm may be eligible to receive a 10% investment tax credit for qualified business facility (QBF) investments in excess of $50,000 in a QBF. This credit may be carried forward for the next 10 tax years as long as the firm is recertified in the tax year the carry forward is used. Schedule K-59 must be completed for each QBF in the initial year and, if necessary, for any carry forward year for each location.

DEFINITIONS

Qualified Firm: A for-profit business establishment, subject to state income, sales or property taxes, identified:

- under the standard industrial classification (SIC) codes as in effect July 1, 1993, major groups 20 through 39 (or the appropriate North American Industry Classification System (NAICS) designation as in effect October 1, 2000), major groups 40 through 51 (or the appropriate NAICS designation), and major groups 60 through 89, (or, the appropriate NAICS designation); OR
- as a corporate or regional headquarters or back-office operation of a national or multinational corporation regardless of SIC code or NAICS designation.

A business establishment may be assigned a SIC code or NAICS designation according to the primary business activity at a single physical location in Kansas.

There are additional qualifications to meet the definition of "qualified firm." Contact the Kansas Department of Commerce for additional information.

Full-Time Equivalent Employees: For the period of training, divide the number of hours worked by part-time employees during the pertinent measurement interval by an amount equal to the corresponding multiple of a 40-hour work week and adding the quotient to the number of full-time employees.

Qualified Business Facility Investment: The value of the real and tangible personal property, except inventory or property held for sale to customers in the ordinary course of business, which constitutes the new business facility. See K.S.A. 79-32,154(e).

Corporate Headquarters: A facility where principal officers of the corporation are housed and from which direction, management or administrative support for transactions is provided.

LINE BY LINE INSTRUCTIONS

PART A – GENERAL INFORMATION

Line 1 – Enter the period certified by the Kansas Department of Commerce.

Line 2 – Enter the certification number received from the Kansas Department of Commerce.

PART B – HPIP TRAINING AND EDUCATION CREDIT

The training and education credit is authorized through the High Performance Incentive Program (HPIP) and shall be claimed in the tax year for which the company is certified. If the HPIP certification period should overlap two tax years, the taxpayer shall have the choice of which tax year to claim the training and education tax credit.

Line 3 – Enter the total qualified business **cash** investment in the training and education of the qualified firm's employees during the 12-month measurement period specified on your HPIP eligibility form or certification letter. Do not include spending used to match the state's Kansas Industrial Retraining (KIR) program.

Line 4 - Enter the total dollar amount expended for payroll costs for both full time and part time positions. This should correspond to the amount reported on your Employers' Quarterly Wage Report and Contribution Return, Form K-CNS 1001.

Line 5 – Multiply line 4 by 2%.

Line 6 – Subtract line 5 from line 3.

Line 7 – Enter the amount from line 6 or $50,000, whichever is less. This is the total training and education credit for the amount of cash investment made.

Line 8 – Partners, shareholders, or members must enter their ownership percentage in the partnership or S corporation. All other taxpayers enter 100%.

Line 9 – Enter on line 9 the lesser of line 7 multiplied by line 8 or your tax liability. This is the share of the credit for the amount invested this year. Enter this amount on the appropriate line of Form K-40, Form K-41, Form K-120, or Form K-130.

Apply this credit to your tax liability before any other credits. This amount cannot exceed your tax liability.

PART C - HPIP INVESTMENT CREDIT

Qualified business facility investment is the value of the real and tangible personal property, except inventory or property held for sale to customers in the ordinary course of the taxpayer's business, which constitutes the qualified business facility, or which is used by the taxpayer in the operation of the QBF, during the taxable year for which the HPIP investment tax credit is claimed. The value of such property during the taxable year shall be: (1) its original cost if owned by the taxpayer; or (2) eight times the net annual rental rate if leased by the taxpayer.

The certification period is important for the HPIP program. All **three** of the following conditions must be net for property to be eligible for the HPIP investment tax credit:

- Only those expenditures for real and tangible personal property made during the certification period will qualify for the credit:
- The property must be capable of being used by the taxpayer or must be used by the taxpayer in the operation of the QBF placed in service during the certification period (no property classified or defined as construction in process); and
- Only that property identified on the capital investment project form submitted to the Kansas Department of Commerce (KDOC) shall be eligible.

Current Year Investment:

The QBF investment for HPIP purposes is computed based on a monthly average of the HPIP qualified investment made during the certified months that fall within the taxpayer's tax year. The investment or expenditures must meet the qualifications listed above. This property will also be present in the property factor for apportionment purposes. The QBF investment shall be determined by dividing the sum of the total value of such HPIP property on the last business day of each full calendar month during the portion of the taxable year during which the QBF was in operation

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and for which the taxpayer was HPIP certified by the number of full calendar months the facility is in operation and for which the taxpayer was HPIP certified.

Existing Facility Investment:

For investment in a QBF, which facility existed and was operated by the taxpayer prior to the investment, a base amount of investment will be deducted from the current year's HPIP investment average. The base shall consist of the average HPIP investment made by the taxpayer in all prior year's at this QBF. This property will also be present in the property factor for apportionment purposes. The base QBF investment for HPIP purposes shall be determined by dividing the sum of the total cumulative value of such HPIP property on the last business day of each full calendar month during the portion of the prior taxable year's for which the taxpayer was HPIP certified (recertified) by the number of full calendar months the taxpayer was HPIP certified (recertified) during such prior taxable years. Only HPIP QBF investment that is related to the facility will be in the base.

Line 10 – Enter the street address and city of the qualified business facility.

Line 11 – Complete investment schedule below.

Column (1) – Filing Period.

Lines (a) through (l): Enter the months in the order of the filing period being used by the legal entity.

Column (2): Base year-QBF Monthly Investment. Enter the tax period prior to the tax period of the qualifying credit (Base).

Lines 11(a) through 11(l): Column 2 is used to compute activity at the ABF prior to the year in which a credit is qualified. That is referred to as the "base" year. If the QBF was in operation in the prior year and the taxpayer has been certified previously under the HPIP program, enter the total cumulative value of HPIP investment at this QBF on the last business day of each full calendar month during the portion of the preceding tax year's for which the taxpayer was HPIP certified (recertified).

Line 11(m): Enter the total of 11(a) through 11(l).

Line 11(n): Divide the total in line 11(m) by the number of months of investment.

Line 11(o): Enter the capitalized rents.

Line 11(p): Add line 11(n) and 11(o). This amount will be carried to column 3, line 11(q).

Column (3): Qualifying Year-QBF Monthly Investment. Enter the year you are establishing the current credit.

Lines 11(a) through 11(l): Enter the total cumulative value HPIP investment on the last business day of each full calendar month of operation at the QBF during the portion of the taxable year the QBF was in operation and for which the taxpayer was HPIP certified (recertified). If the QBF was in operation for only three full months during the tax year and the taxpayer was certified for those three months, you would enter the investment for those three months.

Line 11(m): Add lines 11(a) through 11(l).

Line 11(n): Divide line 11(m) by the number of months certified within this tax year.

Line 11(o): Property rented by the taxpayer and used at the QBF is valued at eight times the net annual rental rate.

Line 11(p): Add line 11(n) and 11(o)

Line 11(q): Enter the "base" amount from Column 2, line 11(p).

Line 11(r): Subtract line 11(q) from line 11(p)

Line 11(s): Minimum investment allowed is $50,000.

Line 11(t): Subtract $50,000 from Column 3, line 11(r).

Line 11(u): Multiply line 11(t) by 10%.

Line 12 – Partners, shareholders or members must enter their ownership percentage in the partnership or S corporation. All other taxpayers enter 100%.

Line 13 – Your share of the credit for the amount invested this year. Multiply line 11(u) by line 12.

Line 14 – Enter the total Kansas tax liability for the current tax year after all previously claimed credits (including the HPIP Training and Education Tax Credit calculated in Part B plus any prior year carry forward available).

Line 15 – Enter the lesser of line 13 or line 14. This is the amount of credit that can be used this tax period. Enter this amount on the appropriate line of Form K-40, Form K-41, Form K-120, or Form K-130.

Line 16 - Subtract line 15 from line 13. Do not enter an amount less than zero. This is the amount of credit to be carried forward. Part D will need to be completed for the next tax period.

NOTE: If you are claiming the investment tax credit allowed on line 15, Schedule K-59, you may not claim a business and job development credit on Schedule K-34 using the same QBF investment.

PART D - CARRY OVER SCHEDULE

This schedule is to be used to track the credit carry forward. You will complete a new line for each tax year the credit is carried forward until the credit exhausted or is past the 10 tax years. Once a credit is established, any tax year in which the credit is not claimed will be considered as one of the 10 tax year. To claim remaining credit forward the taxpayer must be recertified.

The taxpayer must be recertified by the Kansas Department of Commerce for the majority of the tax year in which the carry forward is to be claimed, except that no carry forward shall be allowed for deduction after the 10th taxable year succeeding the taxable year in which the credit initially was claimed.

When applying a carry forward credit, you will need to submit the first page of the schedule K-59 with lines 14, 15 and 16 completed.

Lines 17 through 26

a - Tax Year: For line 17, enter the first tax year following the tax year the credit was computed. For lines 18 through 26, enter the tax year succeeding the prior tax year.

b - Certification No.: Enter the certification or recertification number from the Kansas Department of Commerce for this tax year entered on line a.

c - Certification Period: Enter the time period covered under the certification or recertification for the tax year.

d - Carry Forward Amount: For line 17, enter the amount from Part C, line 16. For lines 18 through 26, enter the prior tax year's line f, Part D until the 10 years have expired.

e - Credit Used: Enter the credit amount to be applied against the tax liability of the tax year. Enter this amount on line 15 of Schedule K-59.

f - Carry Forward Available: Subtract line e from line d. This is the amount of credit available for the next tax year. Enter this amount on line 16 of Schedule K-59.

Taxpayer Assistance

Questions you may have about qualifying for the high performance incentive program should be addressed to:

Kansas Department of Commerce
1000 SW Jackson, Suite 100
Topeka, KS 66612-1354
Phone: (785) 296-5298

For assistance in completing this schedule contact:

Taxpayer Assistance Center
Docking State Office Building – 1st Floor
915 SW Harrison St., Topeka, KS 66625-2007

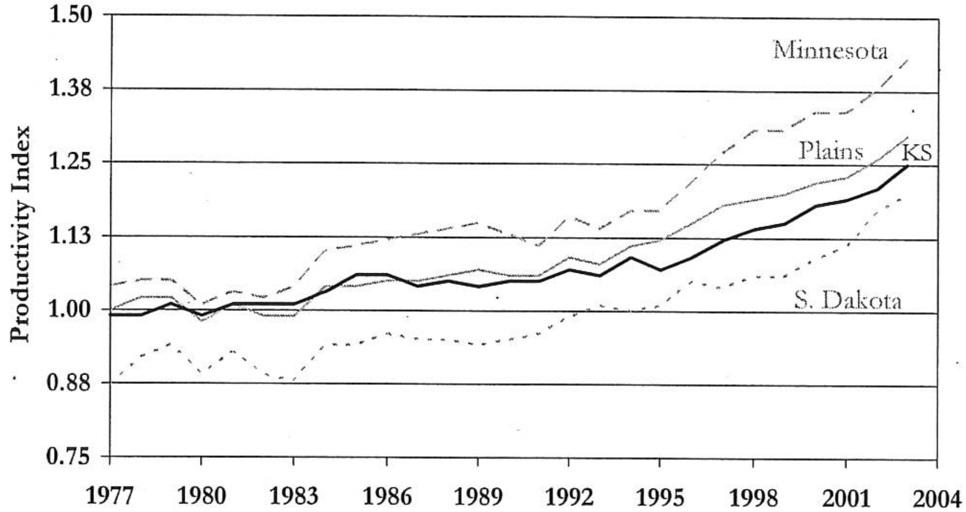
Phone: (785) 368-8222
Hearing Impaired TTY: (785) 296-6461

Additional copies of this schedule and other tax forms are available from our office or web site: **www.ksrevenue.org**

Testimony before the Senate Committee on Assessment and Taxation
Arthur P. Hall, Director, Center for Applied Economics, KU School of Business
March 8, 2006

Productivity in the Plains

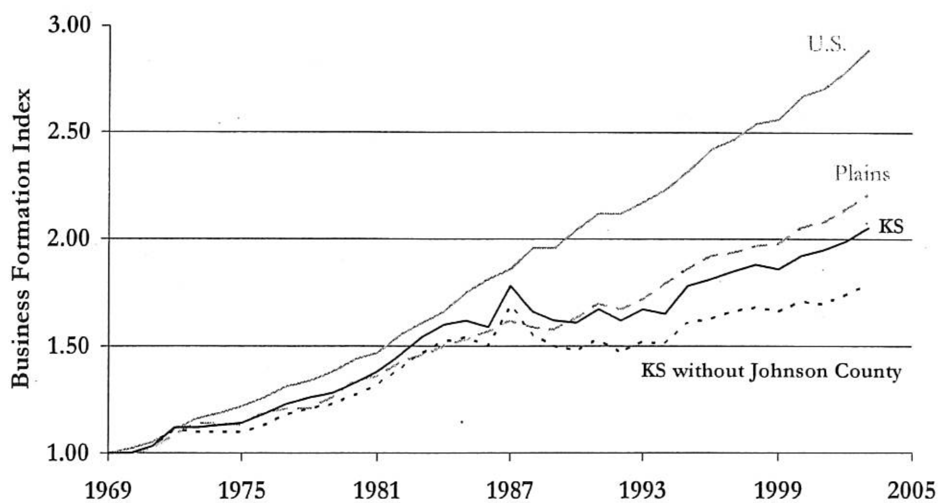
Convergence and Divergence



Source: U.S. Bureau of Economic Analysis and Center for Applied Economics

Rate of New Business Formation

Does Kansas Have a Poor Investment Climate?



Source: U.S. Bureau of Economic Analysis and Center for Applied Economics

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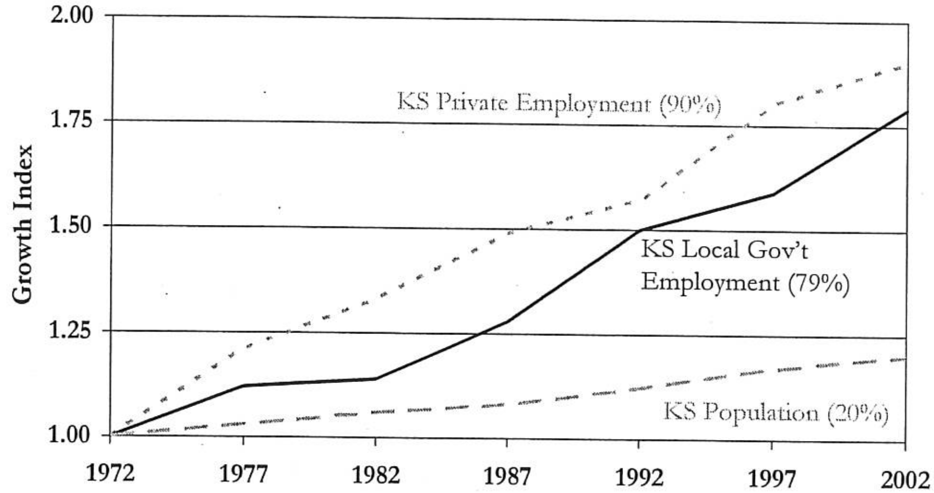
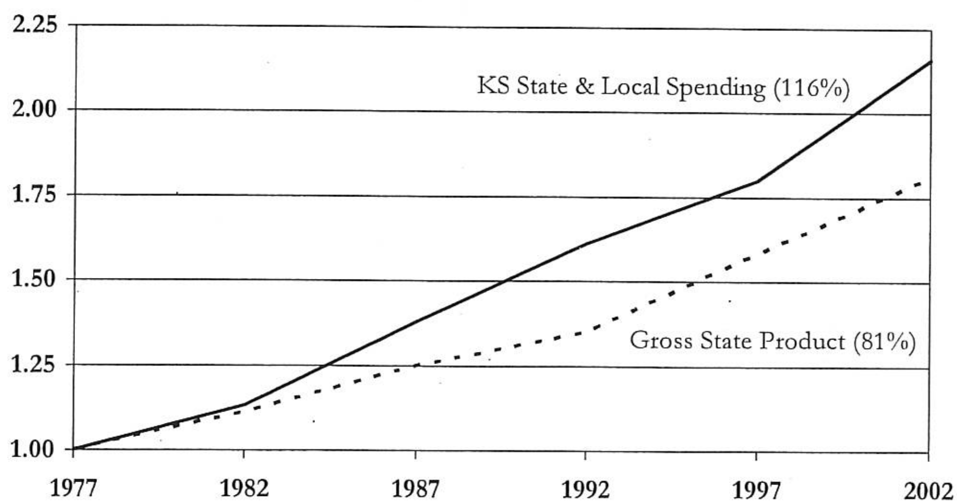
Private vs Local Gov't Employment



Source: U.S. Bureau of Economic Analysis, U.S. Census Bureau, Center for Applied Economics

KS Government Spending and GSP

(Federal Funds Omitted)

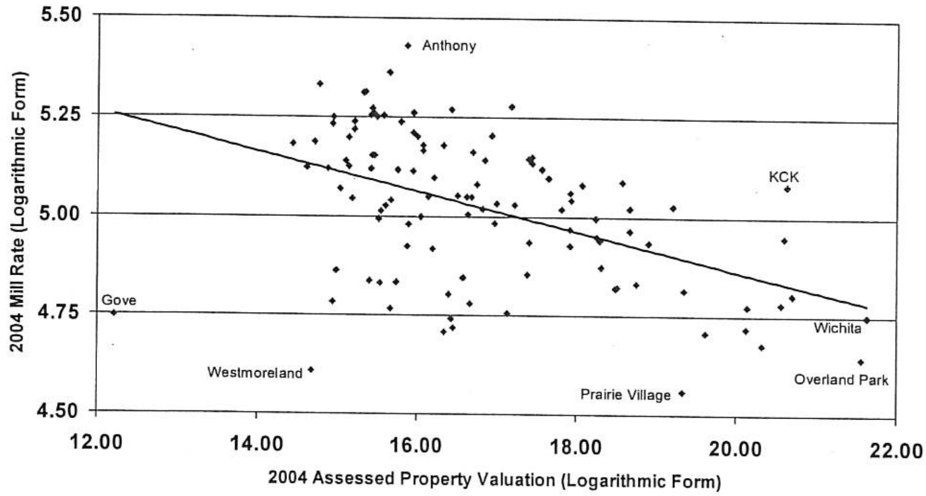


Source: U.S. Bureau of Economic Analysis, U.S. Census Bureau, Center for Applied Economics

4-12

Relationship of Mill Rates to Property Valuation in 112 KS Localities

Are Smaller Localities Stifling their Own Growth with Higher Mills?

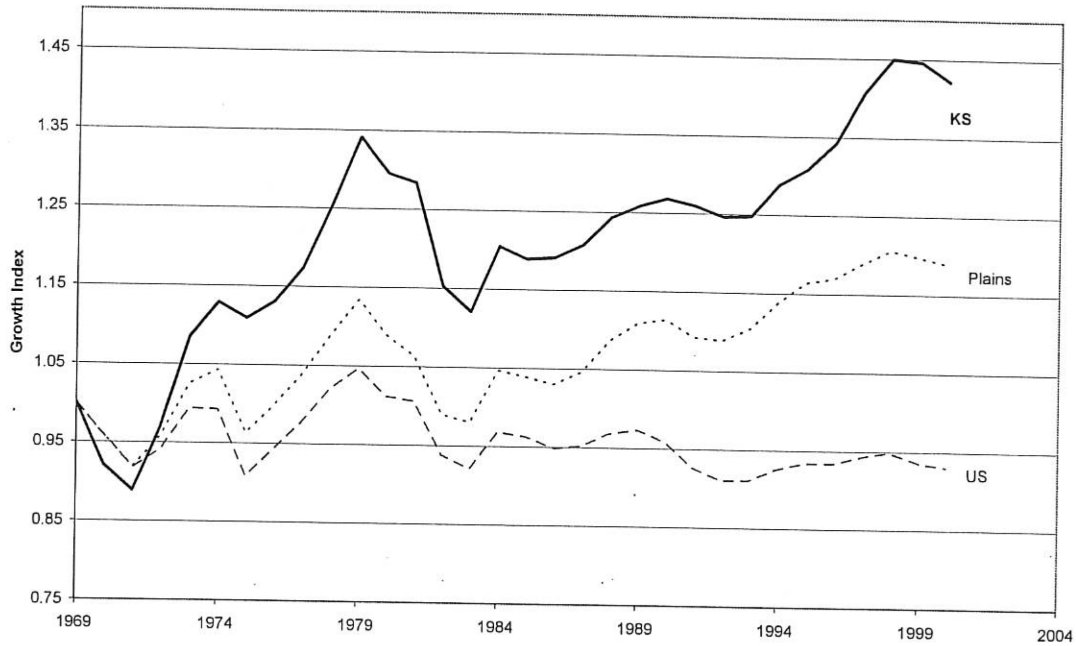


Source: Kansas League of Municipalities, Center for Applied Economics

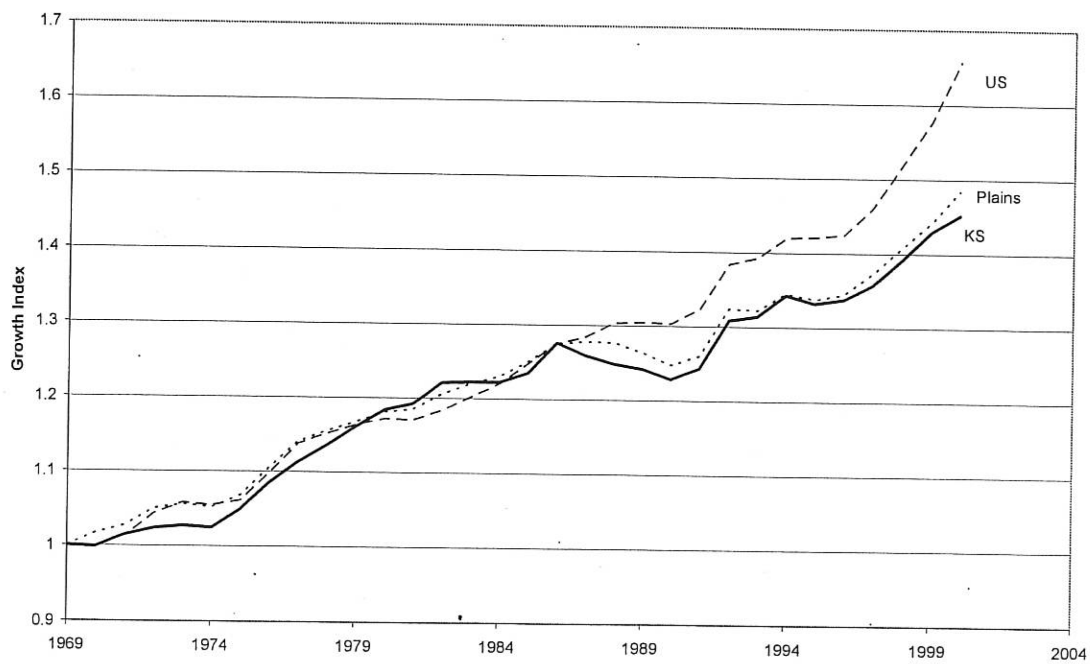
Salient facts and research:

- Kansas is unique among the states in terms of the size and growth rate (over the past 30 years) of its local government sector. Excluding Washington, D.C., Kansas ranks third behind Wyoming and New York in terms of the number of local government employees per capita. This figure includes K-12 education and community colleges.
- Many high-quality academic studies that have investigated cross-country differences in economic growth have shown that, in general, the more the government sector spends as a share of the economy's output (GDP), the slower the economy will grow.
- Research explicitly related to the U.S. states found that "state and local policies have a more profound influence on the private capital-to-labor ratio in a region than on private output. Furthermore, the evidence suggests that the growth of government—whether it be in terms of services or infrastructure—appears to discourage growth of the private sector." The private capital-to-labor ratio is a metric directly related to labor productivity.
- New research has demonstrated that increased public spending—particularly spending on wages—may stifle private investment and growth more than taxation: Among a group of 18 advanced economies, an increase of one percentage point in the ratio of the government wage bill to GDP leads to an immediate decrease in investment as a share of GDP of 0.48 percentage points and a cumulative decrease of 2.56 percentage points after five years.

Manufacturing Employment



Manufacturing Earnings Per Worker



4-14

Returns on a Hypothetical Investment

(10 Year Life, No Salvage Value)

Investment Amount: $1 Million

Senator Barnett's Investment Tax Credit Proposal

Annual Net Cash Flow Before Credit	Rate of Return: No Credit	Rate of Return: with Credit*
100,000	0.00%	1.92%
150,000	8.14%	10.31%
152,500	8.51%	10.70%
155,000	8.88%	11.07%
160,000	9.61%	11.82%
165,000	10.32%	12.56%
170,000	11.03%	13.29%
175,000	11.73%	14.01%
200,000	15.10%	17.50%

* Assumes the entire credit is used after one year. No $50,000 threshold.

House Proposal to Reform Machinery and Equipment Property Tax*

Annual Net Cash Flow Before M&E	Rate of Return: Current Law	Rate of Return: No M&E
100,000	-2.11%	0.00%
150,000	6.20%	8.14%
152,500	6.57%	8.51%
155,000	6.95%	8.88%
160,000	7.68%	9.61%
165,000	8.40%	10.32%
170,000	9.12%	11.03%
175,000	9.82%	11.73%
200,000	13.22%	15.10%

* Assumed Tax Rate: 125 Mills

A Review of Economic Research Related to Taxation and Economic Growth

The effect of state and local fiscal policy on a state's economic performance remains a controversial topic in economic research. Thirty years of effort have produced mostly ambiguous results, especially as regards the magnitude of the negative effects. However, as with any research endeavor, data and research techniques improve over time. The following text highlights the research findings that I find most compelling, based primarily on methodological design.

Taxes and State Economic Performance. The primary challenge that researchers face is isolating the influences of taxation from the many other factors that influence economic decision making. In addition, researchers have tended to focus on average tax rates (primarily because of convenience) rather than the more appropriate measure of marginal tax rates. Here are some useful findings from studies that attempt to control for the standard research deficiencies:

- A 1996 Atlanta fed study that evaluated a 30-year period and made a significant effort to isolate marginal tax rates found concluded that "it appears that state and local taxes have temporary growth effects that are stronger over shorter intervals and a permanent growth effect that does not die out over time, at least for the sample considered. . . . If long-term growth rates seem too low relative to other states, lowering aggregate state and local marginal tax rates is likely to have a positive effect on long-term growth rates. This likelihood is greater if the reduction in marginal tax rates is sustained rather than temporary."

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- A 2004 study published in *Public Finance Review* explicitly evaluated income taxes (rather than tax levels in general) and controlled for other economic factors by focusing on economic growth only in the border counties of each state. "The results show that over a 30-year period from 1960 to 1990, states that raised their income tax rates more than their neighbors had slower income growth and, on average, a 3.4% reduction in per capita income."
- A consistent finding in recent studies indicates that state sales tax policy may have as much or more influence than income tax policy on state economic growth rates. More research is required to provide a cogent explanation of this pattern.
- A 1996 study published in the *American Economic Review* established a method to isolate differences among state tax law as regards foreign direct investment. The study discovered that: (1) state corporate tax rate differences of 1 percentage point were associated with a difference of 9-11 percent in manufacturing-related foreign direct investment, (2) state corporate tax rate differences of 1 percentage point were associated with a difference of three percent in the likelihood of foreign concerns establishing affiliates in a state, and (3) states with zero corporate tax rates (5 of the 50 states) strongly influenced the percentage of foreign direct investment, but not the likelihood of establishing affiliates.
- Taxes constitute only one element of fiscal policy. How states and localities use the revenue they collect is also critically important in a system-wide analysis. The more that each taxpayer perceives that their tax dollars are purchasing value-added services, the less likely it will be that taxes produce a negative influence on economic growth. A best-in-class study published in *The Review of Regional Studies* (2003) produced a set of results consistent with (and more comprehensive than) a set of earlier studies. The table below provides a summary of results for the average state; it compares the effect on growth from financing specific types of services with specific types of tax instruments. A plus-sign (+) indicates a statistically significant positive relationship; a minus-sign a statistically significant negative relationship; a blank, no statistically significant relationship:

The Joint Effect of Taxes and Spending on Key Economic Growth Variables

	Private Employment				Private Investment				Private Production			
	Sales	Property	Income	Corp. Income	Sales	Property	Income	Corp. Income	Sales	Property	Income	Corp. Income
Welfare		-	+		-				-			+
Transportation	+		+		-					+	+	+
Environment					-	-	-	-				
Housing		-			-						+	+
Public Safety	-	-	-	-	-	-			-	-		
Higher Education	-	-	-	-	-	-	-		-	-	-	
K-12 Education	-	-	-	-	-	-	-	-	-	-	-	
Health & Hospitals		-			-	-	-	-	-	-		
Other Gov't Services	+		+		-	-	-					+

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Income Taxes and Self Employment (or Entrepreneurship). In general, published economic research provides ambiguous evidence on the question of income tax rates and self-employment. Some studies even show a positive relationship between tax rates and self-employment, meaning that higher taxes are related with higher rates of self-employment. However, the ambiguous results disappear when research methods make the appropriate distinction between marginal and average income tax rates. Some useful findings:

- Empirical evidence from the advanced industrialized (OECD) economies indicates that marginal and average tax rates have opposite effects on the decision to self-employ. Marginal tax rates have a negative effect on self-employment. Average tax rates have a positive effect on self employment. This finding helps reconcile the ambiguous findings of the traditional literature.
- Consistent with the aforementioned finding, higher degrees of tax rate progressivity are associated with slower rates of self-employment (entrepreneurial entry into the market). A study focused on the U.S. federal tax rate changes of 1993 calculated that the increased spread in marginal tax rates from two percentage points to seven percentage points decreased the probability of entering self-employment by nine percent.
- Yet another study, focused on sole proprietorship investment in the U.S., showed that marginal income tax rates accounted for a significant percentage of the user cost of capital (i.e., the cost of investment); and the user cost of capital was a primary driver of the sole proprietors' investment decision. On average, a ten percent increase in the user cost of capital lowers investment outlays by 17.8 percent (and vise versa). The same study also showed an inverse relationship between the marginal tax rate and the probability of a sole proprietor hiring employees.

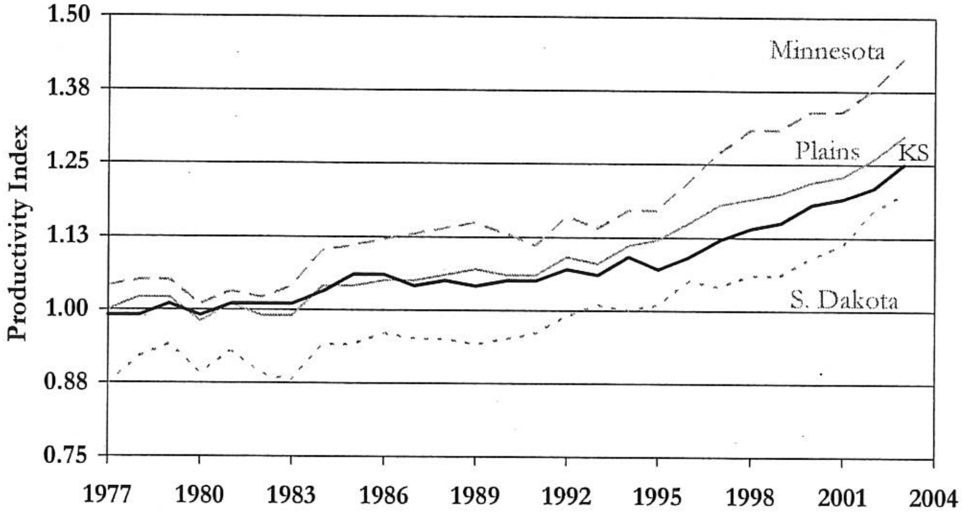
Estate Tax. Overall, economic research findings on the economic effects of the estate tax produce (fragile) evidence that the tax tends to reduce wealth accumulation. Some useful findings:

- Taxable estates that also incur an estate tax liability represent about two percent of adult deaths. About 5 percent of taxable estates (those with estate values of $5 million or more) pay about 50 percent of the estate tax liability. A 1995 study documented that 95 percent of family-owned farms could have passed heirs without estate tax liability under the 1995 rules; a percentage of at least 75 percent would apply to closely held businesses.
- Some research indicates that the estate tax, in effect, acts like a high-rate capital gains tax. One study argued that the estate tax has the same incentive effects on entrepreneurs as a doubling of income tax rates. Another study calculated that the estate tax has the effect of raising the cost of investment capital by between 1.3 and 1.9 percentage points.
- The estate tax rate in effect when a person is 45 years old (or the rate in effect 10 years before death) has a much more (statistically) significant negative influence on wealth accumulation (estate size) than the tax rate prevailing in the year of death.
- One study shows that receipt of a large inheritance raises the probability that the recipient household will start a business; it also increases the probability that the business will survive and expand.

Testimony before the Senate Committee on Assessment and Taxation
Arthur P. Hall, Director, Center for Applied Economics, KU School of Business
March 8, 2006

Productivity in the Plains

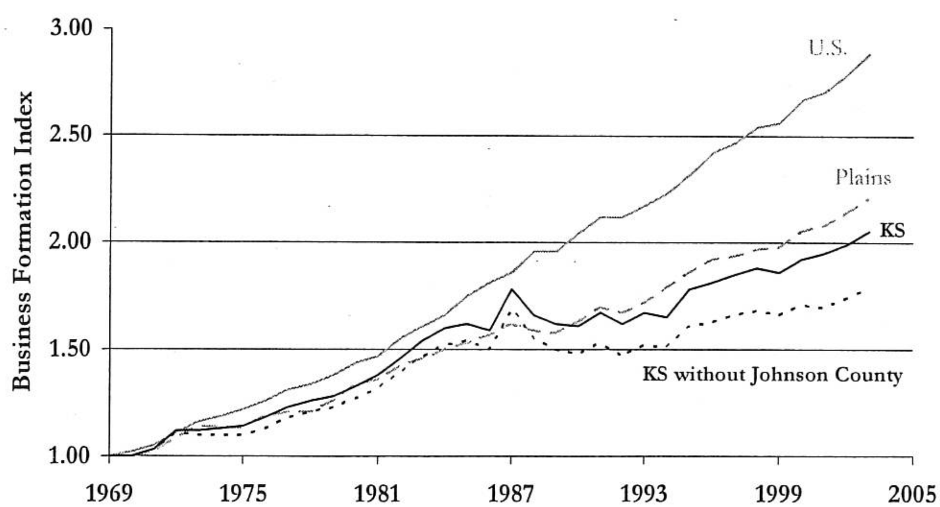
Convergence and Divergence



Source: U.S. Bureau of Economic Analysis and Center for Applied Economics

Rate of New Business Formation

Does Kansas Have a Poor Investment Climate?



Source: U.S. Bureau of Economic Analysis and Center for Applied Economics

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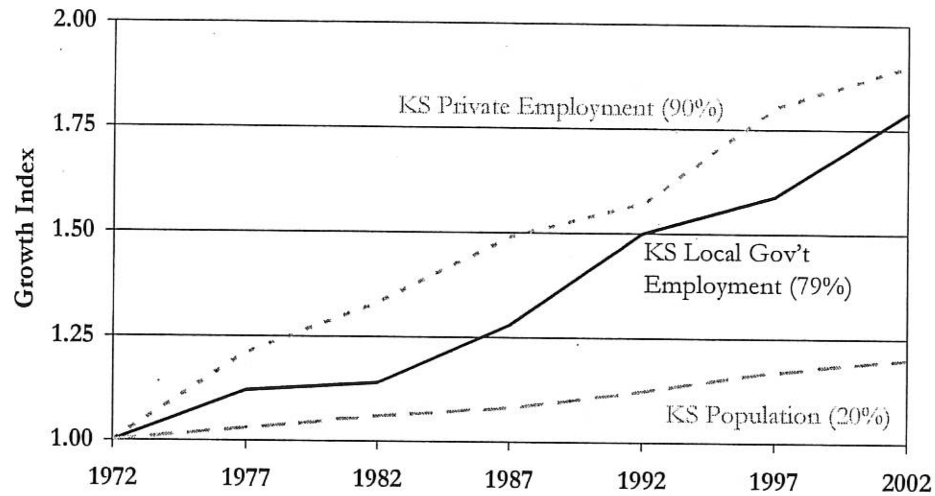
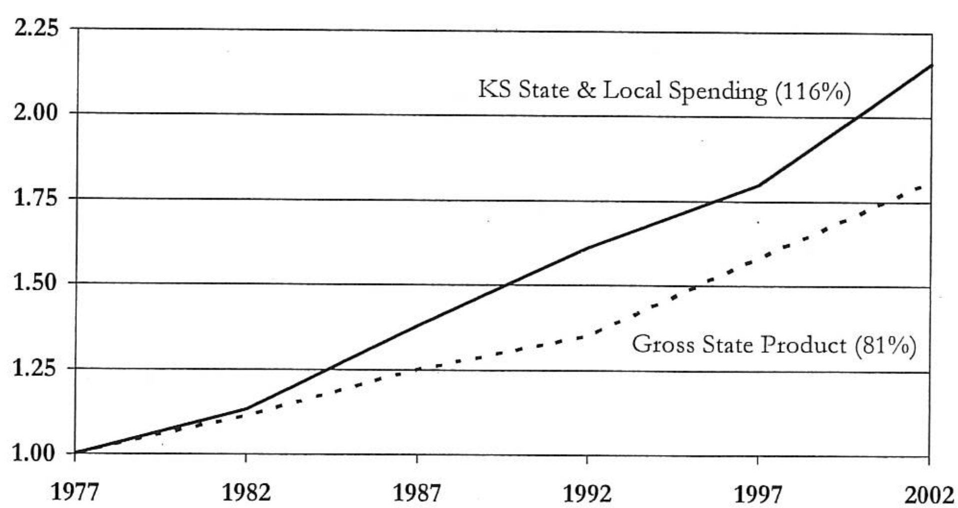
Private vs Local Gov't Employment



Source: U.S. Bureau of Economic Analysis, U.S. Census Bureau, Center for Applied Economics

KS Government Spending and GSP

(Federal Funds Omitted)



Source: U.S. Bureau of Economic Analysis, U.S. Census Bureau, Center for Applied Economics

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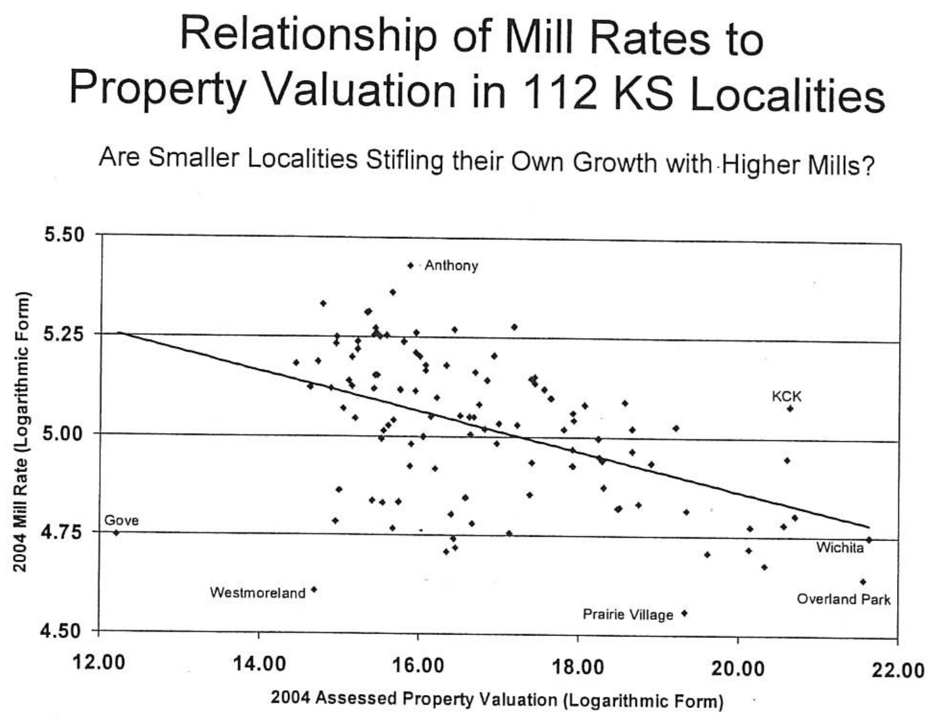

Source: Kansas League of Municipalities, Center for Applied Economics

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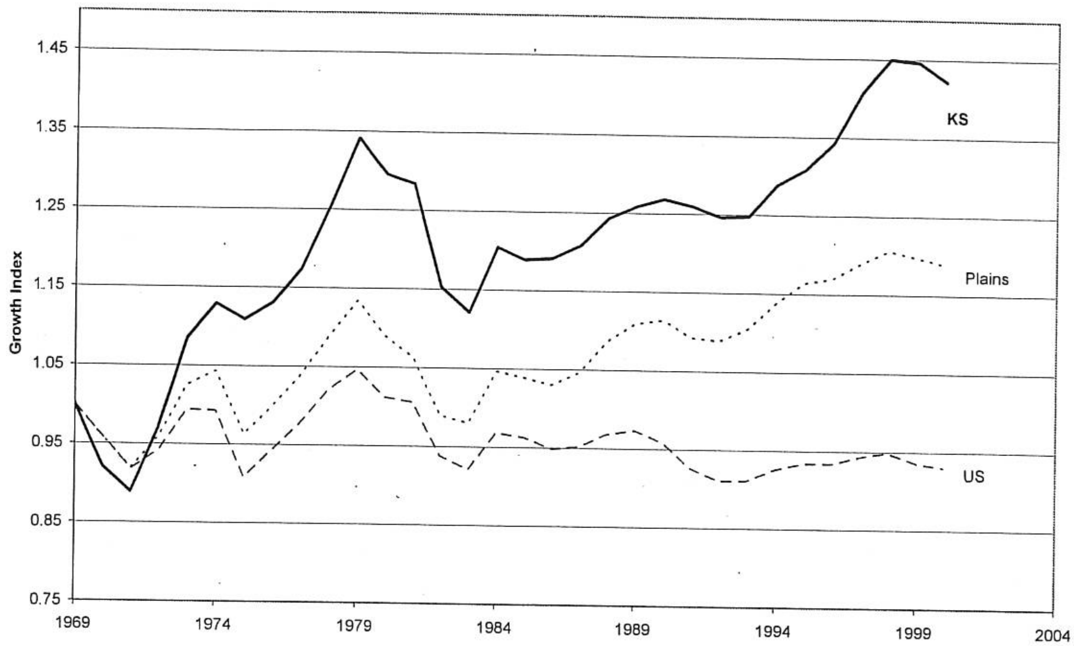
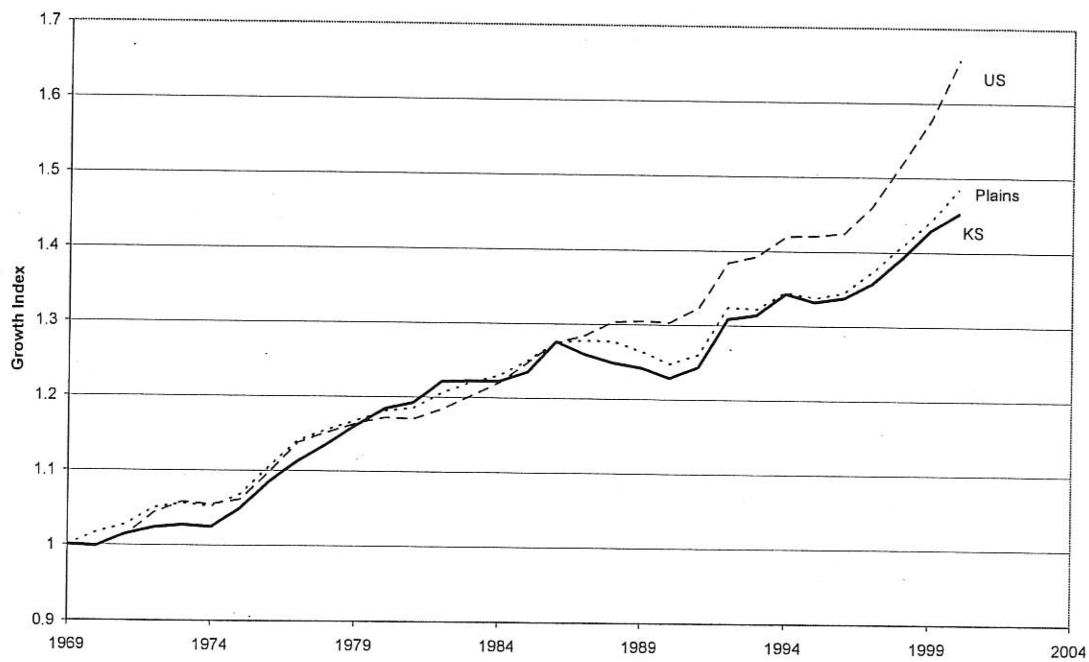
Manufacturing Employment



Manufacturing Earnings Per Worker



4-21

Returns on a Hypothetical Investment
(10 Year Life, No Salvage Value)

Investment Amount: $1 Million

Senator Barnett's Investment Tax Credit Proposal

Annual Net Cash Flow Before Credit	Rate of Return: No Credit	Rate of Return: with Credit*
100,000	0.00%	1.92%
150,000	8.14%	10.31%
152,500	8.51%	10.70%
155,000	8.88%	11.07%
160,000	9.61%	11.82%
165,000	10.32%	12.56%
170,000	11.03%	13.29%
175,000	11.73%	14.01%
200,000	15.10%	17.50%

* Assumes the entire credit is used after one year. No $50,000 threshold.

House Proposal to Reform Machinery and Equipment Property Tax*

Annual Net Cash Flow Before M&E	Rate of Return: Current Law	Rate of Return: No M&E
100,000	-2.11%	0.00%
150,000	6.20%	8.14%
152,500	6.57%	8.51%
155,000	6.95%	8.88%
160,000	7.68%	9.61%
165,000	8.40%	10.32%
170,000	9.12%	11.03%
175,000	9.82%	11.73%
200,000	13.22%	15.10%

* Assumed Tax Rate: 125 Mills

A Review of Economic Research Related to Taxation and Economic Growth

The effect of state and local fiscal policy on a state's economic performance remains a controversial topic in economic research. Thirty years of effort have produced mostly ambiguous results, especially as regards the magnitude of the negative effects. However, as with any research endeavor, data and research techniques improve over time. The following text highlights the research findings that I find most compelling, based primarily on methodological design.

Taxes and State Economic Performance. The primary challenge that researchers face is isolating the influences of taxation from the many other factors that influence economic decision making. In addition, researchers have tended to focus on average tax rates (primarily because of convenience) rather than the more appropriate measure of marginal tax rates. Here are some useful findings from studies that attempt to control for the standard research deficiencies:

- A 1996 Atlanta fed study that evaluated a 30-year period and made a significant effort to isolate marginal tax rates found concluded that "it appears that state and local taxes have temporary growth effects that are stronger over shorter intervals and a permanent growth effect that does not die out over time, at least for the sample considered. . . . If long-term growth rates seem too low relative to other states, lowering aggregate state and local marginal tax rates is likely to have a positive effect on long-term growth rates. This likelihood is greater if the reduction in marginal tax rates is sustained rather than temporary."

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- A 2004 study published in *Public Finance Review* explicitly evaluated income taxes (rather than tax levels in general) and controlled for other economic factors by focusing on economic growth only in the border counties of each state. "The results show that over a 30-year period from 1960 to 1990, states that raised their income tax rates more than their neighbors had slower income growth and, on average, a 3.4% reduction in per capita income."
- A consistent finding in recent studies indicates that state sales tax policy may have as much or more influence than income tax policy on state economic growth rates. More research is required to provide a cogent explanation of this pattern.
- A 1996 study published in the *American Economic Review* established a method to isolate differences among state tax law as regards foreign direct investment. The study discovered that: (1) state corporate tax rate differences of 1 percentage point were associated with a difference of 9-11 percent in manufacturing-related foreign direct investment, (2) state corporate tax rate differences of 1 percentage point were associated with a difference of three percent in the likelihood of foreign concerns establishing affiliates in a state, and (3) states with zero corporate tax rates (5 of the 50 states) strongly influenced the percentage of foreign direct investment, but not the likelihood of establishing affiliates.
- Taxes constitute only one element of fiscal policy. How states and localities use the revenue they collect is also critically important in a system-wide analysis. The more that each taxpayer perceives that their tax dollars are purchasing value-added services, the less likely it will be that taxes produce a negative influence on economic growth. A best-in-class study published in *The Review of Regional Studies* (2003) produced a set of results consistent with (and more comprehensive than) a set of earlier studies. The table below provides a summary of results for the average state; it compares the effect on growth from financing specific types of services with specific types of tax instruments. A plus-sign (+) indicates a statistically significant positive relationship; a minus-sign a statistically significant negative relationship; a blank, no statistically significant relationship:

The Joint Effect of Taxes and Spending on Key Economic Growth Variables

	Private Employment				Private Investment				Private Production			
	Sales	Property	Income	Corp. Income	Sales	Property	Income	Corp. Income	Sales	Property	Income	Corp. Income
Welfare		-	+		-				-			+
Transportation	+		+		-					+	+	+
Environment					-	-	-	-				
Housing		-			-						+	+
Public Safety	-	-	-	-	-	-			-	-		
Higher Education	-	-	-	-	-	-	-		-	-	-	
K-12 Education	-	-	-	-	-	-	-	-	-	-	-	
Health & Hospitals		-			-	-	-	-	-	-		
Other Gov't Services	+		+		-	-	-					+

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Income Taxes and Self Employment (or Entrepreneurship). In general, published economic research provides ambiguous evidence on the question of income tax rates and self-employment. Some studies even show a positive relationship between tax rates and self-employment, meaning that higher taxes are related with higher rates of self-employment. However, the ambiguous results disappear when research methods make the appropriate distinction between marginal and average income tax rates. Some useful findings:

- Empirical evidence from the advanced industrialized (OECD) economies indicates that marginal and average tax rates have opposite effects on the decision to self-employ. Marginal tax rates have a negative effect on self-employment. Average tax rates have a positive effect on self employment. This finding helps reconcile the ambiguous findings of the traditional literature.
- Consistent with the aforementioned finding, higher degrees of tax rate progressivity are associated with slower rates of self-employment (entrepreneurial entry into the market). A study focused on the U.S. federal tax rate changes of 1993 calculated that the increased spread in marginal tax rates from two percentage points to seven percentage points decreased the probability of entering self-employment by nine percent.
- Yet another study, focused on sole proprietorship investment in the U.S., showed that marginal income tax rates accounted for a significant percentage of the user cost of capital (i.e., the cost of investment); and the user cost of capital was a primary driver of the sole proprietors' investment decision. On average, a ten percent increase in the user cost of capital lowers investment outlays by 17.8 percent (and vise versa). The same study also showed an inverse relationship between the marginal tax rate and the probability of a sole proprietor hiring employees.

Estate Tax. Overall, economic research findings on the economic effects of the estate tax produce (fragile) evidence that the tax tends to reduce wealth accumulation. Some useful findings:

- Taxable estates that also incur an estate tax liability represent about two percent of adult deaths. About 5 percent of taxable estates (those with estate values of $5 million or more) pay about 50 percent of the estate tax liability. A 1995 study documented that 95 percent of family-owned farms could have passed heirs without estate tax liability under the 1995 rules; a percentage of at least 75 percent would apply to closely held businesses.
- Some research indicates that the estate tax, in effect, acts like a high-rate capital gains tax. One study argued that the estate tax has the same incentive effects on entrepreneurs as a doubling of income tax rates. Another study calculated that the estate tax has the effect of raising the cost of investment capital by between 1.3 and 1.9 percentage points.
- The estate tax rate in effect when a person is 45 years old (or the rate in effect 10 years before death) has a much more (statistically) significant negative influence on wealth accumulation (estate size) than the tax rate prevailing in the year of death.
- One study shows that receipt of a large inheritance raises the probability that the recipient household will start a business; it also increases the probability that the business will survive and expand.

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