MINUTES

SPECIAL COMMITTEE ON ASSESSMENT AND TAXATION

September 16-17, 2010
Room 548-S—Statehouse

Members Present

Representative Richard Carlson, Chairperson
Senator Les Donovan, Vice-chairperson
Senator Terrie Huntington
Senator Dick Kelsey
Senator Janis Lee (Thursday only)
Senator Bob Marshall
Representative Lisa Benlon
Representative Stan Frownfelter (Thursday only)
Representative Jeff King
Representative Marvin Kleeb
Representative Julie Menghini
Representative Don Schroeder
Representative Sharon Schwartz

Staff Present

Chris Courtwright, Kansas Legislative Research Department
Reed Holwegner, Kansas Legislative Research Department
Gordon Self, Office of the Revisor of Statutes
Scott Wells, Office of the Revisor of Statutes
Marla Morris, Committee Assistant

Conferees

Representative Arlen Siegfreid
Willis Heck, Chairman, Kansas Advisory Council on Intergovernmental Relations (KACIR)
Joan Wagnon, Secretary, Kansas Department of Revenue
Steve Stotts, Kansas Department of Revenue
Senator Dick Kelsey
Randall Allen, Kansas Association of Counties
Daniel Murray, National Federation of Independent Business
John Stephenson, National Taxpayers' Union
Rodney Steven, Genesis Health Clubs
Greg Ferris, Kansas Association of Health and Fitness Clubs

Mark Tallman, Kansas Association of School Boards
Don Moler, League of Kansas Municipalities
Dr. Art Hall, Center for Applied Economics, University of Kansas School of Business
Dave Trabert, Kansas Policy Institute
Joseph R. Crosby, Policy Council on State Taxation
Jonathan Williams, American Legislative Exchange Council
Denise Walsh, Hill's Pet Nutrition, Inc.
Earl Long, Fair Tax KC
Kent Eckles, Kansas Chamber of Commerce

Others Attending

See attached list.

Thursday, September 16
Morning Session

The meeting was called to order by Chairperson Carlson at 10:18 a.m. in Room 548-S, Statehouse.

Chairperson Carlson introduced Senator Les Donovan, Vice-chairperson, and Ranking Minority Member, Representative Julie Menghini. Chairperson Carlson briefed the group on the intended structure of the three-days of Committee meetings.

Chairperson Carlson explained the Legislative Coordinating Council's (LLC's) charge to the Committee to:

- Review the Kansas tax structure and ways it can be improved and simplified;
- Study the overall tax structure and policy of the state and local units of government by reviewing the relationship of the various taxes imposed to each other and to the economy;
- Review ways to identify a fair, simple, and effective tax structure that operates in the best interests of all Kansas citizens;
- Study ways to decrease tax rates by broadening the tax bases, as well as studying the potential effects of a fair and flat consumption tax and a flat and simplified income tax; and
- Review what current taxes could be eliminated if such new tax were to be imposed.

The Chairperson requested all interested parties prepare suggestions for simplifying and improving the state and local tax structure; and for encouraging additional capital investment in the private sector and economic development through significant income or property tax reform, or both.

Vice-chairperson Donovan stated he looked forward to the opportunity to hear the various proposals offering fair tax reforms and suggestions on improving Kansas and ways to bring more jobs to the state. Representative Menghini expressed her interest in listening to the information offered and working to implement methods to create a more broad-based tax system.

Chris Courtwright, Kansas Legislative Research Department (KLRD), presented an overview of the charge presented to the Committee (Attachment 1). He discussed and provided the following documents for consideration by the Committee:

- Legislative Adjustments to Consensus Estimates for FY 2010 and FY 2011 (Attachment 2);
- State General Fund Receipts FY 2010 (Attachment 3);
- Draft State General Fund (SGF) Receipts, July-August FY 2011 (Attachment 4);
- Various tables representing Kansas State and Local Taxes for FY 2008-FY 2010 (Attachment 5);
- Residential Exemption Summary from the Division of Property Valuation presenting data in response to a request from a Committee member concerning a 20 mill levy (Attachment 6);
- Conclusions and Recommendations from 2006 Special Committee on Assessment and Taxation State and Local Tax Policy (Attachment 7); and
- Pages 2-33 from the 2006 Special Committee on Assessment and Taxation State and Local Tax Policy Conclusions and Recommendations—recommended questions to be asked and answered by all parties seeking sales tax exemption legislation (Attachment 8).

Reed Holwegner, KLRD, briefed the Committee on the potential agenda items for the November 12, 2010, meeting of the Special Committee on Assessment and Taxation. He directed the Committee members' attention to the following documents that could be presented at the November meeting by staff from the Legislative Division of Post Audit:

- February 2010 Legislative Division of Post Audit Performance Audit Report—Kansas Tax Revenues, Part II: Reviewing Sales Tax Exemptions (available from the Kansas Legislative Research Department); and
- Highlights—February 2010 Legislative Division of Post Audit Performance Audit Report Highlights (Attachment 9).

Chairperson Carlson called a recess at 11:55 a.m.

Afternoon Session

Chairperson Carlson called the meeting to order at 1:35 p.m.

Representative Arlen Siegfreid testified in support of the Simplified State Tax Structure Committee (Attachment 10). He authored and presented the proposal which passed the House during the 2010 Legislative Session. "HB 2463 - Establishing the Simplified State Tax Structure" aimed to assemble members of the House and Senate Tax Committees to accomplish three goals:

- Review the current tax structure to recognize inefficiencies and redundancies;
- Submit recognition on how to streamline our tax structures; and
- Develop a strategy to broaden and flatten the tax base while investigating the consequences to all citizens.

Representative Siegfreid encouraged the Committee to take the initial step and support the proposal.

Willis Heck, Chairman, Kansas Advisory Council on Intergovernmental Relations (KACIR), and Mayor of Newton, Kansas, presented KACIR's recommendations to address the erosion of the tax base and the imbalance in the state's three major funding sources: property tax, sales tax, and income tax (Attachment 11). KACIR presented its *Tax-Base Policy Evaluation Guide* to the Committee members to provide them a means for accessing tax exemptions and credits. A copy of the guide is available through KACIR.

Joan Wagnon, Secretary, Kansas Department of Revenue (KDOR), presented testimony supporting a review of the current tax policies (Attachment 12). She recommended eliminating all sales tax exemptions, with exception to the sales tax on lottery tickets and food stamps, which are required by law.

She provided the following documents to assist in the study of current tax policy:

- 1995 Report of the Governor's Tax Equity Task Force (Attachment 13);
- Kansas Tax Credits-Tax year 2007 (Attachment 14);
- List of State Sales Tax Exemptions—Listed by Group (Attachment 15);
- State Sales Tax Exemption Fiscal Impact Estimate—All Funds (Attachment 16); and
- State Sales Tax Exemption Summary—Listed by Statute Cite (Attachment 17).

Steve Stotts, KDOR, presented information on a flat tax comparison (Attachment 18).

Mr. Stotts provided the following information on broad-based sales tax, also known as a fair tax or consumption tax, for comparison and consideration:

- A copy of the State of Missouri Senate Committee Substitute Senate Joint Resolution No. 29 from the 95th General Assembly (Attachment 19);
- Committee on Legislative Research Oversight Division, Fiscal Note, State of Missouri (Attachment 20); and
- Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System—Report on the President's Advisory Panel on Federal Tax Reform, November 2005 (Attachment 21).

Senator Dick Kelsey presented a comprehensive proposal, put together in coordination with Chris Courtwright, KLRD, that would make major changes in the state tax structure (Attachment 22).

The proposal included:

- Eliminating sales tax on food, but not to include food served at restaurants;
- Eliminating corporate income tax;
- Reducing individual income tax; and
- Reducing state sales tax by 1.0 percent.

Senator Kelsey asked Secretary Wagnon to share her comments and stand with him for questions, as she worked closely with him on this proposal. She stated his numbers are accurate and the approach is acceptable. Senator Kelsey, Secretary Wagnon, Chris Courtwright, and Steve Stotts stood for questions.

Randall Allen, Executive Director, Kansas Association of Counties, offered comments on the state and local tax structure on behalf of the 102 member counties he represents (Attachment 23).

Daniel Murray, National Federation of Independent Business (NFIB), presented testimony on behalf of small business owners throughout Kansas (Attachment 24). He urged the Committee to keep in mind the unique challenges that face small businesses when considering the Kansas tax structure.

John Stephenson, National Taxpayers Union (NTU), proposed the following three reforms for the Committee to consider (Attachment 25):

- Lower tax rates or eliminate certain taxes;
- Implement property caps; and
- Index income taxes to inflation.

His testimony provided statistics relating to where Kansas ranks on a national level.

Rodney Steven II, President, Genesis Health Club, asked the Committee to establish fairness in the tax treatment of health clubs (Attachment 26). He referred to the exempt status of the Wichita YMCA as a basis for his request.

Greg Ferris, Kansas Health and Fitness Association, representing taxpaying clubs in cities from Kansas City to Garden City, testified to the inequity in the tax exempt status of certain clubs (Attachment 27).

Chairperson Carlson adjourned the meeting at 4:50 p.m.

Friday, September 17
Morning Session

Chairperson Carlson called the meeting to order at 9:15 a.m. Representative Lukert was appointed by House Minority Leader Paul Davis, to serve on the Special Committee on Assessment and Taxation in the absence of Representative Stan Frownfelter.

Mark Tallman, Kansas Association of School Boards (KASB), presented the views of the KASB pertaining to improving the state's tax system for the benefit of all Kansans. Mr. Tallman's testimony offered recommendations and observations from the perspective of tax policy regarding public education (Attachment 28).

Don Moler, League of Kansas Municipalities (LKM), testified on behalf of the LKM member cities concerning state and local tax policy and the erosion of the sales and property tax bases (Attachment 29).

Dr. Art Hall, Executive Director, Center for Applied Economics, University of Kansas School of Business, provided an informational handout (Attachment 30) concerning "expensing," or permitting all businesses to take an immediate income tax writeoff for new investments made in Kansas. His testimony addressed his research report, *Embracing Dynamism: The Next Phase in Kansas Economic Development Policy* (Attachment 31).

Dave Trabert, President, Kansas Policy Institute, presented input for the promotion of economic growth and exploring how Kansas' tax policy can be optimized to create jobs and spur economic development (Attachment 32).

Joseph R. Crosby, Chief Operating Officer and Senior Director, Policy Council on State Taxation (COST), presented testimony on COST's view of the Kansas tax system (Attachment 33). COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional entities.

Chairperson Carlson called a recess at 11:50 a.m.

Afternoon Session

Chairperson Carlson reconvened the meeting at 1:20 p.m.

Jonathan Williams, Director, Tax and Fiscal Policy Task Force, American Legislative Exchange Council (ALEC), presented a summary of ALEC's guiding principles of tax reform (Attachment 34). He offered data presented in the book *Rich States, Poor States,* published by ALEC. (A copy of the book is available through Kansas Legislative Research Department).

Denise Walsh, Director of Corporate Taxes, Hill's Pet Nutrition, Inc., presented comments and suggestions on how to encourage additional capital investment in the private sector and economic development through tax reform (Attachment 35).

Earl Long, Fair Tax KC, presented a proposal of a simple tax system for consideration (Attachment 36). The system he recommends is called The ONE TAX Plan. Included with his written testimony is a copy of Dr. Art Hall's paper "A Comprehensive Retail Sales Tax for the State of Kansas" (Attachment 37).

Kent Eckles, Vice-president of Government Affairs, Kansas Chamber of Commerce, testified in favor of the reform of the state's tax structure to spur economic growth in Kansas (Attachment 38).

Chairperson Carlson asked the members to carefully consider the information received for the purpose of coming to a consensus and moving forward with a new tax policy.

The Committee will meet next on Friday, November 12, 2010, in Room 548-S, Statehouse. The meeting adjourned at 2:45 p.m.

Prepared by Marla Morris
Edited by Reed Holwegner

Approved by Committee on:

November 12, 2010
(Date)

50933 RLH

~~HOUSE TAXATION COMMITTEE~~
Special Committee on Assessment & Taxation

DATE: 9-16-10

NAME	REPRESENTING
Derek Hein	Hein Law Firm
Larry R Baer	LKM
Kent Eckles	KS Chamber of Commerce
Mike Taylor	Unified Gov/Wyco-KCK
Rob Mealy	Kearney & Assoc
Terry Forsyth	KNEA
Melissa Wangemann	KAC
Christy Caldwell	Topeka Chamber
Berend Koops	Hein Law Firm
Larry Berg	City of Hays
Michelle Butler	Capitol Strategies
Dodie Wellshear	Ad Astra Group
Gene Meyer	Kansas Reporter
Mark Tallman	KASB
John Stephenson	National Taxpayers Union
Ron Seeber	KGFA/KARA/KAEP
Dan Murray	NFIB
Whitney Damron	ONEOK, Inc
Dana Fiske	VZW
Mike Murray	Capitol Advantage
Leslie Kaufman	Ks Co-op Council

HOUSE TAXATION COMMITTEE

DATE: 9-16-10

NAME	REPRESENTING
Jenni Rose	KCSL
Randall Allen	Ks. Association of Counties
Dan Moler	LKM
Natalie Haag	Security Benefit
Lindsey Douglas	KDOT

~~HOUSE TAXATION COMMITTEE~~
Special Committee on Assessment & Taxation

DATE: September 17, 2010

NAME	REPRESENTING
Mark Tallman	KASB
Kent Eckles	Kansas Chamber
JOE CROSBY	COUNCIL ON STATE TAXATION
Dan Korber	KS Inc
Michelle Butler	Cap. Strategies
Sandy Braden	GBA
Bob Vancrum	GKC Chamber
TRAVIS LOWE	Little Govt Relations
Mike Murray	Capital Advantage
Leslie Kaufman	Ks Coop Council

KANSAS LEGISLATIVE RESEARCH DEPARTMENT
68-West–Statehouse, 300 SW 10th Ave.
Topeka, Kansas 66612-1504
(785) 296-3181 ◆ FAX (785) 296-3824

kslegres@klrd.ks.gov http://www.kslegislature.org/klrd

September 13, 2010

To: Special Committee on Assessment and Taxation

From: Chris W. Courtwright, Principal Economist

Re: Interim Study on State and Local Tax Structure Optimization

During the 2010 Session, the House approved HB 2463, which would have established a tax study commission with a two-year charge to travel the state while analyzing ways the Kansas state and local tax structure can be improved and simplified. Although that legislation not acted upon by the Senate, the Legislative Coordinating Council (LCC) subsequently approved a request by Representative Carlson to establish a more traditional interim tax committee based in Topeka with a virtually identical charge.

The Special Committee on Assessment and Taxation is asked to study the overall tax structure and policy of the state and local units by reviewing the relationship of the various taxes imposed to each other and to the economy; and seek to identify a fair, simple and effective tax structure that operates in the best interests of all Kansas citizens. The Committee specifically is charged with looking at ways to decrease tax rates by broadening tax bases, as well as studying the potential effects of a fair and flat consumption tax and a flat and simplified income tax. In addition, the Committee is to explore what current taxes could be eliminated if a new such tax were to be imposed. Finally, the Committee should make whatever recommendations it deems appropriate to the incoming 2011 Kansas Legislature.

Capital Investment; Income and Property Tax Reform

Chairman Carlson has outlined one critical component to the study by calling for public testimony (in addition to providing input on tax structure simplification) to focus on tax policy changes that would encourage additional private-sector capital investment, with particular emphasis on income and property tax reform ideas.

Many of these ideas are expected to be provided during the public hearings at the September 16-17 meeting.

Tax "Expenditures"

A second important component to the charge obviously involves the broadening of tax bases (via potential elimination of exemptions, credits, and other loopholes) in the name of tax equity, overall simplicity, and improved administrative efficiency.

> "Both tax exemptions and tax-deductibility are a form of subsidy that is administered through the tax system. A tax exemption has much the same effect as a cash grant to the organization of the amount of tax it would have to pay on its income."
>
> *Regan v. Taxation With Representation of Washington, 461 U.S. 540*
> (Written by Former Justice Rehnquist for a Unanimous Court)

This language from the US Supreme Court equating tax exemptions and government subsidies in essence suggests that there is no practical difference between an exemption and an appropriation.

For the sales tax, the number of "tax expenditures" enacted by explicit exemptions has tended to increase every year (while at the same time the percentage of consumption expenditures associated with certain services which do not have a visible exemption also has continued to grow). This narrowing of the tax base is a major factor behind the declining elasticity of the sales tax.

For the income tax, "tax expenditures" can take any number of different forms, including tax credits; accelerated depreciation or expensing; and deductions or other adjustments to income.

KANSAS LEGISLATIVE RESEARCH DEPARTMENT

68-West–Statehouse, 300 SW 10th Ave.
Topeka, Kansas 66612-1504
(785) 296-3181 ◆ FAX (785) 296-3824

kslegres@klrd.ks.gov http://www.kslegislature.org/klrd

June 1, 2010

To: Governor Mark Parkinson and Legislative Budget Committee

From: Chris W. Courtwright, Principal Economist

Re: Legislative Adjustments to Consensus Estimates to FY 2010 and FY 2011

Pursuant to KSA 75-6701, the Legislative Research Department and Division of the Budget have adjusted the most recent estimates of State General Fund (SGF) receipts for FY 2010 and FY 2011. These adjustments reflect the fiscal impact of legislation involving receipts to the SGF enacted during the 2010 Legislative Session subsequent to the Consensus Revenue Estimate made on April 16, 2010. The attached tables show changes by source and incorporate those changes into the overall estimates for FY 2010 and FY 2011. FY 2010 receipts were increased by $36.731 million relative to the April estimate, attributable to several changes in transfers enacted in the omnibus appropriations bill. FY 2011 receipts were increased by $672.529 million, with much of the difference attributable to a sales and use tax rate increase and numerous adjustments to transfers.

An additional section has been added to this report discussing the implications for SGF receipts in FY 2012 relative to certain legislation enacted in 2010 and prior years.

The Consensus Group will meet again prior to December 4 to consider revisions to the newly adjusted FY 2011 estimate and to make an initial estimate for FY 2012.

FY 2010

The following FY 2010 adjustment was made:

House Sub. for SB 572, the omnibus bill, increased the estimate for net transfers by $36.731 million, with the major change attributable to an additional $38.0 million transfer from the State Highway Fund (SHF) to the SGF ($10.0 million of which will be additional federal funds received as a result of enactment of a primary safety belt law in HB 2130).

FY 2011

The following FY 2011 adjustments were made:

SB 430 contains a number of provisions that will impact FY 2011 receipts, including various changes to 2009 legislation designed to provide a "haircut" for selected income tax credits; amendments to a number of different tax statutes relative to the definition of the term "willfully"; and the imposition of a small fee under certain circumstances for taxpayers' entering into installment payment plans. In addition, the Department of Revenue is expected to use the new fee revenues to hire additional personnel to enhance delinquent tax collections. The combined provisions of the bill increase SGF receipts by $0.588 million. Relative to specific tax sources, the individual income tax estimate is increased by $0.775 million; the sales tax estimate is increased by $2.043 million; and the financial institutions privilege tax estimate is decreased by $2.230 million.

Senate Sub. for HB 2360, which raises the sales and use tax rate on July 1 from 5.3 to 6.3 percent, also adjusts several disposition of revenue provisions, expands the food sales tax rebate program, and expands the earned income tax credit program -- all of which combine to increase SGF receipts by a total of $303.636 million. The sales tax estimate is increased by $277.568 million; the use tax estimate is increased by $41.068 million; and the individual income tax estimate is decreased by $15.000 million.

House Sub. for SB 572, the omnibus bill, increases SGF receipts by a total of $368.185 million. Of this amount, an $8.0 million ($6.4 million individual income tax and $1.6 million sales tax) increase is attributable to a tax amnesty that will run from September 1 to October 15; and $360.185 million is attributable to numerous changes in transfers. Notable transfer adjustments include a new transfer of $149.3 million from the SHF; elimination of a $44.0 million "slider" payment to local units of government; reduction of $35.0 million in a transfer to the Biosciences Initiatives Fund; elimination of a $10.1 million transfer to the Special City and County Highway Fund; and inclusion of $33.0 million in additional transfers from the Expanded Lottery Act Revenues Fund ($8.0 million of which will come from expanded gaming proceeds; and $25.0 million of which come as a result of the South Central gaming zone privilege fee originally expected to have been received in FY 2010).

Senate Sub. for HB 2226, which increased traffic fines but provided for a lesser distribution to the SGF, will reduce agency earnings by $0.220 million.

Senate Sub. for HB 2356, which diverts certain child care facility registration fees away from the SGF to a new fee fund, will reduce agency earnings by $0.160 million.

SB 452, which provides for an acceleration of certain liquor license fees, will increase agency earnings by $0.500 million.

Two additional pieces of legislation are expected to have an impact on FY 2011 receipts but could not be quantified. Any civil penalties levied under the Kansas Civil Protection Act for violations of the new Musical Performance Advertising Act (House Sub. for SB 269) will have a slightly positive (but indeterminate) impact on agency earnings. Certain new fees associated with the Naturopathic Doctor Licensure Act (House Sub. for SB 83) also will increase agency earnings by a slightly positive (but indeterminate) amount, as 20 percent of such fees are earmarked for deposit in the SGF.

FY 2012 and Thereafter

Although the Consensus Group will not make its initial estimate for FY 2012 until the fall, worthy of note is the fact that a number of provisions in previously enacted legislation will further reduce SGF receipts:

- Legislation enacted in 2006 that decoupled the Kansas estate tax from the federal law beginning in 2007 and eliminated the Kansas tax altogether in 2010 will reduce receipts relative to the prior law by an estimated $52.0 million in FY 2012.

- Legislation enacted in 2007 that phases out the franchise tax will reduce receipts relative to the prior law by an estimated $48.0 million in FY 2012.

- Legislation enacted in 2006 relative to a property tax exemption for business machinery and equipment is expected to reduce motor carrier property tax receipts to the SGF relative to the prior law by $7.4 million in FY 2012.

- Additional legislation enacted in 2005 to divert severance tax receipts away from the SGF to a special trust fund will reduce the SGF share by $13.354 million relative to the pre-2005 law (and by $6.290 million more than the current estimated FY 2011 diversion of $7.064 million). The trust fund diversion is expected to increase to $13.550 million in FY 2013 and remain at that level in subsequent years.

- Current estimates are that "slider" transfer payments (originally enacted in 2006) to local units, which are scheduled to resume in FY 2012, will reduce SGF receipts by $25.5 million.

- Receipts attributable to the tax amnesty provisions in the omnibus bill (expected to produce $8.0 million in FY 2011 receipts) will not be repeated in FY 2012 or any subsequent year.

- The sunsetting of a portion of the sales and use tax increase (on July 1, 2013 the rate will be reduced from 6.3 to 5.7 percent), as well as disposition of revenue language that diverts an increasing share of receipts to the State Highway Fund, will reduce SGF receipts in FY 2014 by $351.703 million less than such receipts in FY 2013. SGF receipts in FY 2015 will decline by an additional $29.399 below the FY 2014 level.

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Table 1
Consensus Revenue Estimate for Fiscal Years 2010 and 2011
and FY 2009 Actual Receipts
(Dollars in Thousands)

	FY 2009 (Actual)		FY 2010 (Revised 6/8)		FY 2011 (Revised 6/8)	
	Amount	Percent Change	Amount	Percent Change	Amount	Percent Change
Property Tax:						
Motor Carrier	$ 29,257	0.8 %	$ 24,000	(18.0) %	$ 24,000	0.0 %
Income Taxes:						
Individual	$2,682,000	(7.4) %	$ 2,510,000	(6.4) %	$2,577,175	2.7 %
Corporation	240,258	(44.4)	250,000	4.1	255,000	2.0
Financial Inst.	26,192	(21.0)	20,000	(23.6)	20,770	3.9
Total	$2,948,450	(12.3) %	$ 2,780,000	(5.7) %	$2,852,945	2.6 %
Estate Tax	$ 22,530	(49.1) %	$ 9,000	(60.1) %	$ 5,000	(44.4) %
Excise Taxes:						
Retail Sales	$1,689,516	(1.3) %	$ 1,640,000	(2.9) %	$1,971,211	20.2 %
Compensating Use	235,026	(4.6)	205,000	(12.8)	271,068	32.2
Cigarette	107,216	(4.9)	99,000	(7.7)	95,000	(4.0)
Tobacco Products	5,728	3.2	6,300	10.0	6,600	4.8
Cereal Malt Bev.	2,089	(6.2)	2,100	0.5	2,100	0.0
Liquor Gallonage	18,215	3.6	18,200	(0.1)	18,800	3.3
Liquor Enforcement	53,794	7.6	56,500	5.0	58,000	2.7
Liquor Drink	9,141	2.7	9,100	(0.4)	9,300	2.2
Corp. Franchise	41,720	(10.6)	34,000	(18.5)	17,000	(50.0)
Severance	124,249	(16.1)	84,000	(32.4)	98,400	17.1
Gas	73,814	(19.3)	41,400	(43.9)	50,900	22.9
Oil	50,436	(11.0)	42,600	(15.5)	47,500	11.5
Total	$2,286,693	(2.7) %	$ 2,154,200	(5.8) %	$2,547,479	18.3 %
Other Taxes:						
Insurance Prem.	$ 119,590	1.7 %	$ 118,800	(0.7) %	$ 123,000	3.5 %
Miscellaneous	1,794	(65.7)	1,800	0.3	1,800	0.0
Total	$ 121,384	(1.2) %	$ 120,600	(0.6) %	$ 124,800	3.5 %
Total Taxes	$5,408,314	(8.4) %	$ 5,087,800	(5.9) %	$5,554,224	9.2 %
Other Revenues:						
Interest	$ 64,199	(42.3) %	$ 23,000	(64.2) %	$ 25,000	8.7 %
Net Transfers	35,582	109.4	127,731	259.0	131,694	3.1
Agency Earnings	80,879	50.1	52,500	(35.1)	56,320	7.3
Total	$ 180,660	185.0 %	$ 203,231	12.5 %	$ 213,014	4.8 %
Total Receipts	$5,588,974	(1.9) %	$ 5,291,031	(5.3) %	$5,767,238	9.0 %

Table 2
State General Fund Receipts
FY 2010 Revised
Comparison of April 2010 Estimate to June 2010 Estimate
(Dollars in Thousands)

	FY 2010 CRE Est. 04/16/10	FY 2010 CRE Est. Revised 06/08/10	Difference Amount	Difference Pct. Chg.
Property Tax:				
Motor Carrier	$ 24,000	$ 24,000	$ 0	-- %
Income Taxes:				
Individual	$ 2,510,000	$ 2,510,000	$ 0	-- %
Corporation	250,000	250,000	0	--
Financial Inst.	20,000	20,000	0	--
Total	$ 2,780,000	$ 2,780,000	$ 0	-- %
Estate Tax	$ 9,000	$ 9,000	$ 0	-- %
Excise Taxes:				
Retail Sales	$ 1,640,000	$ 1,640,000	$ 0	-- %
Compensating Use	205,000	205,000	0	--
Cigarette	99,000	99,000	0	--
Tobacco Product	6,300	6,300	0	--
Cereal Malt Beverage	2,100	2,100	0	--
Liquor Gallonage	18,200	18,200	0	--
Liquor Enforcement	56,500	56,500	0	--
Liquor Drink	9,100	9,100	0	--
Corporate Franchise	34,000	34,000	0	--
Severance	84,000	84,000	0	--
Gas	41,400	41,400	0	--
Oil	42,600	42,600	0	--
Total	$ 2,154,200	$ 2,154,200	$ 0	-- %
Other Taxes:				
Insurance Premiums	$ 118,800	$ 118,800	$ 0	-- %
Miscellaneous	1,800	1,800	0	--
Total	$ 120,600	$ 120,600	$ 0	-- %
Total Taxes	$ 5,087,800	$ 5,087,800	$ 0	-- %
Other Revenues:				
Interest	$ 23,000	$ 23,000	$ 0	-- %
Net Transfers	91,000	127,731	36,731	40.4
Agency Earnings	52,500	52,500	0	--
Total Other Revenue	$ 166,500	$ 203,231	$ 36,731	22.1 %
Total Receipts	$ 5,254,300	$ 5,291,031	$ 36,731	0.7 %

Table 3
State General Fund Receipts
FY 2011 Revised
Comparison of April 2010 Estimate to June 2010 Estimate
(Dollars in Thousands)

	FY 2011 CRE Est. 04/16/10	FY 2011 CRE Est. Revised 06/08/10	Difference Amount	Difference Pct. Chg.
Property Tax:				
Motor Carrier	$ 24,000	$ 24,000	$ 0	-- %
Income Taxes:				
Individual	$ 2,585,000	$ 2,577,175	$ (7,825)	(0.3) %
Corporation	255,000	255,000	0	--
Financial Inst.	23,000	20,770	(2,230)	(9.7)
Total	$ 2,863,000	$ 2,852,945	$ (10,055)	(0.4) %
Estate Tax	$ 5,000	$ 5,000	$ 0	-- %
Excise Taxes:				
Retail Sales	$ 1,690,000	$ 1,971,211	$ 281,211	16.6 %
Compensating Use	230,000	271,068	41,068	17.9
Cigarette	95,000	95,000	0	--
Tobacco Product	6,600	6,600	0	--
Cereal Malt Beverage	2,100	2,100	0	--
Liquor Gallonage	18,800	18,800	0	--
Liquor Enforcement	58,000	58,000	0	--
Liquor Drink	9,300	9,300	0	--
Corporate Franchise	17,000	17,000	0	--
Severance	98,400	98,400	0	--
Gas	50,900	50,900	0	--
Oil	47,500	47,500	0	--
Total	$ 2,225,200	$ 2,547,479	$ 322,279	14.5 %
Other Taxes:				
Insurance Premiums	$ 123,000	$ 123,000	$ 0	-- %
Miscellaneous	1,800	1,800	0	--
Total	$ 124,800	$ 124,800	$ 0	-- %
Total Taxes	$ 5,242,000	$ 5,554,224	$ 312,224	6.0 %
Other Revenues:				
Interest	$ 25,000	$ 25,000	$ 0	-- %
Net Transfers	(228,491)	131,694	360,185	--
Agency Earnings	56,200	56,320	120	0.2
Total Other Revenue	$ (147,291)	$ 213,014	$ 360,305	(244.6) %
Total Receipts	$ 5,157,100	$ 5,157,100	$ -	-- %
Total Receipts	$ 5,094,709	$ 5,767,238	$ 672,529	13.2 %

Legislative Adjustments by Bill by Source to FY 2010 Estimates

($ in millions)

	Transfers	Total
H Sub SB 572	$ 36.731	$ 36.731
Total by Source	$ 36.731	$ 36.731

Legislative Adjustments by Bill by Source to FY 2011 Estimates

($ in millions)

	Individual Income	Sales	Use	Financial Instititutions	Agency Earnings	Transfers	Total
SB 430	$ 0.775	$ 2.043		$ (2.230)			$ 0.588
S Sub HB 2360	(15.000)	277.568	41.068				303.636
H Sub SB 572	6.400	1.600				360.185	368.185
S Sub HB 2226					(0.220)		(0.220)
S Sub HB 2356					(0.160)		(0.160)
SB 452					0.500		0.500
Total by Source	$ (7.825)	$ 281.211	$ 41.068	$ (2.230)	$ 0.120	$ 360.185	$ 672.529

KANSAS LEGISLATIVE RESEARCH DEPARTMENT

68-West–Statehouse, 300 SW 10th Ave.
Topeka, Kansas 66612-1504
(785) 296-3181 ◆ FAX (785) 296-3824

kslegres@klrd.ks.gov http://www.kslegislature.org/klrd

July 19, 2010

To: Legislative Budget Committee

STATE GENERAL FUND RECEIPTS

FY 2010

The Legislative Research Department recently received from the Division of Accounts and Reports information on the total State General Fund (SGF) receipts from FY 2010.

Total receipts to the SGF were $98.6 million, or 1.9 percent, below the final adjusted estimate (which includes any legislation enacted after the Consensus Revenue estimate). Taxes only in FY 2010 were $101.9 million, or 2.0 percent, below the adjusted estimate – most notably, in lower-than-estimated individual income taxes.

Tax sources that exceeded the estimate by more than $1.0 million were retail sales ($12.0 million, or 0.7 percent); corporate franchise ($7.5 million, or 21.9 percent); and insurance premiums ($1.6 million, or 1.3 percent).

Tax sources falling below the adjusted estimate by more than $1.0 million were individual income ($91.8 million, or 3.7 percent); corporation income ($25.1 million, or 10.0 percent); financial institutions income ($3.5 million, or 17.4 percent); severance ($2.1 million, or 2.5 percent); and liquor enforcement ($1.7 million or 3.0 percent).

Of particular note is the shortfall in individual income taxes. Withholding receipts for salaried individuals declined 1.3 percent in FY 2010, compared to a positive growth rate of 1.6 percent in FY 2009 and 6.2 percent in FY 2008. Estimated income tax payments, largely from self-employed individuals, in FY 2010 fell 19.5 percent, compared to a decline of 14.2 percent in FY 2009 and positive growth of 12.1 percent in FY 2008.

Interest receipts exceeded the estimate by $1.6 million, or 7.1 percent. Net transfers and agency earnings both exceeded the estimate by $0.9 million.

Total SGF receipts in FY 2010 were below total SGF receipts in FY 2009 by $396.5 million, or 7.1 percent. Tax receipts only for FY 2010 were below FY 2009 tax receipts only by $422.4 million, or 7.8 percent.

A Certificate of Indebtedness of $700 million was discharged or redeemed by the State General Fund prior to the end of the fiscal year, as required by law. The redemption took place on June 24, 2010.

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STATE GENERAL FUND RECEIPTS

FY 2010

(dollar amounts in thousands)

	Actual FY 2009	Estimate*	FY 2010 Actual	Difference	Percent increase relative to: FY 2009	Estimate
Property Tax:						
Motor Carriers	$ 29,257	$ 24,000	$ 24,993	$ 993	(14.6)%	4.1%
Income Taxes:						
Individual	$ 2,682,000	$ 2,510,000	$ 2,418,208	$ (91,792)	(9.8)%	(3.7)%
Corporation	240,258	250,000	224,940	(25,060)	(6.4)	(10.0)
Financial Inst.	26,192	20,000	16,515	(3,485)	(36.9)	(17.4)
Total	$ 2,948,450	$ 2,780,000	$ 2,659,663	$ (120,337)	(9.8)%	(4.3)%
Estate Tax	$ 22,530	$ 9,000	$ 8,396	$ (604)	(62.7)%	(6.7)%
Excise Taxes:						
Retail Sales	$ 1,689,516	$ 1,640,000	$ 1,652,037	$ 12,037	(2.2)%	0.7%
Comp. Use	235,026	205,000	205,540	540	(12.5)	0.3
Cigarette	107,216	99,000	99,829	829	(6.9)	0.8
Tobacco Prod.	5,728	6,300	6,352	52	10.9	0.8
Cereal Malt Bev.	2,089	2,100	1,989	(111)	(4.8)	(5.3)
Liquor Gallonage	18,215	18,200	17,953	(247)	(1.4)	(1.4)
Liquor Enforce.	53,794	56,500	54,827	(1,673)	1.9	(3.0)
Liquor Drink	9,141	9,100	8,930	(170)	(2.3)	(1.9)
Corp. Franchise	41,720	34,000	41,462	7,462	(0.6)	21.9
Severance	124,249	84,000	81,870	(2,130)	(34.1)	(2.5)
Gas	73,814	41,400	39,988	(1,412)	(45.8)	(3.4)
Oil	50,436	42,600	41,882	(718)	(17.0)	(1.7)
Total	$ 2,286,693	$ 2,154,200	$ 2,170,788	$ 16,588	(5.1)%	0.8%
Other Taxes:						
Insurance Prem.	$ 119,590	$ 118,800	$ 120,375	$ 1,575	(0.7)%	1.3%
Miscellaneous	1,794	1,800	1,655	(145)	(7.7)	(8.1)
Total	$ 121,384	$ 120,600	$ 122,030	$ 1,430	(0.5)%	1.2%
Total Taxes	$ 5,408,314	$ 5,087,800	$ 4,985,870	$ (101,930)	(7.8)%	(2.0)%
Other Revenue:						
Interest	$ 64,199	$ 23,000	$ 24,629	$ 1,629	(61.6)%	7.1%
Transfers (net)	35,582	127,731	128,586	855	--	0.7
Agency Earnings and Misc.	80,879	52,500	53,365	865	(34.0)	1.6
Total	$ 180,660	$ 203,231	$ 206,579	$ 3,348	14.3%	1.6%
TOTAL RECEIPTS	$ 5,588,974	$ 5,291,031	$ 5,192,449	$ (98,582)	(7.1)%	(1.9)%

* Consensus estimate as of April 16, 2010 as subsequently adjusted for legislation enacted after that date. A Certificate of Indebtedness of $700 million was redeemed or repaid, as required by law, before the end of the fiscal year. The redemption was made on June 24, 2010.

NOTES: Details may not add to totals due to rounding.

Kansas Legislative Research Department

September 14, 2010

DRAFT

STATE GENERAL FUND RECEIPTS
July - August, FY 2011
(dollar amounts in thousands)

	Actual FY 2010	FY 2011 Estimate*	FY 2011 Actual	FY 2011 Difference	Percent increase relative to: FY 2010	Percent increase relative to: Estimate
Motor Carriers	$ 738	$ 150	$ 1,655	$ 1,505	124.2%	1003.2%
Income Taxes:						
Individual	$ 339,090	$ 365,000	$ 370,757	$ 5,757	9.3%	1.6%
Corporation	14,196	10,000	9,342	(658)	(34.2)	(6.6)
Financial Inst.	(1,437)	(600)	(630)	(30)	(56.2)	5.0
Total	$ 351,848	$ 374,400	$ 379,469	$ 5,069	7.9%	1.4%
Estate Tax	$ 1,198	$ 800	$ 330	$ (470)	(72.5)%	(58.8)%
Excise Taxes:						
Retail Sales	$ 286,664	$ 291,000	$ 314,448	$ 23,448	9.7%	(8.1)%
Comp. Use	36,366	41,000	43,494	2,494	19.6	6.1
Cigarette	17,319	16,000	17,638	1,638	1.8	10.2
Tobacco Prod.	1,112	1,125	1,140	15	2.5	1.3
Cereal Malt Bev.	397	400	367	(33)	(7.5)	(8.2)
Liquor Gallonage	3,184	3,300	3,258	(42)	2.3	(1.3)
Liquor Enforce.	9,573	10,000	9,597	(403)	0.2	(4.0)
Liquor Drink	1,481	1,500	1,515	15	2.3	1.0
Corp. Franchise	2,609	1,200	2,323	1,123	(11.0)	93.6
Severance	9,298	15,250	15,771	521	69.6	3.4
Gas	4,978	7,000	6,861	(139)	37.8	(2.0)
Oil	4,320	8,250	8,910	660	106.3	8.0
Total	$ 368,003	$ 380,775	$ 409,550	$ 28,775	11.3%	7.6%
Other Taxes:						
Insurance Prem.	$ (4,145)	$ (1,200)	$ (111)	$ 1,089	(97.3)%	(90.8)%
Miscellaneous	196	250	299	49	52.5	19.6
Total	$ (3,949)	$ (950)	$ 188	$ 1,138	(104.8)%	(119.8)%
Total Taxes	$ 717,839	$ 755,175	$ 791,192	$ 36,017	10.2%	4.8%
Other Revenue:						
Interest	$ 3,792	$ 4,700	$ 2,256	$ (2,444)	(40.5)%	(52.0)%
Transfers (net)	(24,162)	12,870	(8,089)	(20,959)	(66.5)	--
Agency Earnings and Misc.	7,013	8,500	5,903	(2,597)	(15.8)	(30.6)
Total	$ (13,358)	$ 26,070	$ 71	$ (25,999)	(100.5)%	(99.7)%
TOTAL RECEIPTS	$ 704,481	$ 781,245	$ 791,263	$ 10,018	12.3%	1.3%

* Consensus estimate as of April 16, 2010, as subsequently adjusted for legislation enacted after that date. Excludes $700 million to the State General Fund due to an issuance of a Certificate of Indebtedness.

NOTES: Details may not add to totals due to rounding.

Special Committee on Assessment and Taxation

September 16-17, 2010

Attachment #4

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Table 1
Kansas State and Local Taxes -- FY 2008 - FY 2010
($ in thousands)

	FY 2008	FY 2009	FY 2010	pct of fy 10 total	pct chng from fy 09
General Property (a)	3,765,993	3,953,527	3,996,442	34.69%	1.09%
Sales and Use (b)	3,126,006	3,019,908	2,944,083	25.55%	-2.51%
Inc and Privilege	3,410,089	2,998,010	2,699,159	23.43%	-9.97%
M Fuels	431,307	421,272	424,571	3.69%	0.78%
Various Vehicle (a) (c)	336,165	346,570	338,873	2.94%	-2.22%
Unemp Comp	223,271	171,035	305,645	2.65%	78.70%
Veh Reg	189,238	195,721	205,239	1.78%	4.86%
Ins Premiums	133,913	128,554	138,769	1.20%	7.95%
Liquor and Beer	106,339	111,553	111,361	0.97%	-0.17%
Cig and Tobacco	118,253	112,944	106,181	0.92%	-5.99%
Severance	159,325	133,601	93,783	0.81%	-29.80%
Corp Franchise	46,659	41,720	41,462	0.36%	-0.62%
Mort Reg	50,679	41,563	41,397	0.36%	-0.40%
T Guest	31,437	32,084	29,129	0.25%	-9.21%
M Car Property	29,032	29,257	24,993	0.22%	-14.57%
Estate/Inh	44,247	22,530	8,396	0.07%	-62.73%
Intangibles (a)	3,382	4,326	3,645	0.03%	-15.74%
Parimutuel	1,946	262	13	0.00%	-95.04%
All Other (d)	8,763	7,921	7,879	0.07%	-0.53%
Total	12,216,044	11,772,358	11,521,020	100.00%	-2.13%

(a) Taxes levied for collection during the fiscal year.
(b) Includes state, county, city, municipal university, and other special district sales and use taxes.
(c) Includes motor vehicle, recreational vehicle, 16m and 20m "tagged" vehicles, and rental car excise taxes.
(d) Total revenue from nine taxes, the largest of which for FY 2010 was the clean water drinking tax at $2.873 million.

TABLE 2

State Tax Revenue, Net Refunds, FY 2005- FY 2010
(In Thousands)

	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Property						
Educational Bldg. (1	$ 25,491	$ 26,901	$ 29,143	$ 30,215	$ 31,207	$ 30,517
Institutional Bldg. (1	12,746	13,450	14,572	15,108	15,603	15,258
State General	538	55	26	18	10	4
Mortgage Regis. (2	1,145	1,204	1,258	1,093	1,008	1,087
Motor Carrier	20,404	22,056	25,812	29,032	29,257	24,993
Various Vehicle (3	4,500	4,621	4,704	4,778	4,819	4,728
Excess Local Effort (4	3,640	4,526	6,170	3,700	3,500	4,449
Total	$ 68,464	$ 72,813	$ 81,685	$ 83,944	$ 85,404	$ 81,036
Income and Privilege						
Individual	$ 2,079,782	$ 2,401,129	$ 2,744,934	$ 2,944,851	$ 2,731,560	$ 2,457,704
Corporation	226,040	350,204	442,324	432,078	240,258	224,940
Financial Inst.	22,013	31,058	31,126	33,160	26,192	16,515
Total	$ 2,327,835	$ 2,782,388	$ 3,218,384	$ 3,410,089	$ 2,998,010	$ 2,699,159
Inheritance/Estate (5	$ 51,803	$ 51,784	$ 55,620	$ 44,247	$ 22,530	$ 8,396
Sales, Use, and Excise						
Retail Sales	$ 1,747,774	$ 1,844,744	$ 1,934,390	$ 1,983,594	$ 1,958,999	$ 1,918,397
Compensating Use	257,412	282,853	307,635	281,153	268,182	234,873
Subtotal	$ 2,005,186	$ 2,127,597	$ 2,242,025	2,264,747	2,227,181	2,153,270
Motor Fuels	425,556	428,166	434,047	431,307	421,272	424,571
Vehicle Registration (6	161,394	162,714	169,867	168,822	174,952	185,034
Cereal Malt Beverage	2,077	2,090	2,091	2,228	2,089	1,989
Liquor Gallonage	16,493	17,508	17,901	18,474	19,140	18,869
Liquor Enforcement	41,904	44,234	47,138	49,983	53,794	54,827
Liquor Drink	29,492	31,450	33,834	35,654	36,530	35,676
Cigarette	118,939	117,899	115,282	112,705	107,216	99,829
Tobacco Prod.	5,039	5,093	5,305	5,548	5,728	6,352
Corporation Franchise	47,085	46,880	47,892	46,659	41,720	41,462
Boat Registration	869	992	1,038	992	1,078	1,087
Severance	111,147	143,476	124,758	159,325	133,601	93,783
New Tires	719	692	711	707	677	681
Motor Vehicle Rental	2,761	2,862	3,361	3,366	3,396	3,126
Drycleaning & Laundry	1,274	1,205	1,242	1,178	1,103	993
Clean Water	2,509	3,285	3,535	3,226	2,905	2,873
Total	$ 2,972,444	$ 3,136,143	$ 3,250,027	$ 3,304,921	$ 3,232,382	$ 3,124,422

	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Gross Receipts						
Insurance Premiums						
Foreign Cos. (7	$ 91,409	$ 94,471	$ 96,862	$ 102,800	$ 92,843	$ 100,173
Domestic Cos.	16,272	18,708	17,941	15,825	19,840	21,720
Firefighter Relief	8,759	8,969	9,267	9,393	9,679	10,291
Fire Marshal	5,588	5,671	5,771	5,895	6,192	6,585
Subtotal	$ 122,028	$ 127,819	$ 129,841	$ 133,913	$ 128,554	$ 138,769
Private Car Cos.	$ 812	$ 883	$ 892	$ 851	$ 512	$ 385
Music-Dramatic Tax	22	20	57	30	36	38
Bingo Enforcement	585	583	535	500	515	454
Transient Guest (8	457	483	531	636	628	590
Parimutuel	3,210	3,004	2,758	1,946	262	13
Illegal Drugs	869	849	1,047	1,176	1,060	1,338
Combative Arts (9	0	35	45	103	35	30
Total	$ 127,983	$ 133,676	$ 135,706	$ 5,242	$ 3,048	$ 2,848
Unemployment Comp.	$ 340,352	$ 344,562	$ 273,395	$ 223,271	$ 171,035	$ 305,645
TOTAL STATE TAXES	**$ 5,888,881**	**$ 6,521,366**	**$ 7,014,817**	**$ 7,205,627**	**$ 6,640,963**	**$ 6,360,275**

Sources: Financial reports of the Division of Accounts and Reports and records of tax-collecting agencies. Details might not add to totals due to rounding.

1. Taxes levied for collection in the fiscal year as reported by the Department of Revenue, including the state's small share (if any) of certain in-lieu tax levies.
2. The state's 1/26 share of the tax.
3. Amount received by the state from the motor, recreational, and 16m and 20m "tagged" vehicle taxes.
4. "Excess local effort" produced from the mandatory school district general fund property tax levy and returned to the state pursuant to the school finance formula (see KSA 2006 Supp. 72-6431).
5. For FY 2003, includes $2.237 million in succession tax collections; and for FY 2004, includes $2.898 million in succession tax refunds.
6. State receipts only, excluding amounts retained by county treasurers.
7. Includes retailatory taxes.
8. State's 2 percent share of the tax.
9. Created by the Kansas Professional Regulated Sports Act, enacted in 2004.

TABLE 3

Allocation to Funds of Total State Tax Revenue (Net of Refunds) FY 2010 (In Thousands)

	Amount	Percent of Total	Cumulative Percent	Taxes Credited to: SGF	Other Funds
Individual Income	$ 2,457,704	38.64%	38.64%	$ 2,418,208	$ 39,496
Retail Sales	1,918,397	30.16	68.80	1,652,037	266,360
Motor Fuels	424,571	6.68	75.48	-	424,571
Unemployment Compensation	305,645	4.81	90.42	-	305,645
Compensating Use	234,873	3.69	79.17	205,540	29,333
Corporation Income	224,940	3.54	82.71	224,940	-
Motor Vehicle Registration	185,034	2.91	85.62	-	185,034
Insurance Premiums	138,769	2.18	92.61	120,375	18,394
Liquor and Beer	111,361	1.75	96.03	83,699	27,662
Cigarette and Tobacco	106,181	1.67	94.27	106,181	-
Oil Severance	47,621	0.75	97.50	41,882	5,739
Gas Severance	46,162	0.73	96.75	39,988	6,174
State Property	45,779	0.72	98.22	4	45,775
Corporation Franchise	41,462	0.65	98.87	41,462	-
Motor Carrier Property	24,993	0.39	99.26	24,993	-
Financial Institutions Privilege	16,515	0.26	99.52	16,515	-
Estate/Inheritance	8,396	0.13	99.66	8,396	-
State Motor Vehicle	4,549	0.07	99.73	-	4,549
Excess Local Effort (Property)	4,449	0.07	99.80	-	4,449
Vehicle Rental Excise	3,126	0.05	99.85	-	3,126
Water	2,873	0.05	99.89	-	2,873
Illegal Drugs	1,338	0.02	99.95	335	1,003
Boat Registration	1,087	0.02	99.92	-	1,087
State Mortgage Reg.	1,087	0.02	99.96	-	1,087
Drycleaning	993	0.02	99.91	-	993
New Tires	681	0.01	99.97	-	681
State Transient Guest	590	0.01	99.98	590	-
Bingo	454	0.01	99.99	303	151
Private Car Co.	385	0.01	100.00	385	-
State Tagged Vehicle	125	0.00	100.00	-	125
State Rec. Vehicle	54	0.00	100.00	-	54
Music, Dramatic	38	0.00	100.00	38	-
Combative Arts	30	0.00	100.00	-	30
Parimutuel	13	0.00	100.00	-	13
Total	**$ 6,360,275**	**100.00%**		**$ 4,985,870**	**$ 1,374,405**
				78.39%	**21.61%**

TABLE 4

Local Government Tax Revenue, FY 2005-2010
(In Thousands)

	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Counties						
Tangible Property (1	$ 862,537	$ 930,828	$ 998,314	$ 1,044,608	$ 1,091,024	$ 1,092,163
Intangibles (2	1,101	1,171	1,319	1,640	1,901	1,695
Mortgage Registration (3	50,547	54,613	50,522	49,586	40,555	40,310
Motor Vehicle Registration (3	14,017	13,936	13,847	20,416	20,769	20,205
Transient Guest	1,223	1,436	1,641	1,984	2,202	2,055
Various Vehicle (4	99,961	105,294	105,946	108,972	110,505	110,123
Sales and Use	357,153	452,328	501,037	488,320	428,481	422,739
Subtotal-Counties	$ 1,386,539	$ 1,559,606	$ 1,672,626	$ 1,715,526	$ 1,695,437	$ 1,689,290
Cities						
Tangible Property (1	$ 607,241	$ 638,071	$ 676,378	$ 718,474	$ 761,859	$ 766,064
Intangibles (2	861	898	897	866	1,182	925
Transient Guest	21,158	22,242	23,789	28,817	29,254	26,484
Various Vehicle (4	68,749	72,197	73,536	74,533	75,138	74,289
Sales and Use	300,442	309,776	315,998	335,577	325,301	330,012
Subtotal-Cities	$ 998,451	$ 1,043,184	$ 1,090,598	$ 1,158,267	$ 1,192,734	$ 1,197,774
Schools (5						
Tangible Property (1	$ 1,389,409	$ 1,506,044	$ 1,607,240	$ 1,687,446	$ 1,777,869	$ 1,800,243
Various Vehicle (4	112,258	109,726	117,938	122,941	124,569	123,333
Subtotal-Schools	$ 1,501,667	$ 1,615,770	$ 1,725,178	$ 1,810,387	$ 1,902,438	$ 1,923,576
Townships						
Tangible Property (1	$ 46,223	$ 48,743	$ 51,271	$ 54,704	$ 59,447	$ 61,164
Intangibles (2	626	576	752	876	1,243	1,025
Various Vehicle (4	5,062	5,389	5,402	5,602	5,734	5,916
Subtotal-Townships	$ 51,911	$ 54,708	$ 57,425	$ 61,182	$ 66,424	$ 68,105
Special Districts						
Tangible Property (1	$ 145,871	$ 155,489	$ 200,320	$ 211,720	$ 213,008	$ 226,580
Various Vehicle (4	13,340	15,011	15,703	15,973	17,590	17,358
Sales and Use (6	21,481	26,369	34,514	37,362	38,944	38,062
Subtotal-Special Districts	$ 180,692	$ 196,869	$ 250,537	$ 265,055	$ 269,542	$ 282,000
TOTAL LOCAL TAXES	**$ 4,119,260**	**$ 4,470,137**	**$ 4,796,364**	**$ 5,010,417**	**$ 5,131,395**	**$ 5,160,745**
Exhibit:						
Tangible Property	$ 3,051,281	$ 3,279,174	$ 3,533,523	$ 3,716,952	$ 3,903,207	$ 3,946,214
Various Vehicle	299,370	307,617	318,525	328,021	338,355	331,019
Total	$ 3,350,651	$ 3,586,791	$ 3,852,048	$ 4,044,973	$ 4,241,562	$ 4,277,233
Exhibit:						
Local Sales and Use	$ 679,076	$ 788,473	$ 851,549	$ 861,259	$ 792,727	$ 790,813

Sources: Reports and records of the Department of Revenue

1. Taxes levied for collection in the fiscal year. Includes certain in-lieu taxes, e.g., on industrial revenue bond property.
2. Taxes collected on a calendar-year basis.
3. Calendar year revenue, e.g., the figure in the FY 2010 column is for CY 2009.
4. Calendar year taxes for motor, recreational, and 16m and 20m "tagged" vehicles.
5. School districts, community colleges, and municipal universities, including out-district tuition tax levies made by counties and townships.
6. Collections by the Department of Revenue for municipal universities, transportation development districts, community improvement districts, certain sales tax and revenue bond districts, and the Horsethief Reservoir district.

Special Note

This table does not include revenue from certain taxes for which annual data are not compiled, *e.g.*, occupation and franchise taxes; and development excise taxes.

Kansas Tax Facts

2009 Supplement to the Seventh Edition

December 2009

Kansas Legislative Research Department
300 SW Tenth Avenue—Room 68-W
Phone: (785) 296-3181/FAX (785) 296-3824
Topeka, Kansas 66612-1504
kslegres@klrd.state.ks.us ❖ http://www.kslegislature.org/klrd/

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FOREWORD

The Seventh Edition of *Kansas Tax Facts* was published in December, 2000. This addendum is designed to supplement and update that publication by providing data from FY 2004 through FY 2009. Summaries of significant tax legislation enacted in 2001 through 2008 may be found in the *Summary of Legislation* publications available at http://skyways.lib.ks.us/ksleg/KLRD/summaries.htm

Chris W. Courtwright, Principal Economist, is responsible for this publication.

Combined State and Local Tax Revenue

Kansas state and local government net tax revenue totaled $11.772 billion in FY 2009, which equated to $4,201 per capita and to 10.82 percent of Kansas personal income in CY 2008. Following are the tax levies or collections, combining state and local tax revenue, in descending order of magnitude for FY 2009.

Table 1
Kansas State and Local Taxes
(In Thousands)

	FY 2007	FY 2008	FY 2009	% FY 09 Total	% Change from FY 08
General Property (a)	$ 3,627,149	$ 3,765,993	$ 3,953,527	33.58%	4.98%
Sales and Use (b)	3,093,574	3,126,006	3,019,908	25.65	(3.39)
Income and Privilege	3,218,384	3,410,089	2,998,010	25.47	(12.08)
Motor Fuels	434,047	431,307	421,272	3.57	(2.33)
Various Vehicle (a) (c)	326,590	336,165	346,570	2.94	3.10
Vehicle Registration	183,714	189,238	195,721	1.66	3.43
Unemployment Comp.	273,395	223,271	171,035	1.45	(23.40)
Severance	124,758	159,325	133,601	1.13	(16.15)
Insurance Premiums	129,841	133,913	128,554	1.09	(4.00)
Cigarette and Tobacco	120,587	118,253	112,944	0.96	(4.49)
Liquor and Beer	100,964	106,339	111,553	0.95	4.90
Estate/Inheritance	55,620	44,247	22,530	0.19	(49.08)
Corporation Franchise	47,892	46,659	41,720	0.35	(10.59)
Mortgage Registration	51,780	50,679	41,563	0.35	(17.99)
Transient Guest	25,961	31,437	32,084	0.27	2.06
Motor Carrier Property	25,812	29,032	29,257	0.25	0.78
Intangibles (a)	2,968	3,382	4,326	0.04	27.91
Parimutuel	2,758	1,946	262	0.00	(86.54)
All Other (d)	9,102	8,763	7,921	0.07	(9.61)
Total	**$ 11,811,181**	**$ 12,216,044**	**$ 11,772,358**	**100.00%**	**(3.63)%**

(a) Taxes levied for collection during the fiscal year.

(b) Includes state, county, city and municipal university sales and use taxes.

(c) Includes motor vehicle, recreational vehicle, 16m and 20m "tagged" vehicles, and rental car excise taxes.

(d) Total revenue from nine taxes, the largest of which for FY 2009 was the clean water drinking tax at $2.905 million.

State and Local Tax Structure – Overview

Kansas has had a broad-based state and local tax structure since the 1930s when income, sales, and other taxes were adopted. The broadening continued—at least through the 1980s—with the adoption of various privilege, gross receipts, and severance taxes. One result of these changes is that the general property tax, while still by far the most important tax source for local governments, now is far less significant in terms of the overall state and local tax mix.

The 1992 school finance law substantially altered school district property taxes. In 1991, school district general fund property tax levies ranged from 9.12 mills (Burlington) to 97.69 mills (Parsons). The 1992 law established a uniform general fund mill levy rate of 32 mills for 1992, 33 mills for 1993, and 35 mills for 1994 and thereafter. Beginning in 1997, the Legislature provided major reductions in the general fund levy—which currently is set at 20 mills—in addition to an exemption from that levy for residential property to the extent of the first $20,000 of its valuation.

Some Highlights of this Supplement

- In FY 2009, total state and local tax revenue in Kansas was $11.772 billion, with state taxes accounting for $6.641 billion—or about 56.4 percent—of the total. State and local taxes fell by 3.63 percent below the FY 2008 figure of $12.216 billion. State taxes decreased by about $565 million, or 7.84 percent, from FY 2008 to FY 2009, while local taxes increased by $121 million, or 2.41 percent.

- Local governments continue to spend most of the state and local tax revenue. In FY 2009, local government tax revenue was $5.131 billion; and local units received another $3.950 billion from state taxes allocated to or shared with them. Thus, local units received $9.081 billion, or about 77 percent, of total state and local taxes in FY 2009. Over 59 percent of the state's tax revenue was shared with or allocated to local units, mostly for education.

- While the general property tax is still the most important single revenue producer, its proportion of total state and local taxes has steadily declined over the decades—from 82 percent of the total in FY 1930, to 56 percent in FY 1960, and to 34 percent in FY 2009 (or about 37 percent if the various vehicle taxes, which are levied in lieu of the general property tax, are included). But the trend has reversed itself recently, since in FY 1998 the general property tax was only about 27 percent of the burden (or 31 percent if vehicle taxes were included).

- Income and privilege taxes accounted for 25 percent of state and local tax revenue in FY 2009, compared with 11 percent in FY 1970 and only 2 percent in FY 1940. These taxes were at about 27 percent of the total in FY 2001 but fell as low as 22 percent in FY 2003 and FY 2004 in the wake of the national recession. The figure also was back at 28 percent in FY 2008 before the impact of the most recent recession.

- Sales and use tax revenue over the decades also has been increasing significantly as part of the state-local tax mix, *i.e.*, rising from 10 percent of the total in FY 1940, to 16 percent in FY 1970, and to about 26 percent in FY 2009. The spread of local sales taxes has contributed significantly to the growth of sales tax revenue since 1970.

- State and local tax revenue in FY 2009 was 10.82 percent of CY 2008 Kansas personal income. Historically, this figure has remained remarkably constant. (The ratio was 14.63 percent in FY 1940; 11.64 percent in FY 1970; and 11.55 percent in FY 1990). The following table provides the data for the last six fiscal years.

Taxes as Percent of Personal Income

	State	Local	Both
FY 2004	6.52%	4.59%	11.11%
FY 2005	6.76	4.73	11.48
FY 2006	7.18	4.92	12.10
FY 2007	7.12	4.87	11.98
FY 2008	6.94	4.82	11.76
FY 2009	6.11	4.72	10.82

- Although the rate of growth in overall local taxes decelerated somewhat in FY 2009 the rate growth in local property taxes remained fairly constant. Local property taxes in FY 2009 increased by $186 million. Of this amount, schools accounted for $91 million of the increase. Local property taxes in FY 2008 increased by $183 million. Of this amount, schools accounted for $80 million of the increase. Property taxes in FY 2007 had increased by about 7.7 percent, or $254 million, with schools accounting for $101 million of the increase. Property taxes in FY 2006 had increased by $228 million (7.5 percent), with $117 million of the increase attributable to schools.

- It should be noted that while the courts have held that the mandatory school district general fund property tax levy is a state tax, it is primarily treated as a local tax for the maintenance of historical tax tables. The relatively small portion of "excess" local effort that is recaptured for deposit in the State School District Finance Fund is treated as a state tax receipt.

State Tax Revenue

In FY 2009, state tax revenue totaled $6.641 billion, which was a decrease of $565 million, or 7.84 percent below collections in FY 2008. FY 2008 reports had increased over FY 2007 receipts by $191 million, or 2.72 percent. FY 2007 receipts had been up $494 million, or 7.57 percent above FY 2006 receipts. FY 2006 receipts had grown by $632 million, or 10.74 percent above FY 2005 collections. Receipts in FY 2005 had grown by $425 million, or 7.78 percent, above FY 2004. (Total state tax collections had declined in two of the previous four fiscal years prior to FY 2003 and likely would have declined in FY

2003 but for the enactment of an estimated $295 million in new taxes by the 2002 Legislature. State tax collections grew by 6.3 percent in FY 2004.) Individual income taxes fell by over $213 million in FY 2009 (after growing by $200 million, $344 million, and $321 million in FY 2008, FY 2007, and FY 2006, respectively).

For FY 2009, Table 3 shows state tax revenues in descending order of importance and how much of such revenue was credited to the State General Fund (SGF) and to other state funds. In that year, 81.44 percent went to the SGF and 18.56 percent was deposited in other funds.

Individual income taxes, corporation income taxes, and sales and use taxes accounted for 78 percent of SGF tax receipts in FY 2009. The same four sources comprised just over 80 percent of SGF taxes in FY 1985.

State and Local Taxes

The relative balance in the big three sources of state and local tax revenue – sales, income, and property – that Kansas had achieved for a number of years after the 1992 school finance law appears to have eroded slightly since the late 1990s. (In FY 1992 – prior to the implementation of that law – property and vehicle taxes comprised 38.7 percent of total state and local revenues; sales and use taxes, 22.7 percent; and income and privilege taxes, 21.1 percent.)

In FY 2009, property and vehicle taxes accounted for 36.5 percent of the burden; sales and use taxes, 25.7 percent; and income and privilege taxes, 25.5 percent. As recently as FY 1998, the figures were much more closely balanced: 30.9 percent for property and vehicles; 28.1 percent for sales and use; and 28.0 percent for income and privilege.

Economists generally believe that with a diversified revenue portfolio not relying too heavily on a single source, Kansas state and local governments are better able to withstand economic downturns. Indeed, the Governor's Tax Equity Task Force in 1995 concluded as a major tax policy objective that:

> The state and local tax system should be balanced and diversified. A diversified tax system offers a blend of economic tradeoffs. Because all revenue sources have their weaknesses, a balanced tax system will reduce the magnitude of problems caused by over reliance on a single tax source. It will also result in lower rates on each tax and reduce the pressure of competition from other states that have lower rates for a particular tax.

Shown below for the last eight years are state, local, and combined state and local tax revenues.

State and Local Tax Revenue
(In thousands)

Fiscal Year	State	Percent Change	Local	Percent Increase	State and Local	Percent Change
2002	$ 4,905,300	(3.63)%	$ 3,493,328	8.59%	$ 8,398,626	1.11%
2003	5,141,714	4.82	3,632,124	3.97	8,773,839	4.47
2004	5,470,064	6.39	3,852,334	6.06	9,322,398	6.25
2005	5,888,881	7.66	4,119,260	6.93	10,008,141	7.36
2006	6,521,366	10.74	4,470,137	8.52	10,991,503	9.83
2007	7,014,817	7.57	4,796,364	7.30	11,811,181	7.46
2008	7,205,627	2.72	5,010,417	4.46	12,216,044	3.43
2009	6,640,963	(7.84)	5,131,395	2.41	11,772,358	(3.63)

Comparative Kansas Tax Burden

Kansas is not a high tax state, according to federal comparison statistics. Using the two major tax burden comparisons (taxes as a percent of personal income or per capita), the state over the years consistently has finished in the middle when compared with all other states. For example, Kansas finished number 25 in state tax revenue as a percent of personal income; and number 22 in per capita state tax revenue in FY 2008, the latest year for which data are available from all states for such statistics. Kansas finished number 31 in per capita state and local collections; and number 27 in state and local collections as a percent of personal income in FY 2007, the latest data for these statistics. Economic development proponents sometimes suggest that the Kansas tax burden figures should be compared more closely with the data from surrounding states. The following table provides this comparison.

50-State Tax Burden Ranking of Kansas and Surrounding States
(1 = highest tax burden; 50 = lowest)

	FY 2008 State Taxes as Percent of Personal Income	FY 2008 State Taxes Per Capita	FY 2007 State and Local as Percent of Personal Income (a)	FY 2007 State and Local Per Capita (a)
Arkansas	7	19	34	51
Oklahoma	29	34	40	42
Kansas	25	22	27	31
Nebraska	35	32	15	18
Iowa	32	36	17	29
Missouri	45	47	43	46
Colorado	48	41	41	19

(a) Total state and local tax collections, excluding federal transfers

Source: U.S. Census Bureau

Recommended Tax Policy Objectives

The aforementioned Governor's Tax Equity Task Force in 1995 recommended that all tax legislation "be evaluated with the following objectives in mind."

- Kansas should maintain its enviable reputation as a fiscally responsible state.
- A tax system should produce revenues that are adequate to finance an agreed-upon level of public services over time.
- A tax system should produce adequate revenue during economic downturns and also respond to economic growth.
- State and local taxing and spending decisions should be consistent with economic growth and development.
- Administration of the tax system should be fair and efficient.
- Fiscal accountability should be strengthened by making taxpayers aware of their true tax liabilities.
- Tax revisions should not unduly erode the tax base.
- State fiscal policy should advance the interests of the state as a whole, while facilitating the fiscal autonomy of local governments.
- Policymakers must recognize that tax policy influences economic behavior, and not always in the desired manner.
- Kansans should be able to rely upon a stable tax policy.
- The state and local tax system should be balanced and diversified.

TABLE 2

State Tax Revenue, Net Refunds, FY 2004- FY 2009
(In Thousands)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Property						
Educational Bldg. (1	$ 24,051	$ 25,491	$ 26,901	$ 29,143	$ 30,215	$ 31,207
Institutional Bldg. (1	12,025	12,746	13,450	14,572	15,108	15,603
State General	13,718	538	55	26	18	10
Mortgage Regis. (2	1,140	1,145	1,204	1,258	1,093	1,008
Motor Carrier	19,498	20,404	22,056	25,812	29,032	29,257
Various Vehicle (3	4,415	4,500	4,621	4,704	4,778	4,819
Excess Local Effort (4	9,636	3,640	4,526	6,170	3,700	3,500
Total	$ 84,483	$ 68,464	$ 72,813	$ 81,685	$ 83,944	$ 85,404
Income and Privilege						
Individual	$ 1,899,334	$ 2,079,782	$ 2,401,129	$ 2,744,934	$ 2,944,851	$ 2,731,560
Corporation	141,173	226,040	350,204	442,324	432,078	240,258
Financial Inst.	25,435	22,013	31,058	31,126	33,160	26,192
Total	$ 2,065,942	$ 2,327,835	$ 2,782,388	$ 3,218,384	$ 3,410,089	$ 2,998,010
Inheritance/Estate (5	$ 48,064	$ 51,803	$ 51,784	$ 55,620	$ 44,247	$ 22,530
Sales, Use, and Excise						
Retail Sales	$ 1,706,678	$ 1,747,774	$ 1,844,744	$ 1,934,390	$ 1,983,594	$ 1,958,999
Compensating Use	225,156	257,412	282,853	307,635	281,153	268,182
Subtotal	$ 1,931,834	$ 2,005,186	$ 2,127,597	$ 2,242,025	2,264,747	2,227,181
Motor Fuels	423,853	425,556	428,166	434,047	431,307	421,272
Vehicle Registration (6	157,276	161,394	162,714	169,867	168,822	174,952
Cereal Malt Beverage	2,165	2,077	2,090	2,091	2,228	2,089
Liquor Gallonage	16,615	16,493	17,508	17,901	18,474	19,140
Liquor Enforcement	40,256	41,904	44,234	47,138	49,983	53,794
Liquor Drink	28,492	29,492	31,450	33,834	35,654	36,530
Cigarette	119,789	118,939	117,899	115,282	112,705	107,216
Tobacco Prod.	4,797	5,039	5,093	5,305	5,548	5,728
Corporation Franchise	36,806	47,085	46,880	47,892	46,659	41,720
Boat Registration	846	869	992	1,038	992	1,078
Severance	91,039	111,147	143,476	124,758	159,325	133,601
New Tires	727	719	692	711	707	677
Motor Vehicle Rental	2,615	2,761	2,862	3,361	3,366	3,396
Drycleaning & Laundry	1,267	1,274	1,205	1,242	1,178	1,103
Clean Water	2,734	2,509	3,285	3,535	3,226	2,905
Total	$ 2,861,111	$ 2,972,444	$ 3,136,143	$ 3,250,027	$ 3,304,921	$ 3,232,382

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	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Gross Receipts						
Insurance Premiums						
Foreign Cos. (7	$ 89,467	$ 91,409	$ 94,471	$ 96,862	$ 102,800	$ 92,843
Domestic Cos.	18,465	16,272	18,708	17,941	15,825	19,840
Firefighter Relief	8,404	8,759	8,969	9,267	9,393	9,679
Fire Marshal	5,491	5,588	5,671	5,771	5,895	6,192
Subtotal	$ 121,827	$ 122,028	$ 127,819	$ 129,841	$ 133,913	$ 128,554
Private Car Cos.	$ 740	$ 812	$ 883	$ 892	$ 851	$ 512
Music-Dramatic Tax	20	22	20	57	30	36
Bingo Enforcement	651	585	583	535	500	515
Transient Guest (8	422	457	483	531	636	628
Parimutuel	3,530	3,210	3,004	2,758	1,946	262
Illegal Drugs	705	869	849	1,047	1,176	1,060
Combative Arts (9	0	0	35	45	103	35
Total	$ 127,895	$ 127,983	$ 133,676	$ 135,706	$ 5,242	$ 3,048
Unemployment Comp.	$ 282,569	$ 340,352	$ 344,562	$ 273,395	$ 223,271	$ 171,035
TOTAL STATE TAXES	**$ 5,470,064**	**$ 5,888,881**	**$ 6,521,366**	**$ 7,014,817**	**$ 7,205,627**	**$ 6,640,963**

Sources: Financial reports of the Division of Accounts and Reports and records of tax-collecting agencies. Details might not add to totals due to rounding.

1. Taxes levied for collection in the fiscal year as reported by the Department of Revenue, including the state's small share (if any) of certain in-lieu tax levies.
2. The state's 1/26 share of the tax.
3. Amount received by the state from the motor, recreational, and 16m and 20m "tagged" vehicle taxes.
4. "Excess local effort" produced from the mandatory school district general fund property tax levy and returned to the state pursuant to the school finance formula (see KSA 2006 Supp. 72-6431).
5. For FY 2003, includes $2.237 million in succession tax collections; and for FY 2004, includes $2.898 million in succession tax refunds.
6. State receipts only, excluding amounts retained by county treasurers.
7. Includes retailatory taxes.
8. State's 2 percent share of the tax.
9. Created by the Kansas Professional Regulated Sports Act, enacted in 2004.

TABLE 3

Allocation to Funds of Total State Tax Revenue (Net of Refunds) FY 2009 (In Thousands)

	Amount	Percent of Total	Cumulative Percent	Taxes Credited to: SGF	Other Funds
Individual Income	$ 2,731,560	41.13%	41.13%	$ 2,682,000	$ 49,560
Retail Sales	1,958,999	29.50	70.63	1,689,516	269,483
Motor Fuels	421,272	6.34	76.97	0	421,272
Compensating Use	268,182	4.04	81.01	235,026	33,156
Corporation Income	240,258	3.62	84.63	240,258	0
Motor Vehicle Registration	174,952	2.63	87.26	0	174,952
Unemployment Compensation	171,035	2.58	89.84	0	171,035
Insurance Premiums	128,554	1.94	91.78	119,590	8,964
Cigarette and Tobacco	112,944	1.70	93.48	112,944	0
Liquor and Beer	111,553	1.68	95.16	83,239	28,314
Gas Severance	79,369	1.20	96.35	73,814	5,555
Oil Severance	54,232	0.82	97.17	50,436	3,796
State Property	46,820	0.71	97.87	10	46,810
Corporation Franchise	41,720	0.63	98.50	41,720	0
Motor Carrier Property	29,257	0.44	98.94	29,257	0
Financial Institutions Privilege	26,192	0.39	99.34	26,192	0
Estate/Inheritance	22,530	0.34	99.68	22,530	0
State Motor Vehicle	4,642	0.07	99.75	0	4,642
Excess Local Effort (Property)	3,500	0.05	99.80	0	3,500
Vehicle Rental Excise	3,396	0.05	99.85	0	3,396
Water	2,905	0.04	99.89	0	2,905
Drycleaning	1,103	0.02	99.91	0	1,103
Boat Registration	1,078	0.02	99.93	0	1,078
Illegal Drugs	1,060	0.02	99.94	264	796
State Mortgage Reg.	1,008	0.02	99.96	0	1,008
New Tires	677	0.01	99.97	0	677
State Transient Guest	628	0.01	99.98	628	0
Bingo	515	0.01	99.98	343	172
Private Car Co.	512	0.01	99.99	512	0
Parimutuel	262	0.00	100.00	0	262
State Tagged Vehicle	123	0.00	100.00	0	123
State Rec. Vehicle	54	0.00	100.00	0	54
Music, Dramatic	36	0.00	100.00	36	0
Combative Arts	35	0.00	100.00	0	35
Total	**$ 6,640,963**	**100.00%**		**$ 5,408,314**	**$ 1,232,649**
				81.44%	**18.56%**

TABLE 4

Local Government Tax Revenue, FY 2004-2009
(In Thousands)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Counties						
Tangible Property (1	$ 825,062	$ 862,537	$ 930,828	$ 998,314	$ 1,044,608	$ 1,091,024
Intangibles (2	1,399	1,101	1,171	1,319	1,640	1,901
Mortgage Registration (3	59,416	50,547	54,613	50,522	49,586	40,555
Motor Vehicle Registration (3	13,664	14,017	13,936	13,847	20,416	20,769
Transient Guest	1,090	1,223	1,436	1,641	1,984	2,202
Various Vehicle (4	95,270	99,961	105,294	105,946	108,972	110,505
Sales and Use	314,378	357,153	452,328	501,037	488,320	428,481
Subtotal-Counties	$ 1,310,279	$ 1,386,539	$ 1,559,606	$ 1,672,626	$ 1,715,526	$ 1,695,437
Cities						
Tangible Property (1	$ 585,292	$ 607,241	$ 638,071	$ 676,378	$ 718,474	$ 761,859
Intangibles (2	1,005	861	898	897	866	1,182
Transient Guest	18,873	21,158	22,242	23,789	28,817	29,254
Various Vehicle (4	65,927	68,749	72,197	73,536	74,533	75,138
Sales and Use	279,897	300,442	309,776	315,998	335,577	304,461
Subtotal-Cities	$ 950,994	$ 998,451	$ 1,043,184	$ 1,090,598	$ 1,158,267	$ 1,171,894
Schools (5						
Tangible Property (1	$ 1,263,235	$ 1,389,409	$ 1,506,044	$ 1,607,240	$ 1,687,446	$ 1,777,869
Various Vehicle (4	107,807	112,258	109,726	117,938	122,941	124,569
Subtotal-Schools	$ 1,371,042	$ 1,501,667	$ 1,615,770	$ 1,725,178	$ 1,810,387	$ 1,902,438
Townships						
Tangible Property (1	$ 45,258	$ 46,223	$ 48,743	$ 51,271	$ 54,704	$ 59,447
Intangibles (2	720	626	576	752	876	1,243
Various Vehicle (4	4,890	5,062	5,389	5,402	5,602	5,734
Subtotal-Townships	$ 50,868	$ 51,911	$ 54,708	$ 57,425	$ 61,182	$ 66,424
Special Districts						
Tangible Property (1	$ 139,165	$ 145,871	$ 155,489	$ 200,320	$ 211,720	$ 213,008
Various Vehicle (4	12,955	13,340	15,011	15,703	15,973	17,590
Sales and Use (6	17,031	21,481	26,369	34,514	37,362	59,785
Subtotal-Special Districts	$ 169,151	$ 180,692	$ 196,869	$ 250,537	$ 265,055	$ 290,383
TOTAL LOCAL TAXES	**$ 3,852,334**	**$ 4,119,260**	**$ 4,470,137**	**$ 4,796,364**	**$ 5,010,417**	**$ 5,131,395**
Exhibit:						
Tangible Property	$ 2,858,012	$ 3,051,281	$ 3,279,174	$ 3,533,523	$ 3,716,952	$ 3,903,207
Various Vehicle	286,849	299,370	307,617	318,525	328,021	338,355
Total	$ 3,144,861	$ 3,350,651	$ 3,586,791	$ 3,852,048	$ 4,044,973	$ 4,241,562
Exhibit:						
Local Sales and Use	$ 611,306	$ 679,076	$ 788,473	$ 851,549	$ 861,259	$ 792,727

Sources: Reports and records of the Department of Revenue

1. Taxes levied for collection in the fiscal year. Includes certain in-lieu taxes, e.g., on industrial revenue bond property.
2. Taxes collected on a calendar-year basis.
3. Calendar year revenue, e.g., the figure in the FY 2009 column is for CY 2008.
4. Calendar year taxes for motor, recreational, and 16m and 20m "tagged" vehicles.
5. School districts, community colleges, and municipal universities, including out-district tuition tax levies made by counties and townships.
6. Collections by the Department of Revenue for municipal universities, transportation development districts, certain sales tax and revenue bond districts, and the Horsethief Reservoir district.

Special Note

This table does not include revenue from certain taxes for which annual data are not compiled, *e.g.*, occupation and franchise taxes; and development excise taxes.

TABLE 5 — PERCENTAGE OF COMBINED STATE AND LOCAL TAX REVENUE

Ranked on the Basis of FY 2009

	FY 2009	FY 2008	FY 2007	FY 2006	FY 2005	FY 2004	FY 2000	FY 1990	FY 1980	FY 1970	FY 1960	FY 1950	FY 1940	FY 1930
General Property (a)	33.58%	30.83%	30.26%	30.24%	30.91%	31.30%	28.00%	32.34%	39.19%	53.06%	56.44%	52.19%	62.95%	82.02%
Sales and Use (b)	25.65	25.59	26.13	26.53	26.82	27.28	28.58	22.55	19.75	15.74	15.34	15.76	9.94	-
Income and Privilege	25.47	27.91	27.18	25.31	23.36	22.16	27.01	21.87	21.42	10.57	6.73	4.95	2.04	-
Motor Fuels	3.58	3.53	3.67	3.90	4.25	4.55	4.54	4.61	5.24	8.81	8.26	11.00	9.92	8.18
Various Vehicle (c)	2.94	2.75	2.76	2.87	3.06	3.15	3.31	5.66	-	-	-	-	-	-
Vehicle Registration	1.66	1.55	1.55	1.61	1.75	1.83	1.89	2.02	3.03	3.50	4.39	4.35	3.99	5.69
Unemployment Comp.	1.45	1.83	2.31	3.13	3.40	3.03	1.36	3.49	3.86	1.77	2.21	2.51	4.85	-
Severance	1.13	1.30	1.05	1.31	1.11	0.98	0.72	1.71	-	-	-	-	-	-
Insurance Premiums	1.09	1.10	1.10	1.16	1.22	1.31	0.86	1.44	1.54	1.22	1.31	1.22	0.99	1.05
Cigarette and Tobacco	0.96	0.97	1.02	1.12	1.24	1.34	0.67	1.15	1.44	2.20	1.83	2.08	1.27	0.63
Liquor and Beer	0.95	0.87	0.85	0.87	0.90	0.94	0.93	1.03	1.30	1.08	1.09	2.24	0.49	-
Mortgage Registration	0.35	0.41	0.44	0.51	0.52	0.65	0.46	0.25	0.38	0.20	0.28	0.39	0.30	0.30
Corporation Franchise	0.35	0.38	0.40	0.43	0.47	0.39	0.21	0.19	0.25	0.09	0.13	0.17	0.31	0.34
Transient Guest	0.27	0.26	0.22	0.22	0.23	0.22	0.22	0.15	0.04	-	-	-	-	-
Motor Carrier Property	0.25	0.24	0.22	0.20	0.20	0.21	0.20	0.20	0.19	0.15	0.16	0.09	0.03	(e)
Estate/Inheritance	0.19	0.36	0.47	0.47	0.52	0.52	0.80	0.89	1.19	0.82	0.82	0.48	0.39	0.67
Intangibles	0.04	0.03	0.03	0.02	0.03	0.03	0.06	0.23	0.98	0.64	0.70	1.09	0.93	0.72
Parimutuel	0.00	0.02	0.02	0.03	0.03	0.04	0.05	0.16	-	-	-	-	-	-
All Other (d)	0.07	0.07	0.08	0.08	0.08	0.08	0.13	0.06	0.20	0.15	0.31	1.48	1.60	0.40
Total	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**

(a) Taxes levied for collection during the fiscal year.
(b) Local sales taxes included starting in FY 1980.
(c) Includes motor vehicle, recreational vehicle, 16m and 20m "tagged" vehicles, and rental car excise taxes.
(d) Total revenue from nine taxes.
(e) Included in the general property tax until the law was changed in 1935.

TABLE 6

State and Local Government Taxes in Relation to Population and Personal Income

	FY 2009	FY 2008	FY 2007	FY 2006	FY 2005	FY 2004
State Taxes ($000)	$ 6,640,963	$ 7,205,627	$ 7,014,817	$ 6,521,366	$ 5,888,881	$ 5,470,064
Local Taxes ($000)	5,131,395	5,010,417	4,796,364	4,470,137	4,119,260	3,852,334
Total ($000)	**$ 11,772,358**	**$ 12,216,044**	**$ 11,811,181**	**$ 10,991,503**	**$ 10,008,141**	**$ 9,322,398**
State Population (000)	2,802	2,777	2,756	2,742	2,731	2,722
Kansas Personal Income ($ millions)	$ 108,778.7	$ 103,844.8	$ 98,554.4	$ 90,850	$ 87,171.4	$ 83,900.6
Per Capita Income	38,822	37,395	35,760	33,133	31,919	30,823
Per Capita Taxes						
State	$ 2,370	$ 2,595	$ 2,545	$ 2,378	$ 2,156	$ 2,010
Local	1,831	1,804	1,740	1,630	1,508	1,415
Total	**$ 4,201**	**$ 4,399**	**$ 4,286**	**$ 4,009**	**$ 3,665**	**$ 3,425**
Ratio of Taxes to Person Income						
State	6.11%	6.94%	7.12%	7.18%	6.76%	6.52%
Local	4.72%	4.82%	4.87%	4.92%	4.73%	4.59%
Total	**10.82%**	**11.76%**	**11.98%**	**12.10%**	**11.48%**	**11.11%**

Estimates of the U.S. Department of Commerce as of October 16, 2009.

Residential Exemption Summary

	Value	Penalty	Total Value	Tax	% Change
2010 July	29,511,131,498	39,804,338	29,550,935,836		
Residential Exemption	2,231,539,951		2,231,539,951	$ 44,630,799	0.3%
USD General Fund (20 mills)	27,279,591,547		27,319,395,885	$ 545,591,831	-2.9%
2009 November	30,312,186,115	47,174,193	30,359,360,308		
Residential Exemption	2,225,459,836		2,225,459,836	$ 44,509,197	0.5%
USD General Fund (20 mills)	28,086,726,279		28,133,900,472	$ 561,734,526	-2.4%
2008 November	31,000,343,745	49,576,073	31,049,919,818		
Residential Exemption	2,215,489,371		2,215,489,371	$ 44,309,787	0.8%
USD General Fund (20 mills)	28,784,854,374		28,834,430,447	$ 575,697,087	3.2%
2007 November	30,086,916,177	51,751,974	30,138,668,151		
Residential Exemption	2,197,903,494		2,197,903,494	$ 43,958,070	1.2%
USD General Fund (20 mills)	27,889,012,683		27,940,764,657	$ 557,780,254	4.1%
2006 November	28,964,281,984	49,721,986	29,014,003,970		
Residential Exemption	2,171,528,104		2,171,528,104	$ 43,430,562	1.4%
USD General Fund (20 mills)	26,792,753,880		26,842,475,866	$ 535,855,078	7.7%
2005 November	27,019,361,810	45,626,611	27,064,988,421		
Residential Exemption	2,142,325,690		2,142,325,690	$ 42,846,514	1.4%
USD General Fund (20 mills)	24,877,036,120		24,922,662,731	$ 497,540,722	6.8%
2004 November	25,398,439,083	49,348,317	25,447,787,400		
Residential Exemption	2,113,510,281		2,113,510,281	$ 42,270,206	1.4%
USD General Fund (20 mills)	23,284,928,802		23,334,277,119	$ 465,698,576	6.4%
2003 November	23,960,004,861	45,672,758	24,005,677,619		
Residential Exemption	2,084,634,673		2,084,634,673	$ 41,692,693	1.5%
USD General Fund (20 mills)	21,875,370,188		21,921,042,946	$ 437,507,404	4.3%
2002 November	23,034,628,287	46,396,186	23,081,024,473		
Residential Exemption	2,054,619,628		2,054,619,628	$ 41,092,393	1.4%
USD General Fund (20 mills)	20,980,008,659		21,026,404,845	$ 419,600,173	2.7%
2001 November	22,458,551,515	46,790,369	22,505,341,884		
Residential Exemption	2,026,375,183		2,026,375,183	$ 40,527,504	1.5%
USD General Fund (20 mills)	20,432,176,332		20,478,966,701	$ 408,643,527	8.2%
2000 November	20,874,510,721	44,475,083	20,918,985,804		
Residential Exemption	1,996,408,068		1,996,408,068	$ 39,928,161	2.1%
USD General Fund (20 mills)	18,878,102,653		18,922,577,736	$ 377,562,053	6.9%

Special Committee on Assessment and Taxation

September 16-17, 2010

Attachment #6

Special Committee on Assessment and Taxation

State and Local Tax Policy

Conclusions and Recommendations

The Committee expresses its concern about the recent trend of legislation that would earmark future sales, income, and property tax streams for funds other than the State General Fund (SGF). The Committee recommends that the withholding tax in particular no longer be allowed to be diverted away from the SGF, except as a last resort relative to retention of an existing business. The Committee further expresses its concern about the erosion of all major tax bases, especially the sales tax base. The Committee strongly recommends that certain specific questions relating to justification of any new exemptions be answered by all parties seeking sales tax exemption legislation. The Committee also strongly recommends that the leadership of the standing tax committees develop rules that would prohibit advancement of any sales tax exemption legislation until these questions have been answered satisfactorily by proponents.

The Committee notes that the top corporation income tax bracket may represent an economic development disincentive and encourages the 2007 Kansas Legislature to consider reducing that rate as part of a broader restructuring of the corporation income tax. That restructuring also should include simplification of the "high performance" income tax credit program be simplified; and the creation of broader availability for investment income tax credits in general. The Committee recommends the repeal of seldom-used income tax credits.

The Committee further recommends a corporation franchise tax exemption for certain assets of subsidiary corporations.

The Committee finds that one of the biggest future challenges involves local governmental service delivery systems and public angst over the property taxes associated therewith.

The Committee asks the Property Valuation Division to conduct a study of townships and report back to the tax and local government committees with respect to how many townships are actively levying property taxes; and what are the range of activities being funded.

The Committee also recommends that the Legislature act as a facilitator to the discussion of local service delivery restructuring by enacting legislation that would repeal any and all statutory barriers to restructuring. The Secretary of Revenue should compile an exhaustive list of all such barriers and submit it to the tax and local government committees during the first week of the 2007 session.

The Committee further recommends that a tool be developed to evaluate the possibility of multi-jurisdictional service-delivery systems by quantifying potential property tax savings associated with such entities. This tool, which would be developed under the auspices of the KACIR, would be made available free-of-charge to local units of government wishing to explore realignment of certain services, including infrastructure maintenance, health, vehicle registration, reappraisal, elections, and deed registration. Access to such information would allow local units of government and their taxpayers to make well-informed decisions about how to proceed.

Special Committee on Assessment and Taxation
September 16-17, 2010
Attachment #7

A second model should also be developed by KACIR that would help estimate the amount of property tax relief that could be provided if the funding of certain public safety functions were to be assumed by the state. One proposal would empower citizens within each of the 31 judicial districts to abolish county attorneys and replace that system with state-funded district attorneys. Data should continue to be compiled prior to the start of the session regarding county attorney budgets and mill levy equivalencies, and the tax and judiciary committees should jointly review the data. Legislation should subsequently be introduced that would allow citizens within the judicial districts to hold elections that would change their prosecutorial model. The model also should continue to be adapted to help quantify property tax relief associated with having additional state funding of other public safety functions, including corrections.

Proposed Legislation: None.

BACKGROUND

The 2005 Special Committee on Assessment and Taxation, as part of a broad topic entitled, "Analysis of State and Local Tax Policy," received a report from Secretary Wagnon on a number of studies that had been commissioned by the Department of Revenue and the Kansas Advisory Commission on Intergovernmental Relations (KACIR), including studies of sales and property tax base erosion; tax incidence; and the rapid expansion of state and local governmental debt. That Committee anticipated "the importance of the need to give these reports in-depth review and therefore requests that the Legislative Coordinating Council (LCC) again approve a Special Committee on Assessment and Taxation to study the same state and local tax policy topic during the summer and fall of 2006."

The LCC subsequently agreed to renew the broad-based state and local tax study, charging the 2006 Special Committee with studying and projecting the future of Kansas tax policy for the next 10 to 20 years. As a follow-up to a 2005 interim study, the 2006 Committee was further asked to review the current state and local tax structure, focusing on the shifts in reliance on sales, property, and income taxes since 1990. The Committee was asked to review which tax structure components would be most equitable to the taxpayers of Kansas; and would improve Kansas' competitiveness with other states.

Other 2005 Recommendations

In addition to recommending that a new study be empaneled to receive the studies being prepared by the Department of Revenue and KACIR, the 2005 Special Committee made a number of other findings and recommendations in three areas – state and local tax policy linkage; long-run growth and the SGF; and business tax recommendations.

State and Local Tax Policy Linkage

- The Committee recommended that the context within which the Legislature views state tax policy and potential changes should always include consideration of the implications on local tax policy, especially property taxes.

- The Committee strongly encouraged the 2006 Legislature to provide property tax relief by authorizing the restoration of sales tax demand transfers to local units of government. If it was determined that the demand transfer program needed to be restructured, the Committee recommended that special emphasis be placed on providing additional funds for local units in rural areas.

- The Committee also asked that the standing tax committees monitor the implications of the growing regional differences in local sales tax rates.

Long-Run Growth and the SGF

- The Committee made a finding that the overall elasticity of tax receipts, especially SGF tax receipts, appeared to be declining to the point that the ability of the state to fund ongoing and necessary expenditures without periodic tax increases has been imperilled. The Committee expressed its concern about the recent trend of legislation to earmark future sales, income, and property tax revenue streams from specific industries or businesses, including legislation associated with the development of sales-tax-and revenue bonds and the neighborhood revitalization program.

- The Committee, therefore, recommended that a more rigorous fiscal review be applied to future legislation seeking to earmark revenues historically placed in the SGF and asked that all such bills be referred to the standing tax committees.

- Because of the proliferation of legislation associated with the diversion of revenues, the Committee asked that the standing tax and appropriations committees' work with staff at the Division of Budget and the Legislative Research Department to develop a new monthly receipts report that disaggregates taxes and other receipts relative to the amount placed in the SGF compared to the amount placed in all other funds.

- Also because of the concern over long-run state revenue growth issues, the Committee further recommended that the 2006 Legislature memorialize Congress to minimize all federal preemption of state taxing authority.

Business Tax Recommendations

- The Committee expressed its concern about the volatility of corporation income tax receipts over the last decade. The Committee therefore recommended that the Department of Revenue report to the standing tax committees on policy options regarding modernization and structural changes to the tax that would help assure that it continues to be a viable revenue source well into the future.

- The Committee recommended that the Legislature attempt to provide a property tax exemption for commercial and industrial machinery and equipment and notes that options under consideration would include a full statutory exemption; expansion of the existing income tax credit to 100 percent; or a constitutional amendment authorizing the Legislature to phase in a full exemption over a period of years.

Committee Activities

At the September meeting, the Committee received the KACIR studies, which were conducted by the Kansas Public Finance Center, a part of the Hugo Wall School of Urban and Public Affairs at Wichita State University.

Dr. John Wong presented a study on tax incidence. Among the principal findings was a conclusion that the Kansas individual income tax is modestly progressive; and that such progressivity does not completely offset the regressivity of the other major tax sources.

Dr. Wong then presented a study on sales tax base erosion, noting that economic and technological changes in recent years had joined legislatively enacted exemptions as the major sources of erosion. He said that one study had estimated that extending the tax to all "readily taxable" services could

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increase revenue by over $500 million. He added that the main arguments for inclusion of additional services in the sales tax base included:

- the sales tax should be as broadly applicable to consumer expenditures as possible;
- taxation of services would reduce the regressivity of the sales tax;
- revenues would be more responsive to rising levels of personal income; and
- administration of the tax would be simplified if the tax were extended to those services entered in conjunction with the sales of tangible personal property.

Dr. Glenn Fisher presented a study on property tax base erosion, stating that the Kansas property tax is evolving largely into a real estate tax, due at least in part to the increased propensity of the Legislature to exempt personal property. He said that given the importance of the tax for local government revenue, any major changes in the property tax system would likely be controversial and potentially painful.

Dr. Bart Hildreth presented a study on the extent to which Kansas local government debt has been increasing over the last 15 years. He said that policy choices for those concerned about the mounting local debt burden included enacting tighter limits; promoting debt coordination; and enhancing transparency to enable taxpayer "comparison" shopping.

The Chair subsequently offered an invitation to all communities across Kansas to attend the October meeting and outline their service deliveries and revenue needs in their respective regions. Communities were invited to determine how an ideal local funding package might look and to bring any and all innovative approaches forward to the Committee.

At the October meeting, Secretary Wagnon delivered her perspective on the past, present, and future of Kansas state and local tax policy. She said that if the Legislature continued to allow erosion of the major tax bases, there would be higher tax rates; less equity among various groups of taxpayers; less competitiveness and more taxpayer discontent; and more special interest groups' requesting exemptions – creating a vicious cycle.

She said that the KACIR studies had indicated that Kansas state and local tax policy faces a number of serious challenges in addition to tax base erosion, including over-reliance on the property tax; declining elasticity of major tax sources; and increasing demands on state and local governmental services.

Secretary Wagnon said that tax base erosion had been occurring because of the enactment of a number of exemptions and tax credits; and because of economic shifts in consumption and business practices, many relating to new technologies. She also said that the authorization of sales tax and revenue (STAR) bonds and the propensity of the Legislature to earmark future revenue streams threatened the elasticity of tax receipts relative to the State General Fund (SGF). She said that once a special practice or tax treatment had been established, it was often difficult for the Legislature to backtrack and stop that process. Faced with a similar situation more than three decades ago, the "Hodge Committee" in the early 1970s formed a special commission to review tax policies and make decisions on which special exemptions, exceptions, and credits should be restructured or totally eliminated.

The Secretary said that she hoped the Committee would strongly recommend that the Legislature, in the future, protect the withholding tax and not allow any other circumstances wherein major tax sources could be diverted from the SGF.

The Secretary subsequently outlined a variety of policy options for the Committee to consider, including modernizing the corporation income tax structure by adjusting the rate structure and the apportionment formula; simplifying various business-related tax credits and repealing those which are seldom used; developing criteria for evaluating future sales tax exemption requests; eliminating the franchise tax imposed on the assets of certain subsidiary corporations; and continuing the discussion about restructuring local government finance.

Conferees representing AARP and Kansas Action for Children said that Kansas should consider a number of equity issues, including the ability to pay, when looking at major tax structure issues.

The Executive Director of the League of Kansas Municipalities said that cities could reduce reliance on property taxes if they were granted additional authority to levy local income, earnings, motor fuel, and excise taxes. He also said that the Legislature could remove impediments that discourage local units from combining for the purpose of streamlining the delivery of local governmental services.

A conferee representing the Kansas Association of Counties agreed, stating that all levels of government needed to nurture a culture of cross-jurisdictional collaboration.

A representative of the Unified Government of Wyandotte County and Kansas City, Kansas, said that the entity strongly supported a local option earnings tax which could be used to further reduce property taxes.

A conferee representing the Kansas Chamber of Commerce and Industry stated that the business machinery and equipment property tax exemption was extremely helpful to many Kansas businesses; and that some form of corporation franchise tax relief would continue to help those businesses stimulate the economy.

Following a discussion of local revenue needs, the Committee began an extensive discussion of local and regional service delivery structures. The Chair stated that the number of local units of government in Kansas was the highest in the nation in per capita terms and wondered aloud whether the more than 4,000 taxing entities in the state represented the most efficient structure for delivering services. Representative Jerry Henry suggested that one of the universities or the KACIR attempt to build a model for analyzing a multi-county service delivery system with an emphasis on efficiency and not on politics. The Chair said that he would try to have Secretary Wagnon, prior to the November meeting, coordinate discussions about that idea with local units of government and other stakeholders. Secretary Wagnon said that she would bring the topic up for discussion on November 1 at the KACIR summit in Salina. Senator Derek Schmidt and Senator Greta Goodwin also volunteered to establish a working group that would explore the possibility of relieving local property taxpayers of the burden of supporting most public safety functions by moving most funding for such functions to the state level.

At the November meeting, the Committee reviewed its work at the previous two meetings and made final policy decisions.

Conclusions and Recommendations

Long-Run Growth and SGF Receipts

The Committee again expresses its concern (just as it did in 2005) about the recent trend of legislation that would earmark future sales, income, and property tax streams for funds other than the SGF.

The Committee recommends that the withholding tax, in particular, no longer be allowed to be diverted away from the SGF, except as a last resort relative to retention of an existing business. The Committee encourages the Legislature to first attempt to utilize any and all other tools at its disposal in business retention or business attraction efforts.

The Committee further expresses its concern about the erosion of all major tax bases, especially the sales tax base. The Committee strongly recommends that certain specific questions relating to justification of any new exemptions be answered by all parties seeking sales tax exemption legislation (see Tax Incidence and Tax Base Erosion topic for more details).

The Committee also strongly recommends that the leadership of the standing tax committees develop rules that would prohibit advancement of any sales tax exemption legislation until these questions have been answered satisfactorily by proponents.

Business Tax Recommendations

The Committee notes that the top corporation income tax bracket of 7.35 percent may well represent an economic development disincentive and, therefore, encourages the 2007 Kansas Legislature to consider reducing that rate as part of a broader restructuring of the corporation income tax. As part of that restructuring, the Committee also recommends that the "high performance" income tax credit program be simplified; and that the availability of investment income tax credits in general be broadened. The Committee recommends the repeal of seldom-used income tax credits.

The Committee further recommends a corporation franchise tax exemption for certain assets of subsidiary corporations which have been subject to taxation previously as assets of parent corporations.

Local Governmental Service Delivery and Property Taxes

The Committee finds that one of the biggest challenges facing policymakers over the next decade involves local and regional governmental service delivery systems and public angst over the property taxes associated with those services and systems.

The Committee notes that townships by far appear to represent the largest number of taxing subdivisions in the state. The Committee asks the Property Valuation Division to conduct a study of townships and report back to the tax and local government committees with respect to how many townships are actively levying property taxes and how many are not; and what are the range of activities being funded by the townships.

The Committee also recommends that the debate regarding potential restructuring of local service delivery systems be driven by local needs and local issues and not by state mandates. The Legislature may best act as a facilitator to this discussion by enacting legislation that would repeal any and all statutory barriers and impediments to local governmental service restructuring. The Secretary of Revenue, in conjunction with the League of Kansas Municipalities and Kansas Association of Counties, should compile an exhaustive list of all such statutory impediments and submit it to the tax and local government committees during the first week of the 2007 legislative session.

The Committee further recommends that a tool be developed to evaluate the possibility of multi-jurisdictional service-delivery systems by quantifying potential property tax savings and budget reductions associated with such entities. This tool, which would be developed under the auspices of the KACIR by the Hugo Wall School of Urban and Public Affairs at Wichita State University in conjunction with input from the Kansas Association of Counties and League of Kansas Municipalities, would be made available free-of-charge to local units of government wishing to explore realignment of certain local services.

As part of the development of the aforementioned tool, the KACIR should seek the capacity to compare and contrast potential changes in Kansas with other successful examples of local service realignments from around the nation.

Local services and functions that potentially could be reviewed would include infrastructure maintenance, health, vehicle registration, reappraisal, elections, and deed registration. Access to such information would allow local units of government and their taxpayers to make their own well-informed decisions about how to proceed with the discussion.

A second model should also be developed by KACIR and the Hugo Wall School of Urban and Public Affairs that would help estimate the amount of property tax relief that could be provided if the funding of certain public safety functions were to be assumed by the state. One proposal discussed during the interim would empower citizens within each of the 31 judicial districts to abolish county attorneys and replace that system with state-funded district attorneys. Data should continue to be compiled prior to the start of the 2007 session regarding county attorney budgets and mill levy equivalencies, and the tax and judiciary committees should jointly review the data. Legislation should subsequently be introduced that would allow citizens within the judicial districts to hold elections that would change their prosecutorial model in this manner. The model also should continue to be adapted to help quantify the potential property tax relief associated with having additional state funding of other public safety functions, including corrections.

enacted in recent years had made the overall state and local tax structure more regressive.

Also at the October meeting, the Committee received information from the Department of Revenue on the potential impact on certain taxpayers of moving to a revenue-neutral single income tax ("flat") rate income tax structure. Replacing the current individual income tax rates with a 5.10 percent rate would in the aggregate be revenue-neutral, according to the information. The following table summarizes the average impact per return for taxpayers in various Kansas adjusted gross income (KAGI) brackets:

KAGI Brackets		Average Dollar Change
$ 0	$ 10,000	$ 15.39
10,000	20,000	83.26
20,000	30,000	126.29
30,000	50,000	206.89
50,000	75,000	166.19
75,000	100,000	(45.84)
100,000	200,000	(562.79)
$ 200,000	Over	$ (3,915.13)

At the November meeting, the Committee reviewed its work at the previous two meetings and made final policy decisions.

Conclusions and Recommendations

The Committee expresses its concern about the erosion of all major tax bases, especially the sales tax base. The Committee strongly recommends that the following questions be asked of and answered by all parties seeking sales tax exemption legislation:

(1) Does this exemption help maintain the sales tax as a final tax on consumption?

(2) Does this exemption help make the tax more easily administered, or would it lead to confusion over why one organization or entity is taxed while another is not?

(3) Who is the principal beneficiary? What would be lost if the exemption were not to be granted?

(4) Does this exemption establish an unfair competitive advantage for one entity over another?

(5) Is this exemption targeted to a broad class of taxpayers or a narrow group? If the latter, why should all members of the broad class not be included? If the exemption were to be granted, what other groups would look at the precedent and asked to be added to the exemption?

(6) What is the public benefit for granting the exemption? Does it outweigh the loss of revenue for the general activities of the state?

The Committee further recommends that the leadership of the Senate Assessment and Taxation Committee and the House Taxation Committee develop committee rules that would prohibit advancement of any sales tax exemption legislation until these questions have been answered satisfactorily by proponents of such legislation.

Finally, the Committee recommends that the standing tax committees consider tax incidence and progressivity-regressivity issues with respect to all major state and local tax policy changes.

Special Committee on Assessment and Taxation

September 16-17, 2010

Attachment #8

Legislative Post Audit Performance Audit Report Highlights

Highlights

Kansas Tax Revenues, Part II: Reviewing Sales Tax Exemptions

Report Highlights

February 2010 • 10PA03.2

Audit Concern

Legislators have expressed an interest in knowing whether some sales tax exemptions should be considered for elimination.

Other Relevant Facts

Over the years, the percent of State revenues provided by sales taxes has declined from 51% in fiscal year 1980 to 49% in fiscal year 2009.

Most sales tax exemptions don't have a measurable purpose. In essence, they subsidize the operations of all entities granted the exemption by lowering their costs of doing business, or by making it "easier" for people to buy their products.

Many sales tax exemptions were created or expanded in recent years, including 12 new or expanded exemptions in 1998, 8 in 2001, and 25 in 2006 and 2007.

13 of the State's 99 sales tax exemptions account for $4.1 billion or 96% of the forgone sales tax revenue. In all, 6 of those 13 exemptions ensure that goods are taxed only at the final point of sale, or avoid taxation of governmental entities. Those 6 exemptions cost about $3.4 billion.

AUDIT QUESTION: *Does Kansas Have Sales Tax Exemptions that Potentially Should Be Considered for Elimination?*

AUDIT ANSWER and KEY FINDINGS:

- Kansas currently has 99 sales tax exemptions costing the State an estimated $4.2 billion in fiscal year 2009.
- Sales tax exemptions in several areas aren't in line with good tax policy because they provide unequal treatment for similar types of taxpayers. For example,
  - exemptions for 44 specifically named non-profit organizations or associations, costing about $2.2 million annually
  - exemptions for non-profits such as hospitals and nursing homes but not their for-profit counterparts
  - an exemption for coin-operated laundries, but not other laundry or coin-operated businesses
- Some of the costliest sales tax exemptions enacted as a matter of public policy relate to machinery and equipment ($231 million), educational/ youth activities ($58.5 million), labor services ($182 million), utilities ($136 million), and health care ($70 million). Although there may be good public policy reasons for having such exemptions, they significantly erode the State's tax base.
- Recently, many sales tax exemptions have been expanded to exempt "sales by" or "purchases made on behalf of" certain organizations. Such provisions broaden those entities' exemptions, are looser and more at-risk of abuse, and don't distinguish between isolated/occasional sales and ongoing sales.
- The Legislature hasn't adopted broad policy goals regarding the types of organizations, services, or activities it wants to exempt from sales taxes, making it difficult to have a consistent basis for deciding which exemptions have merit and should be continued.

Special Committee on Assessment and Taxation

September 16-17, 2010

Attachment #9

We Recommended

- We recommended that the Legislature review the sales tax exemptions noted above to determine what changes if any should be made. We also recommended that the Legislature consider establishing a broad sales tax policy outlining the types of sales it wants to exempt and developing criteria regarding what fits within that broad policy.

Agency Response: *The Department of Revenue generally concurred with the report's findings and recommendations.*

DO YOU HAVE AN IDEA FOR IMPROVED GOVERNMENT EFFICIENCY OR COST SAVINGS?

If you have an idea to share with us, send it to ideas@lpa.ks.gov, or write to us at the address shown. We will pass along the best ones to the Legislative Post Audit Committee.

LEGISLATIVE DIVISION OF POST AUDIT

800 SW Jackson
Suite 1200
Topeka, Kansas 66612-2212
Telephone (785) 296-3792
FAX (785) 296-4482
E-mail: LPA@lpa.ks.gov
Website:
http://kslegislature.org/postaudit

Barbara J. Hinton,
Legislative Post Auditor

For more information about this audit report, please contact
KATRIN OSTERHAUS
(785) 296-3792
Katrin.Osterhaus@lpa.ks.gov

STATE OF KANSAS

ARLEN H. SIEGFREID
SPEAKER PRO TEM

September 16, 2010

MEMORANDUM

To: Members of the Special Committee on Assessment and Taxation
Re: Support for the Simplified State Tax Structure Committee

Mr. Chairman and Members of the House Taxation Committee:

As you know, one of the most daunting challenges we face as legislators stems from our inability to predict the ultimate consequences of the decisions we make. The Kansas tax code exemplifies this notion, and as it exists today, it represents a convoluted mosaic of proposals which renders many substantive changes in tax structure meaningless, ineffective, or counterproductive.

In response, I authored a proposal during this legislative session, establishing the Simplified State Tax Structure Committee. The bill simply aimed to assemble members of the House and Senate Tax committees to accomplish 3 simple goals:

1) Review our current tax structure to recognize inefficiencies and/or redundancies.
2) Submit recommendations on how to streamline our tax structure.
3) Develop a strategy to broaden and flatten the tax base while investigating the consequences to all citizens.

With this information, and their subsequent recommendations we will not only increase our competitive standing in relation to surrounding states, but also enable job creators in Kansas to thrive and grow. By designing a more streamlined and efficient tax code our producers are relieved of the burdens inherent in our current system—enabling them to in turn streamline their business models and create more jobs for Kansans.

However, a new tax model doesn't simply benefit producers; it also benefits us as legislators. The value of clarity and precision for this committee and others will be the ability to more accurately understand the direct impact of our decisions. By eliminating the analytical variables inherent in the current formula, we empower ourselves with the ability to more accurately determine what works, what doesn't work, and react accordingly.

Mr. Chairman, a simplified tax structure is one of the most basic tools we can incorporate in re-starting our economy. The concepts addressed in HB 2436 represent a critical part of this process. I encourage this initial step, and ask that the members of this committee join me in supporting this proposal.

Special Committee on Assessment and Taxation

September 16-17, 2010

Attachment #10

Topeka Office: Statehouse, Room 330-N, 300 SW 10th Ave, Topeka, KS 66612, Ph (78
Home Address: 1403 W. Prairie Terrace, Olathe, KS 66061, Ph (913) 764-36

Recommendations from KACIR to accompany the Policy Evaluation Guide

The relative burden of taxes borne by state and local property tax is now high compared to state and local sales taxes and state income taxes. Policy choices as well as the economy and taxpayer behavior have contributed to this shift. Generally, Kansas strives to keep these three sources at about one-third each.

State and Local Tax Receipts	FY 1995	FY 2008	
Sales and Use (state and local)	33.2%	$3.027B	29%
Income (Individual and Corp) and Privilege	29.0%	$3.580B	32%
Property, real and personal	37.8%	$3.770B	39%

There has literally been an explosion of new sales tax exemptions since 1995--some of them very significant in size, such as the expansion of the manufacturing machinery equipment exemption, the addition of exemptions for churches and a host of other non-profits, custom software, aircraft repair, to name a few. In addition, STAR bonds are becoming increasingly popular and the increasing number of projects may divert state sales tax revenues for a significant period of time. Transfers of sales tax revenue to the state highway funds, loss of revenue from internet shopping and the escalating trend of consumer dollars going to purchase services, most of which are non-taxable, all contribute to this picture.

At the same time income tax revenues will automatically increase in times of strong economic growth--and the late 90's and the years between the 2002 recession and the current one have produced phenomenal growth in income tax receipts. Incomes of the very wealthy have skyrocketed during these boom years, and the state's income tax coffers have benefited from that. Corporate income tax receipts have echoed that effect (although they can certainly crash in the bad years).

During this same period in the 90s, reduced funding for schools forced increased reliance on the local option budgets, causing property taxes to rise. Although a court challenge caused funding to increase dramatically for schools, the recent recession is trimming that level of funding back. The state should ensure that its actions in funding schools and other funding allocations to local government do not widen this gap further.

Knowing that the state budget resources are limited and there is no legislative appetite for tax increases, the KACIR has formulated these recommendations to address the erosion of the tax base and the imbalance in the states three major funding sources.

I. Property Tax Recommendations.

In order to reduce the reliance on property taxes:

1. The legislature should enact a moratorium on any new property tax exemption granted by the legislature for the years 2010, 2011, and 2012. Any new exemption that is granted should automatically sunset in 3 years to ensure a review of its effectiveness.

Special Committee on Assessment and Taxation

September 16-17, 2010

Attachment #11

2. In addition to the moratorium, the legislature should direct Legislative Post Audit to reexamine all property tax exemptions granted since 1995 to ensure the exemption is performing as expected and report to the tax and appropriations related committees in the House and Senate. The following schedule will allow for such review during the next 3 years:

- Exemptions granted 1995 – 2000 Review in 2010
- Exemptions granted 2001 – 2005 Review in 2011
- Exemptions granted 2006 – 2011 Review in 2012

3. The tax and appropriations committees in the House and Senate should examine the following specific exemptions in the 2010 session and review the effectiveness of each one. The KACIR questions whether these are meeting the stated public policy objectives and whether they need to be changed or repealed.

- Exemptions for pipelines, K.S.A. 79-227
- Exemptions for refineries, K.S.A. 79-226
- Exemption for low production oil wells, in light of price of oil/barrel, K.S.A. 79-201t
- Lifetime exemption for Wind Farms, K.S.A. 79-201 eleventh

4. Local governments should examine the potential savings from County-County consolidation, City-County consolidation, functional or regional consolidation. Tools to evaluate consolidation are available from the KACIR, on the Department of Revenue website, www.ksrevenue.org.

II. Sales Tax Recommendations.

Erosion of the sales tax base is a rapidly growing problem. Local governments are becoming very dependent on the sales tax to supplement the property taxes as a source of revenue, but they have little say in exemptions that are granted.

1. At a minimum, the legislature should enact a moratorium on any new sales tax exemption granted for the years 2010, 2011, and 2012. Any new exemption that is granted should automatically sunset in 3 years.

2. The KACIR has reviewed the existing sales tax exemptions and recommends a group to be repealed. The total fiscal note for FY 2011 is $207.84 million, including the consumer utility exemption. Without the utilities, the total is $67.7 million. Business services are not included. This list was compiled by using the following policy choices:

- Repeal all exemptions granted "by name" to a specific organization. Either replace it with an exemption for all organizations similarly situated, or revoke the exemption.

- Tax all admissions to recreation activities or events, whether operated by a non-profit organization, city, county or private organization. These changes should be made in the 2010 legislative session.

- Reestablish the policy that was set by the Hodge Commission that all non-profit and religious organizations pay sales tax on their purchases.

- Clarify the original construction statute to remove repair and tax separately the repair of personal property. (Currently these services are taxed if they include the alteration or repair of tangible personal property.) The result is that washing a floor is not taxed, but waxing a floor (applying tangible personal property) is taxed. There are also problems with distinguishing labor services in the repair area from original construction. The change will rewrite those statutes for clarity and ensure that all the household labor services are appropriately taxed, with or without the application of tangible personal property.

3. If the legislature is unable to repeal these specifically identified exemptions, the KACIR recommends that all current sales tax exemptions, with the exception of those that are definitional exclusions, be scheduled to automatically sunset over the next 5 years so they may be reexamined by the legislature.

4. The legislature should consider imposing a sales tax on household or personal services more broadly. These include items such as tanning beds, beauty and barber, etc. A specific imposition statute would be required. The KACIR recommendation does NOT include business inputs or health services such as medical, dental, legal, advertising, etc. The fiscal note is approximately $5.9 million in FY2011.

5. The legislature should develop and adopt a comprehensive policy for exempting fund-raising events of non-profit organizations and require all existing exemptions to come into compliance with this policy by 2012.

6. If the sales tax exemptions are not repealed, then the Legislature should change its practices and begin to appropriate money specifically for the recipients of the exemption.

III. Income Tax Recommendations.

Tax credits continue to proliferate, as do the requests from business to retain the withholding tax as an incentive to development in addition to other tax incentives. Income taxes are still the most elastic tax source (grow as the economy grows) but without some protection, this most important of tax sources will soon erode significantly in the same manner as the property and sales taxes. The following recommendations protect the income tax base (corporate, individual and privilege):

1. Enact legislatively a moratorium on any new income tax credit granted by the legislature for the years 2010, 2011, and 2012. Any new credit that is granted should automatically sunset in 3 years.

2. Enact legislatively a moratorium on any new incentive program that permits the utilization of an employer's withholding tax as an incentive to development. Presently the Impact Fund and the PEAK program are using these funds, as well as several special authorizations for manufacturers (Cessna, Spirit, Siemens, Goodyear.)Impact is a well-funded mechanism for economic development and should be the only dedicated use of the withholding tax.

3. Tax credits should not be transferable. Legislative Post Audit is undertaking a study of tax credits so KACIR will wait to see their report before making further recommendations on transferability or refundability.

4. The Historic Preservation Tax Credit must be reexamined and adjusted by the legislature in 2010.

5. All tax credits that were enacted in 2008 and 200should be reviewed in 2012.

6. There are numerous credits that are no longer used. They should be repealed for two reasons: the space on the tax form is limited, and with the move to electronic filing, the vendors do not want to program for a credit that is not used.

7. Those credits that were only minimally used, under $100,000 should be amended to sunset in 2011 so they can be reviewed by the legislature in 2011.

REPEAL THESE CREDITS:
This list is of credits in tax year 2007 that were not utilized.
Either dollars, filers, or fewer than 5 so the amount is confidential.

Statutory Reference	Description	Beg Date	End Date
These credits have no sunset date:			
K.S.A. 65-7101	Assistive Technology Contribution credit	2003	none
K.S.A. 79-32,207 *Confidential	Plugging an abandoned oil or gas well credit	1998	none
K.S.A. 79-32,204	Swine facility improvement credit	1998	none
K.S.A. 79-32,200	Temporary assistance to families contribution credit	1994	none
K.S.A. 74-50,208 *Confidential	Individual Development Acct credit	2005	none
K.S.A. 79-32,242 *Confidential	Law Enf Training Center credit	2006	None
These credits have a sunset date:			
K.S.A. 79-32,233	Biomass-to-Energy credit	2006	2011
K.S.A. 79-32,239	Integ Coal Gasification Power Plant credit	2006	2011
K.S.A. 79-32,229	Nitrogen Fertilizer Plant credit	2006	2011
K.S.A. 79-32,218 *Confidential	Petroleum Refinery credit	2006	2011
K.S.A. 79-32,224	Qualifying Pipeline credit	2006	2011
K.S.A. 79-32,212 *Confidential	Single city port authority credit	2002	2021

JOAN WAGNON, SECRETARY

KANSAS

DEPARTMENT OF REVENUE
OFFICE OF THE SECRETARY

MARK PARKINSON, GOVERNOR

Testimony for the Interim Joint Committee on Taxation
Septmber 16, 2010

I have often suggested to various Taxation committees, that we need to modernize our tax systems. We have made great strides in the administration of taxes, such as more authority for electronic filing, improved processes for collecting taxes, but the policy side still needs much work.

Studies which have been completed in the last 3-5 years under the auspices of the Kansas Advisory Council on Intergovernmental Relations and the Department of Revenue have pointed out potentially devastating trends in tax policy. Those trends point to the narrowing of the tax base, the accelerating use of exemptions and credits which contribute to that base erosion, and the changes in the economy which make provisions in our tax code outmoded and outdated. For example, the telecommunication industry is changing faster than states can modernize their definitions. The use of digitally delivered books, instead of hard copy books is another example of economic changes affecting the tax base. Those studies have been presented to both regular and interim taxation committees. Copies of the executive summary are attached. The complete studies are available on the department's website: www.ksrevenue.org/KACIR

There is value in "taking a step back" occasionally, and thoughtfully and completely examining the tax climate in a state, and recommending changes. The most complete and far reaching such examination was in the 1970's when the Hodge Commission promulgated sweeping changes which the legislature enacted. It has taken nearly 35 years to undo some of their fine work. The Hodge Commission was basically a multiyear interim study by the legislature which produced many recommendations.

The 1995 Tax Equity Task Force, created by Executive Order of Governor Graves, produced scholarly work and useful ideas, but failed to produce a legislative champion to see their ideas and strategies enacted into law. I have personally referred to that work when looking for information, or ways to solve problems. This report provided impetus for the removal of the

DOCKING STATE OFFICE BUILDING, 915 SW HARRISON ST., TOPEKA
Voice 785-296-3041 Fax 785-296-7928 http://www.ksreve

A

Proposal for a Tax Reform Commission

The state tax structure hasn't been reviewed in a comprehensive manner since 1995 when Governor Graves Tax Equity Task Force issued its report which included tax policy objectives and findings. That report consisted of a number of research papers which examined many facets of the tax system; however, few of its recommendations were enacted into law. Instead, the legislature set about cutting taxes and reduced the tax base by $990 million by the end of the decade, forcing the legislature to raise sales tax and franchise tax rates in order to weather an economic downturn in 2001.

Since then, the number of tax credits and sales tax exemptions has proliferated, and the legislature has passed legislation to eliminate the inheritance tax and the franchise tax. This intentional narrowing of the tax base has caused concern among some advocacy organizations, particularly those concerned with children, schools, local government. Other economic forces are narrowing the tax base as well, such as the loss of sales tax base as consumers accelerate their purchases on the internet without remitting sales tax.

Advocates for tax reform cite the changes in the economy of the 21st century as a compelling reason for creating a tax structure for the 21st century that matches up with the dramatic changes in the economy and taking a multilevel view of the state economy, from local to state to federal.

Therefore, the Governor is asked to create by executive order a tax reform commission charged with analyzing the current tax system in light of the new economy and recommending whatever changes are needed to meet the following objectives:

a. Preventing further erosion of the tax base through credits, exemptions and other legislative enactments as well as erosion because of the growing service economy;
b. Sustaining a sufficient revenue flow to meet the state's obligations as well as those of local governments and schools;
c. Modernizing tax laws to meet needs of rapidly changing industries including telecommunications;
d. Distributing the tax burden equitably
e. Designing a tax code to grow the Kansas economy while making Kansas an attractive business location.

The Tax Reform Commission is authorized to conduct meetings at locations around the state, take testimony, contract for additional studies if necessary, and work with stakeholders in order to provide a preliminary report of findings and conclusions to the Governor and Legislature by January, 2009, and again on January, 2010. The Commission will expire on December 31, 2010 and shall publish its final report of findings and conclusions in 2010.

Structure of the Commission shall be as follows:

a. One representative of a global export business, preferably in the agricultural sector;

B

History of Sales Taxes in Kansas, including establishing LAVTR.

A collective sense of urgency enveloped the enactment of state sales tax in Kansas. National lawmakers had passed the Social Security Act in August of 1935. In March of 1936, Kansas officials were notified by the U.S. Social Security Board that the state's plan for administering assistance under the act–relying as it did under the Kansas constitution on county administration–did not meet federal requirements for state administration nor assure equitable distribution of assistance throughout the state. Governor Landon interrupted his campaign for president to call a special session of the Kansas legislature in July and request that lawmakers propose amendments to the state constitution that would bring Kansas into compliance with the national law, allow for state financial participation, and make Kansans eligible for assistance. Lawmakers complied, and Kansas voters adopted the amendments in November by over a two-to-one margin. Shortly thereafter, the 1937 legislative session was called to order and faced the immediate issue of how to implement and finance state participation in the national act.

A state sales tax had been given consideration by state officials prior to 1937, but few had stepped forward to justify the tax. A state tax code commission had embraced a state income tax in 1929 but also concluded that no form of sales taxation offered a satisfactory solution in Kansas. The Kansas farm lobby had opposed taxation of sales in 1931 and 1933, and was joined in their opposition by organized labor in 1935. A few business interests had promoted a state sales tax in the early 1930s but more from a desire to scuttle enactment of the state income tax than from principles of taxation. While neither candidate in the 1936 campaign for governor raised the issue of a sales tax, Democrat Walter Huxman called for state relief for needy and elderly citizens and state assistance to schools through some form of "direct taxation." Against a less than positive backdrop, a two percent tax on retail sales sailed through both houses of a Republican-controlled legislature by wide margins in April of 1937.

Once elected governor, Huxman acknowledged, as did most state legislators, that the sales tax was a regressive tax that fell more heavily on the poor. Huxman gave lukewarm support to a one percent sales tax as a source of needed revenue and did sign the final bill. In final legislative action on the sales tax bill a number of opposing lawmakers decried the

2

Kansas Department of Revenue
Sales Tax Exemptions, Admissions and Legislative Proposals

Admissions	Taxable	Exempt
Museums	x	
Historical Societies	x	
Community Theaters	x	
Cosmosphere	x	
PTA/PTO Carnival	x	
4-H Club Events	x	
County Fairs	x	
Friends of the Library Charitable Event	x	
Friends of the Zoo Event	x	
Non-profit Association Fundraising Events	x	
Golfing Fundraising Event for a non-profit org,	x	
Community Days (Wild West Days, Apple Cider Days, Prairie Days, etc)	x	
American Lung Association event	x	
Charity auction	x	
Cultural event held once every 3-years		x
Rotary clubs events	x	
Chamber of commerce events	x	
United Way fundraisers	x	
Little League Games	x	
County sponsored ball games	x	
Fitness Clubs memberships	x	
Zoos	x	
School dances	x	
School athletic events	x	
School class reunion	x	
Annual Event and admission based on purchasing TPP (i.e. button - RiverFest, Railroad Days)		x
City swimming pool		x
Privately owned swimming pool	x	

(note, the above is not addressing participation in sports by youth, those fees are generally exempt from tax)

Kansas Department of Revenue
Sales Tax Exemptions, Admissions and Legislative Proposals

	******************************Exempt				******************************	
	Purchases of TPP	Purchases of Services	Indirect Purchases by Contractor	Sales of TTP	Sales on Behalf Of	Sales of Services
2006 Legislative Proposals						
Catholic Charities	x	x	x	x	x	
CHWC (Comm Housing Wyan Co)	x			x	x	
County Law Library				x	x	
Cross Lines Cooperative	x			x	x	
Dreams Work, Inc	x			x	x	
Food Pantries	x			x	x	
Homeless Shelters	x	x	x	x	x	
KSDS, Inc Ks Specialty Dog Service Inc.	x			x	x	
Lymn Assn of Greater Kansas City	x			x	x	
Marillac Center	x		x	x	x	
Sales by public library				x	x	
SkillsUSA conference.	x	x				
Special Olympics	x	x		x	x	
TLC	x	x	x	x	x	
West Sedgwick County - Sunrise Rotary Club and Sunrise Charitable Fund	x	x				
Youthville	x	x	x	x	x	

D

Kansas Department of Revenue
Office of Policy and Research
Sales Tax Exemption Fiscal Impact Estimate -All Funds
(dollars in millions)

	Receipts	FY 2011 3%	FY 2012 3%	FY 2013 3%	FY 2014 3%	FY 2015 3%	FY 2016 3%
Professional, Scientific & Technical							
Legal Services	$ 786,065	$ 26,017	$ 26,797	$ 27,601	$ 28,429	$ 29,282	$ 30,160
Accounting & Tax Services	$ 643,230	$ 21,289	$ 21,928	$ 22,586	$ 23,263	$ 23,961	$ 24,680
Architectural Services	$ 294,852	$ 9,759	$ 10,052	$ 10,353	$ 10,664	$ 10,984	$ 11,313
Engineering Services	$ 1,793,645	$ 59,365	$ 61,145	$ 62,980	$ 64,869	$ 66,815	$ 68,820
Drafting Services	$ 3,751	$ 124	$ 128	$ 132	$ 136	$ 140	$ 144
Building Inspection Services	$ 4,054	$ 134	$ 138	$ 142	$ 147	$ 151	$ 156
Geophysical surveying and Mapping	$ 17,680	$ 585	$ 603	$ 621	$ 639	$ 659	$ 678
Surveying and Mapping (except geophysical)	$ 29,485	$ 976	$ 1,005	$ 1,035	$ 1,066	$ 1,098	$ 1,131
Testing Services	$ 66,724	$ 2,208	$ 2,275	$ 2,343	$ 2,413	$ 2,486	$ 2,560
Specialized Design Services (1)	$ 121,340	$ 4,016	$ 4,136	$ 4,261	$ 4,388	$ 4,520	$ 4,656
Computer 'systems design & related services	$ 1,966,137	$ 65,074	$ 67,026	$ 69,036	$ 71,108	$ 73,241	$ 75,438
Management, Scientific &Technical Consulting	$ 737,212	$ 24,400	$ 25,132	$ 25,886	$ 26,662	$ 27,462	$ 28,286
Scientific research & development services	$ 255,313	$ 8,450	$ 8,704	$ 8,965	$ 9,234	$ 9,511	$ 9,796
Advertising & Related Services	$ 608,358	$ 20,135	$ 20,739	$ 21,361	$ 22,002	$ 22,662	$ 23,342
Other Prof. Tech, and Science (2)	$ 451,038	$ 14,928	$ 15,376	$ 15,837	$ 16,312	$ 16,802	$ 17,306
Total, Professional, Scientific & Technical	**$ 7,778,884**	**$ 257,459**	**$ 265,183**	**$ 273,138**	**$ 281,332**	**$ 289,772**	**$ 298,465**
Administrative & Support Services							
Office Aministrative Services	$ 343,428	$ 11,366	$ 11,707	$ 12,059	$ 12,420	$ 12,793	$ 13,177
Facilities Support Services	$ 122,236	$ 4,046	$ 4,167	$ 4,292	$ 4,421	$ 4,553	$ 4,690
Employment Services	$ 1,229,323	$ 40,687	$ 41,908	$ 43,165	$ 44,460	$ 45,794	$ 47,167
Business Support Services	$ 627,631	$ 20,773	$ 21,396	$ 22,038	$ 22,699	$ 23,380	$ 24,081
Travel Arrangement and Reservation Services	$ 86,734	$ 2,871	$ 2,957	$ 3,045	$ 3,137	$ 3,231	$ 3,328
Investigation and Security services	$ 193,621	$ 6,408	$ 6,601	$ 6,799	$ 7,003	$ 7,213	$ 7,429
Services to buildings and dwellings (3)	$ 830,576	$ -					
Other Support Services	$ 210,735	$ 6,975	$ 7,184	$ 7,399	$ 7,621	$ 7,850	$ 8,086
Total, Administrative & Support Services	**$ 3,644,284**	**$ 93,126**	**$ 95,919**	**$ 98,797**	**$ 101,761**	**$ 104,814**	**$ 107,958**
Health Care Services							
Physicians	$ 3,384,563	$ 112,019	$ 115,380	$ 118,841	$ 122,407	$ 126,079	$ 129,861
Dentists	$ 819,702	$ 27,130	$ 27,944	$ 28,782	$ 29,645	$ 30,535	$ 31,451
Other Health Practitioners	$ 518,004	$ 17,144	$ 17,659	$ 18,189	$ 18,734	$ 19,296	$ 19,875
Outpatient care centers	$ 460,707	$ 15,248	$ 15,706	$ 16,177	$ 16,662	$ 17,162	$ 17,677
Medical & diagnostic Laboratories	$ 446,881	$ 14,790	$ 15,234	$ 15,691	$ 16,162	$ 16,647	$ 17,146
Home Health Care Services	$ 281,614	$ 9,321	$ 9,600	$ 9,888	$ 10,185	$ 10,490	$ 10,805
Other ambulatory health care services	$ 235,003	$ 7,778	$ 8,011	$ 8,252	$ 8,499	$ 8,754	$ 9,017
Social assistance	$ 1,100,724	$ 36,431	$ 37,524	$ 38,649	$ 39,809	$ 41,003	$ 42,233
Total, Health Care	**$ 7,247,198**	**$ 195,653**	**$ 201,522**	**$ 207,568**	**$ 213,795**	**$ 220,209**	**$ 226,815**
Personal Care							
Personal Care Services (hair, nail and skin)	$ 207,470	$ 6,867	$ 7,073	$ 7,285	$ 7,503	$ 7,728	$ 7,960
Death Care Services	$ 159,835	$ 5,290	$ 5,449	$ 5,612	$ 5,781	$ 5,954	$ 6,133
Other Personal Care (4)	$ 124,776	$ 4,130	$ 4,254	$ 4,381	$ 4,513	$ 4,648	$ 4,787
Total, Personal Care	**$ 492,081**	**$ 16,286**	**$ 16,775**	**$ 17,278**	**$ 17,797**	**$ 18,331**	**$ 18,880**
Other							
Taxi And Limousine Services	$ 13,071	$ 433	$ 446	$ 459	$ 473	$ 487	$ 502
RV Parks and Recreational Camps	$ 3,536	$ 117	$ 121	$ 124	$ 128	$ 132	$ 136
Rooming and Boarding Houses (5)	$ 21,223	$ 702	$ 724	$ 745	$ 768	$ 791	$ 814
Total, Other	**$ 34,294**	**$ 1,252**	**$ 1,290**	**$ 1,328**	**$ 1,368**	**$ 1,409**	**$ 1,452**
Total All Services		$ 563,776	$ 580,689	$ 598,110	$ 616,053	$ 634,535	$ 653,571

The estimate on services was developed based on the U.S Census 2007 Economic Census for the state of Kansas. The Economic Census provides data on receipts by business classifications for both employers and nonemployers. The estimate assumes 50% of the receipts would be exempt from tax. This would allow for sales made to exempt entities (government, schools, exempt businesses) and for sales of tangible property that is already subject to sales tax. An annual increase was applied to each year as shown in the FY column.

(1) data not available in 2007 data, estimating 25% increase over 2002 data
(2) data not available for all catagories, estimating missing data makes up 25% of the industry total
(3) currently taxable
(4) includes parking lots, bail bonding, dating services. Photofinishing omitted- currently taxable
(5) data not available, used 2002 Census data with 10% growth (2% annual)

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EROSION OF THE KANSAS PROPERTY TAX BASE

By
Glenn W. Fisher, Principal Investigator and
Kansas Regents Distinguished Professor Emeritus of Urban Affairs

with the assistance of
Crystal Gile, Graduate Assistant

Contributors:
H. Edward Flentje
W. Bartley Hildreth

Report Prepared for the
Kansas Department of Revenue
in cooperation with the
Kansas Advisory Council on Intergovernmental Relations

Kansas Public Finance Center
Hugo Wall School of Urban and Public Affairs
Wichita State University

December 2006

12-7

Executive Summary
Erosion of Property Tax Base in Kansas

Findings

- **The Kansas property tax is evolving into a real estate tax, and residential real estate is becoming a more important part of taxable real estate.** Real estate made up 44 percent of the total ad valorem base in 1988 and 65 percent in 2005. Residential real estate made up 22 percent in 1988 and 40 in 2005. (Figure 3)

- **The original constitutional exemptions of property used for educational, governmental, religious and similar purposes have been clarified and expanded by statute and total $20 billion, but now are smaller, in relation to all taxable property, than they were fifteen years ago.** In 1989, the real estate exempted under this provision equaled 20 percent of the value of taxable property but by 2005 had declined to 15 percent.

- **Beginning in the 1970s, the exemption of personal property, especially business and agricultural property, has accelerated.** Most exempt personal property is neither listed nor appraised, but the number of exemptions has risen greatly. (Figure 1)

- **Local option exemption of real and personal property deemed important for economic development is common in Kansas.** In 2005, $3.4 billion in appraised value, two percent of total appraised value, was exempted by cities and counties as IRB property or under the constitutional provision allowing exemption of certain property for economic development. Since 1993, total economic development exemptions have fluctuated from a low of 1.5 percent of the appraised value to a high of 2.8 percent.

- **The assessment of locally assessed real estate, the fastest growing category of property, is closely monitored by the state and is appraised close to market value.** In 2005, the statewide ratio of appraised value to sale price was 96 percent. (Figure 6)

- **State assessed utility property values are not subject to sales-ratio studies nor auditing by outside firms, and appraised value of this property is growing less rapidly than locally assessed real estate.** In 1988, public utility property made up 18 percent of assessed value, but dropped to 16 percent after the 1992 constitutional amendment and has since declined to 10 percent. (Figure 3)

- **The value of vehicles appraised by the statutory formula is close to that which would be produced by market-value appraisal, but the phase-in of a reduced assessment ratio in the 1990s resulted in a $1.5 billion reduction in assessed value.** Current motor vehicles make up 11 percent of assessed value, as compared with 14 percent in 1988.

- **Repeal all taxes on personal property and reconfigure local government and government functions so that local governments finance only property-related services from the property tax.** For example, social services now funded with local property taxes would have to be financed by state revenues or other revenue sources.

- **Authorize local government broader access to sales and income taxes.** This choice might be done by consolidating small governments or by creating taxing districts that could more effectively levy income or sales taxes. More governmental functions, for example, schools, could be shifted to the state level.

SALES TAX EROSION IN KANSAS

By
Dr. John D. Wong, Principal Investigator
and Professor of Public Administration

with the assistance of
Nickolaus Hernandez, Graduate Assistant

Report Prepared for the
Kansas Department of Revenue
in cooperation with the
Kansas Advisory Council on Intergovernmental Relations

Kansas Public Finance Center
Hugo Wall School of Urban and Public Affairs
Wichita State University

December 2006

Executive Summary
Sales Tax Base Erosion in Kansas

Principal Findings

- Although the sales tax is generally perceived by many to be a broad-based tax on final consumption, in most states it is neither broad-based nor limited to final consumption.
  - Economic changes and policy decisions have coalesced to accelerate changes in the sales tax base in recent years.
  - The principal causes of erosion of the sales tax base include:
    - Legislated statutory exemptions,
    - Attempts to tax services,
    - Cross-border shopping, and
    - Technological change.
- One important reason for the erosion of the Kansas sales and use tax base is the passage of a large number of statutory exclusions and exemptions to the tax.
  - Since 1937 there have been 71 original exemptions and exclusions from the sales and use tax, 53 expansions in exemptions or exclusions, 20 restrictions in exemptions and exclusions, and 62 other changes in the sales and use tax statutes, for a total of 206 legislative enactment or changes in the Kansas sales and use tax statutes.
  - In 1938 the total value of exclusions and exemptions from the sales and use tax base was $121.4 million of sales.
  - By 2005 this had mushroomed to $68,633.8 million of sales.
  - The value of the exclusions and exemptions is actually nearly twice the size of the actual sales and use tax base in 2005 of $35,706.0 million.
  - In 1938 the total value of exclusions and exemptions was $2.4 million.
  - By 2005 this had mushroomed to $3,637.6 million.
  - The value of the exclusions and exemptions is actually nearly twice the size of the actual sales and use tax collections in 2005 of $1,892.4 million.
  - The largest increases in exemptions and exclusions in the sales and use tax base occurred during the early 1970s and the early 1990s.
- The most significant exclusion is for component parts and items consumed in the production process.
  - In 2005 this item alone accounted for $43,787.0 million of sales that were not taxed.
  - The exclusion of component parts and items consumed in production alone amount to a sales and use tax loss of $2,320.7 million.
  - The second largest exclusion is for government and nonprofit purchases.
  - This exclusion resulted in the loss of approximately $299.9 million in state sales and use tax revenue in 2005.
- The statutory exemption of specifically enumerated services resulted in the loss of approximately $258.0 million in state sales and use tax receipts in 2005.
  - One study estimated that extending the sales tax to all readily-taxable services would increase state sales tax revenues by approximately $500 million or 29 percent.
  - Overall if all services broadly construed were included state sales tax revenue could be increased by as much as $1,944.6 million.

- However, the committee concluded that a general exemption for machinery and equipment used in production was not warranted.
- Arguments for inclusion of services in the sales tax base
  - The sales tax should be as broadly applicable to consumer expenditures as possible and therefore the tax should be imposed on services as well as tangible property because both satisfy personal needs and wants.
  - Taxation of services makes the sales tax less regressive because expenditures for services tend to increase as personal income rises.
  - Revenue from the sales tax is more responsive to rising levels of personal income and economic activity if services are taxable, because under such conditions expenditures for services increase relatively more than purchases of basic commodities.
  - Administration of the sales tax is simplified if the tax is applicable to services rendered in conjunction with sales of tangible personal property, i.e., it is not necessary to separate the amount charged for services from the amount charged for such property.
- The Hodge Committee (1970: 16) recommended that the sales tax should not be extended to include personal and professional services.
  - The committee concluded that if additional services were to be taxed, the most practical approach would be to start with services associated with the sale of tangible property and performed generally by firms already registered under the sales tax act.
  - One of the difficulties of taxing services is determining the situs of intangible services, their allocation, and the application of the *use* tax to such services.
- Without the use tax, purchases from out-of-state sources would be encouraged to the disadvantage of local suppliers.
- Thus, it would be difficult to apply the use tax to purchases of services.
- The Hodge Committee (1970: 12) recommended that the educational exemption should be retained because to remove it would merely mean an increase in property taxes. Further, the committee suggested that expenditures constituting a legitimate part of the school program should be exempt and that the same rules should apply to public and private non-profit schools at all levels of education.
- The Hodge Committee (1970: 12) recommended that that the exemption of purchases by hospitals operated by religious or other non-profit organizations should be continued. It was concluded that a general exemption of purchases by non-profit hospitals would be consistent with the granting of an exemption for purchases of prescription drugs and prescribed medical devices.
- The Hodge Committee (1970: 11) recommended that the exemption of purchases by religious, charitable, and benevolent organizations should be repealed.

State of Kansas

Bill Graves, Governor

Report of the

Governor's Tax Equity Task Force

December 1995

Special Committee on Assessment and Taxation

September 16-17, 2010

Attachment #13

Governor's Tax Equity Task Force

Mr. Keith Roe, Chairman
Mankato

Mr. Robert Bennett, Vice-Chairman
Overland Park

Mr. Larry Barrett
Colby

Senator Phil Martin
Pittsburg

Ms. Nancy Burns
Kansas City

Mr. Bill Moore
Topeka

Mr. Jack Dicus
Topeka

Mr. Ed Nazar
Wichita

Representative Clyde Graeber
Leavenworth

Mr. Jim Pendleton
Prairie Village

Dr. W. Bartley Hildreth
Wichita

Senator Pat Ranson
Wichita

Mr. Matt Ida
Fort Scott

Ms. Shirley Martin-Smith
Lawrence

Mr. Dennis Jones
Lakin

Mr. David Strohm
Augusta

Representative Bruce Larkin
Baileyville

Mr. Ottis Vann
El Dorado

Mr. Murray Lull
Smith Center

Ms. Carol Wiebe
Hillsboro

Secretary of Revenue John LaFaver, Ex-Officio

Task Force Staff

Mr. Chris W. Courtwright
Kansas Legislative Research Department

Mr. Daniel Hermes
Division of the Budget

Ms. Jill Crumpacker
Office of the Governor

Ms. Elizabeth Carlson
Committee Secretary

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Task Force Report

Executive Order No. 95-178, which established the Governor's Tax Equity Task Force, charged the group with conducting a comprehensive review of the Kansas state and local tax structure, including: (1) the current mix of statewide property taxes, sales taxes, and income taxes; and (2) the current reliance on statewide property taxes as a method of financing public education. The Task Force was charged with preparing a report on or before January 1, 1996, analyzing the fairness of the state's current tax policies and recommending any necessary improvements or revisions.

BACKGROUND

Kansas enjoys a national reputation as a fiscally responsible state. This recognition reflects a longstanding commitment by Kansans to each other and their government. Each generation of taxpayers, however, must renew this fiscal legacy.

Taxes fund a variety of public services that citizens rely upon daily, including roads, public safety, and a community of educated citizens. Each tax dollar also carries a demand for wise public stewardship. While it is a political truism that no one likes to pay taxes, it is an economic truism that only people bear the ultimate tax burden. Kansans believe in fairness, and call upon taxes to reflect this principle, too.

A state has its mix of taxes and services continuously tested in a competitive environment with other states and localities, and even with jurisdictions beyond our national borders. Responsible public policy, therefore, dictates a periodic examination of our state and local tax structure.

Aside from this broad and general review, another factor leading to the establishment of the Task Force was the major tax shift proposal embodied in the House Committee of the Whole version of S.B. 41. This legislation, which passed the Kansas House during the 1995 Session was not acted upon by the Kansas Senate. The proposal would have eliminated the mandatory school district general fund property tax levy over a three-year period and replaced it with revenues from sales, income, and privilege tax rate increases.

Governor Bill Graves therefore appointed the Governor's Tax Equity Task Force to examine thoroughly the Kansas state and local tax structure with an emphasis on equity issues, to analyze the tax shift proposal passed by the House, and to return whatever recommendations deemed appropriate to the Governor and the 1996 Kansas Legislature.

KANSAS STATE AND LOCAL TAX STRUCTURE

Total state and local tax revenue increased by 2.8 percent from FY 1994 to FY 1995–from $6.114 billion to $6.288 billion. Local taxes increased by 6.3 percent and state revenues increased by 0.7 percent.

State taxes accounted for $3.815 billion, or 60.7 percent, of FY 1995 total state and local tax revenue. During that fiscal year, 82.8 percent of state tax receipts was credited to the State General Fund and 17.2 percent went to other funds.

Local units of government end up spending most of the state and local tax revenue. Including the $1.985 billion from state taxes allocated to or shared with local units, local units received $4.457 billion, or 70.9 percent, of total FY 1995 state and local taxes.

The Tax Mix

General property tax levies and the in-lieu-of-property-tax on motor vehicles accounted for 33.52 percent of total FY 1995 state and local tax revenue. State and local sales and compensating taxes accounted for 27.43 percent of the combined total, followed next by income and privilege taxes at 23.99 percent. No other tax source produced as much as 5 percent of the total. The sales, income and property tax figures are now more evenly balanced than they were prior to the enactment of 1992 school finance legislation.

In FY 1992–prior to the impact of the 1992 school finance tax shifts–general property and motor vehicle taxes accounted for 38.73 percent of total state and local revenues. Sales and compensating taxes accounted for 22.58 percent in that year, and income and privilege taxes were about 21.13 percent of the total.

The Tax Burden

At the same time, in spite of a number of major changes in Kansas tax policy in recent years (individual income tax changes in response to federal tax reform–1988 and 1989; implementation of reappraisal and classification–1989; enactment of comprehensive highway program–1989; school finance sales, income, and property tax shifts–1992; revised classification amendment–1993; continued proliferation of local sales taxes–1980s and 1990s), the ratio of state and local taxes to Kansas Personal Income (KPI) has remained fairly constant.

Ratio of Taxes to KPI*

Fiscal Year	State	Local	Total
1988	6.90%	5.02%	11.92%
1989	6.70	5.07	11.76
1990	6.86	5.15	12.01
1991	6.64	5.07	11.71
1992	6.64	5.16	11.80
1993	7.27	4.46	11.73
1994	7.52	4.61	12.13
1995	7.20	4.66	11.86
Exhibit:			
1940	6.04%	8.78%	14.82%
1950	4.65	4.89	9.54
1960	4.62	5.87	10.49
1970	5.52	6.25	11.77
1980	6.24	4.43	10.67

* KPI estimates from U.S. Department of Commerce. The personal income figure is for the calendar year in which the fiscal year began.

Per capita state taxes remained flat at $1,494 in both FY 1994 and FY 1995, but per capita local taxes increased from $917 to $968–a 5.6 percent jump.

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The class of property that is the biggest net statewide beneficiary as a result of school finance and the new classification amendment is commercial and industrial real property. Taxes on commercial and industrial real property declined from $444 million in 1991 to $360 million in 1994, a reduction of $84 million.

AD VALOREM TAXES BY CLASS OF PROPERTY, 1991-1994

	1991	% of Total	1992	% of Total	1993	% of Total	1994	% of Total	Change 1991-94
Total Real	$ 1,332,713,087	72.72%	$1,147,469,058	71.37%	$ 1,149,475,203	67.76%	$ 1,234,477,581	67.44%	$ (98,235,506)
Total Personal	258,966,644	14.13%	228,385,567	14.21%	279,429,757	16.47%	302,233,802	16.51%	43,267,158
State Assessed	240,974,214	13.15%	231,874,107	14.42%	267,462,910	15.77%	293,660,637	16.04%	52,686,423
TOTAL	$ 1,832,653,945	100.00%	$ 1,607,728,732	100.00%	$ 1,696,367,870	100.00%	$ 1,830,372,020	100.00%	$ (2,281,925)
Exhibit:									
Residential Real	$ 690,982,069	37.70%	$ 608,794,167	37.87%	$ 637,133,751	37.56%	$ 696,911,196	38.07%	$ 5,929,127
Commercial and Indus. Real	$ 443,669,655	24.21%	$ 376,400,435	23.41%	$ 340,893,091	20.10%	$ 359,655,235	19.65%	$(84,014,420)
Ag. Land (Real)	$ 162,878,956	8.89%	$ 133,379,972	8.30%	$ 138,967,937	8.19%	$ 144,208,364	7.88%	$ (18,670,592)
Mineral Leasehold	$ 111,211,319	6.07%	$ 101,053,152	6.29%	$ 112,529,807	6.63%	$ 116,955,663	6.39%	$ 5,744,344
Bus. Mach. & Equip.	$ 111,385,312	6.08%	$ 97,899,557	6.09%	$ 132,395,793	7.80%	$ 146,945,659	8.03%	$ 35,560,347

Source: Property Valuation Division Statistical Reports.

The following table provides 1991-94 data on levies by type of taxing district:

STATEWIDE AD VALOREM LEVIES BY TYPE OF TAXING DISTRICT FOR 1991 TO 1994

(Amounts are expressed in millions.)

	1991	1992	1993	1994	Percent of 1994 Total	Percent of Increase 91-92	92-93	93-94
State	$ 21.95	$ 21.90	$ 22.31	$ 23.25	1.27%	(0.23)%	1.87%	4.21%
County	392.83	413.55	454.29	472.66	25.82	5.27	9.85	4.04
City	260.61	271.42	285.32	296.60	16.20	4.15	5.12	3.95
Township	23.44	24.05	26.45	27.83	1.52	2.60	9.98	5.22
USD	976.14	709.68	731.33	825.80	45.12	(27.30)	3.05	12.92
Other Schools	83.99	92.35	96.42	98.66	5.39	9.95	4.41	2.32
Out District Tuition	10.09	9.18	8.14	8.50	0.46	(9.02)	(11.33)	4.42
Other Districts	63.61	65.60	72.12	77.08	4.21	3.13	9.94	6.88
Totals	$ 1,832.66	$ 1,607.73	$ 1,696.38	$ 1,830.38	100.00%			
Percent of Increase	10.8%	(12.3)%	5.5%	7.9%				
CPI Increase	4.2%	3.0%	3.0%	2.8%	Est.			

The levy data was taken from the Department of Revenue's publication *Statistical Report of Property Assessment and Taxation* with adjustments by the Kansas Legislative Research Department.

Impact of School Finance and Reclassification

To illustrate some of the tax shifts brought about by 1992 school finance legislation and the 1993 implementation of the revised classification amendment, the first table provides 1991-94 data on the property taxes levied against selected classes of property:

Statewide property taxes in 1994 returned to nearly the same level–$1.83 billion–that they had been at in 1991 (prior to enactment of the 1992 School District Finance and Quality Performance Act).

TASK FORCE ACTIVITIES

The Task Force held its initial meeting on July 12 at Washburn University in Topeka. Governor Graves outlined the challenges to the Task Force and lauded the expertise and diversity being brought to the group by the members.

The Task Force received a variety of information from staff reports at the August 14 meetings at the Statehouse in Topeka and at the September 6 meeting at Wichita State University. The Task Force also began to receive input through public testimony at the Wichita meeting. The Task Force then called upon a tax study team comprised primarily of faculty from Kansas universities to assist in providing valuable research as part of the comprehensive overview of Kansas tax policy. Dr. W. Bartley Hildreth, Regents Distinguished Professor of Public Finance at Wichita State University, was designated to coordinate the efforts of the tax study team.

During the week of September 18, the Task Force split into three subcommittees which met in Garden City, Fort Scott, and Topeka for the purpose of holding public hearings and receiving further citizen input regarding the Kansas tax structure.

The full Task Force met October 5 in Hays to receive additional public testimony. Draft copies of the research papers were presented to the Task Force on October 27 in Johnson County, and the public hearings were concluded.

The Task Force returned to Topeka on November 16-17 to make decisions with respect to policy options that had been discussed during the statewide public hearings and presentation of the research papers by the tax study team. The final version of all research papers are presented later in this report.

RESEARCH PAPERS–SELECTED CONCLUSIONS AND HIGHLIGHTS

An Overview of Kansas State and Local Finance

Glenn Fisher, Wichita State University

- Elasticity measures how fast receipts grow in response to growth in Kansas personal income (KPI). The elasticity of the individual income tax since 1988 is an unusually low .994 and the elasticity of the general sales and use tax is an unusually high 1.022. (Studies from other states have suggested that they have higher income tax elasticity and lower sales tax elasticity.) If these elasticities continue, it means that the yield of these taxes will grow at about the same rate as the growth in KPI.

- The elasticity of the appraised value of taxable property since 1989 is .509. This means that if appraisal practices, the classification system, and tax rates remain the same, property taxes will rise about half as fast as KPI.

- Projections that assumed that personal income continues to rise at a 5.19 percent annual rate and that state and local expenditures rise at the same rate as income indicate a year 2000 shortfall of more than $500 million in tax-financed state and local expenditures.

State Budget Policy

Gloria Timmer, State Division of the Budget

- The Kansas budget has had significant overall growth in the long term, with specific areas of government (especially K-12 education) accounting for most of the recent changes.

- Although there is a perception among some that higher education has accounted for much of the growth in the funding of the budget, data indicate that higher education's share of the SGF has actually declined from 1975 to 1995.

- The majority of the increases in the state budget can be attributed to the state's acceptance of activities previously funded through means or mandates by the federal government.

- The fairly rigid structure and statutory obligations within which the budget must be prepared constrain frivolous spending and revenue adjustments, but also have the effect of limiting the state's ability to respond to serious budget issues in a timely manner.

- While federal funding changes may represent an opportunity to allow the state to better address the needs of Kansas citizens, major funding reductions with only limited flexibility could mean that the state and its citizens will be forced to shoulder the responsibility of conducting business with far fewer resources.

Individual Income Taxes in Kansas: Structure and Distribution

Dan Hermes, State Division of the Budget

- In comparison with surrounding states, Kansas appears to be competitive in taxing individuals that comprise the bulk of income taxpayers--married joint filers and single filers below $50,000 in Kansas Adjusted Gross Income. These groups, where Kansas taxes are at or below the regional average, comprise 98 percent of the individual income tax filers. The only area where Kansas does not appear competitive is for single taxpayers with gross income above $50,000. The area where Kansas appears to be most competitive, with effective rates between 6 and 14 percent below the regional average, is for joint married filers between $25,000 and $50,000 in KAGI. This group of taxpayers comprises just under 19 percent of the total number of returns.

- Indexing income tax personal exemptions, standard deductions, and brackets may not be as great an issue in Kansas as it has been in other states, given the progressive nature of the Kansas individual income tax structure.

Should Kansas Substitute Sales Tax for Property Tax?

Edwin G. Olson, Kansas State University

- Policy decisions involving proposals to increase the sales tax while decreasing the property tax should carefully consider: (1) responsiveness of tax revenues; (2) stability of the tax base; (3) who pays the taxes; (4) tax impact and incidence; (5) economic neutrality; (6) balance among tax bases; (7) fairness; (8) determination of the tax bases; and (9) cost of collection.

- An additional sales tax issue involves the loss of sales and economic activity along the border any time there is a major increase in the rate.

- Since a rapidly expanding share of expenditures for most families is devoted to services, Kansas could consider expanding the sales tax base as a way of increasing the elasticity of the tax. Although controversial, one proposal would be to begin taxing additional services (such as accounting and surveying) sold directly to consumers while at the same time exempting the sales of such services to business firms.

- School district option sales and income taxes would raise equity issues and may not be adequate in rural districts as replacement revenue sources for the property tax.

Taxing Oil and Gas in Kansas

James Richardson, Louisiana State University

- The current oil and gas tax structure in Kansas, including the severance and ad valorem taxes, creates marginal tax rates on new revenues from oil and gas operations that are the highest of the selected states studied for oil activities and second highest for natural gas activities.

- The elimination of 35 mills from the property tax levy would reduce the marginal tax rate on oil revenues from 9.5 percent to 7.9 percent, making it lower than the marginal rates in Texas and New Mexico, but still higher than the marginal rates in Colorado, Illinois, and Oklahoma. The elimination of 35 mills would reduce the marginal rate for gas from 10.2 percent to 8.6 percent, again making it lower than the marginal rates in Texas and New Mexico, but still higher than the marginal rates in Colorado, Illinois, and Oklahoma.

- Improving the marginal tax rate on the oil and gas industry is not sufficient reason to pass S.B. 41. The state should examine carefully, however, alternative methods of reducing the marginal tax rates and the potential benefits and costs of each alternative.

History of the Property Tax in Kansas

Glenn Fisher, Wichita State University

- Although the implementation of the classification amendment along with reappraisal in 1989 was relatively successful in preventing major tax shifts from one major class of property to another (agricultural, residential, business, utility), there were major shifts from subclass to subclass. The exemption of inventories and the favorable treatment of machinery partly offset higher real estate taxes for the business sector as a whole, but there were large gains and losses for particular types of businesses. For example, manufacturing and retail firms gained at the expense of owners of commercial buildings who had little inventory.

- The shift from properties that were relatively over-appraised to those in the same class that were under-appraised was inevitable and desirable, but no less painful. Few taxpayers faced with large tax increases took time to give thanks for the years in which they paid less than their fair share.

- The imposition in 1992 of a uniform statewide school tax rate spotlighted the importance of statewide assessment uniformity and put new burdens on property tax administrators.

Issues Related to Technical Reliability of Kansas Ratio Study

Ronald Wasserstein, Washburn University

- The Kansas sales ratio study is a technically reliable method of evaluating the extent to which property in the state is valued on a uniform and equal basis. The methods for generating confidence interval estimates of the important quantities of median ratio, coefficient of dispersion, and price-related differential are state-of-the-art. Great care is taken by the state Property Valuation Department to insure that the data are accurate and based entirely on valid sales as defined by statute and principles of good practice.

- The ratio study is professional and reliable. Whatever the arguments may be for or against the property tax, the argument that it is impossible to determine whether property is fairly valued is negated by the ratio study.

Use of Property Tax for Public School Finance in Kansas

Nancy McCarthy Snyder, Wichita State University

- The 1992 School District Finance and Quality Performance Act had an immediate impact on property taxes–school district levies dropped $266 million between 1992 and 1993 and total mill levies statewide decreased an average of 14.8 mills.

- The effect on equalization of spending per pupil was less dramatic. Although low spending districts did increase spending significantly, it does not appear that high spending districts reduced spending.

- Because the low enrollment weighting provides substantial assistance to small school districts (those with less than 1,800 students), they are able to maintain relatively high spending levels without additional property taxation. On the other hand, the only way that the larger districts can maintain spending levels is by increasing the property tax burden. School districts accounted for 70.5 percent of the increase in property taxes levied in 1995.

- The move to state financing removes the local control that most school reformers advocate. While equalization may serve a worthy purpose–improving opportunities for students in poor districts, research has been unable to find any causal link between equalization and student achievement or between the share of state funding and student performance.

- Some analysts have argued that school district equalization was one of the major causes of California's 1978 tax revolt. When parents and citizens in affluent school districts lost the ability to tax themselves to pay for the kind of education system that they wanted, property tax limits became much more attractive. When there is no local revenue source to monitor and account for, citizens lose interest. Active civic involvement and public support are essential to good quality public schools.

- There is little doubt that the Kansas state government will continue to be heavily involved in education finance, if for no other reason than that the courts have ordered it. But further efforts to reduce local financing and local control should be viewed from the perspective of not only tax equity, but also of education achievement.

Tax and Spending Limitations in Kansas

Nancy McCarthy Snyder, Wichita State University

- It is impossible to know how high property taxes in Kansas would be in the absence of the tax lid. The property tax has been the slowest growing major source of state and local government revenue over the last 20 years because of its unpopularity.

- The effectiveness of the tax lid is weakened by the statutory exemptions built into it.

- A recent proposal calls for a constitutional amendment to limit the growth in state, city, and county spending to the rate of growth in total personal income. Although many Kansans would probably agree that government should not grow faster than the ability to pay for it, it is unclear whether it is necessary to impose this philosophy through the state *Constitution*. The proposal implies a lack of faith in elected officials at both the state and local level to promote the will of the public. The passage of such a constitutional amendment also could prove problematic at a time when the federal government is returning numerous governmental functions to the states.

- Artificial taxing and spending rules create excuses for citizens, elected officials, and public employees alike to abdicate their civic responsibilities. It is the responsibility of elected leaders to make difficult choices between costs and benefits, to inform the public of those choices, and to accept input from the public about their preferences.

Impact of Fiscal Policy on State Economic Performance

John Wong, Wichita State University

- Based on a model including all business-climate variables and a model including only nonfiscal business-climate variables, Kansas has a more favorable business climate than neighboring states in the areas of manufacturing; retailing; and financial, insurance, and real estate; but has a less favorable business climate than neighboring states in the area of services.

- In terms of revenue effort, Kansas has the lowest sales and income tax effort compared with neighboring states, but has the highest corporate and property tax effort compared with neighboring states. The model including only revenue variables shows Kansas to be only average to below average in business climate relative to neighboring states.

- Kansas spends more on higher education and highways relative to neighboring states, and less on welfare. The expenditure model also shows Kansas to be average to below average in business climate relative to neighboring states.

- Kansas' competitive advantage, therefore, results from nonfiscal factors.

- Taxation alone does not appear to be a critical determinant of business location, but businesses do consider the relationship between the taxes they are paying and the services they receive in return. If state and local policy is a significant factor in business location decisions, then tax reductions could yield more than proportional increases in business activity. But taking this argument to the extreme, the optimal rate of taxation from the perspective of business would be zero. However, an environment without taxes is also likely to be a place without roads, schools, or sewers. If all states proceed under the assumption that they must lower their taxes or offer financial incentives to lure businesses, then the concerted actions of all the states mutually nullify any possible advantages from the action, and bestow upon the "winning" jurisdiction only diminished tax revenues.

Analysis of Tax Policy Impact on Corporations

Charles Krider and Pat Oslund, University of Kansas

- Under the current tax structure, Kansas stands out as the state in the region with the highest taxes on mature business. The sources of the high overall tax level on Kansas businesses are the property tax and the corporate income tax. New or expanding firms in Kansas may be largely shielded from the underlying high Kansas business tax structure by income and property tax incentives.

- The income allocation formula can significantly alter a firm's in-state liability. The higher the weight given to sales, the lower will be the allocation fraction for export-oriented firms.

- The House Committee of the Whole version of S.B. 41 would produce an annual state and local tax savings of about $1,000 per employee for a mature capital-intensive firm, and of about $400 per employee for a less capital-intensive firm. About one-third of this impact would be offset by increases in federal income taxes. Additional offsets could occur if the tax changes tended to increase property values.

Small Towns, Economic Revitalization, and the Property Tax

Garry Mattson, Kansas State University

- Many small Kansas towns because of their scale and limited economic and tax bases are struggling to survive into the next century. Businesses have a powerful bargaining advantage. Firms can bargain and choose between communities in order to minimize costs. Offering tax incentives and municipal services (known as "smokestack chasing") as an economic

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development strategy may cause communities to strike Faustian bargains with prospective businesses, trading off their unique character for short-term economic gain.

- In terms of economic revitalization strategies, infrastructure improvements, which require considerable public financial investment in terms of bonds, is given top priority by many local officials. In terms of innovative fiscal incentives, loan guarantees, tax abatements, and IRBs are the most popular methods.

Impact of Kansas Tax Policy on the Farm Economy

Barry Flinchbaugh and others, Kansas State University

- The average estimated tax paid by Kansas Farm Management Association farms is about $4,865. Of this liability, 15.0 percent was paid via income tax, 8.2 percent was paid via business sales tax, 21.7 percent was paid by personal sales tax, and 55.1 percent was paid via property tax. The average cash net farm income for these farms was $30,670.

- The average tax liability per farm would decrease by $349 assuming a 35 mill decrease in the property tax levy is offset with revenues coming 50 percent from increased sales taxes and 50 percent from increased income taxes.

Distributional Impact of Tax Policy Changes

John Wong and Nancy McCarthy Snyder, Wichita State University

- A 0.5 percentage point increase in the income tax rate would be modestly progressive and would be borne primarily by taxpayers residing in metropolitan areas or counties adjacent to metropolitan areas.

- A 10 mill reduction in the mill levy would primarily benefit less densely populated rural counties in Western Kansas and counties in the greater Kansas City area.

- A 1 cent increase in the sales tax would be somewhat regressive, borne disproportionately by taxpayers in lower income groups.

KANSAS TAX POLICY OBJECTIVES

The Task Force recommends that all tax legislation be evaluated with the following objectives in mind. The group notes that a tax system involves policy tradeoffs based upon the various tax criteria applied to each tax and the overall tax structure. There is no perfect tax or perfect tax package.

Kansas should maintain its enviable reputation as a fiscally responsible state. This hard-earned status reflects a longstanding commitment of Kansas taxpayers and their public officials to rational, well thought out taxing and spending decisions. This farsighted view has allowed Kansans to avoid massive tax increases or draconian spending cuts in response to tough times.

A tax system should produce revenues that are adequate to finance an agreed-upon level of public services over time. Inherently intertwined are taxing and spending policies. Taxes fund a variety of services that citizens rely upon daily, including roads, public safety, and a community of educated citizens. To provide this package of services, governments purchase goods and services in the marketplace, paying prices that may vary from the prices of items purchased by consumers. Each budget year forces policymakers to reconcile seemingly unlimited taxpayer wants with increasing taxpayer dissatisfaction over the level of taxation. Public officials, accountable for wise stewardship of tax dollars, also are responsible for adhering to public preferences.

A tax system should produce adequate revenue during economic downturns and also respond to economic growth. A revenue system must be able to weather economic recessions to preserve some stability in the funding of essential services. And, to the extent that a tax system's rate of growth matches the rate of growth of the economy, the relative size of government services may be maintained without tax rate changes or service reductions. The mix of taxes should help stability in times of economic uncertainty and avoid the need for hasty, unexpected tax increases or service reductions.

State and local taxing and spending decisions should be consistent with economic growth and development. Technology allows people to live in good living environments away from economic centers of activity. Relatedly, business tax policy must focus not only on corporate taxpayers, but also on business activity reflected in personal income tax returns. It is important to minimize any unintended impacts of tax structures on growth and development. Since businesses consider the relationship between the taxes they are paying and the services they receive in return, particular forms of public spending may enhance economic growth and development.

Administration of the tax system should be efficient and fair. Taxpayers deserve competent, consistent revenue administration, or else confidence in the tax system is eroded. A uniform statewide school tax rate spotlights the importance of assessment uniformity by the county tax appraisers. It is essential to have a technically reliable method of measuring adherence to the uniform and equal criteria. Some taxes, such as sales and income taxes, seem to benefit from state administration. The revenue system should minimize compliance costs for taxpayers and administrative costs of collecting taxes. Taxpayers should have access to an ongoing analysis of tax laws, structures, and burdens.

Fiscal accountability should be strengthened by making taxpayers aware of their true tax liabilities. A simple calculation or statement of actual tax liability makes people pause before paying. The property tax generates a yearly bill, even if paid in monthly mortgage payments. Although the personal income tax is subject to payroll withholding for most taxpayers, it also requires a yearly summary of tax liability. In contrast, the sales tax has illusive qualities because most consumers do not know how much they have paid during the year, but it is relatively convenient to pay. The same fiscal illusion happens with excise taxes, such as on gasoline, alcoholic beverages, and tobacco products. Moreover, federal income tax policy rewards taxpayers who itemize by lowering the after-tax effect of property and income taxes, but denies a similar deduction for the sales tax.

Tax revision should not unduly erode the tax base. A broad tax base allows the lowest possible rate, while also enhancing compliance, public acceptability, and the stability of the revenue source. But, there is a tendency to grant exemptions from a uniform or general treatment, and once granted they are hard to remove. It is poor public policy to erode the underlying tax base by granting unwarranted, gratuitous exemptions or exclusions. It is important to remove items from taxability, including but not limited to, economic development incentives, only upon meeting rational, economically meritorious criteria. Further, all exemptions and exclusions should be subject to systematic, continuing review.

State fiscal policy should advance the interests of the state as a whole, while facilitating the fiscal autonomy of local governments including municipalities, counties, and school districts. State fiscal decisions influence local governments. Yet, local officials can more appropriately respond to changing local preferences than can state policymakers. To meet these civic responsibilities, local officials require fiscal flexibility and discretion. Legal and electoral remedies, not state prescriptions, provide the needed accountability.

Policymakers must recognize that tax policy influences economic behavior, and not always in the desired manner. While it is a political truism that no one likes to pay taxes, it is an economic truism that only people bear the ultimate tax burden. A tax system should be fair, both to individual citizens and to businesses operating in the state. Tax reductions for one taxpayer only shift the burden to someone else. This redistribution of burdens can be by design, or occur as an unintentional side effect. If the goal is to redistribute the tax burden, the advocate of change should bear the burden of establishing why those who benefit from the change should do so at the cost of others. If, instead, the driving reason for a tax change is to achieve a stated principle, then compelling reasons must exist before adopting such changes because redistributed tax burdens can have undesirable and unexpected economic effects.

Kansans should be able to rely upon a stable tax policy. With its mix of taxes and services continuously tested in a competitive environment with other states and localities, and jurisdictions beyond national borders, Kansas must continuously review and evaluate its competitiveness. In an increasingly service-driven economy, changes in public responses to taxes may require a major tax restructuring, rate increases, or budget cuts. Frequent changes, however, disrupt business and individual tax planning and may occur before knowing the full economic and competitive effects of past actions.

The state and local tax system should be balanced and diversified. A diversified tax system offers a blend of economic tradeoffs. Because all revenue sources have their weaknesses, a balanced tax system will reduce the magnitude of problems caused by over reliance on a single tax source. It will also result in lower rates on each tax and reduce the pressure of competition from other states that have lower rates for a particular tax.

TASK FORCE FINDINGS

State and Local Finance

1. Kansas enjoys a rough balance between property, sales, and income taxes.

2. Property taxes will probably continue to decline as a share of state and local taxes because they have lower elasticity than income or sales taxes, thus moving the tax system in closer balance.

3. The relative importance of the property tax in Kansas is similar to that in Michigan <u>after</u> that state enacted a sweeping school finance reform program.

4. Kansas state and local taxes as a percentage of total personal income equals the level in 1962. However, Kansas state and local spending is a growing percentage of personal income, reflecting the influence of prices, federal aid programs, and user paid services, among other reasons.

5. Projections for the year 2000 reveal a projected structural deficit of about $500 million in combined state and local government tax financed expenditures, suggesting that a period of severe budget cuts or major tax increases may be on the horizon.

6. The state budget follows the fundamentals of sound state budgeting practice, highlighted by the use of the Consensus Revenue Estimate and a required 7.5 percent ending balance.

7. The state faces an increasingly harsh and competitive fiscal environment, including changes in federal fiscal policy, tax revolts, and the competition for jobs and growth.

8. The federal government is on the brink of turning over substantial responsibilities and authority for programs but backed by questionable funding levels, placing unprecedented uncertainty on state and local budgets that have grown enormously dependent upon this source of funding to provide programs that help Kansans.

9. Although Kansas is an average user of its available tax base when compared nationally, it is in a low tax region, with Oklahoma and Missouri even lower.

10. Unless neighboring states change their tax levels, there is little maneuvering room for Kansas to increase the rates of major tax sources (property, sales, personal income, corporate income, or oil and gas taxation).

11. Small, rural communities need more financial flexibility, not less, as they struggle for jobs, wealth, and growth against the increasingly stronger metropolitan areas.

12. Taxing and spending limits are economically ineffective tools for dealing with the distrust of government.

13. The distributional impacts of tax policy changes are predictable and reflect the value of a balanced tax system.

Individual Income Tax

1. Individual income tax collections since 1988 have grown at a rate less than the growth rate of the state's economy (an elasticity of .994), a finding contrary to traditional public finance and one that demands further analysis.

2. A significant amount of individual income tax revenue is business income, making the individual income tax an essential part of any policy on the level of business taxation.

3. The individual income tax is progressive, meaning that the effective tax rates increase as income increases.

4. The individual income tax treats some taxpayers with similar amounts of income differently, with higher effective tax rates paid by single filers and those who do not itemize.

5. An increase in the individual income tax would be modestly progressive and would be borne primarily by taxpayers residing in metropolitan areas or adjoining counties.

Sales Tax

1. A broad sales tax base is eroded through numerous tax exemptions, and the list expands frequently.

2. The Kansas sales and use tax, with an elasticity of 1.02, grows at the same rate as the state's economy, a better than expected result that deserves close monitoring.

3. Broad coverage of the sales tax to the goods and services sold to consumers has several potential effects: increasing the income elasticity of the sales tax, reducing somewhat its regressivity; and, possibly allowing a decrease in the sales tax rate to generate the same amount of revenue.

4. Rate increases reduce economic activity along the state's border as consumption migrates into the adjacent state.

5. Since sales taxes are <u>not</u> deductible on federal tax returns, but state and local income taxes and property taxes are deductible, the average effect on itemizing taxpayers is that $70 paid in state/local income or property taxes is equal to $100 paid in sales taxes.

6. An increase in the sales tax would be slightly regressive, and borne disproportionately by taxpayers in lower income groups.

Property Tax

1. In the years following the 1989 massive increase in the appraised value of real estate, some property classes have experienced double-digit increases while others have had double-digit decreases.

2. Kansas has made major improvements in valuing assessments on a uniform and equal basis, and the state has a technically reliable method for measuring that quality.

3. The property tax on business machinery and equipment is the highest in the region, with Iowa recently eliminating its tax.

4. Not all taxpayers using machinery and equipment to produce income are treated the same in terms of taxation.

5. Contrary to the impression that local governments have rushed to take advantage of tax reductions created by the 1992 school finance program, the increased property-tax collections of cities, counties, and townships are primarily the result of natural growth in the tax base rather than of increased mill levies; in contrast, school districts have made up most of the increases in property tax levies since 1992.

6. A dollar-level homestead exemption for owner-occupied residences shifts an undue share of the property tax burden to business and commercial property, introduces perverse tax appraisal incentives, and erodes the civic accountability of residents for programs funded from this source.

7. A reduction in the property tax would disproportionately benefit less densely populated rural counties in western Kansas and counties in the greater Kansas City area.

School Finance

1. Kansas public school districts are increasingly reverting to the pre-1992 reform levels of wide spending variation, with unknown future budget implications.

2. For the state to keep pace with inflation-adjusted funding for public schools from property taxes will require that school expenditures stay at an inflation-adjusted level over time if the elasticity of the property tax remains at the 0.51 level.

3. State financing of public schools fosters a trend away from local responsibility and control of public education.

4. Michigan's new school funding program is based on a statewide property tax levy (6 mills on a different classification and assessment scheme), significant local option capability, and property taxes contributing 32 percent of K-12 spending (compared to 33 percent in Kansas).

5. A big step was taken in 1992 in reducing the amount of property taxes used in public education, but the long-term impact is unknown.

6. To continue current state policy will require the Legislature to enact the uniform school levy in 1996.

7. Of concern, a large number of local option budgets expire at the end of the 1996-97 school year. Renewal of these budgets will be subject to protest petition and election.

Business, Mineral, and Farm Taxation

1. Taxation alone is not the major determinant of business location in Kansas; businesses consider the relationship between the taxes they are paying and the services they receive in return.

2. While new and expanding firms can receive tax incentives, mature firms face not only the full tax burden but the highest taxes in this region.

3. The Kansas business tax structure is not as favorable a climate for the state's export industries as exists in many other states.

4. Personal income tax returns include a significant amount of business income, therefore, requiring a new focus on what is business tax policy.

5. Kansas farms face a tax burden that is predominantly one of property taxation, but the average tax per acre and average tax per $100 of market value are among the lowest in the region.

6. Existing oil and gas taxation (especially the personal property tax on mineral leasehold interest) hinders productive use of the numerous low producing wells that predominate in Kansas.

CONCLUSIONS AND RECOMMENDATIONS

The task force recommends that the state tax system reduce its reliance on the uniform school finance levy over time. The task force has not recommended any specific approach to accomplish the reduction in the relative reliance on the property tax but has noted that, given the current tax structure, the property tax will continue to decline as a proportion of total state and local tax revenue given the inelasticity of the property tax. Sharply in contrast to the sales and income tax, the property tax is likely to grow slower than the growth in the economy, given current tax structures and rates for all three of the major tax sources for state and local government. Therefore, absent any action by policy makers, the mix of taxes in Kansas is likely to further converge, producing a system with closer balance among the three major tax sources for financing governments in Kansas.

The task force recommends that the state should not increase the rate of the uniform mill levy for public school finance. In recognition of the necessity of local governments other than public school districts to finance required public services from the property tax, the group recommends that the state should not increase the 35.0 mill levy required for financing of local school districts. Increases in this rate may reduce the ability of other local governments to provide locally required services by increasing pressure on the property tax system.

The task force concludes that the state should not accomplish property tax reductions by increasing income, sales or any other state tax rates. This conclusion specifically rejects concepts of public policy such as those embodied in the House Committee of the Whole version of 1995 S.B. 41. Findings recognized by the task force indicate that the state has little room to increase either the sales or the income tax rates in the state without creating potential competitive disadvantages with neighboring states. Further, the group has adopted a tax policy objective that requires those advancing a goal of redistributing the tax burden to explain why those who benefit from the change should do so at the cost of others. If, instead, the tax change is to achieve a stated purpose, then compelling reasons must exist before adopting the change because of potential undesirable and unexpected economic effects. The task force judged tax shifts to achieve across-the-board property tax reductions through increases in other taxes to meet neither criterion.

The task force concludes that the state cannot eliminate the uniform school finance levy for public school finance over a seven-year time frame through "natural" growth in state revenues. The task force examined and rejected a proposal to eliminate the basic school finance levy over a seven-year time frame without increasing other state or local tax rates or reducing necessary state services. Information on impending budget pressures such as changes in federal financing, rising prison populations, and increasing needs for local government aid to alleviate pressure on other areas that rely on the property tax directly led to this conclusion. A budget crisis of great magnitude would result from not enacting the existing uniform school finance levy for 1996.

The task force concludes that adoption of a residential homestead property tax exemption would be poor public policy. Recent proposals have suggested that the state adopt a dollar value property tax exemption for owner occupied residences. The task force specifically rejects such proposals as presenting major tax policy problems documented by the following six observations:

1. Homeowners facing little if any tax burden can vote additional taxes on other property owners.

2. Renters of property pay annual rents that must include property taxes, whereas owner occupied homesteads are exempt from a portion of the property tax.

3. A dollar specific exemption sets up assessment incentives to under assess higher valued property and over assess lower valued properties

4. Once placed on the exempt list, a property tends to stay there, even if it is used in part for commercial or profit making purposes.

5. Once established, not only it is difficult to remove the exemption, but the political incentive is to advocate increases in the exemption over time.

6. Homestead exemptions greatly reduce the tax burden of residential property, but increase the burden on rental property, commercial property and industrial property.

The task force recommends that the state should increase the income criteria for the current homestead property tax rebate. A consistent theme of testimony presented to the group was the inability for elderly and other individuals on fixed and limited incomes to meet the tax burden imposed from increased property values and increased levies. To address this problem the task force recommends that the state examine increasing the income eligibility for qualification for the current homestead property tax rebate program that is now part of the Kansas personal income tax.

The task force recommends that the state develop a cost-benefit model to use for future proposed sales tax exemptions to determine whether the exemptions make sense from an economic standpoint. Consistent with the objective of limiting gratuitous exemptions and exclusions from the sales tax base, the task force recommends that the state develop cost-benefit models to evaluate the economic reasonability of exemptions proposed in the future.

The task force recommends that the job investment tax credit be reexamined to potentially include all forms of business organization, coupled with a review of the structure and effectiveness of the current credit. Information generated by research conducted for the group indicated that various forms of business organizations comprise a significant portion of the tax paid through the individual income tax. The job investment tax credit stands out as the only credit in current law that discriminates based on the form of business organization. This recommendation may significantly increase the state cost of the credit if the current credit and the expansion of the credit is not refined to apply to businesses and firms that create significant additional jobs and investments for the Kansas economy.

The task force recommends that the state carefully examine a restructuring of the current business income allocation formula. The task force received significant research documentation that the state has high corporate tax burdens relative to the surrounding states. The group recommends that the state examine the existing equal business apportionment formula of sales, payroll and property with a focus on increasing the weight on sales to increase the state's competitive advantage as it relates to export oriented firms.

The task force recommends that the state consider tax policies that reduce the effective tax rate for low producing oil wells. Evidence presented to the task force indicates that Kansas has significantly higher effective tax rates than other energy producing states for oil production. The task force recommends the lowering of the effective tax rate on low producing wells to allow these wells to be more competitive and prevent additional shut-downs.

MINORITY REPORT

While Kansas has a sound national reputation as a fiscally responsible state, tax issues can be some of the most contentious and most volatile. Kansas, like most states, has a mix of taxes to fund the services our citizens rely on daily. Kansas tax policy is tested regularly in the competitive environment for business expansion with other states in the region.

Governor Bill Graves appointed the Governor's Tax Equity Task Force to examine Kansas' state and local tax structure with an emphasis on equity, to analyze tax shift proposals, and to make recommendations to the Governor and Kansas Legislature on those issues.

The Governor is to be commended for forming the Tax Equity Task Force. And, similarly, the members of the Task Force are to be commended for their diligence and hard work on behalf of the citizens of Kansas.

We agree with some of the findings and recommendations of the majority of the Task Force. We agree that all Kansans–its private and corporate citizens alike–should be able to rely on a stable tax policy. The only consensus reached was to reduce the state's reliance on property taxes. The Task Force looked at a number of alternatives to the current tax structure, but didn't come to a consensus on supporting any plan which would reduce property taxes. We wholeheartedly agree with the Task Force recommendation that Kansas **must** reduce its reliance on property taxes. Historically, property taxes have been used more by local governments. However, we must respectfully disagree with the Task Force's rejection of a proposed plan to phase out the statewide property tax levy used to fund Kansas' elementary and secondary schools.

We believe that property taxes are one of the most regressive taxes available to government. Under the current tax structure, Kansas has the highest taxes in the region on mature businesses. An established, mature firm in Kansas will pay higher taxes than would be paid if that same facility were located in another state in the region. For machinery and equipment, Kansas has the highest tax rate in the region. Iowa totally exempts machinery and equipment from property taxes. And Kansas ranks the second highest in the region in taxing commercial and industrial real estate.

State and local governments many times offer property tax abatements to attract new and expanding business. But many mature businesses do not benefit from those policies.

Retaining the current businesses in Kansas does not receive the same amount of attention as does attracting new business to the state. From the information received by the Governor's Tax Equity Task Force, it is clear that mature businesses in Kansas are adversely affected by the current tax structure and do not receive the same tax incentives as do new or expanding businesses.

A property tax reduction of 35 mills would result in a significant savings for mature Kansas businesses. One tax model estimates that a 35 mill reduction would save capital intensive manufacturers $1,056 per employee in state and local taxes. Savings for less capital intensive businesses would be approximately $400 per employee. If the 35 mills currently collected by the state to fund the school finance plan were phased out, Kansas would no longer rank as the highest business tax state in the region. With the 35 mill reduction, a mature, export-oriented firm in Kansas would be closer to the average for the region.

We encourage the Governor and the Kansas Legislature to support a 35 mill reduction in property taxes similar to the plan outlined in Senate Bill 41. The phase out of the 35 mills for funding Kansas' elementary and secondary schools would, for all intents and purposes, end Kansas' reliance on property taxes as a major funding source.

We believe fair taxation is a very important economic development issue for the mature businesses in Kansas which employ thousands of Kansans. And it is equally important for the overall health of the Kansas economy and for this state to remain competitive economically in the region.

SUBMITTED BY TASK FORCE MEMBERS:

Senator Phil Martin, Representative Bruce Larkin, Mr. Dennis Jones, Mr. Matt Ida

Kansas Tax Credits
Tax Year 2007

Program Name	Statutory Reference	Description	Number of Filers	Tax Expenditure
		SUMMARY		
Assistance for Low-Income Individuals Credits/Refunds				
Earned Income Credit	K.S.A. 79-32.205	Credit is available to resident taxpayers in an amount equal to 10% of the earned income tax credit allowed against the federal income tax liability.	197,810	$62,368,216
Food Sales Tax Refund	K.S.A. 79-3635	Refund based on sales tax expenditures for food purchases by individuals or families meeting residency and income guidelines, as well as certain requirements as to age, disability, or claiming dependent children	321,033	$41,231,265
Homestead Property Tax Refund	K.S.A. 79-4501	Refund for property taxes based on qualifying income and property tax or rent expenditures. Refund is limited to taxpayers with low household income	78,601	$20,706,262
Business or Economic Development Credits				
Agritourism Liability Insurance Credit	K.S.A. 74-50.173	An income tax credit shall be allowed in an amount equal to 20% of the cost of liability insurance paid by a registered agritourism operator that operates an agritourism activity.	31	$6,114
Angel Investor Credit	K.S.A. 74-8133	Any angel investor that makes a cash investment in the qualified securities of a qualified Kansas business shall receive a credit of 50% of the amount invested.	163	$2,030,795
Business and Job Development Credit	K.S.A. 79-32.153 K.S.A. 79-32.160a	Any taxpayer that invests in a qualified business facility and hires at least two employees as a result of that investment may be eligible for an investment tax credit of $100 for every $100,000 of investment made and a job creation tax credit of $100 for every qualified business facility employee. Any taxpayer that meets the definition of business in K.S.A. 74-50.114(b), that invests in a qualified business facility and hires a minimum number of employees as a result of that investment may be eligible for an investment tax credit of $1,000 for every $100,000 of investment made and a job creation tax credit of at least $1,500 for every qualified business facility employee.	650	$13,169,602
Business Machinery and Equipment Credit	K.S.A. 79-32.206	A credit may be allowed based on a percentage of the personal property tax levied and paid on commercial and industrial machinery and equipment classified for property taxation purposes pursuant to section 1 of article 11 of the Kansas Constitution in subclass (5) or (6) of class 2, and machinery and equipment classified for such purposes in subclass (2) of class 2.	12,115	$37,572,017
Community Entrepreneurship Investor Credit	K.S.A. 74-99c09	An investor making a cash donation of $250 or more in the Kansas community entrepreneurship fund shall receive a credit of 50% of the total amount of cash donation.	103	$1,169,953
Declared Disaster Capital Investment Credit	K.S.A. 79-32.262	Tax credit for taxpayers making capital investments in businesses located in specific disaster areas.	credit not available for TY 2007	
Film Production Credit	K.S.A. 79-32.258	An eligible film production company that makes direct production expenditures in Kansas that are directly attributable to the production of a film in Kansas may be allowed a credit of 30% of the expenditures.	*CONFIDENTIAL	
High Performance Incentive Program	K.S.A. 74-50.132 K.S.A. 79-32.160a(c)	A qualified firm making a cash investment in the training and education of its employees can receive a credit equal to the portion of the investment in the training and education that exceeds 2% of the businesses total payroll costs. A credit is available for those qualified firms that make an investment in a qualified business facility. The investment credit is 10% of the qualified business facility investment which exceeds $50,000	160	$41,921,368

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September 16-17, 2010
Attachment #14

Kansas Tax Credits
Tax Year 2007

Program Name	Statutory Reference	Description	Number of Filers	Tax Expenditure	
Regional Foundation Credit	K.S.A. 74-50.154	Any taxpayer that contributes to an organization designated as a regional foundation may be eligible to receive a tax credit of 50% of the total amount contributed.	60	$944,788	
Research and Development Credit	K.S.A. 79-32.182b	A taxpayer with qualifying expenditures in research and development activities conducted within Kansas may be eligible to receive a credit of 6 1/2% of the amount expended for research.	267	$2,348,072	
Single City Port Authority Credit	K.S.A. 79-32.212	An income tax credit is allowed equal to 100% of the amount attributable to the retirement of indebtedness authorized by a single city port authority established before January 1, 2002.	*CONFIDENTIAL		
Small Employer Health Benefit Plan Credit	K.S.A. 40-2246	An income tax credit is allowed for any small employer establishing a small employer health benefit plan for the purpose of providing a health benefit plan	163	$397,507	
Telecommunications & Railroad Credit	K.S.A. 79-32.206 K.S.A. 79-32.210	A credit for railroad property taxes levied on qualifying property. A credit for property tax paid by telecommunications companies is allowed on property initially acquired and first placed in service after January 1, 2001 that has an assessment rate of 33%. The credit is equal to the amount of property taxes timely paid for the difference between an assessment level of 25% and the actual assessment of 33%.	134	$2,975,090	
Venture Capital Credits and Local Seed Capital Credits	K.S.A. 74-8205 K.S.A. 74-8304 K.S.A. 74-8401 K.S.A. 74-8316	A 25% tax credit shall be allowed for those taxpayers that invest in stock issued by Kansas Venture Capital, Inc., certified Kansas venture capital companies, certified local seed capital pools, or Sunflower Technology Venture, LP.	*CONFIDENTIAL		
		Energy Related Credits			
Biomass-to-Energy Credit	K.S.A. 79-32.233	A taxpayer that makes a qualified investment in a biomass-to-energy plant shall be allowed a credit equal to 10% of the taxpayer's qualified investment on the first $250,000,000 invested and 5% of the taxpayer's qualified investment that exceeds $250,000,000.	0	$0	
Electric Cogeneration Facility Credit	K.S.A. 79-32.246	An income tax credit is allowed for a taxpayer that makes a qualified investment in a new renewable electric cogeneration facility. The credit is 10% on the first $50,000,000 invested and 5% on the amount of investment that exceeds $50,000,000.	0	$0	
Integrated Coal Gasification Power Plant Credit	K.S.A. 79-32.239	A taxpayer that makes a qualified investment in an integrated coal gasification power plant shall be allowed a credit equal to 10% of the taxpayer's qualified investment on the first $250,000,000 invested and 5% of the taxpayer's qualified investment that exceeds $250,000,000	0	$0	
Nitrogen Fertilizer Plant Credit	K.S.A. 79-32.229	A taxpayer that makes a qualified investment in a nitrogen fertilizer plant shall be allowed a credit equal to 10% of the taxpayer's qualified investment on the first $250,000,000 invested and 5% of the taxpayer's qualified investment that exceeds $250,000,000.	0	$0	
Petroleum Refinery Credit	K.S.A. 79-32.218	A taxpayer that makes a qualified investment in a refinery shal be allowed a credit equal to 10% of the taxpayer's qualified investment on the first $250,000,000 invested and 5% of the taxpayer's qualified investment that exceeds $250,000,000.	*CONFIDENTIAL		
Qualifying Pipeline Credit	K.S.A. 79-32.224	A taxpayer that makes a qualified investment in a new qualifying pipeline shall be allowed a credit equal to 10% of the taxpayer's qualified investment on the first $250,000,000 invested and 5% of the taxpayer's qualified investment that exceeds $250,000,000.	0	$0	
Storage and Blending Equipment Credit	K.S.A. 79-32.252	An income tax credit is allowed to a taxpayer that makes a qualified investment in storage and blending equipment installed at a fuel terminal, refinery or biofuel production plant The credit is 10% on the first $10,000,000 invested and 5% on the amount that exceeds $10,000,000	0	$0	
		Environmental Related Credits			

Kansas Tax Credits
Tax Year 2007

Program Name	Statutory Reference	Description	Number of Filers	Tax Expenditure
Abandoned Well Plugging Credit	K.S.A. 79-32,207	A taxpayer that makes expenditures to plug an abandoned oil or gas well on their land may be eligible for a credit of 50% of the amount expended	*CONFIDENTIAL	
Alternative Fuel Tax Credit	K.S.A. 79-32,201	A credit is allowed for any individual, association, partnership, limited liability company, limited partnership, or corporation that makes expenditures for a qualified alternative-fueled motor vehicle licensed in the state of Kansas or that makes expenditures for a qualified alternative-fuel fueling station.	113	$186,673
Environmental Compliance Credit	K.S.A. 79-32,222	An income tax credit is allowed for a taxpayer that makes qualified expenditures for an existing refinery to comply with environmental standards	0	$0
Swine Facility Improvement Credit	K.S.A. 79-32,204	An income tax credit of 50% of the cost incurred is allowed for a taxpayer making required improvements to a qualified swine facility	0	$0
Social Service Related Credits				
Adoption Credit	K.S.A. 79-32,202	**General Adoption Credit** Residents of Kansas who adopt a child can receive a credit of 25% of the adoption credit allowed against the federal income tax liability on the federal return. **Special Needs/SRS Custody Adoption Credit** A $1,500 credit is available for those Kansas residents that adopt a special needs child or a child in the custody of the secretary of Social and Rehabilitation Services.	1,217	$1,364,988
Assistive Technology Contribution Credit	K.S.A. 65-7107	A taxpayer that makes a contribution to an individual development account reserve fund may qualify for an income tax credit in the amount of 25% of the amount contributed.	0	$0
Child and Dependent Care Credit	K.S.A. 79-32,111a	Credit available only to residents and part-year residents filing as residents. The credit is equal to 25% of the federal credit allowed.	73,492	$9,447,143
Child Day Care Assistance Credit	K.S.A. 79-32,190	A taxpayer may be eligible for a credit if they pay for child day care services for its employees children, locate child day care services for the employees children, or provide facilities and necessary equipment for child day care services for its employees children.	8	$109,119
Community Service Contribution Credit	K.S.A. 79-32,197	Any business firm which contributes to an approved community service organization engaged in providing community services may be eligible to receive a tax credit of at least 50% of the total contribution made.	902	$3,029,564
Disabled Access Credit	K.S.A. 79-32,175 K.S.A. 79-1117	Individual and business taxpayers that incur certain expenditures to make their property accessible to the disabled - may be eligible to receive a credit	46	$81,089
Individual Development Account Credit	K.S.A. 74-50,208	Any program contributor that contributes to an individual development account reserve fund may be eligible for a credit of 50% of the amount contributed	36	$41,893
Temporary Assistance to Families Contribution Credit	K.S.A. 79-32,200 K.S.A. 39-7,132	Any individual, corporation, partnership, trust, estate and other legal entity who enters into an agreement with the Secretary of Social and Rehabilitation Services to provide financial support to a person who receives Temporary Assistance for Families (TAF) is allowed a credit of 70% of the amount of financial assistance given.	0	$0
Other Credits				
Agricultural Loan Interest Reduction Credit	K.S.A. 79-32,181a K.S.A. 79-1126a	A taxpayer which extends or renews an agricultural production loan at least one whole percentage point less than the prime interest rate on loans with equivalent collateral can receive a credit against their tax liability.	*CONFIDENTIAL	
Deferred Maintenance Credit	K.S.A.79-32,261	Tax credit for contributions to defray the cost of capital improvements, equipment or deferred maintenance at Kansas community colleges, technical colleges, or post-secondary educational institutions.	credit not available for TY 2007	

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Kansas Tax Credits
Tax Year 2007

Program Name	Statutory Reference	Description	Number of Filers	Tax Expenditure
Historic Preservation Credit	K.S.A. 79-32,211	An income tax credit is allowed for expenditures incurred in the restoration and preservation of a qualified historic structure.	266	$7,897,508
Historic Site Credit	K.S.A. 79-32,211a	Any taxpayer which contributes to a state-owned historic site or a 501(c)(3) organization which owns and operates a state-owned historic site may receive a tax credit of 50% of the contribution.	*CONFIDENTIAL	
Law Enforcement Training Center Credit	K.S.A. 79-32,242	Any business firm which contributes cash to the Kansas Law Enforcement Training Center to be used by the Center for the purpose of providing programs and courses of instruction for full-time police officers and law enforcement officers designed to fulfill the continuing education and training requirements of officers shall be allowed a credit that shall not exceed 50% of the total amount contributed	*CONFIDENTIAL	
Mathematics and Science Teacher Employment Credit	K.S.A. 79-32,215	An income tax credit shall be allowed to any business firm that has entered into a partnership agreement to employ a Kansas mathematics or science teacher during times that school is not in session.	*CONFIDENTIAL	
National Guard & Reserve Employer Credit	K.S.A. 79-32,244	An income tax credit shall be allowed for employing a member of the Kansas Army and Air National Guard or a member of a Kansas unit of the reserved forces of the United States who was federally activated and deployed on or after August 7, 1990 The credit is 25% of the amount paid as salary or compensation, not to exceed $7,000 for each member employed	*CONFIDENTIAL	
Total of CONFIDENTIAL filers			25	$441,385
TOTAL			**687,395**	**$249,440,411**

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State Sales Tax Exemptions - Listed by Groups

Statute	Description of Exemption or Exclusion	FY2011 ($ in Millions)	FY2012 ($ in Millions)	FY2013 ($ in Millions)	FY2014 ($ in Millions)	FY2015 ($ in Millions)	FY2016 ($ in Millions)
Tax Rate		6.3%	6.3%	6.3%	6.3%	6.3%	6.3%
Annual Rate of Increase		3%	3%	3%	3%	3%	3%
	Conceptual Exclusions						
3602 (e)	Definition of retail sales, exempting wholesale sales and sales for resale	$ -	$ -	$ -	$ -	$ -	$ -
3606 (a)	Motor fuels and items taxed by sales or excise tax	$ 294.65	$ 303.49	$ 312.59	$ 321.97	$ 331.63	$ 341.58
3606 (k)	Vehicles, trailers or aircraft purchased and delivered out of state to a nonresident	$ 19.56	$ 20.15	$ 20.75	$ 21.38	$ 22.02	$ 22.68
3606 (l)	Isolated or occasional sales, except motor vehicles	$ -	$ -	$ -	$ -	$ -	$ -
3606 (m)	Property which becomes an ingredient or component part of property or services produced or manufactured for ultimate sale at retail	$ 2,848.78	$ 2,934.25	$ 3,022.27	$ 3,112.94	$ 3,206.33	$ 3,302.52
3606 (n)	Property consumed in the production, manufacturing, processing, mining, drilling, refining or compounding of property; or irrigation of crops for ultimate sale at retail. In 2000, added provision to eliminate refunds from the Johnson County Water case	$ 373.77	$ 384.99	$ 396.54	$ 408.43	$ 420.69	$ 433.31
3606 (o)	Sales of animals, fowl, aquatic plants, and animals used in agriculture or aquaculture, for production of food for human consumption, the production of animal, dairy, poultry, or aquatic products, fiber or fur or the production of offspring.	$ 210.37	$ 216.69	$ 223.19	$ 229.88	$ 236.78	$ 243.88
	Subtotal	**$ 3,747.14**	**$ 3,859.56**	**$ 3,975.34**	**$ 4,094.60**	**$ 4,217.44**	**$ 4,343.97**
	Public Policy: Charitable, Religious, Benevolent Exemptions						
3603 (e)	Admission to any cultural and historical event which occurs triennially	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (v)	Sales of food products purchased by contractor for use in preparing meals for delivery to homebound elderly persons. In 2004, expanded exemption to all personal property purchased by contractor and sales of food products by or on behalf of contractor or organization	$ 1.05	$ 1.09	$ 1.12	$ 1.15	$ 1.19	$ 1.22
3606 (ii)	Property purchased by nonprofit organization for nonsectarian comprehensive multidiscipline youth development programs and activities and sales of property by or on behalf of such organization	$ 3.33	$ 3.43	$ 3.53	$ 3.64	$ 3.75	$ 3.86
3606 (oo)	Property purchased by a community action group or agency to repair or weatherize housing occupied by low income individuals.	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (qq)	Property and services purchased by a nonprofit museum or historical society which is organized under the federal income taxation code as a 501 (c)(3)	$ 0.50	$ 0.52	$ 0.53	$ 0.55	$ 0.56	$ 0.58
3606 (rr)	Property which will admit purchases to an annual event sponsored by a nonprofit organization organized under the federal income taxation code as a 501 (c)(3)	$ 0.04	$ 0.04	$ 0.04	$ 0.05	$ 0.05	$ 0.05
3606 (tt)	Property and services purchased by not-for-profit corporation for the sole purpose of constructing a Kansas Korean War memorial and is organized under the federal income taxation code as a 501 (c)(3)	$ -	$ -	$ -	$ -	$ -	$ -
3606 (xx)	Property and services purchases by nonprofit zoo or on behalf of a zoo by an entity that is a 501(c)(3)	$ 0.76	$ 0.79	$ 0.81	$ 0.84	$ 0.86	$ 0.89
3606 (yy)	Property and services purchased by a parent-teach association or organizations and all sales of tangible personal property by or on behalf of such association	$ 0.72	$ 0.74	$ 0.76	$ 0.78	$ 0.81	$ 0.83
3606 (aaa)	Property and services purchased by religious organizations and used exclusively for religious purposes	$ 21.99	$ 22.65	$ 23.33	$ 24.02	$ 24.75	$ 25.49
3606 (bbb)	Sales of food for human consumption by organizations exempt by 501(c)(3) pursuant to food distribution programs which offers such food at a price below cost in exchange for the performance of community service by the purchaser.	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (hhh)	Property and services purchased by or on behalf of Domestic Violence Shelters as members of the Kansas coalition against Sexual and Domestic Violence	$ 0.07	$ 0.07	$ 0.08	$ 0.08	$ 0.08	$ 0.08
3606 (iii)	Property and services purchased by organizations distributing food without charge to other nonprofit food distribution programs. Includes taxes paid on and after July 1, 2005 and prior to July 1, 2006.	$ 0.30	$ 0.31	$ 0.32	$ 0.33	$ 0.34	$ 0.35
3606 (ppp)	Property and services purchased by non-profit Homeless Shelters, and sales made by or on behalf of these organizations.	$ 0.14	$ 0.14	$ 0.14	$ 0.15	$ 0.15	$ 0.16
3606 (ttt)	Property and services purchased a contractor for a purpose of restoring, constructing, equipping, reconstructing, maintaining, repairing, enlarging, furnishing or remodeling a home or facility owned by a nonprofit museum which is a qualified under the governor hometown heritage act (KSA 75-5071)	$ 0.13	$ 0.14	$ 0.14	$ 0.15	$ 0.15	$ 0.16
	Subtotal	**$ 29.04**	**$ 29.91**	**$ 30.81**	**$ 31.73**	**$ 32.68**	**$ 33.66**
	Public Policy: Exemptions to Charitable Organizations by Name						

Special Committee on Assessment and Taxation

September 16-17, 2010

Attachment #15

Statute	Description of Exemption or Exclusion	FY2011 ($ in Millions)	FY2012 ($ in Millions)	FY2013 ($ in Millions)	FY2014 ($ in Millions)	FY2015 ($ in Millions)	FY2016 ($ in Millions)
Tax Rate		6.3%	6.3%	6.3%	6.3%	6.3%	6.3%
Annual Rate of Increase		3%	3%	3%	3%	3%	3%
3606 (vv)	Property purchased by the following organizations who are organized under the federal income taxation code as a 501 (c)(3): American Heart Association, Ks Affiliate; Ks Alliance for the Mentally Ill, Inc.; Ks Mental Illness Awareness Council, Heartstrings Community Foundation, Cystic Fibrosis , Spina Bifida Assn, CHWC, Inc., Cross-lines Cooperative Council, Dreams Work, Inc., KSDS, Inc., Lyme Association of Greater Kansas City, Inc Dream Factory, Ottawa Suzuki Strings, International Assn of Lions Clubs, Johnson County young Matrons, American Cancer Society, Community Services of Shawnee, Angel Babies Assn, Kansas Fairground Foundation	$ 1.00	$ 1.03	$ 1.06	$ 1.10	$ 1.13	$ 1.16
3606 (ww)	Property purchased by the Habitat for Humanity for use within a housing project	$ 0.15	$ 0.15	$ 0.15	$ 0.16	$ 0.16	$ 0.17
3606 (ggg)	Property and services purchased by or on behalf of the Kansas Academy of Science.	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (kkk)	Not Used	$ -	$ -	$ -	$ -	$ -	$ -
3606 (lll)	Property and services purchased by Special Olympics Kansas, Inc., and sales made by or on behalf of Special Olympics.	$ 0.03	$ 0.03	$ 0.04	$ 0.04	$ 0.04	$ 0.04
3606 (mmm)	Property and services purchased by Marillac Center, Inc. and sales made by or on behalf of the Marillac Center.	$ 0.07	$ 0.07	$ 0.07	$ 0.07	$ 0.08	$ 0.08
3606 (nnn)	Property and services purchased by West Sedgwick County - Sunrise Rotary Club for constructing boundless playground.	$ 0.03	$ 0.03	$ 0.03	$ 0.03	$ 0.03	$ 0.03
3606 (qqq)	Property and services purchased by TLC for Children and Families, Inc. and sales made by or on behalf of TLC	$ 0.22	$ 0.22	$ 0.23	$ 0.24	$ 0.24	$ 0.25
3606 (sss)	Property and services purchased by catholic charities or youthville and sales made by or on behalf of catholic charities or youthville	$ 0.81	$ 0.84	$ 0.86	$ 0.89	$ 0.92	$ 0.94
3606 (uuu)	Property and services purchased by Kansas Children's Service League and sales made by or on behalf of the KCSL	$ 0.19	$ 0.20	$ 0.20	$ 0.21	$ 0.21	$ 0.22
3606 (vvv)	Property and services purchased by Jazz in the Woods and sales made by or on behalf of such organization	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.02
3606 (www)	Property purchased by or behalf of Frontenac Education Foundation and sales made by or on behalf of such organization	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
3606 (xxx)	Property and services purchased by the Booth Theatre Foundation, Inc. Provides for refund of sales taxes paid from January to July 2007.	$ 0.04	$ 0.04	$ 0.04	$ 0.04	$ 0.04	$ 0.05
3606 (yyy)	Property and services purchased by the TLC Charities Foundation, Inc. and sales made by or on behalf of these organizations.	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
3606 (zzz)	Property purchased by Rotary Club of Shawnee Foundation	$ -	$ -	$ -	$ -	$ -	$ -
3606 (aaaa)	Property and services purchased by or on behalf of Victory in the Valley and sales made by or on behalf of such organization	$ 0.02	$ 0.02	$ 0.02	$ 0.02	$ 0.03	$ 0.03
3606 (bbbb)	Guadalupe Health Foundation, sales of entry or praticipation fees, chrages or tickets for annual fundraising event	$ 0.14	$ 0.14	$ 0.15	$ 0.15	$ 0.16	$ 0.16
3606 (cccc)	Property and services purchased by or on behalf of Wayside Waifs for the purpose of providing such organizatoins annual fundraising event and sales made by or on behalf of such organization	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.01
3606 (dddd)	Property or services purchased by or on behalf of Goodwill Industries or Easter Seals o Kansas, Inc for the purpose of providing education, training and employment opportunities for people with disabilities and other barriers to employment	$ 0.05	$ 0.05	$ 0.05	$ 0.05	$ 0.05	$ 0.05
3606 (eeee)	Property or services purchased by or on behalf of All Beef Battalion, Inc. for the purpose of educating, promoting and participating as a contract group through the beef cattle industry in order to carry out such projects that provide support and morale to members of the United States armed forces and military services.	$ 0.00	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.01
3606 (ffff)	Property and services purchased by Sheltered Living, Inc for the purpose of providing residential and services for people with developmental disabilities or mental retardation, or both; and sales made on behalf of such organization	$ 0.04	$ 0.04	$ 0.04	$ 0.04	$ 0.04	$ 0.04
	Subtotal	**$ 2.82**	**$ 2.90**	**$ 2.99**	**$ 3.08**	**$ 3.17**	**$ 3.26**
	Public Policy: Consumer Exemptions						
3602 (ii)	Modified definition of sales or selling price to not include cash rebates granted by a manufacturer to a purchaser or lessee of a mew motor vehicle if paid directly to the retailer as a result of the original sale. The exemption is granted from July 1, 2006 and ending June 30, 2009.	$ -	$ -	$ -	$ -	$ -	$ -
3603 (b)	Taxes telephone and telegraph services except certiain interstate and international services and value-added nonvoice data services	$ 1.83	$ 1.89	$ 1.94	$ 2.00	$ 2.06	$ 2.12
3603 (c)	Residential and agricultural use utilities. Effective Jan 1 2006, exemption fmoved here from 3606 (w) and (x).	$ 157.06	$ 161.77	$ 166.62	$ 171.62	$ 176.77	$ 182.07

Statute	Description of Exemption or Exclusion	FY2011 ($ in Millions)	FY2012 ($ in Millions)	FY2013 ($ in Millions)	FY2014 ($ in Millions)	FY2015 ($ in Millions)	FY2016 ($ in Millions)
Tax Rate		6.3%	6.3%	6.3%	6.3%	6.3%	6.3%
Annual Rate of Increase		3%	3%	3%	3%	3%	3%
3603 (o)	Motor vehicles exchanged for corporate stock, corporate transfer to itself and immediate family member sales.	$ 0.26	$ 0.27	$ 0.28	$ 0.29	$ 0.30	$ 0.31
3603 (p)	Labor services of installing or applying property in original construction of a building or facility or the construction reconstruction, restoration, replacement or repair or a residence, bridge or highway	$ 230.39	$ 237.30	$ 244.42	$ 251.75	$ 259.30	$ 267.08
3603 (v)	Sales of bingo cards, bingo faces and instant bingo tickets. Tax rate 2.5 on July 1, 2001 to June 30, 2002; exempt on July 1, 2002	$ 3.46	$ 3.57	$ 3.67	$ 3.78	$ 3.90	$ 4.01
3606 (u)	Leases or rentals of property used as a dwelling for more than 28 consecutive days.	$ 0.92	$ 0.95	$ 0.98	$ 1.01	$ 1.04	$ 1.07
3606 (w)	Residential and agricultural use of water and severing oil & gas and property exempt from property tax. Effective Jan 1 2006, exemption for residential and agricultural use of electricity and heat moved to 3603(c).	$ 14.69	$ 15.13	$ 15.59	$ 16.05	$ 16.54	$ 17.03
3606 (x)	Sales of propane, gas, LP-gas, coal, wood, and other fuel sources for the production of heat or lighting for noncommercial use in a residential premise. Effective Jan 1 2006, exemption for residential and agricultural moved hereto 3603(c).	$ -	$ -	$ -	$ -	$ -	$ -
3606 (bb)	Used mobile and manufactured homes	$ 5.62	$ 5.79	$ 5.96	$ 6.14	$ 6.32	$ 6.51
3606 (ee)	Lottery tickets and shares made as part of a lottery operated by the State of Kansas	$ 17.88	$ 18.42	$ 18.97	$ 19.54	$ 20.13	$ 20.73
3606 (ff)	New mobile or manufactured homes to the extent of 40% of the gross receipts	$ 4.12	$ 4.24	$ 4.37	$ 4.50	$ 4.64	$ 4.78
3606 (ooo)	Sales made by or on behalf of a public library	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.02	$ 0.02
	Subtotal	**$ 436.26**	**$ 449.34**	**$ 462.82**	**$ 476.71**	**$ 491.01**	**$ 505.74**
	Public Policy: Governmental Exemptions						
3603 (g)	Service of renting of rooms by holds or accommodation brokers to federal government or any federal employee in performance of official government duties.	$ 0.15	$ 0.16	$ 0.16	$ 0.17	$ 0.17	$ 0.18
3603 (h)	Service of leasing or renting machinery and equipment owned by city purchased with industrial revenue bonds prior to July 1, 1973	$ -	$ -	$ -	$ -	$ -	$ -
3606 (b)	Property or services purchases by State of Kansas, political subdivision, nonprofit hospital or blood /donor bank. In 2001, deleted sales of water to make purchases for water suppliers exempt.(Neutral FN due to Clean Water Fee)	$ 419.30	$ 431.87	$ 444.83	$ 458.18	$ 471.92	$ 486.08
3606 (d)	Property or services purchased by contractor for building or repair of buildings for nonprofit hospital, elementary or secondary schools or nonprofit educational institutions, and for state correctional institution	$ 150.74	$ 155.26	$ 159.91	$ 164.71	$ 169.65	$ 174.74
3606 (e)	Property or services purchases by federal government, its agencies or instrumentality's	$ 7.02	$ 7.23	$ 7.44	$ 7.67	$ 7.90	$ 8.13
3606 (s)	Sales of property or services purchased by a groundwater management district	$ 0.05	$ 0.06	$ 0.06	$ 0.06	$ 0.06	$ 0.06
3606 (z)	Property and services purchased directly by a port authority or a contractor therefore.	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (ss)	Property and services purchased by a public broadcasting station licensed by FCC as a noncommercial educational television or radio station.	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (uu)	Property and services purchased by rural fire fighting organization	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (rrr)	Property and services purchased by county law library,	$ 0.14	$ 0.14	$ 0.14	$ 0.15	$ 0.15	$ 0.16
	Subtotal	**$ 577.39**	**$ 594.71**	**$ 612.55**	**$ 630.92**	**$ 649.85**	**$ 669.35**
	Public Policy: Educational Exemptions						
3606 (c)	Property or services purchased and leasing by elementary or secondary schools and educational institutions	$ 74.10	$ 76.32	$ 78.61	$ 80.97	$ 83.39	$ 85.90
3606 (h)	Rental of nonsectarian textbooks by elementary or secondary schools	$ 1.21	$ 1.25	$ 1.29	$ 1.32	$ 1.36	$ 1.40
	Subtotal	**$ 75.31**	**$ 77.57**	**$ 79.89**	**$ 82.29**	**$ 84.76**	**$ 87.30**
	Public Policy: Health Care Exemptions						
3606 (p)	Sales for prescription drugs	$ 89.16	$ 91.83	$ 94.59	$ 97.42	$ 100.35	$ 103.36
3606 (q)	Sales of insulin dispensed by pharmacist for treatment of diabetes	$ 0.69	$ 0.71	$ 0.73	$ 0.75	$ 0.77	$ 0.80
3606 (r)	Sales of prosthetic or orthopedic appliances prescribed by a doctor. IN 2004, exempted all hearing aids, parts and batteries by licensed providers	$ 10.48	$ 10.80	$ 11.12	$ 11.46	$ 11.80	$ 12.15
3606 (hh)	Medical supplies and equipment purchased by nonprofit skilled nursing home or intermediate nursing care home for providing medical services to residents	$ 1.32	$ 1.36	$ 1.40	$ 1.44	$ 1.48	$ 1.53
3606 (jj)	Property and services, includes leasing of property, purchased for community-based mental retardation facility or mental health center.	$ 3.06	$ 3.15	$ 3.24	$ 3.34	$ 3.44	$ 3.54

Statute	Description of Exemption or Exclusion	FY2011 ($ in Millions)	FY2012 ($ in Millions)	FY2013 ($ in Millions)	FY2014 ($ in Millions)	FY2015 ($ in Millions)	FY2016 ($ in Millions)
Tax Rate		6.3%	6.3%	6.3%	6.3%	6.3%	6.3%
Annual Rate of Increase		3%	3%	3%	3%	3%	3%
3606 (ll)	Educational materials purchased for distribution to the public at no charge by a nonprofit public health corporation	$ 0.10	$ 0.11	$ 0.11	$ 0.11	$ 0.12	$ 0.12
3606 (ccc)	Property and services purchases by health care centers and clinics who are serving the medically underserved.	$ 0.48	$ 0.49	$ 0.51	$ 0.52	$ 0.54	$ 0.55
3606 (jjj)	Sales of dietary supplements dispensed by prescription order by a licensed practitioner or mid-level practitioner.	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
	Subtotal	**$ 105.29**	**$ 108.45**	**$ 111.70**	**$ 115.05**	**$ 118.50**	**$ 122.06**
	Public Policy: Agriculture Exemptions						
3606 (t)	Sales of farm or aquaculture machinery and equipment, parts and services for repair and replacement. In 2006, added work-site utility vehicle as exempt. To include precision farm equipment	$ 62.91	$ 64.79	$ 66.74	$ 68.74	$ 70.80	$ 72.93
3606 (mm)	Seeds, tree seedlings, fertilizers, insecticides, etc., and services purchased and used for producing plants to prevent soil erosion on land devoted to agricultural use.	$ 1.21	$ 1.25	$ 1.29	$ 1.32	$ 1.36	$ 1.40
	Subtotal	**$ 64.12**	**$ 66.04**	**$ 68.02**	**$ 70.06**	**$ 72.17**	**$ 74.33**
	Legal Exemptions						
3606 (g)	Sales, repair or modification of aircraft sold for interstate commerce directly through an authorized agent. IN 2004, expanded aircraft exemption for repair, modification plus parts and labor	$ 9.25	$ 9.52	$ 9.81	$ 10.10	$ 10.41	$ 10.72
3606 (y)	Sales of materials and services used in repairing, maintaining, etc., of railroad rolling stock used in interstate commerce	$ 1.19	$ 1.22	$ 1.26	$ 1.30	$ 1.34	$ 1.38
3606 (aa)	Materials and services brought into Kansas for usage outside of Kansas for repair, services, alteration, maintenance, etc. used for the transmission of liquids or national gas by a pipeline in interstate commerce	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (dd)	Property purchased with food stamps issued by US Department of Agriculture	$ 9.61	$ 9.90	$ 10.19	$ 10.50	$ 10.81	$ 11.14
3606 (gg)	Property purchased with vouchers issued pursuant to the federal special supplemental food program for women, infants and children	n/a	n/a	n/a	n/a	n/a	n/a
3606 (ddd)	Property and services purchases by any class II or III railroad (shortline) for track and facilities used directly in interstate commerce. Only for calendar year 1999.	n/a	n/a	n/a	n/a	n/a	n/a
	Subtotal	**$ 20.04**	**$ 20.64**	**$ 21.26**	**$ 21.90**	**$ 22.56**	**$ 23.23**
	Public Policy: Exemption of Services						
3603 (f)	Coin operated Laundry Services	$ 0.46	$ 0.48	$ 0.49	$ 0.51	$ 0.52	$ 0.54
3603 (m)	Fees and charges by any political subdivision, youth recreation organization exclusively providing services to persons 18 or younger organized as a 501(c)(3) for sports, games and other recreational activities and entry fees and charges for participation.	$ 1.15	$ 1.18	$ 1.22	$ 1.25	$ 1.29	$ 1.33
3603 (n)	Dues charged by any organization pursuant to paragraph 8 and 9 of 79-201 (veteran & humanitarian organizations) and zoos	$ 0.42	$ 0.43	$ 0.45	$ 0.46	$ 0.48	$ 0.49
3606 (nn)	Services rendered by advertising agency or broadcast station	$ 5.37	$ 5.53	$ 5.69	$ 5.86	$ 6.04	$ 6.22
	Subtotal	**$ 7.40**	**$ 7.62**	**$ 7.85**	**$ 8.09**	**$ 8.33**	**$ 8.58**
	Public Policy: Exemptions for Businesses						
3603 (q)	Exemption for Service of repairing, servicing , maintaining custom computer software as described in section 3603 (s)	$ -	$ -	$ -	$ -	$ -	$ -
3603 (s)	Customized computer software and services for modifying software for single end use and billed as a separate invoiced item. In 2004, amended to tax only prewritten software. Custom software is exempt	$ 6.54	$ 6.74	$ 6.94	$ 7.15	$ 7.36	$ 7.59
3606 (f)	Property purchased by railroad or public utility for use in the movement of interstate commerce	$ 19.68	$ 20.27	$ 20.88	$ 21.51	$ 22.15	$ 22.82
3606 (i)	Lease or rental of films, records, tapes, etc. by motion picture exhibitors	$ 2.16	$ 2.23	$ 2.30	$ 2.36	$ 2.44	$ 2.51
3606 (j)	Meals served without charge to employees if duties include furnishing or sale of such meals or drinks	$ 4.80	$ 4.94	$ 5.09	$ 5.24	$ 5.40	$ 5.56
3606 (cc)	Property or services purchased for constructing, reconstructing, enlarging or remodeling a business; sale and installation of machinery and equipment purchased for installation in such business. (Enterprise Zone Exemption)	$ 83.10	$ 85.59	$ 88.16	$ 90.80	$ 93.53	$ 96.33
3606 (kk)	Machinery and equipment used directly and primarily in the manufacture, assemblage, processing, finishing, storing, warehousing or distributing of property for resale by the plant or facility. In 2004, added exemption for building new facility in Riverton Ks (minimal impact)	$ 146.75	$ 151.15	$ 155.69	$ 160.36	$ 165.17	$ 170.13

Statute	Description of Exemption or Exclusion	FY2011 ($ in Millions)	FY2012 ($ in Millions)	FY2013 ($ in Millions)	FY2014 ($ in Millions)	FY2015 ($ in Millions)	FY2016 ($ in Millions)
Tax Rate		6.3%	6.3%	6.3%	6.3%	6.3%	6.3%
Annual Rate of Increase		3%	3%	3%	3%	3%	3%
3606 (pp)	Drill bits and explosives used in the exploration and production of oil or gas	$ 0.51	$ 0.53	$ 0.54	$ 0.56	$ 0.57	$ 0.59
3606 (zz)	Machinery and equipment purchased by over-the-air free access radio or television station used directly and primarily for producing signal or the electricity essential for producing the signal.	$ 1.21	$ 1.24	$ 1.28	$ 1.32	$ 1.36	$ 1.40
3606 (eee)	Property and services purchases for reconstruction, reconstruction, renovation, repair of grain storage facilities or railroad sidings. Only for calendar year 1999 and 2000.	n/a	n/a	n/a	n/a	n/a	n/a
3606 (fff)	Material handling equipment, racking systems & other related machinery & equipment used for the handling, movement or storage of tangible personal property in a warehouse or distribution facility; installation, repair, maintenance services, and replacement parts.	$ 7.95	$ 8.18	$ 8.43	$ 8.68	$ 8.94	$ 9.21
	Subtotal	**$ 272.70**	**$ 280.88**	**$ 289.30**	**$ 297.98**	**$ 306.92**	**$ 316.13**
	Total	$ 5,337.49	$ 5,497.61	$ 5,662.54	$ 5,832.42	$ 6,007.39	$ 6,187.61

Kansas Department of Revenue
Office of Policy and Research
Sales Tax Exemption Fiscal Impact Estimate -All Funds
(dollars in millions)

	Receipts	FY 2011 3%	FY 2012 3%	FY 2013 3%	FY 2014 3%	FY 2015 3%	FY 2016 3%
Professional, Scientific & Technical							
Legal Services	$ 786,065	$ 26,017	$ 26,797	$ 27,601	$ 28,429	$ 29,282	$ 30,160
Accounting & Tax Services	$ 643,230	$ 21,289	$ 21,928	$ 22,586	$ 23,263	$ 23,961	$ 24,680
Architectural Services	$ 294,852	$ 9,759	$ 10,052	$ 10,353	$ 10,664	$ 10,984	$ 11,313
Engineering Services	$ 1,793,645	$ 59,365	$ 61,145	$ 62,980	$ 64,869	$ 66,815	$ 68,820
Drafting Services	$ 3,751	$ 124	$ 128	$ 132	$ 136	$ 140	$ 144
Building Inspection Services	$ 4,054	$ 134	$ 138	$ 142	$ 147	$ 151	$ 156
Geophysical surveying and Mapping	$ 17,680	$ 585	$ 603	$ 621	$ 639	$ 659	$ 678
Surveying and Mapping (except geophysical)	$ 29,485	$ 976	$ 1,005	$ 1,035	$ 1,066	$ 1,098	$ 1,131
Testing Services	$ 66,724	$ 2,208	$ 2,275	$ 2,343	$ 2,413	$ 2,486	$ 2,560
Specialized Design Services (1)	$ 121,340	$ 4,016	$ 4,136	$ 4,261	$ 4,388	$ 4,520	$ 4,656
Computer 'systems design & related services	$ 1,966,137	$ 65,074	$ 67,026	$ 69,036	$ 71,108	$ 73,241	$ 75,438
Management, Scientific &Technical Consulting	$ 737,212	$ 24,400	$ 25,132	$ 25,886	$ 26,662	$ 27,462	$ 28,286
Scientific research & development services	$ 255,313	$ 8,450	$ 8,704	$ 8,965	$ 9,234	$ 9,511	$ 9,796
Advertising & Related Services	$ 608,358	$ 20,135	$ 20,739	$ 21,361	$ 22,002	$ 22,662	$ 23,342
Other Prof. Tech, and Science (2)	$ 451,038	$ 14,928	$ 15,376	$ 15,837	$ 16,312	$ 16,802	$ 17,306
Total, Professional, Scientific & Technical	**$ 7,778,884**	**$ 257,459**	**$ 265,183**	**$ 273,138**	**$ 281,332**	**$ 289,772**	**$ 298,465**
Administrative & Support Services							
Office Aministrative Services	$ 343,428	$ 11,366	$ 11,707	$ 12,059	$ 12,420	$ 12,793	$ 13,177
Facilities Support Services	$ 122,236	$ 4,046	$ 4,167	$ 4,292	$ 4,421	$ 4,553	$ 4,690
Employment Services	$ 1,229,323	$ 40,687	$ 41,908	$ 43,165	$ 44,460	$ 45,794	$ 47,167
Business Support Services	$ 627,631	$ 20,773	$ 21,396	$ 22,038	$ 22,699	$ 23,380	$ 24,081
Travel Arrangement and Reservation Services	$ 86,734	$ 2,871	$ 2,957	$ 3,045	$ 3,137	$ 3,231	$ 3,328
Investigation and Security services	$ 193,621	$ 6,408	$ 6,601	$ 6,799	$ 7,003	$ 7,213	$ 7,429
Services to buildings and dwellings (3)	$ 830,576	$ -					
Other Support Services	$ 210,735	$ 6,975	$ 7,184	$ 7,399	$ 7,621	$ 7,850	$ 8,086
Total, Administrative & Support Services	**$ 3,644,284**	**$ 93,126**	**$ 95,919**	**$ 98,797**	**$ 101,761**	**$ 104,814**	**$ 107,958**
Health Care Services							
Physicians	$ 3,384,563	$ 112,019	$ 115,380	$ 118,841	$ 122,407	$ 126,079	$ 129,861
Dentists	$ 819,702	$ 27,130	$ 27,944	$ 28,782	$ 29,645	$ 30,535	$ 31,451
Other Health Practitioners	$ 518,004	$ 17,144	$ 17,659	$ 18,189	$ 18,734	$ 19,296	$ 19,875
Outpatient care centers	$ 460,707	$ 15,248	$ 15,706	$ 16,177	$ 16,662	$ 17,162	$ 17,677
Medical & diagnostic Laboratories	$ 446,881	$ 14,790	$ 15,234	$ 15,691	$ 16,162	$ 16,647	$ 17,146
Home Health Care Services	$ 281,614	$ 9,321	$ 9,600	$ 9,888	$ 10,185	$ 10,490	$ 10,805
Other ambulatory health care services	$ 235,003	$ 7,778	$ 8,011	$ 8,252	$ 8,499	$ 8,754	$ 9,017
Social assistance	$ 1,100,724	$ 36,431	$ 37,524	$ 38,649	$ 39,809	$ 41,003	$ 42,233
Total, Health Care	**$ 7,247,198**	**$ 195,653**	**$ 201,522**	**$ 207,568**	**$ 213,795**	**$ 220,209**	**$ 226,815**
Personal Care							
Personal Care Services (hair, nail and skin)	$ 207,470	$ 6,867	$ 7,073	$ 7,285	$ 7,503	$ 7,728	$ 7,960
Death Care Services	$ 159,835	$ 5,290	$ 5,449	$ 5,612	$ 5,781	$ 5,954	$ 6,133
Other Personal Care (4)	$ 124,776	$ 4,130	$ 4,254	$ 4,381	$ 4,513	$ 4,648	$ 4,787
Total, Personal Care	**$ 492,081**	**$ 16,286**	**$ 16,775**	**$ 17,278**	**$ 17,797**	**$ 18,331**	**$ 18,880**
Other							
Taxi And Limousine Services	$ 13,071	$ 433	$ 446	$ 459	$ 473	$ 487	$ 502
RV Parks and Recreational Camps	$ 3,536	$ 117	$ 121	$ 124	$ 128	$ 132	$ 136
Rooming and Boarding Houses (5)	$ 21,223	$ 702	$ 724	$ 745	$ 768	$ 791	$ 814
Total, Other	**$ 34,294**	**$ 1,252**	**$ 1,290**	**$ 1,328**	**$ 1,368**	**$ 1,409**	**$ 1,452**
Total All Services		**$ 563,776**	**$ 580,689**	**$ 598,110**	**$ 616,053**	**$ 634,535**	**$ 653,571**

The estimate on services was developed based on the U.S Census 2007 Economic Census for the state of Kansas. The Economic Census provides data on receipts by business classifications for both employers and nonemployers. The estimate assumes 50% of the receipts would be exempt from tax. This would allow for sales made to exempt entities (government, schools, exempt businesses) and for sales of tangible property that is already subject to sales tax. An annual increase was applied to each year as shown in the FY column.

(1) data not available in 2007 data, estimating 25% increase over 2002 data
(2) data not available for all catagories, estimating missing data makes up 25% of the industry total
(3) currently taxable
(4) includes parking lots, bail bonding, dating services. Photofinishing omitted- currently taxable
(5) data not available, used 2002 Census data with 10% growth (2% annual)

Special Committee on Assessment and Taxation

September 16-17, 2010

Attachment #16

State Sales Tax Exemptions Summary - Listed by Statute Cite

Statute	Description of Exemption or Exclusion	FY2011 ($ in Millions)	FY2012 ($ in Millions)	FY2013 ($ in Millions)	FY2014 ($ in Millions)	FY201 ($ in Millions)	/2016 ($ in Millions)
Tax Rate		6.30%	6.30%	6.30%	6.30%	6.30%	6.30%
Annual Rate of Increase		3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
3602 (e)	Definition of retail sales, exempting wholesale sales and sales for resale	$ -	$ -	$ -	$ -	$ -	$ -
3602 (ii)	Modified definition of sales or selling price to not include cash rebates granted by a manufacturer to a purchaser or lessee of a mew motor vehicle if paid directly to the retailer as a result of the original sale. The exemption is granted from July 1, 2006 and ending June 30, 2009.	$ -	$ -	$ -	$ -	$ -	$ -
3603 (b)	Taxes telephone and telegraph services except certiain interstate and international services and value-added nonvoice data services	$ 1.83	$ 1.89	$ 1.94	$ 2.00	$ 2.06	$ 2.12
3603 (c)	Residential and agricultural use utilities. Effective Jan 1 2006, exemption fmoved here from 3606 (w) and (x).	$ 157.06	$ 161.77	$ 166.62	$ 171.62	$ 176.77	$ 182.07
3603 (e)	Admission to any cultural and historical event which occurs triennially	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3603 (f)	Coin operated Laundry Services	$ 0.46	$ 0.48	$ 0.49	$ 0.51	$ 0.52	$ 0.54
3603 (g)	Service of renting of rooms by holds or accommodation brokers to federal government or any federal employee in performance of official government duties.	$ 0.15	$ 0.16	$ 0.16	$ 0.17	$ 0.17	$ 0.18
3603 (h)	Service of leasing or renting machinery and equipment owned by city purchased with industrial revenue bonds prior to July 1, 1973	$ -	$ -	$ -	$ -	$ -	$ -
3603 (m)	Fees and charges by any political subdivision, youth recreation organization exclusively providing services to persons 18 or younger organized as a 501(c)(3) for sports, games and other recreational activities and entry fees and charges for participation.	$ 1.15	$ 1.18	$ 1.22	$ 1.25	$ 1.29	$ 1.33
3603 (n)	Dues charged by any organization pursuant to paragraph 8 and 9 of 79-201 (veteran & humanitarian organizations) and zoos	$ 0.42	$ 0.43	$ 0.45	$ 0.46	$ 0.48	$ 0.49
3603 (o)	Motor vehicles exchanged for corporate stock, corporate transfer to itself and immediate family member sales.	$ 0.26	$ 0.27	$ 0.28	$ 0.29	$ 0.30	$ 0.31
3603 (o)	In 2004, changed the way sales tax computed on isolated and occasional sales of vehicles. Estimated to generate $2 million annually	$ -	$ -	$ -	$ -	$ -	$ -
3603 (p)	Labor services of installing or applying property in original construction of a building or facility or the construction reconstruction, restoration, replacement or repair or a residence, bridge or highway	$ 230.39	$ 237.30	$ 244.42	$ 251.75	$ 259.30	$ 267.08
~~3603 (q)~~	~~Exemption for Service of repairing, servicing , maintaining custom computer software as described in section 3603 (s)~~	$ -	$ -	$ -	$ -	$ -	$ -
3603 (s)	Customized computer software and services for modifying software for single end use and billed as a separate invoiced item. In 2004, amended to tax only prewritten software. Custom software is exempt	$ 6.54	$ 6.74	$ 6.94	$ 7.15	$ 7.36	$ 7.59
3603 (v)	Sales of bingo cards, bingo faces and instant bingo tickets. Tax rate 2.5 on July 1, 2001 to June 30, 2002; exempt on July 1, 2002	$ 3.46	$ 3.57	$ 3.67	$ 3.78	$ 3.90	$ 4.01
3606 (a)	Motor fuels and items taxed by sales or excise tax	$ 294.65	$ 303.49	$ 312.59	$ 321.97	$ 331.63	$ 341.58
3606 (b)	Property or services purchases by State of Kansas, political subdivision, nonprofit hospital or blood /donor bank. In 2001, deleted sales of water to make purchases for water suppliers exempt.(Neutral FN due to Clean Water Fee)	$ 419.30	$ 431.87	$ 444.83	$ 458.18	$ 471.92	$ 486.08
3606 (c)	Property or services purchased and leasing by elementary or secondary schools and educational institutions	$ 74.10	$ 76.32	$ 78.61	$ 80.97	$ 83.39	$ 85.90
3606 (d)	Property or services purchased by contractor for building or repair of buildings for nonprofit hospital, elementary or secondary schools or nonprofit educational institutions, and for state correctional institution	$ 150.74	$ 155.26	$ 159.91	$ 164.71	$ 169.65	$ 174.74
3606 (e)	Property or services purchases by federal government, its agencies or instrumentality's	$ 7.02	$ 7.23	$ 7.44	$ 7.67	$ 7.90	$ 8.13
3606 (f)	Property purchased by railroad or public utility for use in the movement of interstate commerce	$ 19.68	$ 20.27	$ 20.88	$ 21.51	$ 22.15	$ 22.82
3606 (g)	Sales, repair or modification of aircraft sold for interstate commerce directly through an authorized agent. IN 2004, expanded aircraft exemption for repair, modification plus parts and labor	$ 9.25	$ 9.52	$ 9.81	$ 10.10	$ 10.41	$ 10.72
3606 (h)	Rental of nonsectarian textbooks by elementary or secondary schools	$ 1.21	$ 1.25	$ 1.29	$ 1.32	$ 1.36	$ 1.40
3606 (i)	Lease or rental of films, records, tapes, etc. by motion picture exhibitors	$ 2.16	$ 2.23	$ 2.30	$ 2.36	$ 2.44	$ 2.51
3606 (j)	Meals served without charge to employees if duties include furnishing or sale of such meals or drinks	$ 4.80	$ 4.94	$ 5.09	$ 5.24	$ 5.40	$ 5.56
3606 (k)	Vehicles, trailers or aircraft purchased and delivered out of state to a nonresident	$ 19.56	$ 20.15	$ 20.75	$ 21.38	$ 22.02	$ 22.68
3606 (l)	Isolated or occasional sales, except motor vehicles	$ -	$ -	$ -	$ -	$ -	$ -
3606 (m)	Property which becomes an ingredient or component part of property or services produced or manufactured for ultimate sale at retail	$ 2,848.78	$ 2,934.25	$ 3,022.27	$ 3,112.94	$ 3,206.33	$ 3,302.52
3606 (n)	Property consumed in the production, manufacturing, processing, mining, drilling, refining or compounding of property; or irrigation of crops for ultimate sale at retail. In 2000, added provision to eliminate refunds from the Johnson County Water case	$ 373.77	$ 384.99	$ 396.54	$ 408.43	$ 420.69	$ 433.31
3606 (o)	Sales of animals, fowl, aquatic plants, and animals used in agriculture or aquaculture, for production of food for human consumption, the production of animal, dairy, poultry, or aquatic products, fiber or fur or the production of offspring.	$ 210.37	$ 216.69	$ 223.19	$ 229.88	$ 236.78	$ 243.88
3606 (p)	Sales for prescription drugs	$ 89.16	$ 91.83	$ 94.59	$ 97.42	$ 100.35	$ 103.36
3606 (q)	Sales of insulin dispensed by pharmacist for treatment of diabetes	$ 0.69	$ 0.71	$ 0.73	$ 0.75	$ 0.77	$ 0.80
3606 (r)	Sales of prosthetic or orthopedic appliances prescribed by a doctor. IN 2004, exempted all hearing aids, parts and batteries by licensed providers	$ 10.48	$ 10.80	$ 11.12	$ 11.46	$ 11.80	$ 12.15
3606 (s)	Sales of property or services purchased by a groundwater management district	$ 0.05	$ 0.06	$ 0.06	$ 0.06	$ 0.06	$ 0.06
3606 (t)	Sales of farm or aquaculture machinery and equipment, parts and services for repair and replacement. In 2006, added work-site utility vehicle as exempt. To include precision farm equipment	$ 62.91	$ 64.79	$ 66.74	$ 68.74	$ 70.80	$ 72.93
3606 (u)	Leases or rentals of property used as a dwelling for more than 28 consecutive days.	$ 0.92	$ 0.95	$ 0.98	$ 1.01	$ 1.04	$ 1.07

Special Committee on Assessment and Taxation

September 16-17, 2010

Attachment #17

State Sales Tax Exemptions Summary - Listed by Statute Cite

Statute	Description of Exemption or Exclusion	FY2011 ($ in Millions)	FY2012 ($ in Millions)	FY2013 ($ in Millions)	FY2014 ($ in Millions)	FY. ($ in Millions)	FY2016 ($ in Millions)
Tax Rate		6.30%	6.30%	6.30%	6.30%	6.30%	6.30%
Annual Rate of Increase		3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
3606 (v)	Sales of food products purchased by contractor for use in preparing meals for delivery to homebound elderly persons. In 2004, expanded exemption to all personal property purchased by contractor and sales of food products by or on behalf of contractor or organization	$ 1.05	$ 1.09	$ 1.12	$ 1.15	$ 1.19	$ 1.22
3606 (w)	Residential and agricultural use of water and severing oil & gas and property exempt from property tax. Effective Jan 1 2006, exemption for residential and agricultural use of electricity and heat moved to 3603(c).	$ 14.69	$ 15.13	$ 15.59	$ 16.05	$ 16.54	$ 17.03
3606 (x)	Sales of propane, gas, LP-gas, coal, wood, and other fuel sources for the production of heat or lighting for noncommercial use in a residential premise. Effective Jan 1 2006, exemption for residential and agricultural moved hereto 3603(c).	$ -	$ -	$ -	$ -	$ -	$ -
3606 (y)	Sales of materials and services used in repairing, maintaining, etc., of railroad rolling stock used in interstate commerce	$ 1.19	$ 1.22	$ 1.26	$ 1.30	$ 1.34	$ 1.38
3606 (z)	Property and services purchased directly by a port authority or a contractor therefore.	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (aa)	Materials and services brought into Kansas for usage outside of Kansas for repair, services, alteration, maintenance, etc. used for the transmission of liquids or national gas by a pipeline in interstate commerce	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (bb)	Used mobile and manufactured homes	$ 5.62	$ 5.79	$ 5.96	$ 6.14	$ 6.32	$ 6.51
3606 (cc)	Property or services purchased for constructing, reconstructing, enlarging or remodeling a business; sale and installation of machinery and equipment purchased for installation in such business. (Enterprise Zone Exemption)	$ 83.10	$ 85.59	$ 88.16	$ 90.80	$ 93.53	$ 96.33
3606 (dd)	Property purchased with food stamps issued by US Department of Agriculture	$ 9.61	$ 9.90	$ 10.19	$ 10.50	$ 10.81	$ 11.14
3606 (ee)	Lottery tickets and shares made as part of a lottery operated by the State of Kansas	$ 17.88	$ 18.42	$ 18.97	$ 19.54	$ 20.13	$ 20.73
3606 (ff)	New mobile or manufactured homes to the extent of 40% of the gross receipts	$ 4.12	$ 4.24	$ 4.37	$ 4.50	$ 4.64	$ 4.78
3606 (gg)	Property purchased with vouchers issued pursuant to the federal special supplemental food program for women, infants and children	n/a	n/a	n/a	n/a	n/a	n/a
3606 (hh)	Medical supplies and equipment purchased by nonprofit skilled nursing home or intermediate nursing care home for providing medical services to residents	$ 1.32	$ 1.36	$ 1.40	$ 1.44	$ 1.48	$ 1.53
3606 (ii)	Property purchased by nonprofit organization for nonsectarian comprehensive multidiscipline youth development programs and activities and sales of property by or on behalf of such organization	$ 3.33	$ 3.43	$ 3.53	$ 3.64	$ 3.75	$ 3.86
3606 (jj)	Property and services, includes leasing of property, purchased for community-based mental retardation facility or mental health center.	$ 3.06	$ 3.15	$ 3.24	$ 3.34	$ 3.44	$ 3.54
3606 (kk)	Machinery and equipment used directly and primarily in the manufacture, assemblage, processing, finishing, storing, warehousing or distributing of property for resale by the plant or facility. In 2004, added exemption for building new facility in Riverton Ks (minimal impact)	$ 146.75	$ 151.15	$ 155.69	$ 160.36	$ 165.17	$ 170.13
3606 (ll)	Educational materials purchased for distribution to the public at no charge by a nonprofit public health corporation	$ 0.10	$ 0.11	$ 0.11	$ 0.11	$ 0.12	$ 0.12
3606 (mm)	Seeds, tree seedlings, fertilizers, insecticides, etc., and services purchased and used for producing plants to prevent soil erosion on land devoted to agricultural use.	$ 1.21	$ 1.25	$ 1.29	$ 1.32	$ 1.36	$ 1.40
3606 (nn)	Services rendered by advertising agency or broadcast station	$ 5.37	$ 5.53	$ 5.69	$ 5.86	$ 6.04	$ 6.22
3606 (oo)	Property purchased by a community action group or agency to repair or weatherize housing occupied by low income individuals.	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (pp)	Drill bits and explosives used in the exploration and production of oil or gas	$ 0.51	$ 0.53	$ 0.54	$ 0.56	$ 0.57	$ 0.59
3606 (qq)	Property and services purchased by a nonprofit museum or historical society which is organized under the federal income taxation code as a 501 (c)(3)	$ 0.50	$ 0.52	$ 0.53	$ 0.55	$ 0.56	$ 0.58
3606 (rr)	Property which will admit purchases to an annual event sponsored by a nonprofit organization organized under the federal income taxation code as a 501 (c)(3)	$ 0.04	$ 0.04	$ 0.04	$ 0.05	$ 0.05	$ 0.05
3606 (ss)	Property and services purchased by a public broadcasting station licensed by FCC as a noncommercial educational television or radio station.	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (tt)	Property and services purchased by not-for-profit corporation for the sole purpose of constructing a Kansas Korean War memorial and is organized under the federal income taxation code as a 501 (c)(3)	$ -	$ -	$ -	$ -	$ -	$ -
3606 (uu)	Property and services purchased by rural fire fighting organization	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (vv)	Property purchased by the following organizations who are organized under the federal income taxation code as a 501 (c)(3): American Heart Association, Ks Affiliate; Ks Alliance for the Mentally Ill, Inc.; Ks Mental Illness Awareness Council, Heartstrings Community Foundation, Cystic Fibrosis , Spina Bifida Assn, CHWC, Inc., Cross-lines Cooperative Council, Dreams Work, Inc., KSDS, Inc., Lyme Association of Greater Kansas City, Inc Dream Factory, Ottawa Suzuki Strings, International Assn of Lions Clubs, Johnson County young Matrons, American Cancer Society, Community Services of Shawnee, Angel Babies Assn, Kansas Fairground Foundation	$ 1.00	$ 1.03	$ 1.06	$ 1.10	$ 1.13	$ 1.16
3606 (ww)	Property purchased by the Habitat for Humanity for use within a housing project	$ 0.15	$ 0.15	$ 0.15	$ 0.16	$ 0.16	$ 0.17
3606 (xx)	Property and services purchases by nonprofit zoo or on behalf of a zoo by an entity that is a 501(c)(3)	$ 0.76	$ 0.79	$ 0.81	$ 0.84	$ 0.86	$ 0.89
3606 (yy)	Property and services purchased by a parent-teach association or organizations and all sales of tangible personal property by or on behalf of such association	$ 0.72	$ 0.74	$ 0.76	$ 0.78	$ 0.81	$ 0.83
3606 (zz)	Machinery and equipment purchased by over-the-air free access radio or television station used directly and primarily for producing signal or the electricity essential for producing the signal.	$ 1.21	$ 1.24	$ 1.28	$ 1.32	$ 1.36	$ 1.40
3606 (aaa)	Property and services purchased by religious organizations and used exclusively for religious purposes	$ 21.99	$ 22.65	$ 23.33	$ 24.02	$ 24.75	$ 25.49

State Sales Tax Exemptions Summary - Listed by Statute Cite

Statute	Description of Exemption or Exclusion	FY2011 ($ in Millions)	FY2012 ($ in Millions)	FY2013 ($ in Millions)	FY2014 ($ in Millions)	FY2015 ($ in Millions)	FY2016 ($ in Millions)
Tax Rate		6.30%	6.30%	6.30%	6.30%	6.30%	6.30%
Annual Rate of Increase		3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
3606 (bbb)	Sales of food for human consumption by organizations exempt by 501(c)(3) pursuant to food distribution programs which offers such food at a price below cost in exchange for the performance of community service by the purchaser.	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (ccc)	Property and services purchases by health care centers and clinics who are serving the medically underserved.	$ 0.48	$ 0.49	$ 0.51	$ 0.52	$ 0.54	$ 0.55
3606 (ddd)	Property and services purchases by any class II or III railroad (shortline) for track and facilities used directly in interstate commerce. Only for calendar year 1999.	n/a	n/a	n/a	n/a	n/a	n/a
3606 (eee)	Property and services purchases for reconstruction, reconstruction, renovation, repair of grain storage facilities or railroad sidings. Only for calendar year 1999 and 2000.	n/a	n/a	n/a	n/a	n/a	n/a
3606 (fff)	Material handling equipment, racking systems & other related machinery & equipment used for the handling, movement or storage of tangible personal property in a warehouse or distribution facility; installation, repair, maintenance services, and replacement parts.	$ 7.95	$ 8.18	$ 8.43	$ 8.68	$ 8.94	$ 9.21
3606 (ggg)	Property and services purchased by or on behalf of the Kansas Academy of Science.	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (hhh)	Property and services purchased by or on behalf of Domestic Violence Shelters as members of the Kansas coalition against Sexual and Domestic Violence	$ 0.07	$ 0.07	$ 0.08	$ 0.08	$ 0.08	$ 0.08
3606 (iii)	Property and services purchased by organizations distributing food without charge to other nonprofit food distribution programs. Includes taxes paid on and after July 1, 2005 and prior to July 1, 2006.	$ 0.30	$ 0.31	$ 0.32	$ 0.33	$ 0.34	$ 0.35
3606 (jjj)	Sales of dietary supplements dispensed by prescription order by a licensed practitioner or mid-level practitioner.	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (kkk)	Not Used						
3606 (lll)	Property and services purchased by Special Olympics Kansas, Inc., and sales made by or on behalf of Special Olympics.	$ 0.03	$ 0.03	$ 0.04	$ 0.04	$ 0.04	$ 0.04
3606 (mmm)	Property and services purchased by Marillac Center, Inc. and sales made by or on behalf of the Marillac Center.	$ 0.07	$ 0.07	$ 0.07	$ 0.07	$ 0.08	$ 0.08
3606 (nnn)	Property and services purchased by West Sedgwick County - Sunrise Rotary Club for constructing boundless playground.	$ 0.03	$ 0.03	$ 0.03	$ 0.03	$ 0.03	$ 0.03
3606 (ooo)	Sales made by or on behalf of a public library	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.02	$ 0.02
3606 (ppp)	Property and services purchased by non-profit Homeless Shelters, and sales made by or on behalf of these organizations.	$ 0.14	$ 0.14	$ 0.14	$ 0.15	$ 0.15	$ 0.16
3606 (qqq)	Property and services purchased by TLC for Children and Families, Inc. and sales made by or on behalf of TLC	$ 0.22	$ 0.22	$ 0.23	$ 0.24	$ 0.24	$ 0.25
3606 (rrr)	Property and services purchased by county law library.	$ 0.13	$ 0.14	$ 0.14	$ 0.15	$ 0.15	$ 0.16
3606 (sss)	Property and services purchased by catholic charities or youthville and sales made by or on behalf of catholic charities or youthville	$ 0.81	$ 0.84	$ 0.86	$ 0.89	$ 0.92	$ 0.94
3606 (ttt)	Property and services purchased a contractor for a purpose of restoring, constructing, equipping, reconstructing, maintaining, repairing, enlarging, furnishing or remodeling a home or facility owned by a nonprofit museum which is a qualified under the governor hometown heritage act (KSA 75-5071)	$ 0.13	$ 0.14	$ 0.14	$ 0.15	$ 0.15	$ 0.16
3606 (uuu)	Property and services purchased by Kansas Children's Service League and sales made by or on behalf of the KCSL	$ 0.19	$ 0.20	$ 0.20	$ 0.21	$ 0.21	$ 0.22
3606 (vvv)	Property and services purchased by Jazz in the Woods and sales made by or on behalf of such organization	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.02
3606 (www)	Property purchased by or behalf of Frontenac Education Foundation and sales made by or on behalf of such organization	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
3606 (xxx)	Property and services purchased by the Booth Theatre Foundation, Inc. Provides for refund of sales taxes paid from January to July 2007.	$ 0.04	$ 0.04	$ 0.04	$ 0.04	$ 0.04	$ 0.05
3606 (yyy)	Property and services purchased by the TLC Charities Foundation, Inc. and sales made by or on behalf of these organizations.	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
3606 (zzz)	Property purchased by Rotary Club of Shawnee Foundation	$ -	$ -	$ -	$ -	$ -	$ -
3606 (aaaa)	Property and services purchased by or on behalf of Victory in the Valley and sales made by or on behalf of such organization	$ 0.02	$ 0.02	$ 0.02	$ 0.02	$ 0.03	$ 0.03
3606 (bbbb)	Guadalupe Health Foundation, sales of entry or praticipation fees, chrages or tickets for annual fundraising event	$ 0.14	$ 0.14	$ 0.15	$ 0.15	$ 0.16	$ 0.16
3606 (cccc)	Property and services purchased by or on behalf of Wayside Waifs for the purpose of providing such organizatoins annual fundraising event and sales made by or on behalf of such organization	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.01
3606 (dddd)	Property or services purchased by or on behalf of Goodwill Industries or Easter Seals o Kansas, Inc for the purpose of providing education, training and employment opportunities for people with disabilities and other barriers to employment	$ 0.05	$ 0.05	$ 0.05	$ 0.05	$ 0.05	$ 0.05
3606 (eeee)	Property or services purchased by or on behalf of All Beef Battalion, Inc. for the purpose of educating, promoting and participating as a contract group through the beef cattle industry in order to carry out such projects that provide support and morale to members of the United States armed forces and military services.	$ 0.00	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.01
3606 (ffff)	Property and services purchased by Sheltered Living, Inc for the purpose of providing residential and services for people with developmental disabilities or mental retardation, or both; and sales made on behalf of such organization	$ 0.04	$ 0.04	$ 0.04	$ 0.04	$ 0.04	$ 0.04
	1% exemption from rate increase on construction contracts	$ 1.57	$ 0.44	$ -	$ -	$ -	$ -
	Total	**$ 5,337.49**	**$ 5,497.61**	**$5,662.54**	**$ 5,832.42**	**$ 6,007.39**	**$ 6,187.61**

State Sales Tax Exemptions Summary - Listed by Statute Cite

Statu	Description of Exemption or Exclusion	FY2011 ($ in Millions)	FY2012 ($ in Millions)	FY2013 ($ in Millions)	FY2014 ($ in Millions)	F\ ($ in Millions)	FY2016 ($ in Millions)
Tax Rate		6.30%	6.30%	6.30%	6.30%	6.30%	6.30%
Annual Rate of Increase		3.00%	3.00%	3.00%	3.00%	3.00%	3.00%

Updated through 2011 Legislative changes.

Simulation 040

Changes: **Flat Tax**

Kansas Department of Revenue
Individual Income Tax
Tax Year 2010

Dollars are in Thousands

KAGI Brackets		Returns	Tax Liability Current Law	Tax Liability Proposed Change	Dollar Change	Percent Change	Average Dollar Change
$ -	$ 10,000	275,100	$ 15,670	$ 23,191	$ 7,521	48.0%	$ 27.34
$ 10,000	$ 20,000	245,700	$ 63,996	$ 91,028	$ 27,032	42.2%	$ 110.02
$ 20,000	$ 30,000	132,100	$ 70,783	$ 86,878	$ 16,095	22.7%	$ 121.84
$ 30,000	$ 50,000	254,000	$ 334,301	$ 391,880	$ 57,579	17.2%	$ 226.69
$ 50,000	$ 75,000	188,900	$ 508,423	$ 542,822	$ 34,399	6.8%	$ 182.10
$ 75,000	$ 100,000	105,700	$ 515,462	$ 511,882	$ (3,580)	-0.7%	$ (33.87)
$ 100,000	$ 200,000	100,200	$ 537,594	$ 495,681	$ (41,913)	-7.8%	$ (418.29)
$ 200,000	Over	22,400	$ 579,157	$ 481,329	$ (97,828)	-16.9%	$ (4,367.32)
		1,324,100	$ 2,625,386	$ 2,624,691	$ (695)	0.0%	$ (0.52)

Proposed Change:

Taxable Income Brackets

All Taxpayers
All Taxable Income 5.25%

Current Law

Taxable Income Brackets

Single			
$ -	$ 15,000		3.50%
$ 15,000	$ 30,000	$ 525	6.25%
$ 30,000	Over	$ 1,462.50	6.45%

Married			
$ -	$ 30,000		3.50%
$ 30,000	$ 60,000	$ 1,050	6.25%
$ 60,000	Over	$ 2,925	6.45%

Special Committee on Assessment and Taxation
September 16-17, 2010
Attachment #18

SECOND REGULAR SESSION

SENATE COMMITTEE SUBSTITUTE FOR

SENATE JOINT RESOLUTION NO. 29

95TH GENERAL ASSEMBLY

Reported from the Committee on Governmental Accountability and Fiscal Oversight, February 18, 2010, with recommendation that the Senate Committee Substitute do pass.

TERRY L. SPIELER, Secretary.

4139S.03C

JOINT RESOLUTION

Submitting to the qualified voters of Missouri, an amendment repealing section 4(d) of article X of the Constitution of Missouri, and adopting one new section in lieu thereof relating to the revenue-neutral replacement of state taxes on income with an amended sales and use tax.

Be it resolved by the Senate, the House of Representatives concurring therein:

That at the next general election to be held in the state of Missouri, on Tuesday next following the first Monday in November, 2010, or at a special election to be called by the governor for that purpose, there is hereby submitted to the qualified voters of this state, for adoption or rejection, the following amendment to article X of the Constitution of the state of Missouri:

Section A. Section 4(d), article X, Constitution of Missouri, is repealed and one new section adopted in lieu thereof, to be known as section 4(d), to read as follows:

Section 4(d). 1. In enacting any law imposing a tax on or measured by income, the general assembly may define income by reference to provisions of the laws of the United States as they may be or become effective at any time or from time to time, whether retrospective or prospective in their operation. The general assembly shall in any such law set the rate or rates of such tax. The general assembly may in so defining income make exceptions, additions, or modifications to any provisions of the laws of the United States so referred to and for retrospective exceptions or modifications to those provisions which are retrospective.

2. For all tax years beginning on or after January 1, 2012, no tax shall be imposed upon any income derived from any source within this state, and all revenues lost as a result of the prohibition on the taxation of income under this section shall be replaced by the levy and

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Attachment #19

imposition of a tax upon the consumption or use in this state of taxable property or services. Taxable property or services shall mean any property (including leaseholds of any term or rents with respect to such property but excluding intangible personal property and used property) and any service consumed or used in this state, except for such property purchased to be a component part or ingredient of the new tangible personal property to be sold at retail. No tax shall be imposed under this section on any taxable property or service purchased for a business purpose in a trade or business, including agriculture, or purchased for an investment purpose and held exclusively for an investment purpose. For purposes of this section, the term "purchased for a business purpose in a trade or business" shall mean purchased by a person engaged in a trade or business and used in that trade or business for resale, to produce, provide, render or sell taxable property or services, or in furtherance of other bona fide business purposes. For purposes of this section, the term "purchased for an investment purpose" shall mean property purchased exclusively for purposes of appreciation or the production of income, and tuition and fees paid to an accredited institution of higher education for educational services. All sales tax exemptions in place as of the effective date of this section exempting purchases other than the purchases enumerated in this article shall be void.

3. The rate of the tax levied and imposed under subsection 2 of this section shall be five and eleven one-hundredths percent. As may be recommended by the tax adjustment commission established by subsection 8 of this section or otherwise, the general assembly may enact one rate adjustment, to be effective no later than the beginning of fiscal year 2013, after the imposition of such tax if the revenue lost as a result of the prohibition on the taxation of income is greater than or less than the revenue received from the tax imposed in this section. Notwithstanding the limitation on total state revenues as provided in article X, section 18 of this constitution, such adjustment shall be calculated to ensure that the amount of revenue received is substantially equal to the amount of revenue that would have been generated by the taxes repealed under this section averaged over the three immediately preceding fiscal years. Local political subdivisions shall recalculate their local tax rates, including local tax revenue to be

deposited in the school district trust fund, affected by this section to produce the same or substantially similar revenue as collected in the immediately previous fiscal year. The general assembly may provide by law for determining the scope of taxable services and for otherwise implementing the provisions of this section. Exemptions from such tax may be provided by law upon an affirmative vote of at least two-thirds of the elected members of both chambers and approval by the governor.

4. Notwithstanding the provisions of sections 43(a) and 47(a) of article IV of this constitution, the rates of tax levied and imposed under those sections shall undergo a one-time calculation, taking into account any adjustment in the tax base. This recalculation would determine the new rates that would produce an amount of revenue for the fiscal year of recalculation substantially equal to the amount actually received in the year or recalculation under the prior rate described in those sections of the constitution. These new tax rates shall be recalculated in this same manner should the rate of tax levied under section 4(d) of article X of this constitution be readjusted.

5. The taxes that are replaced under this section are as follows:

(1) Withholding taxes and individual and corporate income taxes;

(2) Corporation franchise and bank franchise taxes;

(3) All existing state sales and use taxes.

6. The department of revenue shall determine a method for providing sales tax rebates for each duly registered qualified household of this state. The sales tax rebate shall be distributed to each qualified household beginning January 1, 2012. The monthly amount of the rebate shall be equal to the product of the rate of sales tax established under this section and one-twelfth of the annual poverty guidelines updated periodically in the Federal Register by the United States Department of Health and Human Services under the authority of 42 U.S.C. Section 9902(2), as amended.

7. The department of revenue shall promulgate rules as otherwise provided by law to implement the provisions of this section.

8. There is hereby created a "Tax Adjustment Commission", whose members shall be the governor, or his or her designee, the chair of the house budget committee, and the chair of the senate appropriations committee. The purpose of the tax adjustment commission shall be to recommend a one-time adjustment to the rate of

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tax established in subsection 3 of this section. The commission shall meet prior to January 1, 2013, to conduct studies of a tax rate adjustment which would provide an amount substantially equal to the amount of revenue that would have been generated by the taxes repealed under this section in fiscal year 2011. The tax rate adjustment shall only be recommended to the general assembly upon unanimous vote of the commission. If the general assembly is not in regular or special session at the time the commission's recommendation is received, the general assembly shall automatically convene in special session within fourteen days of receipt of the recommendation. A concurrent resolution, not subject to substantive amendment in either chamber, shall be introduced in the house of representatives for approval or rejection. If approved, the concurrent resolution shall be considered by the senate for approval or rejection. If approved by both chambers, the concurrent resolution shall be presented to the governor, and, within fourteen days of such presentment, the governor shall return the concurrent resolution to the house of representatives endorsed with his or her approval or accompanied by his or her objections. If the concurrent resolution is approved by the governor, the tax rate adjustment shall become effective at the beginning of the following calendar quarter. If the concurrent resolution is not approved by the governor, the general assembly shall automatically convene in special session within fourteen days of such disapproval to reconsider the resolution as otherwise provided in section 32 of article III of this constitution. If the concurrent resolution is approved by the required two-third majority, the tax rate adjustment shall become effective at the beginning of the following calendar quarter.

9. The revisor of statutes, in conjunction with the department of revenue, the state tax commission, and other tax-related agencies and departments, shall prepare and submit to the committee on legislative research a proposed bill repealing those provisions of law which are deemed unenforceable or unnecessary under the provisions of this section.

10. The provisions of this section are severable. If any provision of this section is found by a court of competent jurisdiction to be unconstitutional, the remaining provisions are valid except to the extent that the court finds that the valid provisions, standing alone, are

incomplete and are incapable of being executed in accordance with the will of the people.

Section B. Pursuant to chapter 116, RSMo, and other applicable constitutional provisions and laws of this state allowing the general assembly to adopt ballot language for the submission of a joint resolution to the voters of this state, the official ballot title of the amendment proposed in section A of this act shall read as follows:

"A 'yes' vote will amend the Constitution of the State of Missouri to eliminate individual and corporate income tax, and state sales and use tax and to enact a single, revenue-neutral sales tax of five and eleven one-hundredths percent on new purchases of goods and services, and to exempt property purchased for business or investment from the sales tax, and to provide each qualified family with a sales tax rebate to ensure no state sales tax is paid on purchases up to the federal poverty level.

A 'no' vote would not amend the Constitution of the State of Missouri.".

✓

COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 4139-03
Bill No.: SCS for SJR 29
Subject: Constitutional Amendments; General Assembly; Governor; Revenue Department; Taxation and Revenue
Type: Original
Date: February 19, 2010

Bill Summary: This proposal replaces all taxes on income with a sales and use tax.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2011	FY 2012	FY 2013
General Revenue	$0 or ($231,504 to more than $7,231,504)	$0 or ($2,397,353)	$0 or ($1,611,368)
Total Estimated Net Effect on General Revenue Fund	**$0 or ($231,504 to more than $7,231,504)**	**$0 or ($2,397,353)**	**$0 or ($1,611,368)**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2011	FY 2012	FY 2013
Total Estimated Net Effect on Other State Funds	**$0**	**$0**	**$0**

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 14 pages.

Special Committee on Assessment and Taxation

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Attachment #20

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2011	FY 2012	FY 2013
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2011	FY 2012	FY 2013
Total Estimated Net Effect on FTE	**0**	**0**	**0**

☒ Estimated Total Net Effect on All funds expected to exceed $100,000 savings or (cost).

☒ Estimated Net Effect on General Revenue Fund expected to exceed $100,000 (cost).

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2011	FY 2012	FY 2013
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Officials from the **Office of Administration - Budget and Planning (BAP)** state this proposal, upon voter approval, eliminates the taxes listed below beginning January 1, 2012. Lost state revenues are to be replaced by a state sales tax of 5.11%. This sales tax shall apply to any goods or services, except those used as business inputs, or for an investment purpose. Further, the tax shall not apply to intangible personal or used property. Political subdivisions may adjust their sales tax rates so that this proposal is revenue neutral. Taxes eliminated include:

1. Withholding and individual and corporate income taxes.
2. Corporate and bank franchise taxes.
3. All existing state sales and use taxes.

BAP notes that this proposal intends the new sales tax to generate revenues substantially equal to those collected in FY 11. Assuming neutrality is achieved, current projections call for revenues in FY 11 to be well below the levels collected in FY 08, an extraordinary decline which would not have happened except for the recession which began in 2007. This proposal would not allow for state revenues to recover from the unprecedented declines of FYs 09-10. This proposal would make it difficult for the state to provide the level of services currently demanded and those demanded in the future.

The proposal does not directly address motor vehicle sales tax collections, which may be substantially impacted by this proposal. While the sales tax rate on new vehicles would increase, the rate would be zero on used vehicles. Further, significant revenues would be generated from the taxation of motor fuel. BAP defers to MODOT for an estimate of the impacts of these provisions.

The proposal calls for a 5.11% sales tax rate on a much-expanded sales tax base. However, data that is sufficiently detailed to estimate consumer spending while excluding difficult-to-define concepts such as business inputs, rents, and investment is extremely difficult to access. What little literature is available on this topic suggests this rate is likely too low. For instance, the Show-Me Institute has calculated the rate to be 5.79%. Estimates from other groups, such as the Institute for Taxation and Economic Policy, range higher, as much 12% or more. Assuming the 5.79% rate is correct, this proposal would be short of revenue neutrality by nearly 11.74%. Estimating lost individual income, sales tax, and corporate revenues at a very rough $7.1B, this leads to a revenue shortfall of $834M. This calculation does not include revenues needed to cover the costs of the rebate.

ASSUMPTION (continued)

Because of the reduced points of tax collection and the complicated sales tax rebate system, numerous new opportunities for tax fraud may be invented. BAP defers to the DOR for a discussion of such issues, the costs that might be incurred to prevent such fraud, and the considerable administrative costs that will be necessary to transition to the new tax system. Conversely, it is likely that taxpayers that are currently evading income taxes could face higher tax payments as a result of this proposal.

This proposal would effectively eliminate most of the tax credit incentive programs in the state, as well as the Senior Property Tax Credit (Circuit Breaker). This may result in a roughly $120M increase in appropriations for the Homestead Preservation Program, depending on the number of qualifying seniors. BAP defers to the DED and other state agencies that administer tax credits for estimated impacts on those programs.

Officials from the **Department of Transportation (MoDOT)** state Article IV of the Constitution remains in place regarding funding for highways and transportation, therefore the new effective 5.11% would apply to the motor vehicle sales and use tax. By eliminating the exemptions currently in place, sales tax on fuel and commercial motor vehicles would be considered state revenue derived from highway users. The effective date of legislation is January 1, 2012. A 2% growth rate for FY12-FY13 is based on FY09 actuals. MoDOT also assumes there would be a loss of funds due to the sales tax exemption for state purchases being removed.

MoDOT assumes an increase in income to the State Road fund of $137.3 million to Unknown in FY 2012 as well as an increase of $282.0 million in FY 2013. MoDOT also anticipates a corresponding increase to cities and counties of $66.8 million in FY 2012 and $134.9 million in FY 2013 (full year). MoDOT also assumes smaller impacts to the Road Bond Fund ($14.3 million increase in FY 2013), the Transportation Fund ($0.3 million increase in FY 2013, Department of Transportation Highway Safety Fund ($0.1 million loss in FY 2013, and State Highway and Transportation Department Fund ($2.4 million loss in FY 2013).

Oversight assumes the new sales and use tax would be established in such a way that revenue neutrality would occur for Total State funds as well as revenue within each fund.

Officials from the **Department of Revenue (DOR)** had the following comments and assumptions:

- The FTE impact for fiscal year 2012 is based on a nine-month cycle. Personnel will be required to be fully trained as of January 1, 2012. The Department will need to hire and begin training temporary staff in October 2011.

ASSUMPTION (continued)

- This would eliminate the individual income tax for tax years beginning after Jan 1, 2012. This would impact many individuals who have credits that can be carried forward to 2012 and beyond.

- For fiscal year 2011, DOR assumes no additional full time employees would be needed.

- Currently motor fuel is exempt from sales tax if it is subject to the motor fuel tax. Because this exemption is eliminated, all motor fuel would be subject to a sales tax in addition to the motor fuel tax unless used in a trade or business.

- This legislation will have a significantly larger impact on DOR if we are required to collect the tax from the person consuming, using or storing the tangible personal property or taxable service.

- Section 4(d)2. specifies, "... in furtherance of other bona fide business purposes." This makes everything from "for resale" to "services, or" superfluous

Personal Tax:
- For FY 11 - Personal Tax will retain 100% of existing staff to continue the processing and collection duties of individual income tax.
- For FY 12 - Personal Tax will retain 100% of existing staff to continue the processing and collection duties of individual income tax.
- For FY 13 - Personal Tax will retain 100% of existing staff for the first six months to continue the processing and collection duties of individual income tax (July 2012 through December 2012). For the last six months of FY13 (January 2013 - June 2013), Personal Tax will retain 81% of existing staff (108 FTE out of 134 FTE) for processing and collection duties of individual income tax. Personal Tax expects late filing and amended returns for Fiduciary Income Tax and Property Tax Credits.
- Personal Tax will move employees to replace the temporary employees hired in business tax on a one-for-one basis.

Collections and Tax Assistance (CATA)
- The registration area would see an impact because including all services as a taxable product would greatly expand the types of businesses that will need to register for sales/use tax.
- Presuming the number of businesses required to register for sales tax doubles, CATA could see the following impact:
- FY11 - No impact

ASSUMPTION (continued)

- FY12 - Based on the presumption of doubling the number of businesses, for registration, contacts, collection effort -CATA will need an additional 88 temporary employees (CATA's FY09 sales use tax and registration FTE impact was 44) Training will begin in October of 2011.
- FY13 - Anticipate CATA could reduce 15% of the temporary employees due to a decline in income, withholding and corporate tax accounts (this reduction can be seen in the 2013 column of the attached spreadsheet).

Sales, Excise and Business Tax:

- The following impact is based upon the assumption that the workload for sales/use tax will double because of the additional filers. Based upon FY09 program costs, which include processing, correspondence, error correction, refunds, etc., Business tax will need an additional 97 temporary employees for sales/use tax.
- DOR assumes that although the new sales tax would go into effect January 1, 2012, current staff responsible for corporate tax, withholding tax and personal tax will not be available for reallocation until the last half of FY13, and even then, it may be only a fraction of the employees. Therefore, temporary staff will be needed until the current staff can be reallocated.
    - FY 11 - No impact
    - FY 12 - Business tax will need 97 temporary employees. Training will begin in October of 2011. These would be temporary employees who receive no benefits.
    - FY 13 - For the first half of the year Business tax will need the 97 temporary employees and for the second half Business tax will need 73 temporary employees. The reduction for the second half of FY13 is based upon the assumption that 25% of the permanent staff will now be available for reallocation - Rather than hire new temporary staff, which would require training the new staff; it would be more beneficial to retain the temporary employees. The employees would then be eligible for benefits.

- If the number of new filers should more than double, then the amount of additional resources will increase proportionately

Corporate/Withholding Tax:

- For FY 11 - Corporate/Withholding tax will retain 100% of existing staff to continue the processing and collection duties of withholding and corporate tax.
- For FY 12 - Corporate/Withholding tax will retain 100% of existing staff to continue the processing and collection duties of withholding and corporate tax.

ASSUMPTION (continued)

- For FY 13 - Corporate/Withholding tax will retain 33% of existing staff in the Withholding Tax Section (4 out of 12 FTE) and 87% of existing staff in the Corporate Tax Section (34 out of 39 FTE) to continue the processing and collection duties of withholding and corporate tax. The remaining FTE will be moved to the Sales Tax area to replace temporary employees hired in business tax area on a one-to-one basis.

Audit:

- Based upon the information provided from the operating bureaus, the following impact is based upon the assumption that the workload for sales/use tax will double because of the additional filers.
- Based upon fiscal year 2009 program costs, which include audit personnel, we submit the following.
  - In FY09, Field Compliance Bureau (FCB) conducted 1,800 sales and use tax audits.
  - In order to conduct 3,600 sales and use tax audits, it would be necessary to double our audit enforcement staff. To double our current audit staff, we would need to add the following instate and out of state personnel.
  - Currently, FCB has 161 assigned positions. The additional positions would take FCB to 322.
- Each of the instate and out of state facilities would need to be moved to accommodate the increase in personnel.

In summary, DOR assumes the need for 185 Temporary Tax employees (88 in CATA and 97 in Business) in fiscal years 2012 and 2013. State programming expenses for FY 2011 are estimated to be $231,504 (8,736 FTE hours to make updates to the individual income tax processing system (MINITS), the corporate income tax processing system (COINS), the sales tax processing system (MITS), and the withholding tax processing system.

DOR assumes the cost for the temporary employees in FY 2012 and FY 2013 to be $2.3 million and $2.2 million respectively.

Oversight assumes the Field Compliance Bureau would be able to use some of the existing staff that currently conducts income tax or franchise tax audits to conduct new sales and use tax audits. Also, with the start date of the new sales tax being January 1, 2012, Oversight assumes the sales and use tax audits would not be conducted prior to fiscal year 2014. Therefore, Oversight assumes the fiscal impact to the Field Compliance Unit of the Department of Revenue (additional FTE) would be outside the scope of this fiscal note.

ASSUMPTION (continued)

Oversight will also assume DOR will pay the employer FICA tax as the only benefit on the temporary employees.

Officials from the **Office of Secretary of State (SOS)** assume there would be costs due to additional publishing duties related to the Department of Revenue's authority to promulgate rules, regulations, and forms. SOS estimates the division could require approximately 290 new pages of regulations in the Code of State Regulations at a cost of $27.00 per page, and 435 new pages in the Missouri Register at a cost of $23.00 per page. Costs due to this proposal are estimated to be $17,835, however, the actual fiscal impact would be dependent upon the actual rule-making authority and may be more or less. Financial impact in subsequent fiscal years would depend entirely on the number, length, and frequency of the rules filed, amended, rescinded, or withdrawn.

Oversight assumes the SOS could absorb the costs of printing and distributing regulations related to this proposal. If multiple bills pass which require the printing and distribution of regulations at substantial costs, the SOS could request funding through the appropriation process. Any decisions to raise fees to defray costs would likely be made in subsequent fiscal years.

Officials at the **Office of the Secretary of State (SOS)** assume unless a special election is called for the purpose, Joint Resolutions are submitted to a vote of the people at the next general election. If a special election is called to submit a Joint Resolution to a vote of the people, section 115.063.2 RSMo requires the state to pay the costs. Article III section 52(b) of the Missouri Constitution authorizes the general assembly to order a special election for measures referred to the people and Article XII section 2(b) authorizes the governor to call a special election to submit constitutional amendments to a vote of the people.

The SOS is required to pay for publishing in local newspapers the full text of each statewide ballot measure as directed by Article I, Section 26, 27, 28 of the Missouri Constitution and Section 116.230-116.290, RSMo. The Secretary of State's office is provided with core funding to handle a certain amount of normal activity resulting from each year's legislative session. Funding for this item is adjusted each year depending upon the election cycle with $1.3 million historically appropriated in odd numbered fiscal years and $100,000 appropriated in even numbered fiscal years to meet these requirements. The appropriation has historically been an estimated appropriation because the final cost is dependent upon the number of ballot measures approved by the General Assembly and the initiative petitions certified for the ballot. In FY 2009, at the August and November elections, there were 5 statewide Constitutional Amendments or ballot propositions that cost $1.35 million to publish (an average of $270,000 per issue). Therefore, the Secretary of State's office assumes, for the purposes of this fiscal note, that it

ASSUMPTION (continued)

should have the full appropriation authority it needs to meet the publishing requirements. However, because these requirements are mandatory, we reserve the right to request funding to meet the cost of our publishing requirements if the Governor and the General Assembly change the amount or eliminate the estimated nature of our appropriation.

Oversight has reflected in this fiscal note, the state potentially reimbursing local political subdivisions the cost of having this joint resolution voted on during a special election in fiscal year 2011. This reflects the decision made by the Joint Committee on Legislative Research, that the cost of the elections should be shown in the fiscal note. The next scheduled general election is in November 2010 (FY 2011). It is assumed the subject within this proposal could be on that ballot; however, it could also be on a special election called for by the Governor. Therefore, Oversight will reflect a potential election cost reimbursement to local political subdivisions in FY 2011.

To estimate the expense the state would incur for reimbursing local political subdivisions for a special election, Oversight requested expense estimates from all election authorities for an election. Eighty-six out of the one hundred fifteen election authorities responded to Oversight's request. From these respondents; the total election expense that would have to be reimbursed by the state government is over $7 million. Therefore, Oversight will reflect a potential cost borne by the state in FY 2011 of over $7 million for reimbursement to the local political subdivisions. Oversight assumes the Governor could call for a special election to be held prior to November, 2010 regarding this joint resolution; however, if a special election is not called, the subject will be voted on at the general election in November, 2010.

Officials from the **Department of Higher Education** state although this bill could have a significant fiscal impact on the state's general revenue, it's specific impact on the DHE is unknown at this time.

Officials from the **University of Missouri - Economic and Policy Analysis Research Center (EPARC)** state as written, the bill is constructed to be revenue-neutral. "(I)f the revenue lost as a result of the prohibition on the taxation of income is greater than or less than the revenue received" from the replacement state sales tax, the General Assembly may make one adjustment to the sales tax rate "to ensure that the amount of revenue received (under the proposed state sales tax) is substantially equal to the amount of revenue that would have been generated by the taxes repealed." As such, there would be no revenue impact associated with this bill.

ASSUMPTION (continued)

Officials from the **Department of Elementary and Secondary Education (DESE)** state the proposal replaces income tax with a sales and use tax. The language states that the revenue will not be adversely affected. Based on this assumption, the state school foundation formula would not be negatively impacted. However, the impact of an increased sales tax on purchases within the state is unknown. We defer to the Department of Revenue in that regard.

In response to a previous version of this proposal, officials from the **Office of the Governor** assumed the proposal would not impact their office.

In response to a previous version of this proposal, officials from the **University of Missouri** stated the fiscal impact upon passage of SJR 29 should be revenue neutral assuming that the revenue generated by imposition of the sales and use tax is approximately equal to the revenues lost as a result of the prohibition on the taxation of income. However, the base years for equivalency are low tax years for which there were not sufficient general tax revenues to fund current general revenue appropriations resulting in negative impact on higher education.

Officials from the **Missouri Department of Conservation (MDC)** state if the intent of the proposed Constitutional Amendment is to be revenue neutral to the Department, and if the recalculation in Section 4 can accomplish that, it would appear that this would not have a fiscal impact on MDC funds. However, a recalculation to achieve the intended result may be difficult to achieve thus potentially causing an unknown fiscal impact to the Department.

Officials from the **Department of Natural Resources (DNR)** state it appears that the intent of Section 4(d).4. is to allow for the conservation sales tax and the soil and parks sales tax to be recalculated to produce substantially the same amount of revenue. If that is the intent, then for purposes of this fiscal note, DNR would not anticipate a direct fiscal impact from this provision.

If that is not the intent of this proposal and DNR's parks and soils sales tax is eliminated as a result of this proposal, then there would be a significant fiscal impact to the department. Funding would have to be sought to replace the monies currently collected from the department's sales and use tax pursuant to Section 47(a) of the Missouri Constitution. The department assumes the Department of Revenue would be better able to estimate the potential fiscal impact.

This proposal would also appear to eliminate all sales tax exemptions. Currently, the State of Missouri is a tax-exempt entity. If this department is required as a result of this proposal to pay the newly created 5.11% sales tax on the purchase of all goods and services, then there would be a significant unknown fiscal impact to the department. Each state agency's operating budget would increase substantially. The department assumes the Office of Administration would be

ASSUMPTION (continued)

better able to estimate the amount of fiscal impact from this provision for each department.

In response to a previous version of this proposal, officials from **Legislative Research** assumed the proposal will not create a fiscal impact; however, additional compensatory time may be needed for staff attorneys if the proposed clean-up bill is done during regular session.

Officials from the **Missouri House of Representatives** stated the House Budget Chairman's participation on the Tax Adjustment Commission will result in nominal costs that could be absorbed within existing resources. Assuming the need for two weeks of special session involving members of the House of Representatives and assuming tow session days per week, a cost estimate of $41,292 for member mileage expenses (at $20,646 per week assuming all members attend) and $67,288 for member per diem expenses (at $103.26 per day x 163 members x 4 days) can be made. This totals to $108,580 in FY 2011 ($111,837 in FY 2012 and $115,193 in FY 2013 once grown by three percent inflation).

Oversight assumes the business of the Missouri House of Representatives and the Missouri Senate could be conducted during regular session and therefore, would not incur additional costs.

In response to similar proposal from this year (HJR 56), officials from **Cass County** assumed this will not impact current sales taxes that exist in local governments. It is assumed that this proposal just replaces the state income tax with a state-wide sales tax (as defined). Thus, if Cass County is assuming correctly, and its sources of sales tax revenue remain in place, there is no fiscal impact on the county budget.

In response to similar proposal from this year (HJR 56), officials from **St. Louis County** stated they collect $2.6 million in franchise fees, mostly from cable television. If this is included, St. Louis County could be impacted if the sales tax generates less than this amount. The total franchise tax is 5%, so if the sales tax rate is set at 5.11%, St. Louis County would not be impacted.

Oversight will range the fiscal impact to the Department of Revenue from $0 (resolution is not passed by public vote) to their estimate. Oversight also assumes the proposal would be implemented in such a way that sales tax revenues to the state would be equivalent to the lost revenue from income tax, existing sales tax, franchise tax, and bank franchise tax.

Oversight assumes this proposal will not change Total State Revenues.

FISCAL IMPACT - State Government	FY 2011 (10 Mo.)	FY 2012	FY 2013
GENERAL REVENUE			
Costs - Department of Revenue			
Temporary Personnel (185 temps)	$0	$0 or ($1,148,159)	$0 or ($1,360,355)
Fringe Benefits for Temps (FICA)	$0	$0 or ($87,834)	$0 or ($104,067)
Expense and Equipment	$0	$0 or ($1,161,360)	$0 or ($146,946)
Programming Changes	$0 or ($231,504)	$0	.$0
Total Costs - DOR	$0 or ($231,504)	$0 or ($2,397,353)	$0 or ($1,611,368)
Expense - reimbursement of local political subdivisions for special election costs	$0 or (More than $7,000,000)	$0	$0
ESTIMATED NET EFFECT TO THE GENERAL REVENUE FUND	**$0 or ($231,504 to more than $7,231,504)**	**$0 or ($2,397,353)**	**$0 or ($1,611,368)**

FISCAL IMPACT - Local Government	FY 2011 (10 Mo.)	FY 2012	FY 2013
LOCAL POLITICAL SUBDIVISIONS			
Income - cost reimbursement from the State for special election	$0 or More than $7,000,000	$0	$0
Expense - cost for special election	$0 or (More than $7,000,000)	$0	$0
ESTIMATED NET EFFECT TO LOCAL POLITICAL SUBDIVISIONS	**$0**	**$0**	**$0**

FISCAL IMPACT - Small Business

This proposal would have a direct fiscal impact on small businesses that pay income tax, corporate franchise tax, bank franchise tax and/or earnings tax. Also, small businesses may now need to collect and remit a sales tax.

FISCAL DESCRIPTION

Upon voter approval, this proposed constitutional amendment replaces the state individual and corporate income tax, the corporate and bank franchise tax and state sales and use tax with a tax on the sale, use, or consumption of new tangible personal property and taxable services equal to five and eleven-one hundredths percent beginning January 1, 2012. Component parts or ingredients of a new tangible personal property to be sold at retail, federal government purchases, and business-to-business transactions including agriculture will be exempt from the new tax while all other exemptions and tax credits will be eliminated. The enactment of any new exemptions will require a two-thirds affirmative vote by the General Assembly and approval by the Governor. The conservation sales tax, the soil and parks sales tax, and local sales taxes will be recalculated to produce substantially the same amount of revenue. Each qualified family will receive a sales tax rebate based on the federal poverty level guidelines to offset the sales tax on basic necessities.

FISCAL DESCRIPTION (continued)

The Tax Adjustment Commission is created to recommend a one-time adjustment to the new sales tax rate to ensure revenue-neutrality. A rate adjustment may only be recommended to the General Assembly upon a unanimous vote of the Commission. A concurrent resolution, offered in the house of representatives, must be adopted by both houses and sent to the Governor in order to make the one-time rate adjustment recommended by the Commission.

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

Missouri House of Representatives
Office of Administration - Budget and Planning
Department of Transportation
Department of Revenue
Office of the Secretary of State
Department of Higher Education
University of Missouri - Economic and Policy Analysis Research Center
Department of Elementary and Secondary Education
State Tax Commission
Legislative Research
Department of Natural Resources
Department of Conservation
Office of the Governor
St. Louis County
Cass County
University of Missouri

Mickey Wilson

Mickey Wilson, CPA
Director
February 19, 2010

RS:LR:OD (12/02)

Simple, Fair, and Pro-Growth:

Proposals to Fix America's Tax System

Report of the President's Advisory Panel on Federal Tax Reform

November 2005

Special Committee on Assessment and Taxation

September 16-17, 2010

Attachment #21

The President's Advisory Panel on Federal Tax Reform

Panel Members

Chairman	Connie Mack, III
Vice-Chairman	John Breaux
Members	William E. Frenzel
	Elizabeth Garrett
	Edward P. Lazear
	Timothy J. Muris
	James M. Poterba
	Charles O. Rossotti
	Liz Ann Sonders

Executive Director	Jeffrey F. Kupfer

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Acknowledgements

On behalf of all the Panel Members, the Chair, Vice Chair, and Executive Director would like to express their deep appreciation to the Panel staff. Working on a project that lasted much longer than they had originally anticipated, the staff provided invaluable support and guidance. Their dedication, knowledge, and good cheer was truly impressive.

Full-time staff:

Jonathan Ackerman, Senior Counsel
Rosanne Altshuler, Senior Economist
Tara Bradshaw, Communications Director
Itai Grinberg, Counsel
Kanon McGill, Special Assistant
Travis Burk, Staff Assistant

Mark Kaizen, Designated Federal Officer
Kirsten Witter

Part-time or temporary staff and consultants:

Jon Bakija
William Gentry
Ben Getto
Seth Giertz
Jonathan Mable
Noam Neusner
Clarissa Potter
Julie Skelton
David Weisbach

We would also like to recognize the support of the Department of the Treasury and the Internal Revenue Service. The Panel relied on them for many essential tasks, from providing expertise and analysis of our tax reform proposals to assisting with meeting logistics and the printing of our report. Numerous people made the extra effort to assist the Panel, and in particular, we would like to thank the Offices of Tax Analysis and Tax Policy.

In addition, we would like to acknowledge the assistance of the Council of Economic Advisors, the Government Accountability Office, the Organization for Economic Cooperation and Development, the nearly 100 witnesses who appeared at the Panel meetings, and the thousands of interested parties who contributed their views and insights to the Panel.

Federal Tax Reform

November 1, 2005

The Honorable John W. Snow
Secretary of the Treasury
The Department of the Treasury
1500 Pennsylvania Avenue
Washington, DC 20220

Dear Mr. Secretary:

President George W. Bush formed this Panel to identify the major problems in our nation's tax code and to recommend options to make the code simpler, fairer, and more conducive to economic growth. The Panel heard from nearly 100 witnesses and received thousands of written comments. Together, these witnesses and these comments described the unacceptable state of our current tax system. Yet this tax code governs virtually every transaction in the world's largest economy, affecting the daily lives of nearly 300 million people.

Our tax code is rewritten so often that it should be drafted in pencil. Each year, the tax code is adjusted to meet multiple policy goals – some are broadly shared, but many are not. Myriad tax deductions, credits, exemptions, and other preferences may be a practical way to get policy enacted, but it is a poor way to write a tax code. Whether the government spends more or extends a special tax break, the effect is the same: everyone else must pay higher taxes to raise the revenue necessary to run the government.

During the past few decades, panels have been formed repeatedly, legislation introduced annually, and hearings scheduled regularly to study our tax code and recommend changes. In 1986, a bipartisan effort yielded the last major tax reform legislation. But because of the ever-present tendency to tinker with the tax code, we must redouble our efforts to achieve fundamental reform.

Since the 1986 tax reform bill passed, there have been nearly 15,000 changes to the tax code – equal to more than two changes a day. Each one of these changes had a sponsor, and each had a rationale to defend it. Each one was passed by Congress and signed into law. Some of us saw this firsthand, having served in the U.S. Congress for a combined 71 years, including 36 years on the tax-writing committees. Others saw the changes from different perspectives – teaching, interpreting, and even administering the tax code. In retrospect, it is clear that frequent changes to the tax code, no matter how well-intentioned, ultimately undermine the integrity of the code in real and significant ways.

As we moved forward with recommendations for reform, we followed the President's instructions to emphasize simplicity, fairness, and to remove impediments to growth. Achieving all of these principles is no easy task. We recognized from the start of our meetings that while it is relatively straightforward to point out flaws in a tax system and to express a desire for change, it is much more challenging to settle on a specific solution. There are difficult trade-offs. While we have differed at times and we may not all agree with every word in this report, we all fully endorse it.

We unanimously recommend two options to reform the tax code. We refer to one option as the Simplified Income Tax Plan and the other option as the Growth and Investment Tax Plan. Both of them are preferable to our current system. Both satisfy the President's directive to recommend options that are simple, fair, and pro-growth.

The Simplified Income Tax Plan dramatically simplifies our tax code, cleans out targeted tax breaks that have cluttered the system, and lowers rates. It does away with gimmicks and hidden traps like the Alternative Minimum Tax. It preserves and simplifies major features of our current tax code, including benefits for home ownership, charitable giving, and health care, and makes them available to all Americans. It removes many of the disincentives to saving that exist in our current code, and it makes small business tax calculations much easier. It also offers an updated corporate tax structure to make it easier for American corporations to compete in global markets.

The second recommended option, the Growth and Investment Tax Plan, builds on the Simplified Income Tax Plan and adds a major new feature: moving the tax code closer to a system that would not tax families or businesses on their savings or investments. It would allow businesses to expense or write-off their investments immediately. It would lower tax rates, and impose a single, low tax rate on dividends, interest, and capital gains.

As directed by the President, our recommendations have been designed to raise approximately the same amount of money as the current tax system. The issue of whether the tax code should raise more or less revenue was outside of our mandate. Regardless of how one feels about the amount of revenue required to fund our government, all should agree that the tax system needs a solid and rational foundation.

We recognize that our report is just the beginning of the process to fix our broken tax system. The hardest work lies ahead. As a bipartisan Panel, we have heard from witnesses and elicited proposals from members of both major parties. We hope that the Administration and the Congress will carry forward this spirit of bipartisanship.

The effort to reform the tax code is noble in its purpose, but it requires political willpower. Many stand waiting to defend their breaks, deductions, and loopholes, and to defeat our efforts. That is part of the legislative process. But the interests of a few should not stand in the way of the tax code's primary goal: to raise funds efficiently for the common defense, vital social programs, and other goals of shared purpose. If we agree the goals serve us all, we must also agree that the costs must be fairly borne by all.

This report aims to give voice to the frustrated American taxpayer and to provide a blueprint for lasting reform. We look forward to a national debate and a better tax system.

Connie Mack, III, Chairman

John Breaux, Vice-Chairman

William E. Frenzel

Elizabeth Garrett

Edward P. Lazear

Timothy J. Muris

James M. Poterba

Charles O. Rossotti

Liz Ann Sonders

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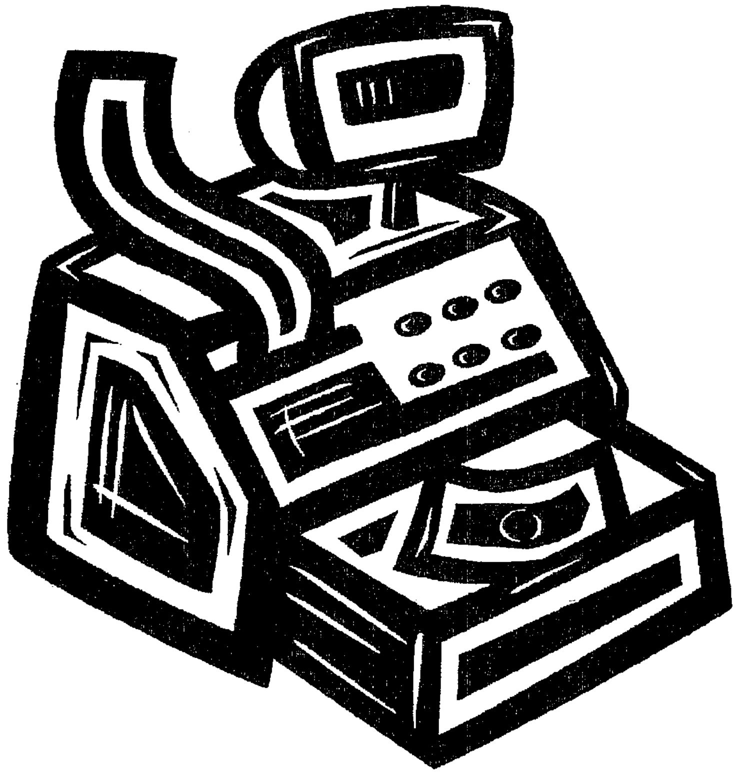
Chapter Nine
National Retail Sales Tax



The Panel considered a number of proposals to reform the income tax, including replacing the entire income tax system with a broad-based national retail sales tax. A retail sales tax is perhaps the most obvious form of consumption tax because it is imposed on the final sales of goods and services to consumers. Like other consumption taxes, the retail sales tax does not tax normal returns to saving and investment and thus may lead to greater economic growth than our current tax system.

After careful evaluation, the Panel decided to reject a complete replacement of the federal income tax system with a retail sales tax for a number of reasons. Two considerations were particularly important to the Panel's decision:

- Replacing the income tax with a retail sales tax, absent a way to ease the burden of the retail sales tax on lower and middle-income Americans, would not meet the requirement in the Executive Order that the Panel's options be appropriately progressive.

- Although a program could be designed to reduce the burden of a retail sales tax on lower-income and middle-income taxpayers by providing cash grants, such cash grants would represent a new entitlement program – by far the largest in American history. Adjusting the distribution of the burden of the retail sales tax through a cash grant program would cost approximately $600 billion to $780 billion per year and make most American families dependent on monthly checks from the federal government for a substantial portion of their incomes. The Panel concluded that such a cash grant program would inappropriately increase the size and scope of government.

The Panel also had additional concerns with replacing the current tax system with a retail sales tax:

- Even with favorable assumptions, a retail sales tax on a broad base with a cash grant program would require a tax rate of at least 34 percent, and likely higher over time if the base erodes, creating incentives for significant tax evasion. A discussion of the range of potential estimates of the tax rate is provided later in this chapter.
- The federal administrative burden for a retail sales tax may be similar to the burden under the current system. A federal agency, such as the IRS, would be required to administer the tax in order to ensure adequate collection of federal revenues and uniform enforcement of the rules and regulations underlying the tax. Indeed, two types of administrations would be required – one to collect the tax and another to keep track of the personal information that would be necessary to determine the size of the taxpayer's cash grant.
- Taxpayers likely would continue to file state income tax returns, which would limit the potential simplification gains from replacing the federal income tax system with a retail sales tax.

Box 9.1. Comparing "Tax-Exclusive" and "Tax-Inclusive" Rates

The 34 percent tax rate mentioned in the introduction to this chapter is a tax-exclusive rate. Sales tax rates are typically quoted on a tax-exclusive basis, while income tax rates typically are quoted on a tax-inclusive basis. If a good costs $100 and bears an additional $34 sales tax, the tax-exclusive sales tax rate is 34 percent. The tax-inclusive rate is 25 percent – $34 (the tax paid) divided by $134 (the total amount the consumer paid). An individual who earns $134 and pays $34 in income taxes would think of themselves as paying approximately 25 percent ($34/$134 = 0.254) of their income in taxes.

Although tax-exclusive and tax-inclusive rates are both valid ways of thinking about tax rates, the easiest way to compare the retail sales tax rate to the state sales taxes paid by most Americans is to consider the tax-exclusive rate. On the other hand, it is appropriate to compare the retail sales tax rate with current income tax rates by utilizing the tax-inclusive rate. For ease of understanding, this chapter uses tax-exclusive rates unless otherwise specified in the text. Tax-inclusive rates are provided in the Appendix.

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As explained in Chapter Three, the retail sales tax and the VAT represent similar ways to tax consumption of goods and services. A VAT and a retail sales tax that share the same tax base, tax rate, and compliance rates would generate the same amount of tax revenue. The Panel, therefore, analyzed a full replacement VAT at the same time it considered a full replacement retail sales tax. Although the Panel concluded that the full replacement VAT might mitigate some of the compliance challenges encountered with a retail sales tax, the Panel's primary objections to a retail sales tax applied equally to a full replacement VAT. As a result, the Panel does not recommend the full replacement VAT as a tax reform option.

Retail Sales Tax with No Cash Grant

Forty-five states and the District of Columbia currently have retail sales taxes. Many states use multiple sales tax rates and exempt many goods and services from tax. The Panel, however, considered a single-rate tax that would be imposed on a broad tax base because such a tax would be simpler to administer and create fewer economic distortions. The Panel's broad tax base would apply to sales of goods and services to consumers, but, to prevent multiple taxation or "cascading," it would not apply to purchases of goods or services by business that are used to produce other goods or services for sale to households.

The Panel initially evaluated the federal retail sales tax using the broad tax base described by advocates of the "FairTax" retail sales tax proposal. That tax base (the "Extended Base") would exempt only educational services, expenditures abroad by U.S. residents, food produced and consumed on farms, and existing housing (or what economists refer to as the imputed rent on owner-occupied and farm housing). The long-term likelihood of maintaining this broad tax base is addressed later in this chapter.

Using the Extended Base and assuming low rates of evasion, the Treasury Department calculated that the tax rate required to replace the federal income tax with a retail sales tax would be 22 percent on a tax-exclusive basis. This tax rate, however, does not include a program designed to ease the burden of the tax on lower-income Americans. Moreover, unless the states repealed their existing sales taxes, most consumers would pay both federal and state sales tax on many goods. The weighted average state and local sales tax rate is approximately 6.5 percent on a tax-exclusive basis. Thus, for sales subject to both federal retail sales tax and state and local sales taxes, the weighted average combined tax-exclusive sales tax rate would be approximately 28.5 percent.

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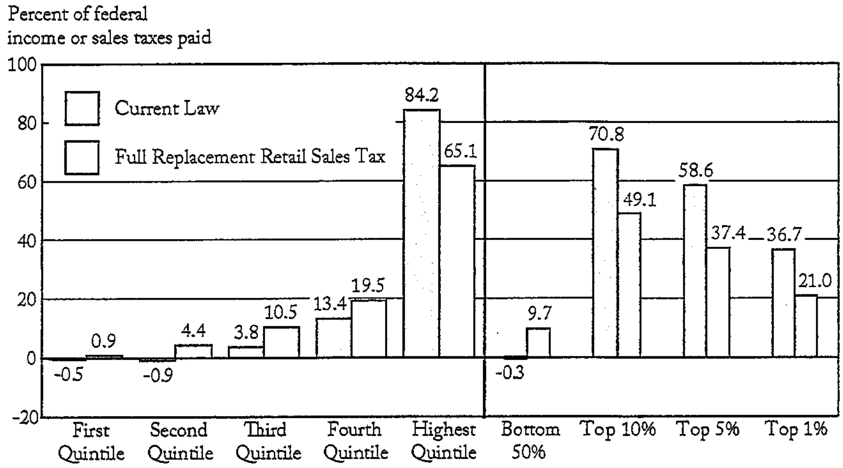
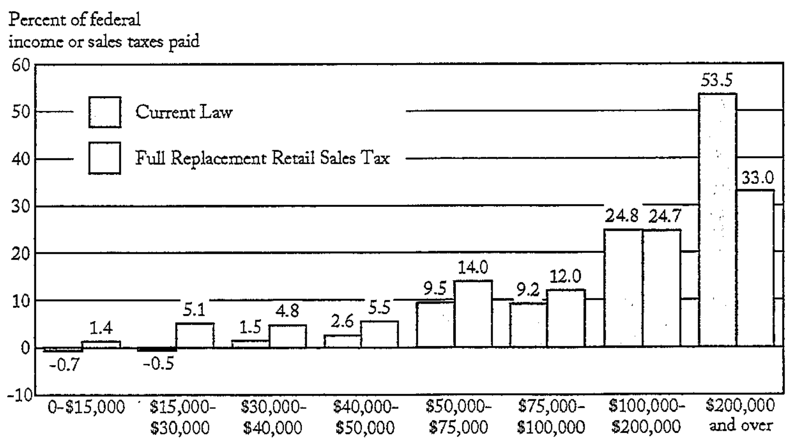
Figure 9.1. Distribution of Federal Tax Burden Under Current Law and the Full Replacement Retail Sales Tax Proposal without Prebate by Income Percentile (2006 Law)



Note: Estimates of 2006 law at 2006 cash income levels. Quintiles begin at cash income of; Second $12,910; Third $27,461; Fourth $45,345; Highest $84,124; Top 10% $123,076; Top 5% $169,521; Top 1% $407,907. Bottom 50% below $36,738.
Source: Department of the Treasury, Office of Tax Analysis.

Figure 9.2. Distribution of Federal Income Tax Burden Under Current Law and the Full Replacement Retail Sales Tax Proposal without Prebate by Income Level (2006 Law)



Note: Estimates of 2006 law at 2006 cash income levels.
Source: Department of the Treasury, Office of Tax Analysis.

Figures 9.1 and 9.2 compare the current distribution of federal taxes paid with the distribution that would exist under a "stand-alone" retail sales tax at a 22 percent tax rate. Adopting this retail sales tax would impose a larger tax burden on lower-income households than the current system because a retail sales tax is imposed directly on

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consumption and does not provide deductions, exemptions, or credits to reduce the tax burden on lower-income Americans. Replacing the current income tax with a stand-alone retail sales tax would increase the tax burden on the lower 80 percent of American families, as ranked by cash income, by approximately $250 billion per year. Such families would pay 34.9 percent of all federal retail sales taxes, more than double the 15.8 percent of federal income taxes they pay today. The top 20 percent of American taxpayers would see their tax burden fall by approximately $250 billion per year. Such families would pay 65.1 percent of all federal retail sales taxes, compared to the 84.2 percent of federal income taxes they pay today.

Lower- and middle-income families would be especially hard hit by a stand alone retail sales tax. For example, the Treasury Department estimates that a hypothetical single mother with one child making $20,000 per year currently pays $723 in total federal taxes (including both the employee and employer shares of the Social Security and Medicare taxes). Under the stand-alone retail sales tax, her tax bill would go up to $6,186 – a tax increase of over 750 percent. A hypothetical married couple with two children making $40,000 per year would pay an additional $6,553 in taxes, an increase of more than 110 percent of total federal tax liability. In contrast, a hypothetical married couple with two children and $300,000 of income currently pays about $89,000 in total federal taxes. Under the stand-alone retail sales tax, this hypothetical family would pay about $72,000, a tax cut of 19 percent. Further discussion of the Treasury Department's hypothetical taxpayer analysis appears in the Appendix.

The Panel concluded that the distribution of the tax burden under a stand-alone retail sales tax would not meet the requirement in the Executive Order that the Panel's tax reform options be appropriately progressive.

Retail Sales Tax with a Cash Grant Program

Universal Cash Grant Program

Retail sales tax proposals generally recognize the distributional effects of a stand-alone retail sales tax. For this reason, such proposals usually include a cash grant program to relieve the burden of the retail sales tax on lower and middle-income families.

The Panel considered the cash grant program advocated by proponents of the FairTax. This program (sometimes called a "Prebate") would provide a monthly monetary grant to all U.S. citizens and residents. The goal of the program would be to provide families with cash sufficient to pay retail sales tax on all their spending up to the poverty level. The program would not be income based so there would be no need to have a federal agency to keep track of personal income. Nevertheless, it would require a federal agency to keep track of family characteristics, such as family size, on which the cash grant would be based.

This cash grant program would be expensive, and would require raising the retail sales tax rate. To pay for the cash grant program and remain revenue-neutral, the required

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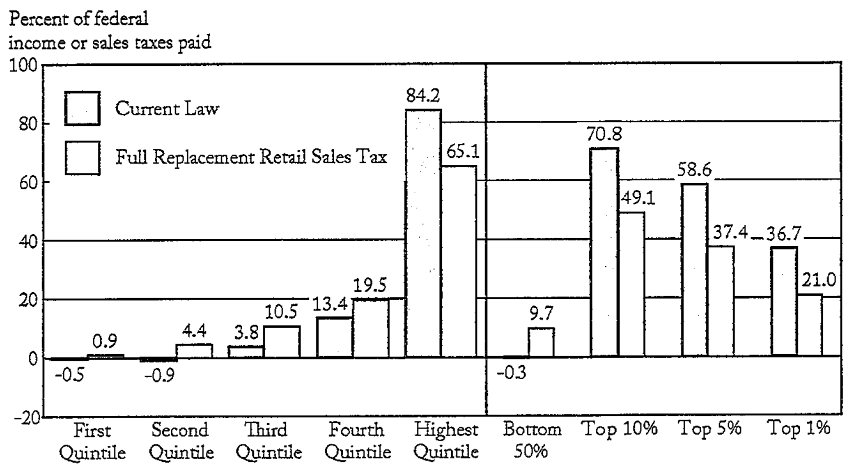
tax rate, assuming evasion rates somewhat lower than those under the income tax, would be 34 percent. Using a higher evasion rate assumption, discussed further below, the tax rate would be 49 percent. If a narrower tax base were used instead of the Extended Base, the tax rate would be even higher.

How would the cash grant program work? The federal government would be required to send monthly checks to every family in America, regardless of their income level. If the tax rate was 34 percent and the before-tax poverty level for an individual was $10,000, all single individuals would receive $3,400 a year from the government. The cash grant would also be adjusted for marital status and family size. For married couples with two children, the cash grant amount in 2006 would be $6,694 per year.

The Prebate-type program would cost approximately $600 billion in 2006 alone. This amount is equivalent to 23 percent of projected total federal government spending and 42 percent of projected total federal entitlement program spending, exceeding the size of Social Security, Medicare, and Medicaid. The Prebate program would cost more than all budgeted spending in 2006 on the Departments of Agriculture, Commerce, Defense, Education, Energy, Homeland Security, Housing and Urban Development, and Interior combined.

Figure 9.3. Distribution of Federal Tax Burden Under Current Law and the Full Replacement Retail Sales Tax Proposal with Prebate by Income Percentile (2006 Law)



Note: Estimates of 2006 law at 2006 cash income levels. Quintiles begin at cash income of; Second $12,910; Third $27,461 Fourth $45,345; Highest $84,124; Top 10% $123,076; Top 5% $169,521; Top 1% $407,907; Bottom 50% below $36,738.
Source: Department of the Treasury, Office of Tax Analysis.

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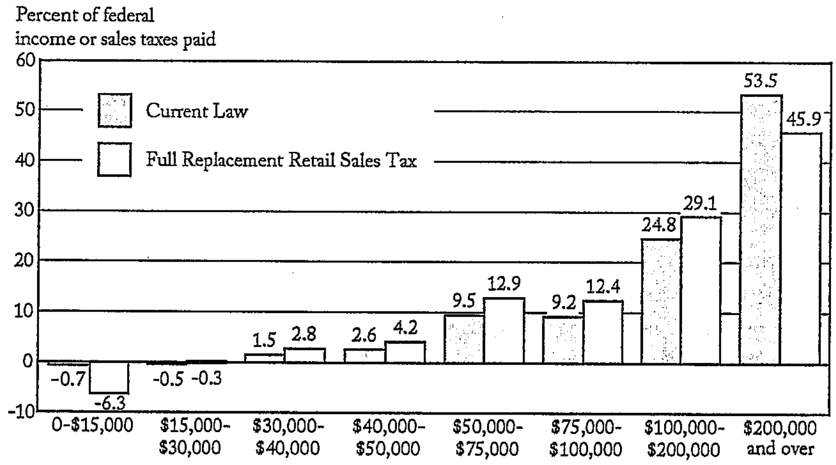
Figure 9.4. Distribution of Federal Income Tax Burden Under Current Law and the Full Replacement Retail Sales Tax Proposal with Prebate by Income Level (2006 Law)



Note: Estimates of 2006 law at 2006 cash income levels.
Source: Department of the Treasury, Office of Tax Analysis.

Figures 9.3 and 9.4 show that low-income and high-income Americans would benefit from the retail sales tax with a Prebate, while middle-income Americans would pay a larger share of the federal tax burden. Separate figures with distributional estimates for 2015 law are not provided because the distribution of the retail sales tax burden in these estimates was identical to the distribution shown in Figures 9.3 and 9.4. American families with the lowest 20 percent of cash incomes currently pay negative 0.5 percent of total federal income taxes because the tax credits they claim exceed their total positive tax liability. Under the retail sales tax with a Prebate, this group would pay negative 5.6 percent of the federal sales tax burden because the amount they would receive in monthly checks from the government would exceed what they would pay in retail sales tax at the cash register. In total, the bottom quintile would bear 5.1 percentage points less of the tax burden. Families with the top 10 percent of cash incomes would also benefit substantially from the retail sales tax. Their share of the tax burden would fall by 5.3 percentage points – from 70.8 percent to 65.5 percent.

Middle-income Americans, however, would bear more of the federal tax burden under the retail sales tax with a Prebate. The Treasury Department's analysis of hypothetical taxpayers shows that married couples at the bottom 25th percentile, 50th percentile, and 75th percentile of the income distribution for married taxpayers would see substantial tax increases under a full replacement retail sales tax. A typical married couple at the bottom 25th percentile of the income distribution earns $39,300 per year and would pay $5,625 dollars in federal taxes in 2006. Under the retail sales tax with a Prebate, the same family would pay $7,997 in net federal taxes after subtracting the Prebate of $6,694, resulting in a tax increase of $2,372, or 42 percent. A typical married couple at the 50th percentile of the income distribution making $66,200

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would pay an additional $4,791, a tax increase of 36 percent, and a typical married couple in the 75th percentile, making $99,600 would pay an additional $6,789, a 29 percent tax increase. A typical single mother at the bottom 25th percentile of the income distribution for head of household taxpayers has $23,100 of income per year and, compared to current law, would pay $5,866 more under the retail sales tax with a Prebate.

Targeted Cash Grant Program

The Panel requested that the Treasury Department develop a more targeted cash subsidy program to alleviate the burden of a retail sales tax on lower- and middle-income American families. The resulting program required a cash grant of up to $7,068 to married couples, plus $2,570 per dependent per year, with a phase-in and a phase-out. Further details regarding the program are provided in the Appendix, as well as a brief discussion of an alternative targeted subsidy program.

The Treasury Department's proposed targeted cash grant program would cost $780 billion in 2006. It would represent 30 percent of total federal government spending, and would dwarf all other federal entitlement programs and exceed the combined size of Social Security and Medicaid. To implement the program, the government would need to collect 34 percent more revenue and redistribute an additional 6 percent of GDP. The Panel concluded that this substantial increase in the amount of revenue collected from taxpayers and redistributed by the federal government was undesirable. Some Panelists were also concerned that the precedent set by the large cash grant program could set the stage for further growth in the size and scope of the federal government. To pay for the targeted cash grant program and remain otherwise revenue-neutral, the tax rate would need to increase to at least 37 percent, assuming low evasion and using the Extended Base.

Administration of a Cash Grant Program Would be Complex

The proposed cash grant programs would require all eligible American families to file paperwork with the IRS or another federal government agency in order to claim their benefits under this new entitlement program. A federal agency would need to manage the program, verify individuals' marital status and number of eligible children, and write checks to every family in the United States. Eligibility rules would be necessary, for example, to ensure that a child claimed as a dependent could not also file for his or her own separate cash grant.

Substantial additional complexity would be imposed by a targeted cash grant program because determining eligibility would require additional information. For example, a program based on annual income would require the IRS or another federal government agency to make many of the same determinations now made under the current income tax.

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Evasion, the Tax Base, and the Required Tax Rate Revisited

The tax rate necessary to replace the revenues from the current individual and corporate income taxes is one key consideration in evaluating a retail sales tax. The two major factors that determine the tax rate are the size of the tax base and the level of evasion. The tax rates and rebate program cost estimates presented thus far have been based on relatively optimistic assumptions about the breadth of the tax base and the evasion rate. As explained above, even under these optimistic assumptions, the Panel does not recommend a full replacement sales tax at the resulting 34 percent tax rate.

The Panel also had substantial concerns that a base as broad as assumed above would not be viable and that evasion rates could be higher than under the present income tax. The Panel believed that in evaluating the retail sales tax it was important to consider the tax rate required under less favorable assumptions regarding the tax base and evasion. Accordingly, the Panel requested that the Treasury Department estimate the required retail sales tax rate using the same tax base as the Partial Replacement VAT described in Chapter Eight and using a base equal to the average state sales tax base.

The Partial Replacement VAT base described in Chapter Eight is slightly narrower than the Extended Base – primarily because it excludes the value of state and local government services. The Extended Base would require state and local governments not only to pay retail sales tax on their purchases from businesses, but also to pay tax at the retail sales tax rate to the federal government on the total value of the salaries that state and local governments pay their employees – this would be equivalent to the value of services provided by state and local governments to their citizens. The Panel concluded that it may be inappropriate for the federal government to directly assess a tax of this sort on state and local government in our federal system. For this reason, the Panel excluded state and local government services from the Partial Replacement VAT base discussed in Chapter Eight.

Existing state sales tax bases are substantially narrower than either of the broad bases studied by the Panel. Most states exempt a variety of specific products and many services from their sales taxes. For example, every state sales tax exempts prescription drugs, most states do not tax health care, approximately 30 states exempt food for home consumption or tax it at a preferential rate, and many states exempt clothing. These exemptions are often justified as a means to ease the burden of a sales tax on basic necessities, but are not well targeted because they often decrease the tax burden on higher-income taxpayers as much or more than they decrease the tax burden on lower or middle-income taxpayers. To illustrate the impact of extensive base erosion on a retail sales tax, the Panel requested that the Treasury Department estimate the tax rate using the average state sales tax base. The Panel acknowledges there are structural differences between state tax systems and a federal tax system that would rely on a retail sales tax instead of an individual and corporate income tax, and that these differences would affect the nature of any base erosion. Nevertheless, the Panel believes that estimating the tax rate using a base equal to the average state sales tax base is illustrative of the impact of base erosion on the tax rate.

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Table 9.1. shows the Treasury Department's estimates of the tax-exclusive retail sales tax rates required to replace the federal income tax using the alternative assumptions regarding evasion rates and the breadth of the tax base. The Extended Base and Partial Replacement VAT Base estimates include the Prebate-type universal cash grant program (calculated to provide all families with cash sufficient to pay a 34 percent retail sales tax on a poverty level amount of spending). The average state sales tax base estimate includes no cash grant program, because exclusions from the base are assumed to fulfill the burden-easing function of the cash grant. These tax rates should be compared both to each other and to the overall burden an individual faces under both the corporate and individual income tax today. Tax-inclusive rates are provided in the Appendix.

Table 9.1. Retail Sales Tax Rate Estimates – Range of Tax-Exclusive Rates

Evasion Rate	Extended Base	Partial Replacement VAT Base	Median State Sales Tax Base
Low Evasion (15%)	34%	38%	64 %
Higher Evasion (30%)	49%	59%	89%

Source: Department of the Treasury, Office of Tax Analysis.

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Box 9.2. Comparing the Treasury Department's Revenue-Neutral Rate Estimate with Estimates Made by Retail Sales Tax Proponents

In their submission to the Panel, proponents of the FairTax claimed that a 30 percent tax exclusive sales tax rate would be sufficient not only to replace the federal income tax, but also to replace all payroll taxes and estate and gift taxes and fund a universal cash grant. In contrast, the Treasury Department concluded that using the retail sales tax to replace only the income tax and provide a cash grant would require at least a 34 percent tax-exclusive rate.

Some may wonder why the tax rate estimated by FairTax advocates for replacing almost all federal taxes (representing 93 percent of projected federal receipts for fiscal year 2006, or $2.0 trillion) is so much lower than the retail sales tax rate estimated by the Treasury Department for replacing the income tax alone (representing 54 percent of projected federal receipts for fiscal year 2006, or $1.2 trillion).

First, it appears that FairTax proponents include federal government spending in the tax base when computing revenues, and assume that the price consumers pay would rise by the full amount of the tax when calculating the amount of revenue the government would obtain from a retail sales tax. However, they neglect to take this assumption into account in computing the amount of revenue required to maintain the government's current level of spending. For example, if a retail sales tax imposed a 30 percent tax on a good required for national defense (for example, transport vehicles) either (1) the government would be required to pay that tax, thereby increasing the cost of maintaining current levels of national defense under the retail sales tax, or (2) if the government was exempt from retail sales tax, the estimate for the amount of revenue raised by the retail sales tax could not include tax on the government's purchases. Failure to properly account for this effect is the most significant factor contributing to the FairTax proponents' relatively low revenue-neutral tax rate.

Second, FairTax proponents' rate estimates also appear to assume that there would be absolutely no tax evasion in a retail sales tax. The Panel found the assumption that all taxpayers would be fully compliant with a full replacement retail sales tax to be unreasonable. The Panel instead made assumptions about evasion that it believes to be conservative and analyzed the tax rate using these evasion assumptions.

Evasion

Tax evasion occurs when taxpayers do not pay taxes that are legally due. Analysts agree that some evasion is inevitable in any tax, and that evasion rates for any tax tend to rise as the tax rate rises. At the request of the Panel, the Treasury Department estimated the revenue neutral retail sales tax rate assuming evasion rates of 15 and 30 percent of personal consumption spending. The Treasury Department assumed no evasion by state and local governments. By comparison, for 2001 the IRS estimates that the evasion rate for the individual income tax was between 18 and 20 percent and the evasion rate of the entire U.S. tax system was about 15 percent.

The retail sales tax would rely on retail businesses to collect all federal tax revenue and eliminate federal individual income tax filing. Therefore, the number of federal tax return filers would fall significantly under the retail sales tax. Further, the complexity of filing a business tax return would decline dramatically as compared to corporate income tax returns. Retail sales tax returns would indicate only total sales, exempt

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sales (sales to businesses with exemption certificates plus export sales) and tax liability. From an enforcement perspective, both the reduced number of tax return filings and the simple nature of the retail sales tax return represent substantial advantages.

Nevertheless, the Panel concluded that a number of features of the retail sales tax would make it difficult to administer and enforce at the high tax rate necessary to be revenue-neutral. A federal retail sales tax assessed at a rate of at least 34 percent, added on to state retail sales taxes, would provide a substantial inducement for evasion at the retail level. Retailers and shoppers could use a number of techniques to evade a retail sales tax. For example, unregistered cash sales to a consumer would allow a transaction to escape taxation. Retailers facing a high retail sales tax might also misapply exemption criteria, whether intentionally or unintentionally, and fail to tax goods that should be taxed. Or, the retailer might collect the tax from customers, but keep the money rather than remit it to the government. At high tax rates, the gain to retailers from evasion is high.

Empirical evidence suggests third-party reporting substantially improves tax compliance, particularly when tax rates are high. For the portion of income from which taxes are not withheld and there is no third-party reporting, income tax evasion rates are estimated to be around 50 percent. There is no third-party reporting in a retail sales tax. Retailers would add their retail sales tax to the pre-tax price for their goods and would remit that amount to the government, but shoppers would not separately report what they bought, and at what price, to the government. The government would rely on retailers alone to report their own taxable and exempt sales.

To obtain exemption from tax, retail purchasers might try to fabricate exemption certificates or otherwise masquerade as tax-free buyers of retail products. For example, individuals might create "paper" businesses solely to obtain business exemption certificates and avoid taxes on purchases for personal use. A related problem involves individuals with legitimate businesses using their business exemptions for personal purchases or for goods or services to give to employees in lieu of cash compensation. Using their business purchase exemption would provide a discount equal to the retail sales tax rate.

With a retail sales tax, retailers would have the responsibility to determine whether the ultimate use of a good or service would be for a business purpose, and therefore would be deserving of the business purchase exemption. Retailers are often ill-equipped to carry out this role. State experience suggests that abuse of exemptions is common, in part because distinguishing between business and individual consumer purchases of so-called "dual use" goods and services – goods and services that are commonly purchased by both businesses and final consumers, such as a plane ticket – can be difficult and costly.

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Box 9.3. Dual-Use Goods and the Problem of "Cascading"

The difficulty of identifying whether dual-use goods are used for business or individual purposes is one reason that states typically include a significant number of business-to-business transactions in their sales tax base. For example, states often do not ask retailers to determine whether a buyer will use a computer for entertainment at home (taxable) or to run a business (exempt). Instead, many states treat sales of computers as taxable unless the buyer certifies that they are purchasing the computer for resale. Thus, many businesses pay sales tax when purchasing computers. That tax then "cascades" into the cost of the goods and services the purchasing business sells to consumers. Taxing goods and services bought by businesses to produce other goods and services is economically inefficient because it haphazardly imposes double (or triple or quadruple) taxation on some consumer goods and services.

Cascading taxes create incentives for business to produce fewer goods or services, shift resources into tax-favored activities, or adopt tax-driven business structures. Cascading taxes also may have a negative impact on U.S. competitiveness because they impose some tax liability on exports and result in less tax being assessed on imports relative to competing domestically-produced goods.

Comparison with State Sales Tax Evasion and Administration

Retail sales tax advocates often note that evasion rates with sales taxes are lower than evasion rates with the income tax. However, state sales tax evasion rates are not likely to be representative of the evasion rate of a full replacement retail sales tax for several reasons.

First, state sales tax rates are a fraction of the tax rates required to replace the federal income tax. Among states that impose sales taxes, tax rates range from 3.5 percent in Virginia to 7.0 percent in Mississippi, Rhode Island, and Tennessee. When combined with local sales taxes, the highest sales taxes are found in Alabama (11.0 percent), Arkansas (10.625 percent), Oklahoma (10.5 percent) and Louisiana (10.5 percent).

Higher tax rates provide greater incentives for taxpayer evasion and avoidance. Those incentives also make administration and enforcement more expensive – and any failure to effectively administer the tax requires a higher tax rate to compensate for lost revenue. No state or country has ever levied a retail sales tax at a tax rate that even approaches the 34 percent required to replace the federal income tax system. State tax administrators told the Panel that they would expect significant compliance problems at such rates.

State sales taxes also do not broadly tax service providers, often because they are difficult to tax. For example, all U.S. state sales taxes exempt most financial services. Other dual-use services, such as utilities, transportation, and communication services are also difficult to tax properly and often are exempt from state sales taxes. It is reasonable to assume that trying to tax these services through a retail sales tax likely would result in more extensive evasion and higher compliance and administrative costs than existing state sales taxes. Although it is difficult to know with any measure of certainty what the evasion rate would be under the RST, the Panel believes that it would likely be at least as high as evasion under the current income tax and that a 30 percent rate of evasion would not be an unreasonable assumption.

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Other Concerns

Response of the States to a Retail Sales Tax

Although some retail sales tax proposals claim the administration of the retail sales tax could be left to the states and the IRS could be eliminated, such a system would likely be unworkable. Existing state sales tax bases are both narrow and varied and it may be difficult to persuade the states to adopt the federal retail sales tax base.

The experience of Canada, which tried to federalize its provincial sales taxes, may be instructive. Canada considered adopting a unified federal and provincial sales tax base in 1987, but intergovernmental discussions failed to produce an agreement to standardize the existing provincial sales tax bases with the base for Canada's federal goods and services tax.

Variation in local sales tax rates within the United States could further complicate any effort to standardize U.S. sales tax bases and rates. As of 2001, Texas alone had 1,109 separate city tax rates, 119 county tax rates, and 67 other special tax jurisdictions. Texas is not atypical in having numerous local sales tax jurisdictions. While some states might bring their sales taxes into conformity with a federal retail sales tax, it is unlikely that all would do so. States have not adopted identical definitions, standards, and rules in their own income tax regimes as those that exist for the federal income tax, even though there would be many administrative and compliance advantages to such an approach.

Given the tremendous variance in the current taxation of retail sales across the United States, the IRS or another federal agency with substantial personnel and resources would almost certainly have to define, administer, and enforce a federal retail sales tax. For example, detailed rules would be necessary to ensure that exemption certificates were issued uniformly and only provided to legitimate businesses for use in purchasing actual business tools, materials, and other inputs. Further, the IRS or another federal agency would likely need to administer the retail sales tax directly in the five states that do not currently impose a sales tax. The same might be true in those states that do not bring their sales tax bases into conformity with the federal retail sales tax base. Finally, because failure to effectively enforce the sales tax would lower federal revenues, Congress might decide that the IRS should maintain a significant enforcement function as a backup mechanism to state tax administration efforts.

State Income Tax

At the Panel's public meetings, state and local tax officials suggested that a federal retail sales tax would encroach on a tax base that traditionally has been left exclusively to states and localities. Currently sales and gross receipts taxes account for about 37 percent of state general tax collections and about 17 percent of local revenues. However, if a federal retail sales tax were put in place at a rate of 34 percent or more, it could become unattractive for states to add their own rates on top of the federal retail sales tax.

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If the federal government were to cease taxing income, states might choose to shift their revenue-raising to the income base from the sales base. State income taxes could rise, while state sales tax rates could fall. In any event, unless states found a substitute source of revenue, they likely would maintain their income taxes. For that reason, it is reasonable to expect that taxpayers would need to continue to keep track of income-related information and file income tax returns, regardless of whether the federal government eliminates the federal income tax. Furthermore, with an income-based cash grant program, tracking income at the federal level would remain a necessity.

Today, 45 states and the District of Columbia have state income taxes. Most states use federal adjusted gross income as the starting point in determining the state individual income tax base. Eliminating the federal income tax would remove the common basis upon which most state income taxes are now structured. State and local income tax returns would likely become much more complex if they could not be based on a pre-existing federal income tax return that includes a calculation of annual income. Greater disparities among state income tax systems and potential distortions would likely develop as state income tax structures diverge from each other over time in the absence of a common federal income tax base as a starting point.

State income tax compliance initiatives currently rely in large measure on information that the states receive from the third-party reporting structure created by the federal income tax – such as W-2 and 1099 forms as well as other standard tax forms that report income. In the absence of the federal third-party reporting system, states would need to impose information reporting requirements on individuals, employers, financial institutions, and others in order to maintain their income tax systems. States might bind together to coordinate enforcement of state income taxes and impose those reporting requirements. But if states chose to impose reporting requirements independently, multi-state businesses could face many different sets of reporting obligations. Simplification of the federal tax system through a retail sales tax might be achieved at the expense of greater overall complexity in the combined system of state and federal taxation.

Compliance Burden on Small Business

A retail sales tax also likely would place a disproportionate burden on small retail businesses. Few statistical studies exist on the compliance costs for retailers of different sizes. However, a well-regarded study conducted by the State of Washington Department of Revenue in 1998 suggests that, although such costs are low overall, they are disproportionately high for small retailers. In Washington, the cost of collecting sales tax for retailers with annual gross retail sales of between $150,000 and $400,000 was 6.5 percent of sales tax collected. By comparison, firms with annual gross retail sales greater than $1.5 million spent less than 1 percent of sales tax collected on compliance.

Small vendors, particularly those operating on a cash basis, account for a significant share of the noncompliance in many state sales taxes as well as our current income tax. A retail sales tax would cover all retailers, including small service providers,

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such as dentists, car mechanics, or beauticians, as well as small retail stores. Small service providers would likely find retail sales tax compliance costly and would have noncompliance incentives that would be similar to those for small retail stores.

Macroeconomic Effects of Transition

Some observers have worried about potential macroeconomic disruptions associated with moving from an income tax to a retail sales tax. Although there may be some such disruptions, those considerations were secondary in the Panel's decision not to recommend a retail sales tax.

Full Replacement of the Income Tax with a VAT

The Panel considered replacing the income tax with a VAT at the same time it analyzed a replacement retail sales tax because of the similarities between the two taxes. The Panel concluded that fully replacing the income tax with a VAT would be substantially more administrable than fully replacing the income tax with a retail sales tax. The advantages of a VAT over a retail sales tax with respect to enforcement and compliance are described in Chapter Eight. However, the Panel's objections regarding the increased tax burden on the middle class and increased size of government resulting from the full replacement retail sales tax apply equally to a full replacement VAT. Because of these concerns, the Panel did not recommend a full replacement VAT.

Conclusion

Like other consumption taxes, the full replacement retail sales tax has pro-growth features. Nevertheless, the Panel does not recommend a full replacement retail sales tax. Without a large cash grant program to ease the burden of the tax, a retail sales tax would not be appropriately progressive. A cash grant program to make the tax appropriately progressive would cost at least $600 billion per year – which would make it America's largest entitlement program. The Panel concluded that it was inappropriate to recommend a tax reform proposal that required the federal government to collect and redistribute this amount in additional revenue from taxpayers. The Panel also was concerned with administrative and compliance issues associated with a retail sales tax, as well as difficulties involving coordination with existing state sales taxes.

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KANSAS LEGISLATIVE RESEARCH DEPARTMENT

68-West–Statehouse, 300 SW 10th Ave.
Topeka, Kansas 66612-1504
(785) 296-3181 ◆ FAX (785) 296-3824

kslegres@klrd.ks.gov http://www.kslegislature.org/klrd

September 1, 2010

To: Senator Dick Kelsey

From: Chris W. Courtwright, Principal Economist

Re: Proposed Comprehensive Tax Plan

The purpose of this memo is to briefly outline the components of a comprehensive proposal that would make major changes in the state tax structure while leaving it revenue neutral relative to current law.

As we have been discussing, the major sales and use tax components would include a significant expansion of the state sales tax base pursuant to repealing a number of sales tax exemptions; extending the tax to a number of previously untaxed services; lowering the rate back to 5.3 percent; and eliminating the tax on groceries. Assuming a one-month lag in receipts, the amount of additional revenue provided for all of these changes would be $795.6 million. Repealing the food sales tax rebate program, which would no longer be necessary, would increase net receipts by an additional $42 million. So the amount of additional revenues provided would total $837.6 million.

Repealing the corporation income tax would reduce receipts by $255 million, according to the latest Consensus estimates.

This would leave $582.6 million to apply to a major reduction in individual income taxes. As we discussed, the Legislature would certainly be at liberty to explore any number of options to provide individual income tax relief of this magnitude (including various "flat" tax ideas), since that figure would represent a 22.6 percent tax cut relative to the current Consensus estimate for FY 2011 of approximately $2.577 billion.

Special Committee on Assessment and Taxation

September 16-17, 2010

Attachment #22

ɲator Dick Kelsey September 1, 2010

Restoring Equity in Our Tax System

Basic Goals:

- Eliminate the sales tax on food;
- Eliminate the corporate income tax;
- Reduce the individual income tax;
- Reduce the state sales tax by 1.0 percent;

Path to Reach the Above Goals:

- Apply the reduced state sales tax rate to services (excluding health care services).
  - Professional, scientific and technical services;
  - Administrative and support services;
  - Personal care and taxi services;
  - Other services;
- Eliminate most of the existing sales tax exemptions:
  - EXCEPT:
    - conceptual;
    - lottery tickets; and
    - legal.
  - Include:
    - Governmental;
    - Educational;
    - Agricultural;
    - Charitable; and
    - Consumer.

Proposal - Details

Basic Goals:

- **Eliminate the sales tax on food:**
  - While net changes in sales tax base would increase receipts, rate would be reduced substantially;
  - The sales tax on food would be eliminated effective July 1, 2011;
  - Kansas would join 31 other states (that have a sales tax) that do not tax food. Five states do not have a sales tax;
  - Currently, Kansas is only one of seven states that apply their full sales tax rate to food;
  - Repeal the existing food sales tax rebate program, since it would no longer be needed.
- **Eliminate the corporate income tax:**
  - Cost - $255.0 million.
  - The corporate income tax would be eliminated for tax year 2011.
  - Kansas would join three current states that do not have any type of corporate income tax - Nevada, Washington, and Wyoming.
- **Reduce the individual income tax;**
  - Cost - $582.6 million

- **Reduce the state sales tax by 1.0 percent**;
  - While net changes in sales tax base would increase receipts, rate would be reduced substantially;
  - Decrease the rate from 6.3 percent to 5.3 percent, effectively repealing the 2010 tax increase on many consumer purchases; and
  - The 1.0 percent rate decrease would equate to a savings of $200 on a $20,000 vehicle purchase.

Path to Reach the Above Goals:

- Apply the reduced sales tax rate to services (excluding health care services) (See Attachment A):
  - Professional, scientific and technical services;
  - Administrative and support services;
  - Personal care and taxi services; and
  - Other services.

- Eliminate the most existing sales tax exemptions (See Attachment B):
  - EXCEPT:
    - conceptual;
    - lottery tickets; and
    - legal.
  - Include:
    - Governmental;
    - Educational;
    - Agricultural;
    - Charitable; and
    - Consumer.

Proposal - Worksheet

$ 795.6	-	Repeal all exemptions except conceptual, legal, and lottery; Extending tax to previously untaxed services, but not health care services; Exempt food, reduce rate to 5.3 percent; All occur on July 1, 2011.
(255.0)	-	Repeal Corporation Income Tax
42.0	-	Repeal Food Sales Tax Rebate Credits
(583.6)	-	Lower Individual Income Tax Rates
$ 0.0	-	Final Fiscal Note Relative to Current Law

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How Is It Fair?

* That coin-operated laundromats are exempt but coin-operated car washes are taxable?

* That municipal golf course admissions are exempt but privately owned golf course admissions are taxable?

* That the labor services associated with washing the floor are exempt but the services associated with waxing the floor are taxable?

* That some backhoes purchased for agricultural use qualify for an exemption but other backhoes purchased and used almost identically are taxable?

* That human haircuts are exempt but pet haircuts are taxable?

* That certain purchases of the West Sedgwick County and the Shawnee Rotary Clubs are exempt but all other Rotary Clubs' purchases are taxable?

Statute	Description of Exemption or Exclusion	FY2011 ($ in Millions)	FY2012 ($ in Millions)	FY2013 ($ in Millions)	FY2014 ($ in Millions)	FY2015 ($ in Millions)	FY2016 ($ in Millions)
Tax Rate		6.3%	6.3%	6.3%	6.3%	6.3%	6.3%
Annual Rate of Increase		3%	3%	3%	3%	3%	3%
	Conceptual Exclusions						
	All Conceptual Exemptions Retained						
	Public Policy: Charitable, Religious, Benevolent Exemptions						
3603 (e)	Admission to any cultural and historical event which occurs triennially	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (v)	Sales of food products purchased by contractor for use in preparing meals for delivery to homebound elderly persons. In 2004, expanded exemption to all personal property purchased by contractor and sales of food products by or on behalf of contractor or organization	$ 1.05	$ 1.09	$ 1.12	$ 1.15	$ 1.19	$ 1.22
3606 (ii)	Property purchased by nonprofit organization for nonsectarian comprehensive multidiscipline youth development programs and activities and sales of property by or on behalf of such organization	$ 3.33	$ 3.43	$ 3.53	$ 3.64	$ 3.75	$ 3.86
3606 (oo)	Property purchased by a community action group or agency to repair or weatherize housing occupied by low income individuals.	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (qq)	Property and services purchased by a nonprofit museum or historical society which is organized under the federal income taxation code as a 501 (c)(3)	$ 0.50	$ 0.52	$ 0.53	$ 0.55	$ 0.56	$ 0.58
3606 (rr)	Property which will admit purchases to an annual event sponsored by a nonprofit organization organized under the federal income taxation code as a 501 (c)(3)	$ 0.04	$ 0.04	$ 0.04	$ 0.05	$ 0.05	$ 0.05
3606 (tt)	Property and services purchased by not-for-profit corporation for the sole purpose of constructing a Kansas Korean War memorial and is organized under the federal income taxation code as a 501 (c)(3)	$ -	$ -	$ -	$ -	$ -	$ -
3606 (xx)	Property and services purchases by nonprofit zoo or on behalf of a zoo by an entity that is a 501(c)(3)	$ 0.76	$ 0.79	$ 0.81	$ 0.84	$ 0.86	$ 0.89
3606 (yy)	Property and services purchased by a parent-teach association or organizations and all sales of tangible personal property by or on behalf of such association	$ 0.72	$ 0.74	$ 0.76	$ 0.78	$ 0.81	$ 0.83
3606 (aaa)	Property and services purchased by religious organizations and used exclusively for religious purposes	$ 21.99	$ 22.65	$ 23.33	$ 24.02	$ 24.75	$ 25.49
3606 (bbb)	Sales of food for human consumption by organizations exempt by 501(c)(3) pursuant to food distribution programs which offers such food at a price below cost in exchange for the performance of community service by the purchaser.	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (hhh)	Property and services purchased by or on behalf of Domestic Violence Shelters as members of the Kansas coalition against Sexual and Domestic Violence	$ 0.07	$ 0.07	$ 0.08	$ 0.08	$ 0.08	$ 0.08
3606 (iii)	Property and services purchased by organizations distributing food without charge to other nonprofit food distribution programs. Includes taxes paid on and after July 1, 2005 and prior to July 1, 2006.	$ 0.30	$ 0.31	$ 0.32	$ 0.33	$ 0.34	$ 0.35
3606 (ppp)	Property and services purchased by non-profit Homeless Shelters, and sales made by or on behalf of these organizations.	$ 0.14	$ 0.14	$ 0.14	$ 0.15	$ 0.15	$ 0.16
3606 (ttt)	Property and services purchased a contractor for a purpose of restoring, constructing, equipping, reconstructing, maintaining, repairing, enlarging, furnishing or remodeling a home or facility owned by a nonprofit museum which is a qualified under the governor hometown heritage act (KSA 75-5071)	$ 0.13	$ 0.14	$ 0.14	$ 0.15	$ 0.15	$ 0.16
	Subtotal	**$ 29.04**	**$ 29.91**	**$ 30.81**	**$ 31.73**	**$ 32.68**	**$ 33.66**
	Public Policy: Exemptions to Charitable Organizations by Name						
3606 (vv)	Property purchased by the following organizations who are organized under the federal income taxation code as a 501 (c)(3): American Heart Association, Ks Affiliate; Ks Alliance for the Mentally Ill, Inc.; Ks Mental Illness Awareness Council, Heartstrings Community Foundation, Cystic Fibrosis , Spina Bifida Assn, CHWC, Inc., Cross-lines Cooperative Council, Dreams Work, Inc., KSDS, Inc., Lyme Association of Greater Kansas City, Inc Dream Factory, Ottawa Suzuki Strings, International Assn of Lions Clubs, Johnson County young Matrons, American Cancer Society, Community Services of Shawnee, Angel Babies Assn, Kansas Fairground Foundation	$ 1.00	$ 1.03	$ 1.06	$ 1.10	$ 1.13	$ 1.16
3606 (ww)	Property purchased by the Habitat for Humanity for use within a housing project	$ 0.15	$ 0.15	$ 0.15	$ 0.16	$ 0.16	$ 0.17

Statute	Description of Exemption or Exclusion	FY2011 ($ in Millions)	FY2012 ($ in Millions)	FY2013 ($ in Millions)	FY2014 ($ in Millions)	FY2015 ($ in Millions)	FY2016 ($ in Millions)
Tax Rate		6.3%	6.3%	6.3%	6.3%	6.3%	6.3%
Annual Rate of Increase		3%	3%	3%	3%	3%	3%
3606 (ggg)	Property and services purchased by or on behalf of the Kansas Academy of Science.	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (kkk)	Not Used	$ -	$ -	$ -	$ -	$ -	$ -
3606 (lll)	Property and services purchased by Special Olympics Kansas, Inc., and sales made by or on behalf of Special Olympics.	$ 0.03	$ 0.03	$ 0.04	$ 0.04	$ 0.04	$ 0.04
3606 (mmm)	Property and services purchased by Marillac Center, Inc. and sales made by or on behalf of the Marillac Center.	$ 0.07	$ 0.07	$ 0.07	$ 0.07	$ 0.08	$ 0.08
3606 (nnn)	Property and services purchased by West Sedgwick County - Sunrise Rotary Club for constructing boundless playground.	$ 0.03	$ 0.03	$ 0.03	$ 0.03	$ 0.03	$ 0.03
3606 (qqq)	Property and services purchased by TLC for Children and Families, Inc. and sales made by or on behalf of TLC	$ 0.22	$ 0.22	$ 0.23	$ 0.24	$ 0.24	$ 0.25
3606 (sss)	Property and services purchased by catholic charities or youthville and sales made by or on behalf of catholic charities or youthville	$ 0.81	$ 0.84	$ 0.86	$ 0.89	$ 0.92	$ 0.94
3606 (uuu)	Property and services purchased by Kansas Children's Service League and sales made by or on behalf of the KCSL	$ 0.19	$ 0.20	$ 0.20	$ 0.21	$ 0.21	$ 0.22
3606 (vvv)	Property and services purchased by Jazz in the Woods and sales made by or on behalf of such organization	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.02
3606 (www)	Property purchased by or behalf of Frontenac Education Foundation and sales made by or on behalf of such organization	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
3606 (xxx)	Property and services purchased by the Booth Theatre Foundation, Inc. Provides for refund of sales taxes paid from January to July 2007.	$ 0.04	$ 0.04	$ 0.04	$ 0.04	$ 0.04	$ 0.05
3606 (yyy)	Property and services purchased by the TLC Charities Foundation, Inc. and sales made by or on behalf of these organizations.	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
3606 (zzz)	Property purchased by Rotary Club of Shawnee Foundation	$ -	$ -	$ -	$ -	$ -	$ -
3606 (aaaa)	Property and services purchased by or on behalf of Victory in the Valley and sales made by or on behalf of such organization	$ 0.02	$ 0.02	$ 0.02	$ 0.02	$ 0.03	$ 0.03
3606 (bbbb)	Guadalupe Health Foundation, sales of entry or praticipation fees, chrages or tickets for annual fundraising event	$ 0.14	$ 0.14	$ 0.15	$ 0.15	$ 0.16	$ 0.16
3606 (cccc)	Property and services purchased by or on behalf of Wayside Waifs for the purpose of providing such organizatoins annual fundraising event and sales made by or on behalf of such organization	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.01
3606 (dddd)	Property or services purchased by or on behalf of Goodwill Industries or Easter Seals o Kansas, Inc for the purpose of providing education, training and employment opportunities for people with disabilities and other barriers to employment	$ 0.05	$ 0.05	$ 0.05	$ 0.05	$ 0.05	$ 0.05
3606 (eeee)	Property or services purchased by or on behalf of All Beef Battalion, Inc. for the purpose of educating, promoting and participating as a contract group through the beef cattle industry in order to carry out such projects that provide support and morale to members of the United States armed forces and military services.	$ 0.00	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.01
3606 (ffff)	Property and services purchased by Sheltered Living, Inc for the purpose of providing residential and services for people with developmental disabilities or mental retardation, or both; and sales made on behalf of such organization	$ 0.04	$ 0.04	$ 0.04	$ 0.04	$ 0.04	$ 0.04
	Subtotal	**$ 2.82**	**$ 2.90**	**$ 2.99**	**$ 3.08**	**$ 3.17**	**$ 3.26**
	Public Policy: Consumer Exemptions						
3602 (ii)	Modified definition of sales or selling price to not include cash rebates granted by a manufacturer to a purchaser or lessee of a mew motor vehicle if paid directly to the retailer as a result of the original sale. The exemption is granted from July 1, 2006 and ending June 30, 2009.	$ -	$ -	$ -	$ -	$ -	$ -
3603 (b)	Taxes telephone and telegraph services except certiain interstate and international services and value-added nonvoice data services	$ 1.83	$ 1.89	$ 1.94	$ 2.00	$ 2.06	$ 2.12
3603 (c)	Residential and agricultural use utilities. Effective Jan 1 2006, exemption fmoved here from 3606 (w) and (x).	$ 157.06	$ 161.77	$ 166.62	$ 171.62	$ 176.77	$ 182.07
3603 (o)	Motor vehicles exchanged for corporate stock, corporate transfer to itself and immediate family member sales.	$ 0.26	$ 0.27	$ 0.28	$ 0.29	$ 0.30	$ 0.31
3603 (p)	Labor services of installing or applying property in original construction of a building or facility or the construction reconstruction, restoration, replacement or repair or a residence, bridge or highway	$ 230.39	$ 237.30	$ 244.42	$ 251.75	$ 259.30	$ 267.08
3603 (v)	Sales of bingo cards, bingo faces and instant bingo tickets. Tax rate 2.5 on July 1, 2001 to June 30, 2002; exempt on July 1, 2002	$ 3.46	$ 3.57	$ 3.67	$ 3.78	$ 3.90	$ 4.01
3606 (u)	Leases or rentals of property used as a dwelling for more than 28 consecutive days.	$ 0.92	$ 0.95	$ 0.98	$ 1.01	$ 1.04	$ 1.07
3606 (w)	Residential and agricultural use of water and severing oil & gas and property exempt from property tax. Effective Jan 1 2006, exemption for residential and agricultural use of electricity and heat moved to 3603(c).	$ 14.69	$ 15.13	$ 15.59	$ 16.05	$ 16.54	$ 17.03

Statute	Description of Exemption or Exclusion	FY2011 ($ in Millions)	FY2012 ($ in Millions)	FY2013 ($ in Millions)	FY2014 ($ in Millions)	FY2015 ($ in Millions)	FY2016 ($ in Millions)
Tax Rate		6.3%	6.3%	6.3%	6.3%	6.3%	6.3%
Annual Rate of Increase		3%	3%	3%	3%	3%	3%
3606 (x)	Sales of propane, gas, LP-gas, coal, wood, and other fuel sources for the production of heat or lighting for noncommercial use in a residential premise. Effective Jan 1 2006, exemption for residential and agricultural moved hereto 3603(c).	$ -	$ -	$ -	$ -	$ -	$ -
3606 (bb)	Used mobile and manufactured homes	$ 5.62	$ 5.79	$ 5.96	$ 6.14	$ 6.32	$ 6.51
3606 (ee)	Lottery tickets and shares made as part of a lottery operated by the State of Kansas	Retained					
3606 (ff)	New mobile or manufactured homes to the extent of 40% of the gross receipts	$ 4.12	$ 4.24	$ 4.37	$ 4.50	$ 4.64	$ 4.78
3606 (ooo)	Sales made by or on behalf of a public library	Retained					
	Subtotal	**$ 418.36**	**$ 430.91**	**$ 443.84**	**$ 457.15**	**$ 470.87**	**$ 484.99**
	Public Policy: Governmental Exemptions						
3603 (g)	Service of renting of rooms by holds or accommodation brokers to federal government or any federal employee in performance of official government duties.	$ 0.15	$ 0.16	$ 0.16	$ 0.17	$ 0.17	$ 0.18
3603 (h)	Service of leasing or renting machinery and equipment owned by city purchased with industrial revenue bonds prior to July 1, 1973	$ -	$ -	$ -	$ -	$ -	$ -
3606 (b)	Property or services purchases by State of Kansas, political subdivision, nonprofit hospital or blood /donor bank. In 2001, deleted sales of water to make purchases for water suppliers exempt.(Neutral FN due to Clean Water Fee)	$ 419.30	$ 431.87	$ 444.83	$ 458.18	$ 471.92	$ 486.08
3606 (d)	Property or services purchased by contractor for building or repair of buildings for nonprofit hospital, elementary or secondary schools or nonprofit educational institutions, and for state correctional institution	$ 150.74	$ 155.26	$ 159.91	$ 164.71	$ 169.65	$ 174.74
3606 (e)	Property or services purchases by federal government, its agencies or instrumentality's	$ 7.02	$ 7.23	$ 7.44	$ 7.67	$ 7.90	$ 8.13
3606 (s)	Sales of property or services purchased by a groundwater management district	$ 0.05	$ 0.06	$ 0.06	$ 0.06	$ 0.06	$ 0.06
3606 (z)	Property and services purchased directly by a port authority or a contractor therefore.	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (ss)	Property and services purchased by a public broadcasting station licensed by FCC as a noncommercial educational television or radio station.	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (uu)	Property and services purchased by rural fire fighting organization	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
3606 (rrr)	Property and services purchased by county law library,	$ 0.14	$ 0.14	$ 0.14	$ 0.15	$ 0.15	$ 0.16
	Subtotal	**$ 577.39**	**$ 594.71**	**$ 612.55**	**$ 630.92**	**$ 649.85**	**$ 669.35**
	Public Policy: Educational Exemptions						
3606 (c)	Property or services purchased and leasing by elementary or secondary schools and educational institutions	$ 74.10	$ 76.32	$ 78.61	$ 80.97	$ 83.39	$ 85.90
3606 (h)	Rental of nonsectarian textbooks by elementary or secondary schools	$ 1.21	$ 1.25	$ 1.29	$ 1.32	$ 1.36	$ 1.40
	Subtotal	**$ 75.31**	**$ 77.57**	**$ 79.89**	**$ 82.29**	**$ 84.76**	**$ 87.30**
	Public Policy: Health Care Exemptions						
3606 (p)	Sales for prescription drugs	Retained					
3606 (q)	Sales of insulin dispensed by pharmacist for treatment of diabetes	Retained					
3606 (r)	Sales of prosthetic or orthopedic appliances prescribed by a doctor. IN 2004, exempted all hearing aids, parts and batteries by licensed providers	$ 10.48	$ 10.80	$ 11.12	$ 11.46	$ 11.80	$ 12.15
3606 (hh)	Medical supplies and equipment purchased by nonprofit skilled nursing home or intermediate nursing care home for providing medical services to residents	$ 1.32	$ 1.36	$ 1.40	$ 1.44	$ 1.48	$ 1.53
3606 (jj)	Property and services, includes leasing of property, purchased for community-based mental retardation facility or mental health center.	$ 3.06	$ 3.15	$ 3.24	$ 3.34	$ 3.44	$ 3.54
3606 (ll)	Educational materials purchased for distribution to the public at no charge by a nonprofit public health corporation	$ 0.10	$ 0.11	$ 0.11	$ 0.11	$ 0.12	$ 0.12
3606 (ccc)	Property and services purchases by health care centers and clinics who are serving the medically underserved.	$ 0.48	$ 0.49	$ 0.51	$ 0.52	$ 0.54	$ 0.55
3606 (jjj)	Sales of dietary supplements dispensed by prescription order by a licensed practitioner or mid-level practitioner.	Minimal	Minimal	Minimal	Minimal	Minimal	Minimal
	Subtotal	**$ 15.44**	**$ 15.91**	**$ 16.38**	**$ 16.87**	**$ 17.38**	**$ 17.90**
	Public Policy: Agriculture Exemptions						
3606 (t)	Sales of farm or aquaculture machinery and equipment, parts and services for repair and replacement. In 2006, added work-site utility vehicle as exempt. To include precision farm equipment	$ 62.91	$ 64.79	$ 66.74	$ 68.74	$ 70.80	$ 72.93

Statute	Description of Exemption or Exclusion	FY2011 ($ in Millions)	FY2012 ($ in Millions)	FY2013 ($ in Millions)	FY2014 ($ in Millions)	FY2015 ($ in Millions)	FY2016 ($ in Millions)
Tax Rate		6.3%	6.3%	6.3%	6.3%	6.3%	6.3%
Annual Rate of Increase		3%	3%	3%	3%	3%	3%
3606 (mm)	Seeds, tree seedlings, fertilizers, insecticides, etc., and services purchased and used for producing plants to prevent soil erosion on land devoted to agricultural use.	$ 1.21	$ 1.25	$ 1.29	$ 1.32	$ 1.36	$ 1.40
	Subtotal	**$ 64.12**	**$ 66.04**	**$ 68.02**	**$ 70.06**	**$ 72.17**	**$ 74.33**
	Legal Exemptions						
3606 (g)	Sales, repair or modification of aircraft sold for interstate commerce directly through an authorized agent. IN 2004, expanded aircraft exemption for repair, modification plus parts and labor	Retained					
3606 (y)	Sales of materials and services used in repairing, maintaining, etc., of railroad rolling stock used in interstate commerce	Retained					
3606 (aa)	Materials and services brought into Kansas for usage outside of Kansas for repair, services, alteration, maintenance, etc. used for the transmission of liquids or national gas by a pipeline in interstate commerce	Retained					
3606 (dd)	Property purchased with food stamps issued by US Department of Agriculture	Retained					
3606 (gg)	Property purchased with vouchers issued pursuant to the federal special supplemental food program for women, infants and children	Retained					
3606 (ddd)	Property and services purchases by any class II or III railroad (shortline) for track and facilities used directly in interstate commerce. Only for calendar year 1999.	Retained					
	Subtotal	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**
	Public Policy: Exemption of Services						
3603 (f)	Coin operated Laundry Services	$ 0.46	$ 0.48	$ 0.49	$ 0.51	$ 0.52	$ 0.54
3603 (m)	Fees and charges by any political subdivision, youth recreation organization exclusively providing services to persons 18 or younger organized as a 501(c)(3) for sports, games and other recreational activities and entry fees and charges for participation.	$ 1.15	$ 1.18	$ 1.22	$ 1.25	$ 1.29	$ 1.33
3603 (n)	Dues charged by any organization pursuant to paragraph 8 and 9 of 79-201 (veteran & humanitarian organizations) and zoos	$ 0.42	$ 0.43	$ 0.45	$ 0.46	$ 0.48	$ 0.49
3606 (nn)	Services rendered by advertising agency or broadcast station	$ 5.37	$ 5.53	$ 5.69	$ 5.86	$ 6.04	$ 6.22
	Subtotal	**$ 7.40**	**$ 7.62**	**$ 7.85**	**$ 8.09**	**$ 8.33**	**$ 8.58**
	Public Policy: Exemptions for Businesses						
3603 (q)	Exemption for Service of repairing, servicing , maintaining custom computer software as described in section 3603 (s)	$ -	$ -	$ -	$ -	$ -	$ -
3603 (s)	Customized computer software and services for modifying software for single end use and billed as a separate invoiced item. In 2004, amended to tax only prewritten software. Custom software is exempt	$ 6.54	$ 6.74	$ 6.94	$ 7.15	$ 7.36	$ 7.59
3606 (f)	Property purchased by railroad or public utility for use in the movement of interstate commerce	$ 19.68	$ 20.27	$ 20.88	$ 21.51	$ 22.15	$ 22.82
3606 (i)	Lease or rental of films, records, tapes, etc. by motion picture exhibitors	$ 2.16	$ 2.23	$ 2.30	$ 2.36	$ 2.44	$ 2.51
3606 (j)	Meals served without charge to employees if duties include furnishing or sale of such meals or drinks	$ 4.80	$ 4.94	$ 5.09	$ 5.24	$ 5.40	$ 5.56
3606 (cc)	Property or services purchased for constructing, reconstructing, enlarging or remodeling a business; sale and installation of machinery and equipment purchased for installation in such business. (Enterprise Zone Exemption)	$ 83.10	$ 85.59	$ 88.16	$ 90.80	$ 93.53	$ 96.33
3606 (kk)	Machinery and equipment used directly and primarily in the manufacture, assemblage, processing, finishing, storing, warehousing or distributing of property for resale by the plant or facility. In 2004, added exemption for building new facility in Riverton Ks (minimal impact)	$ 146.75	$ 151.15	$ 155.69	$ 160.36	$ 165.17	$ 170.13
3606 (pp)	Drill bits and explosives used in the exploration and production of oil or gas	$ 0.51	$ 0.53	$ 0.54	$ 0.56	$ 0.57	$ 0.59
3606 (zz)	Machinery and equipment purchased by over-the-air free access radio or television station used directly and primarily for producing signal or the electricity essential for producing the signal.	$ 1.21	$ 1.24	$ 1.28	$ 1.32	$ 1.36	$ 1.40
3606 (eee)	Property and services purchases for reconstruction, reconstruction, renovation, repair of grain storage facilities or railroad sidings. Only for calendar year 1999 and 2000.	n/a	n/a	n/a	n/a	n/a	n/a
3606 (fff)	Material handling equipment, racking systems & other related machinery & equipment used for the handling, movement or storage of tangible personal property in a warehouse or distribution facility; installation, repair, maintenance services, and replacement parts.	$ 7.95	$ 8.18	$ 8.43	$ 8.68	$ 8.94	$ 9.21
	Subtotal	**$ 272.70**	**$ 280.88**	**$ 289.30**	**$ 297.98**	**$ 306.92**	**$ 316.13**
	Total	**$ 1,462.57**	**$ 1,506.44**	**$ 1,551.63**	**$ 1,598.18**	**$ 1,646.13**	**$ 1,695.51**

Kansas Department of Revenue
Office of Policy and Research
Sales Tax Exemption Fiscal Impact Estimate -All Funds
(dollars in millions)

	Receipts	FY 2011 3%	FY 2012 3%	FY 2013 3%	FY 2014 3%	FY 2015 3%	FY 2016 3%
Professional, Scientific & Technical							
Legal Services	$ 786,065	$ 26,017	$ 26,797	$ 27,601	$ 28,429	$ 29,282	$ 30,160
Accounting & Tax Services	$ 643,230	$ 21,289	$ 21,928	$ 22,586	$ 23,263	$ 23,961	$ 24,680
Architectural Services	$ 294,852	$ 9,759	$ 10,052	$ 10,353	$ 10,664	$ 10,984	$ 11,313
Engineering Services	$ 1,793,645	$ 59,365	$ 61,145	$ 62,980	$ 64,869	$ 66,815	$ 68,820
Drafting Services	$ 3,751	$ 124	$ 128	$ 132	$ 136	$ 140	$ 144
Building Inspection Services	$ 4,054	$ 134	$ 138	$ 142	$ 147	$ 151	$ 156
Geophysical surveying and Mapping	$ 17,680	$ 585	$ 603	$ 621	$ 639	$ 659	$ 678
Surveying and Mapping (except geophysical)	$ 29,485	$ 976	$ 1,005	$ 1,035	$ 1,066	$ 1,098	$ 1,131
Testing Services	$ 66,724	$ 2,208	$ 2,275	$ 2,343	$ 2,413	$ 2,486	$ 2,560
Specialized Design Services (1)	$ 121,340	$ 4,016	$ 4,136	$ 4,261	$ 4,388	$ 4,520	$ 4,656
Computer 'systems design & related services	$ 1,966,137	$ 65,074	$ 67,026	$ 69,036	$ 71,108	$ 73,241	$ 75,438
Management, Scientific &Technical Consulting	$ 737,212	$ 24,400	$ 25,132	$ 25,886	$ 26,662	$ 27,462	$ 28,286
Scientific research & development services	$ 255,313	$ 8,450	$ 8,704	$ 8,965	$ 9,234	$ 9,511	$ 9,796
Advertising & Related Services	$ 608,358	$ 20,135	$ 20,739	$ 21,361	$ 22,002	$ 22,662	$ 23,342
Other Prof. Tech, and Science (2)	$ 451,038	$ 14,928	$ 15,376	$ 15,837	$ 16,312	$ 16,802	$ 17,306
Total, Professional, Scientific & Technical	**$ 7,778,884**	**$ 257,459**	**$ 265,183**	**$ 273,138**	**$ 281,332**	**$ 289,772**	**$ 298,465**
Administrative & Support Services							
Office Aministrative Services	$ 343,428	$ 11,366	$ 11,707	$ 12,059	$ 12,420	$ 12,793	$ 13,177
Facilities Support Services	$ 122,236	$ 4,046	$ 4,167	$ 4,292	$ 4,421	$ 4,553	$ 4,690
Employment Services	$ 1,229,323	$ 40,687	$ 41,908	$ 43,165	$ 44,460	$ 45,794	$ 47,167
Business Support Services	$ 627,631	$ 20,773	$ 21,396	$ 22,038	$ 22,699	$ 23,380	$ 24,081
Travel Arrangement and Reservation Services	$ 86,734	$ 2,871	$ 2,957	$ 3,045	$ 3,137	$ 3,231	$ 3,328
Investigation and Security services	$ 193,621	$ 6,408	$ 6,601	$ 6,799	$ 7,003	$ 7,213	$ 7,429
Services to buildings and dwellings (3)	$ 830,576	$ -					
Other Support Services	$ 210,735	$ 6,975	$ 7,184	$ 7,399	$ 7,621	$ 7,850	$ 8,086
Total, Administrative & Support Services	**$ 3,644,284**	**$ 93,126**	**$ 95,919**	**$ 98,797**	**$ 101,761**	**$ 104,814**	**$ 107,958**
Health Care Services							
	RETAIN EXEMPTIONS						
Personal Care							
Personal Care Services (hair, nail and skin)	$ 207,470	$ 6,867	$ 7,073	$ 7,285	$ 7,503	$ 7,728	$ 7,960
Death Care Services	$ 159,835	$ 5,290	$ 5,449	$ 5,612	$ 5,781	$ 5,954	$ 6,133
Other Personal Care (4)	$ 124,776	$ 4,130	$ 4,254	$ 4,381	$ 4,513	$ 4,648	$ 4,787
Total, Personal Care	**$ 492,081**	**$ 16,286**	**$ 16,775**	**$ 17,278**	**$ 17,797**	**$ 18,331**	**$ 18,880**
Other							
Taxi And Limousine Services	$ 13,071	$ 433	$ 446	$ 459	$ 473	$ 487	$ 502
RV Parks and Recreational Camps	$ 3,536	$ 117	$ 121	$ 124	$ 128	$ 132	$ 136
Rooming and Boarding Houses (5)	$ 21,223	$ 702	$ 724	$ 745	$ 768	$ 791	$ 814
Total, Other	**$ 34,294**	**$ 1,252**	**$ 1,290**	**$ 1,328**	**$ 1,368**	**$ 1,409**	**$ 1,452**
Total All Services		**$ 368,123**	**$ 379,167**	**$ 390,542**	**$ 402,258**	**$ 414,326**	**$ 426,756**

The estimate on services was developed based on the U.S Census 2007 Economic Census for the state of Kansas. The Economic Census provides data on receipts by business classifications for both employers and nonemployers. The estimate assumes 50% of the receipts would be exempt from tax. This would allow for sales made to exempt entities (government, schools, exempt businesses) and for sales of tangible property that is already subject to sales tax. An annual increase was applied to each year as shown in the FY column.

(1) data not available in 2007 data, estimating 25% increase over 2002 data
(2) data not available for all catagories, estimating missing data makes up 25% of the industry total
(3) currently taxable
(4) includes parking lots, bail bonding, dating services. Photofinishing omitted- currently taxable
(5) data not available, used 2002 Census data with 10% growth (2% annual)

KANSAS
ASSOCIATION OF
COUNTIES

TESTIMONY
concerning the State and Local Tax Structure
Special Committee on Assessment & Taxation

Randall Allen, Executive Director
Kansas Association of Counties
September 16, 2010

Chairman Carlson and members of the committee, my name is Randall Allen, Executive Director of the Kansas Association of Counties. I appreciate the opportunity to offer some comments about the state and local tax structure on behalf of our 102 member counties.

One of my first mentors in local government once told me that the best accolade for a local government to earn from its business community and citizens is a reputation for **dependability** and **predictability**. Businesses and citizens need to know that when a county (or any other level of government) says it will do something or provide a service, the business community and citizens can **depend** on it to get done in a reasonably effective and efficient manner. Second, they need to know that the cost of services will be as **predictable** as possible, minimizing sudden changes or "hiccups" as much as possible. In terms of municipal finance, I was taught that a fairly constant mill levy is much better than a ricocheting one, where (for example), a significant mill levy reduction one year is followed by a significant mill levy increase the next, and so forth.

The second foundation for my remarks today has to do with the nature of the state-county relationship. Counties are, by law and tradition, local agents of the State. In so many policy and public service areas, counties do the work of the State of Kansas at the local level. From administering much of the system of property taxation, to elections, to all kinds of human services such as mental health care, services to elderly citizens and to persons with developmental disabilities, to the judicial and public safety functions such as criminal prosecution, the facility and support costs of the judicial system, jury fees, jails and community corrections --- all are examples of how counties share service delivery with the State. We are a partner government, and our functions are inextricably linked. More than any other unit of local government, counties are the arm of the State. So, when there is discussion about improving the state and local tax structure, we take this challenge seriously.

For counties, the majority of the discussion about state and local tax structure necessarily relates to the property tax and its viability. In 2008, counties imposed property tax levies of $1.066 billion statewide. This represented 28.3% of all property taxes levied in Kansas last year, as shown below:

2008 Property Taxes Levied for:	Amount	% of Total
State of Kansas (1.5 mills)	$ 46,505,529	1.2
County Governments	$ 1,066,445,356	28.3
City Governments	617,285,071	16.4

300 SW 8th Avenue
3rd Floor
Topeka, KS 66603-3912
785•272•2585
Fax 785•272•3585

Townships	58,563,579	1.6
Schools (Unified School Districts, Community Colleges, Washburn)	1,766,933,022	46.9
All other (e.g. special districts)	214.520,853	5.7
Total	$ 3,770,253,410	100.0%

To further place the $1.066 billion that counties raised from the property tax in 2008 into perspective, the second largest revenue source for county government is the local-option sales and use tax, which generated about $428 million in 2009. Except for scattered cable television franchise agreements in the unincorporated areas of some counties, county governments in Kansas do not receive franchise fees like cities. In summary, counties are more dependent on the property tax to finance services than any other unit of government.

For this reason, we are increasingly concerned when, in the evolving system of Kansas state and local taxation, we collectively rely more heavily on the property tax. The chart below compares state and local tax receipts in 1995 and 2008, among the three "legs" of the state/local finance "stool" –

State and Local Tax Receipts	FY 1995	FY 2008
Sales and Use (state & local)	32%	29%
Income (individual & corporate) & Privilege	28%	32%
Property	40%	39%

If the conventional wisdom is that good tax policy should result in each tax (sales, income, property) representing approximately one-third of the tax revenues for state and local government in Kansas, the balance (at least in 2008) was not optimal. Obviously, the additional $.01 sales tax effective on July 1, 2010 will change – to some extent – the relative distribution shown above.

Recommendations for Legislative Consideration:

1. **Demand Transfers.** Up until the early part of the current decade, the State allocated a percentage of the state sales and use tax to local governments, including counties, through two major revenue sharing programs, the Local Ad Valorem Tax Reduction (LAVTR) fund, and the City-County Revenue Sharing program. At the time in which the revenue sharing ceased, about $100 million flowed annually from the State to counties and other local governments. While we recognize the significant problems of the State and the challenges of financing K-12 education, restoration of the LAVTR program if only through the flow of gaming revenues would be welcome relief to property taxpayers. The twenty counties (20, of 105 total) without local-option sales taxes would particularly benefit from a resumption of demand transfers, minimally using gaming revenues, a stated purpose in the gaming legislation enacted a few years ago.
2. **Slider Payments (M&E Property Tax Exemption Mitigation).** The slider payments to local governments were targeted to partially, although not

wholly, mitigate the impact on local government property taxes from exempting new machinery and equipment from property taxation. This was the stated public policy purpose of the "slider" provisions. Unfortunately, when the State suspended the slider payments because of budget constraints, the property tax burden on the residual tax base increased, particularly in counties with more robust manufacturing and equipment-intensive business sectors. The exemption has occurred and it is a done deal, and we understand that. While the slider is not authorized in FY 2011, we do not want to forget that there was a mitigation plan that was abandoned.

3. **Tax Base Policy Evaluation Guide.** The Kansas Advisory Council on Intergovernmental Relations (KACIR) developed a "Tax Base Policy Evaluation Guide" for the purpose of determining the appropriateness of various tax exemptions and credits. The underlying premise of the Guide is to raise the question: "are you prepared to provide the recipient(s) of the exemption a specific appropriation in the budget?" If the answer is yes, then the proposed exemption or credit has merit. If the answer is no, the proposed exemption or credit should not be granted. Increased attention to tax exemptions or abatements by not only state legislators, but also county commissioners and city council members, is warranted.
4. **Policy and Service Area Boundaries**. Probably the best way to minimize conflict between and among the State and units of local government is to foster ongoing discussions to inform all of us on the optimal division of duty among governments. For the State and counties, this is most appropriate, because as the local arm of state services, there is need for much greater clarity about what is properly a state responsibility and what is a local (e.g. county) responsibility. Take, for example:

   ◉ Mental Health Responsibilities. Mental Health Reform legislation was passed in the mid-1980s. It meant a significant reduction in state hospital beds and greater reliance on community services. How many people have any institutional memory of the "division of duty" between the State (SRS) and community mental health centers (significant funding from counties)? Who is responsible for financing services to the chronically mentally ill? How are mental health services to uninsured or under-insured, working Kansans to be funded? Is there any wonder that finger-pointing occurs at times as to which entity should pull a greater share of the financing?

   ◉ Juvenile Justice Reform & Corrections. The Kansas Department of Corrections and Juvenile Justice Authority work daily with county sheriffs, county detention facility directors, judges, and county commissioners to manage the prison, jail, community corrections, and juvenile detention population. It is one huge system, yet administered by two different levels of government. A decision by one party has an impact on another party(s).

And, there are many, many more examples. The fact is: we all need to take a deep breath and ***work harder cross-jurisdictionally*** to make sure the service responsibility hand-offs are smoother. From a fiscal perspective, we should be more attentive to clearly identifying certain tax and revenue streams allocated to respective units of government. As an example, the uniform statewide property tax levy for public schools puts greater pressure on the property tax than if some or all of the same revenue were raised from another source. Similarly, local governments' use of local-option sales taxes to fund basic services presents an obstacle for the state when it needs to consider a possible increase in its sales tax rate. The obstacle may not always be a legal or statutory barrier, but there is always a practical, political barrier of making sure that the tax burden placed on our taxpayers is reasonable and can be handled.

Mr. Chairman, thank you for the opportunity to share these comments with you and the committee. Our Association is always pleased to engage with you and other members of the Legislature in a discussion of Kansas' state and local tax structure. I would be happy to answer questions, as you deem appropriate.

The Kansas Association of Counties, an instrumentality of member counties under K.S.A. 19-2690, provides legislative representation, educational and technical services and a wide range of informational services to its member counties. Inquiries concerning this testimony should be directed to Randall Allen or Melissa Wangemann by calling (785) 272-2585.

NFIB

The Voice of Small Business®

Testimony by Mr. Daniel Murray
Kansas State Director, National Federation of Independent Business

Special Committee on Assessment and Taxation
Thursday, September 16, 2010

Good afternoon, Chairman Carlson and members of the Committee. I am pleased to be here on behalf of the National Federation of Independent Business (NFIB) as the Committee reviews the Kansas tax structure and ways it can be improved and simplified. The complexities of the current tax code are especially onerous on small businesses, so I appreciate that the Committee is interested in hearing and considering the perspective of small business owners.

The NFIB is the state's leading small business advocacy organization representing over 4,000 small business owners across Kansas. The typical NFIB member employs about eight to ten employees with annual gross receipts of about $500,000. While there is no one definition of a small business, the problems our members confront relative to the tax code are representative of most small businesses. A few consistent concerns are raised regardless of the trade or industry in which the small business is engaged.

As part of representing small business owners the NFIB pays close attention to the concerns of our members and taxes consistently rates high on the list. The NFIB Research Foundation's Small Business Problems and Priorities consistently ranks tax issues, whether tax rates or complexity, at the top of the list.[1] In addition, the monthly Small Business Economic Trends (SBET) survey regularly ranks taxes as amongst the most important problems.[2]

Taxes and Small Business

Tax law matters to small business owners, and they adjust their business practice to changes in the law. Small businesses face distinct challenges directly related to the structure and management of a typical small business. Small businesses are not simply miniature versions of larger corporations. While tax law impacts each small business in a number of specific ways, there are a few key issues common to most small businesses. These issues are important to keep in mind when considering any changes to the tax laws.

I. Most Small Businesses are Taxed at the Individual Level.

No matter what business structure the small business owner chooses, you cannot separate the business owner from the business. The majority of small businesses are organized as pass through entities, with nearly 75-percent choosing a pass through business structure.[3] This means that most small businesses will pay their taxes at the individual level rather than the corporate level.

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[1] William J. Dennis, *Small Business Problems and Priorities*, NFIB Research Foundation, Washington, DC series.

[2] In the latest Small Business Economic Trends Survey, taxes ranked first among important problems. *Small Business Economic Trends*, NFIB Research Foundation, Washington, DC, August 2010.

[3] Firms of all size responded that 20.9-percent organized as sole proprietors, 5.8-percent as partnerships, 25.6-percent as C-Corps, 30.9-percent as S-Corps, 12.4-percent as LLCs, and 4.2-percent as other/DNK. *Business Structure – NFIB Small Business Poll*, NFIB Research Foundation, Washington, DC, Volume 4; Issue 7; 2004.

Thus, if Congress allows the $250,000 threshold set in the 2001 tax rates to expire at the end of this year, many Kansas small businesses that report more than $250,000 in income will see their tax burden grow. This could not happen at worse time for cash-strapped small businesses. The owner of a pass through business may report a higher amount of income on their individual return than they actually take home. That income is the money invested back into the business: it's the capital they use to purchase new equipment, pay the salary and benefits of workers and meet day-to-day expenses.

An NFIB Research Foundation poll, combined with U.S. Census Bureau statistics, indicates that the businesses most likely to face tax increases are businesses that account for a substantial portion of the workforce. The NFIB survey shows that about 10% of small business owners report more than $250,000. However, the businesses most likely to pay more taxes are firms with 20 to 250 employees. In fact over 30 percent of firms with between 20 to 250 employees would see their taxes increase if the $250,000 threshold expires.[4] In 2006, these businesses accounted for over one-quarter of the U.S. workforce, employing about 33.5 million workers.[5]

<u>II. The importance of cash flow.</u>

Cash flow is an especially difficult challenge for small businesses that is made worse by increasing taxes. One in five small businesses experiences a continuing cash flow problem and one in two businesses face regular cash flow problems.[6] This is a problem common to all small businesses and is just as true for a larger small business as it is for the smallest business.[7]

This is why lost revenue as a result of higher taxes when starting or expanding a business is such a problem. The most common source of capital for starting a business is personal income, in fact many small businesses are started with less than $10,000, and the most important source of capital for expanding a business is earnings retained from business profits, i.e. the amount of money kept after taxes.

Related to the cash flow challenge is the impact that payroll taxes have on small business operations. While the business's tax liability is directly related to its profitability, a payroll tax is levied no matter what the tax liability of the small business is. In many cases, payroll taxes are the highest taxes a lot of small businesses pay each year.[8] In an especially trying year, payroll taxes can exacerbate the small business cash flow challenge.

<u>III. Keep it Simple</u>.

Cumulatively, typical small businesses spend annually between 1.7 billion and 1.8 billion hours on tax compliance and $18 billion to $19 billion on compliance costs.[9] The result is that 88-percent of small business owners now hire a paid tax preparer to complete their returns.[10] Small business owners also spend on average $74.24 per hour on the paperwork associated with tax compliance – the highest paperwork cost imposed on small business by the federal government.[11] Unlike a larger business, the small business does not have a finance department or a staff of accountants and lawyers to focus on the

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[4] Finance Questions – NFIB Small Business Poll, NFIB Research Foundation, Volume 7; Issue 7: 2007.
[5] U.S. Small Business Administration, Office of Advocacy, based on data provided by the U.S. Census Bureau, Statistics of U.S. businesses 2006.
[6] *The Cash Flow Problem – NFIB Small Business Poll*, NFIB Research Foundation, Washington, DC, Volume 1; Issue 3; 2001.
[7] *Ibid.*
[8] William J. Dennis, *NFIB Small Business Policy Guide*, Washington, DC 2000.
[9] Donald DeLuca, Scott Silmar, John Guyton, Wu-Lang Lee, and John O'Hare, "Aggregate Estimates of Small Business Taxpayer Compliance Burden," Proceedings of the 2007 IRS Research Conference.
[10] *Tax Complexity and the IRS – NFIB Small Business Poll*, NFIB Research Foundation, Washington, DC, Volume 6; Issue 6; 2006.
[11] *Paperwork and Record Keeping – NFIB Small Business Poll*, NFIB Research Foundation, Washington, DC, Volume 3; Issue 5; 2003.

nuances and changes in the tax laws. Nor does the typical small business have a full-time human resources specialist to keep up with the tax changes impacting health care and retirement plans.

The complicated and, in many ways unpredictable tax code, places a heavy burden on small business owners. In the end this leads to additional costs and takes money away from the day-to-day business operations or investing in and expanding their business. The estate tax is a good example of this problem. Small business owners spend considerable resources ensuring that their business is passed on to the next generation. These challenges are only made more difficult with the fluctuating rates and exemptions under current law and the impending return of the full tax after 2010.

The confusing tax code leads to more errors, which we believe is the main cause of the tax gap amongst small business owners. The vast majority of small business owners comply with their tax obligations, but a direct correlation exists between the willingness and ability to comply and the small business owners actually meeting their tax obligations.

IV. Certainty for Small Business

More certainty in the law will help to reduce compliance and planning burdens on small businesses. We are hearing regularly from our members that they are concerned about uncertainty, whether it's the expiring individual tax rates, the unresolved estate tax, or potential tax increases at the state and local level. In as much as the state legislature can act on these issues, you should proceed quickly so that small business owners know what the laws are relative to the business decisions they have to make. It is counterproductive in the current economic climate for a business owner to keep capital locked-up until they see what Congress and the legislature does.

Tax Reform

As the Legislature considers changes to the tax law, I would encourage you to keep these four principles in mind as you think about how tax law changes will impact small businesses: 1) most small businesses pay taxes at the individual level; 2) the importance that access to cash has on the operation of the small business; 3) simplifying the code will help to make the code more workable for small businesses; and, 4) providing more certainty in the law.

With those principles in mind, I would like to point to a few items that are especially important to small businesses and reflect these four basic principles. First, low individual rates are important. Because cash flow is so important, keeping rates low will provide the small business with the access to the capital it needs to operate the business as well as to expand the business and create new jobs. Again, the personal income and after tax receipts are the largest sources of capital for small business, so keeping the individual rates low is important, especially at time when traditional capital markets are squeezed and the cost of operating the business is rising. Keeping individual rates low also recognizes the important connection that the business owner has to the business itself.

The Legislature can also look to a few successful reforms to continue to simplify the code for small businesses. Expensing is a good example of simplification and providing the small business with an immediate source of capital. Increasing the allowable expensing amount provides the majority of small business owners with an immediate deduction for almost any investment they make in their business.

Expensing also reduces the complexity of the tax law. Instead of following complicated depreciation schedules and keeping the paperwork associated with the investment, the business owner can simply claim the deduction in the year the item is purchased. As you consider specific issues in the law, increasing the expensing caps and making them permanent would go a long way to reducing complexity and providing an important tax benefit to small business owners.

Creating a standard home office deduction is one change that would reflect the same benefits created by expensing. Home-based businesses are one of the fastest growing areas of small businesses, but the current deduction is especially complicated requiring the business owner to determine how much of the house is used for business and keep detailed records to substantiate the deduction. Instead a simple standard deduction recognizes the use of the home for business purposes and reduces the complexity of the current deduction. Many small business owners avoid the deduction because of the complications and the fear of a potential audit. The standard deduction would allow the business owner to claim a deduction he is entitled to, reduce the filing burden, and ultimately improve tax compliance.

Finally, more certainty in the law will help to reduce compliance and planning burdens on small businesses. Looming tax changes, such as the expiration of the 2001 laws like the estate tax and the lower individual rates, make business planning more difficult. This is especially true for tax preparers and makes tax planning for a client even more of a challenge and increases the potentially for errors. A more certain tax code will help to promote prudent business planning and decisions and improve compliance.

Conclusion

Small businesses truly are the engine of economic growth. This isn't just a slogan as small businesses created 60 to 80 percent of the net new jobs over the last decade. Small business owners are risk takers and entrepreneurs.

The current tax code has become a confusing and unpredictable challenge for the vast majority of small business owners. Our tax laws should not deter or hinder the ability of small business owners to create or expand their businesses. Taxes are a major issue for all small business owners. Tax law can dictate the business decision that an owner will make, whether it is the type of structure to adopt or whether to make an investment.

After decades of patchwork changes to the tax code, the Legislature (and Congress) needs to make adjustments to our tax laws to reduce complexity and confusion and encourage business growth. I appreciate that you are taking a serious look at the Kansas tax structure and urge you to keep in mind the unique challenges that face small businesses.

National Taxpayers Union

Testimony of John Stephenson
State Government Affairs Manager
National Taxpayers Union
On Tax Reform Before the Kansas State Legislature's
Special Interim Committee on Assessment and Taxation

September 16, 2010

I. Introduction

Chairman Carlson and Members of the Committee, my name is John Stephenson. I am the State Government Affairs Manager for the National Taxpayers Union (NTU), the nation's oldest taxpayer advocacy organization. We have 362,000 members across the country, including 4,500 right here in Kansas. I thank you for the opportunity to offer this testimony about tax reforms to consider in the next session of the Legislature.

Today I hope to provide you with the taxpayer's perspective of the how the tax code places unnecessary burdens on individuals and businesses. I will also outline several reforms that I believe will help alleviate the tax burden, spur economic growth, and bring more stability to the state's budget.

I commend you for holding hearings to discuss reforms to Kansas' tax code. The hearings taking place today and tomorrow are testaments to your dedication to finding ways to bring more stability to the state's budget and foster strong economic growth here in Kansas. Although the dark storm clouds of the economic downturn are what bring us here today, there's also a silver lining: the important discussions of these hearings will hopefully lead to a brighter, more prosperous future for all Kansans.

II. Background

In order to find a solution, we must first understand the nature of the problem. Kansas faced an estimated $510 million dollar budget deficit for Fiscal Year 2011. Although the Kansas Department of Revenue reported $38 million more in collections than projected last month, the state is still far from the point where we can unequivocally say that Kansas has emerged from the fiscal storm. The Rockefeller Institute for Government at the University of Albany, which studies state revenues, recently reported that despite two straight quarters of growth, total state revenue collections are still well below pre-recession levels. Kansas tax revenue collections in personal income, corporate income, and sales, for the second quarter this year are down 9.5% from the same quarter a year ago, three and a half percentage points greater than the decline in collections for

108 North Alfred Street * Alexandria, Virginia 22314 * Phone: (703) 683-5700 * Fax: (703) 683-572

the entire Plain State region, according to the Rockefeller Institute. Moreover, with the economic recovery sputtering forward, the states' return to pre-recession revenue collections anytime soon is uncertain. Unfortunately, continued fiscal challenges for the states are almost guaranteed.

Kansas' revenue problems are not the result of taxing too little; in fact, the state has a broad-based tax system. Since the 1930s, the state has levied income, sales, and property taxes. Over the years, Kansas has steadily broadened and increased the taxes it levels on individuals and businesses, which has driven away taxpayers. Ten years ago, according to the Tax Foundation, Kansas had the 26th highest state and local tax burden per capita ($2,739). Kansas now has the 20th highest tax burden per capita ($3,911).

If we break down the figure, we will find that Kansas has the nation's 13th highest property taxes on owner-occupied housing as a percentage of home value. The state also has the 15th highest per capita personal income tax (and the 12th highest per capita corporate income) in the nation. Additionally, Kansas' business tax climate ranks 32nd out of 50.

What's more, these figures are based on data from 2008, the most recent year for which complete data is available. This means that Kansas' tax burden does not account for the latest changes in the state tax code. Unfortunately, Kansas' tax burden will rise following the increase of the state's sales tax rate, which was approved earlier this year.

At first mention, the 20th highest tax burden does not sound like a cause for major concern. However, Kansas' state and local tax burden is higher than the burden in many neighboring states. Missouri's per capita tax burden, at $3,508, is the 33rd highest, Oklahoma's, at $3,761 is 22nd highest, and, at $3,351, Arkansas' is only 37th highest. From business climate to the sales tax, Kansas' neighbors outshine the state with lower tax burdens.

III. Proposed Solutions

Now that we have a better understanding of some of the problems with Kansas' tax code, I will discuss reforms that would help Kansas ensure more revenue stability, while also promote economic growth. I propose that Kansas lower or eliminate some tax rates, impose caps on the growth in property taxes, and index income taxes to inflation.

a. Lower Tax Rates or Eliminate Certain Taxes

First and foremost, Kansas should consider lowering or eliminating some taxes. The fact is that low taxes encourage individuals and businesses to invest in the economy. When taxes are low, people are able to spend more, businesses hire more workers, and there is greater economic growth than there is under high tax rates.

In "Rich States, Poor States," a report by the American Legislative Exchange Council (ALEC), four of the ten states (Florida, South Dakota, Tennessee, and Wyoming) that saw the most growth in gross state product, income, and population between 1998 and 2008 levy no income taxes. In fact, these four states also experienced an 87 percent increase in gross state product and a 12 percent increase in population on average during this time frame. The other six states have some of the lowest tax burdens in the nation. Utah, for example, which leads the nation in economic competitiveness according to ALEC, ranks 35th in its state and local tax burden.

High state and local taxation is a growing concern within the business community, especially since capital is becoming increasingly more mobile. Businesses that do not wish to pay high taxes can now easily pack up and move to a lower tax jurisdiction. Consider AT&T. Founded in New Jersey in 1885, the nation's largest provider of telephone services has since relocated to Dallas, Texas. In explaining his rationale for doing so, Chairman and CEO Randall Stephenson said, "The reasons for a business like ours to be in Texas are really straightforward: low taxes and light regulation. It's all about growth; business moves fast in Texas." Stephenson also said that his company pays more in taxes than it does for payroll. Of course, with the movement of a business there's also a movement of the economic activity that provides the revenues for state treasuries. In an economy where is capital is increasingly mobile, a state cannot afford to fall behind in the competition for business investments.

Kansas is also one of fewer than a dozen states that allow for a local intangibles tax, a levy on gross earnings received from savings accounts, stocks, bonds, and mortgages. Although the intangibles tax represents a small percentage of the overall revenues collected, it increases compliance costs and creates a great deal of confusion for taxpayers within the state. For the sake of efficiency and clarity, Kansas should cast aside the intangibles tax.

b. Implement Property Tax Caps

Second, Kansas should consider limiting increases in property tax collections by capping their rate of growth. Total property taxes in Kansas rose 93 percent between 1997 and 2008, which is three times the rate of inflation and 11 times the growth in the state's population during that time period, according to the Kansas Policy Institute. Property taxes for owner occupied housing as a percentage of median home value in Kansas are now higher than those in Missouri, Oklahoma, and Colorado. What's more, property taxes have increased despite the economic downturn. Between 2007 and 2008, home values across the country fell almost 16 percent, according to a Tax Foundation analysis of the Case-Shiller housing price index. However at the same time, property tax revenues increased by more than 4 percent nationwide. Here in Kansas, property taxes increased by nearly 6 percent from 2007 to 2008.

Property tax caps have proven very effective at reducing property tax burdens, without depriving states of high quality services. In 1980, facing the nation's second highest property tax burden per capita, Massachusetts voters approved a measure that limited property tax increases to 2.5 percent annually. Since then, property taxes have increased by 68 percent nationwide, but in the Bay State they have grown by only 22 percent, according to Joshua Barro of the Manhattan Institute for Policy Research. Further, Massachusetts' schools have consistently scored near the top on the National Assessment of Education Progress examinations, which suggests that restraints on property tax growth do not harm to the quality of public education.

Other states have adopted or are on the verge of adopting similar mechanisms to control the growth of property taxes. New Jersey recently enacted a 2 percent statutory cap on property tax growth to combat its second highest in the nation property tax rates. This November, Indiana voters will decide whether to amend their constitution by voting to limit property tax increases to 1 percent annually on homes. Larry DeBoer, an economist at Perdue University, estimates that Indiana's property tax amendment will save hundreds of dollars on property tax bills for homeowners, especially for those with properties that have higher assessed valuations and who live in larger taxing districts, particularly cities and towns with a number of taxing entities in them. Simply put, property tax caps work for taxpayers and the state, and should be adopted.

c. Index Income Taxes to Inflation

Third, and finally, Kansas should consider indexing its income taxes to inflation. Neither Kansas' corporate nor the personal income tax brackets or exemptions are indexed for inflation. Without indexing, a taxpayer whose income keeps up with the cost of living experiences a phenomenon known as "bracket creep," whereby the taxpayer is bumped into the next highest bracket. Although largely eliminated at the federal level in the early 1980s, many states, including Kansas, have been slow to follow suit. Only 16 states have statutory provisions that eliminate bracket creep. Kansas should be the 17th state to do so.

IV. Conclusion

To summarize, tax reform, in the form of less taxation and limits to growth in taxation, can bring about budget stability and establish a solid platform for economic growth. I hope that the proposals I have outlined this afternoon can help us work together to ensure that Kansas has strong and vibrant economic future. I thank you again for the opportunity to present these views here today. I am happy to answer any questions you might have.

Testimony to the Special Committee on Assessment and Taxation
Rodney Steven II, President
Genesis Health Clubs
September 16, 2010

Mr. Chairman, members of the Committee: My name is Rodney Steven. I am President of Genesis Health Clubs of Wichita, Hutchinson, Emporia and Salina. I am here today to ask you to finally establish fairness in your tax treatment of Health Clubs. Last year Genesis paid or collected and paid millions of dollars in property and sales taxes to State and local governments. My largest competitor, the Wichita YMCA, did not pay any property taxes. They also did not collect any sales tax on it memberships. We brought this issue to the legislature in 2004. Since then the Wichita YMCA has not collected or paid approximately $19 million. Over $10 million is in the last three years and the annual amount grows each year. While this wouldn't solve all of governments' budget issues, it is real money that has not been paid.

If you think I am passionate about this issue you are correct. I have watched forty health clubs in Wichita alone close their doors since the YMCA began its expansion into upscale neighborhoods. So not only has State and Local governments missed out on $19 million it did not collect from the Wichita YMCA, those governments have missed out on millions more in taxes that would have been paid by those clubs. These businesses were paying taxes, collecting sales taxes, and trying to compete with the YMCA. Many of them failed because the YMCA had an extreme cost advantage over them because they pay no taxes.

I believe it is time for the Wichita YMCA to pay property taxes on its facilities in upscale areas. The YMCAs use police, fire, and EMS services many times a week. They get these services for free. With nearly $44 million in profit over the last five years, the YMCA can afford to contribute to pay for the services it uses. However, at the very least my members and the members of the YMCA should be treated equally when it comes to sales tax on memberships. There is no justification for the inequality.

The YMCA will come to you and claim they "earn their exemption". While I applaud the YMCA for some of its programs, the reality is that only about 10% of their revenues go to charitable subsidy. This is their numbers, straight from their tax returns, not mine. Since 1999 their revenues have soared from $11.2 to over $32 million or an increase of nearly $21 million. During that same period their charitable subsidy went up less than $1.4 million. It is pretty easy to understand why their revenues are up and charitable assistance is not. They are building their new clubs in high income areas. Areas that would be served by tax paying clubs if they did not have to directly compete with a YMCA that got a free ride from paying any taxes.

The Wichita YMCA no longer specializes in kids programs or underserved areas. You can see this because over 40% of Wichita YMCA memberships are corporate memberships. The YMCA is a business that gets most of its revenues from selling memberships and

Special Committee on Assessment and Taxation

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Attachment #26

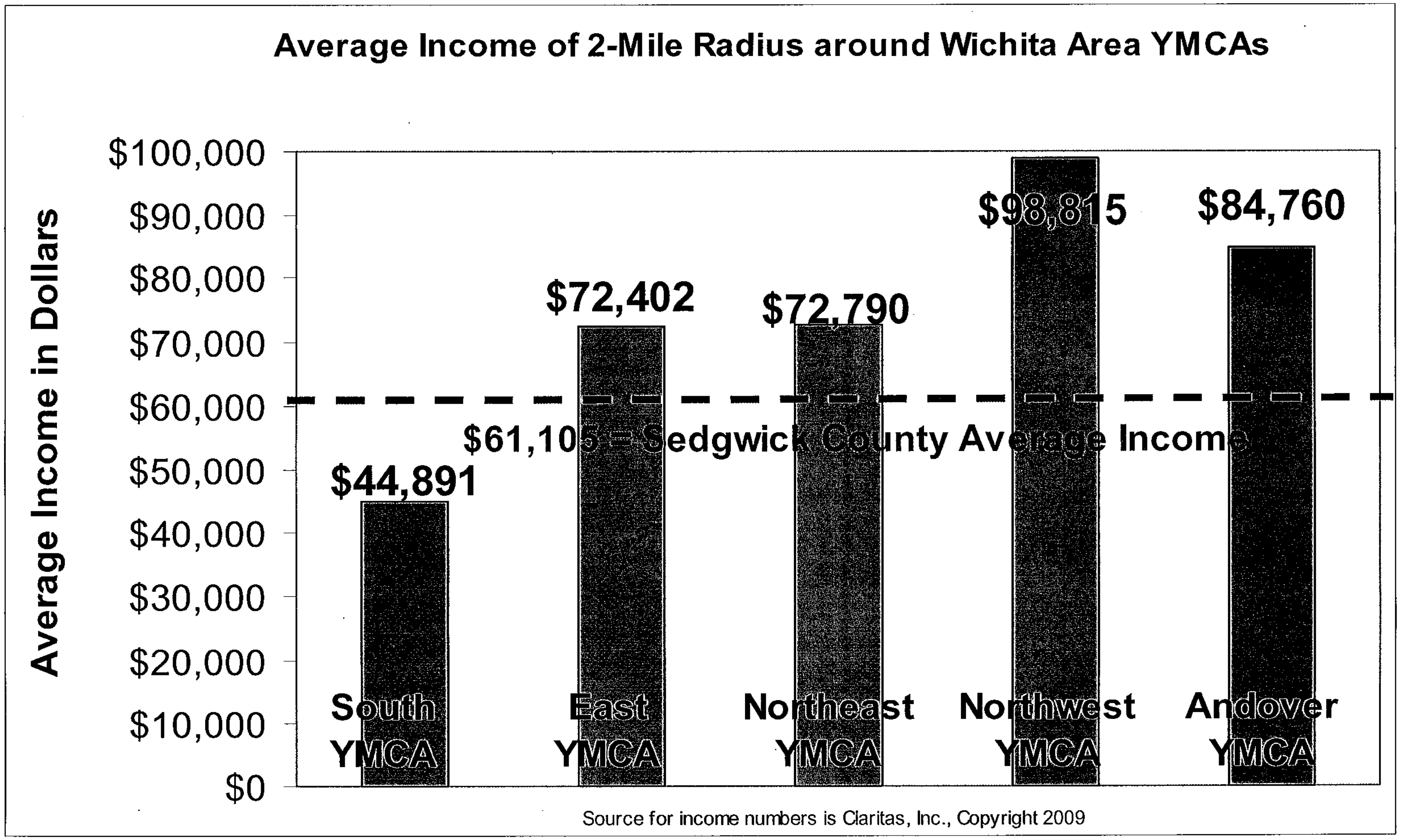
membership related services. This is no different than Genesis Health Clubs. The only difference is I will pay over a million dollars in property taxes and my members will pay almost a million dollars in sales taxes on their membership dues. This is not fair. It is not right. You have the power to correct this wrong. It should be corrected.

Finally, last year you raised the sales tax rate. This makes the inequity even greater. My members pay 7.3% more to belong to a health club than YMCA members. You raised my members' dues by 1% last year and YMCA members got a free pass. YMCA members drive on streets to get to the Y, use government services and attend schools. They are no more citizens than my members. Government should not treat its citizens differently.

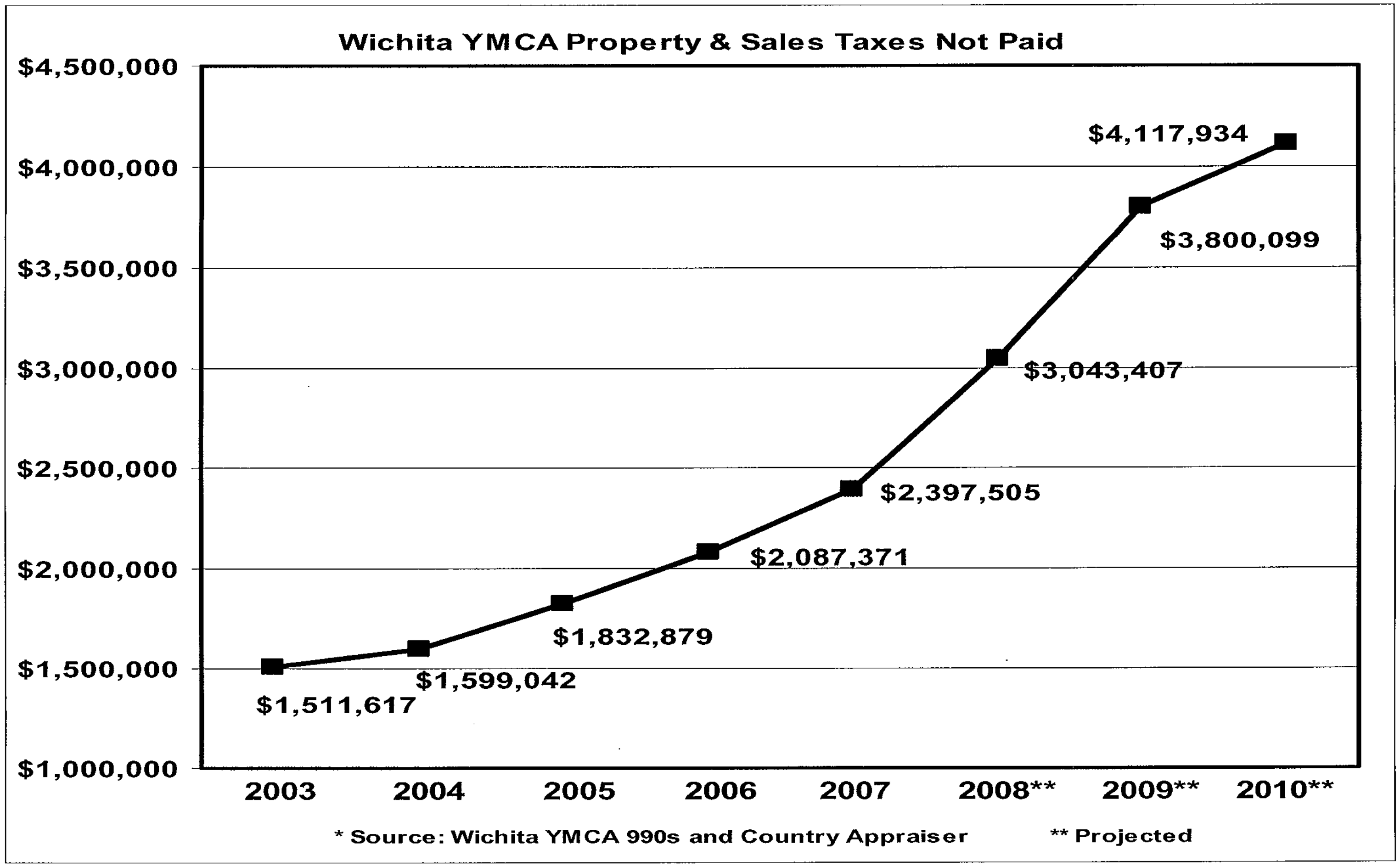
The Department of Revenue has made several recommendations to correct it. Several committees have seen it is wrong and have discussed it. I hope you will take action on this item and pass legislation in the next session that will give equitable tax treatment to like businesses.

I have attached some charts so you can see the numbers for yourself. Thank you for your consideration of these issues.

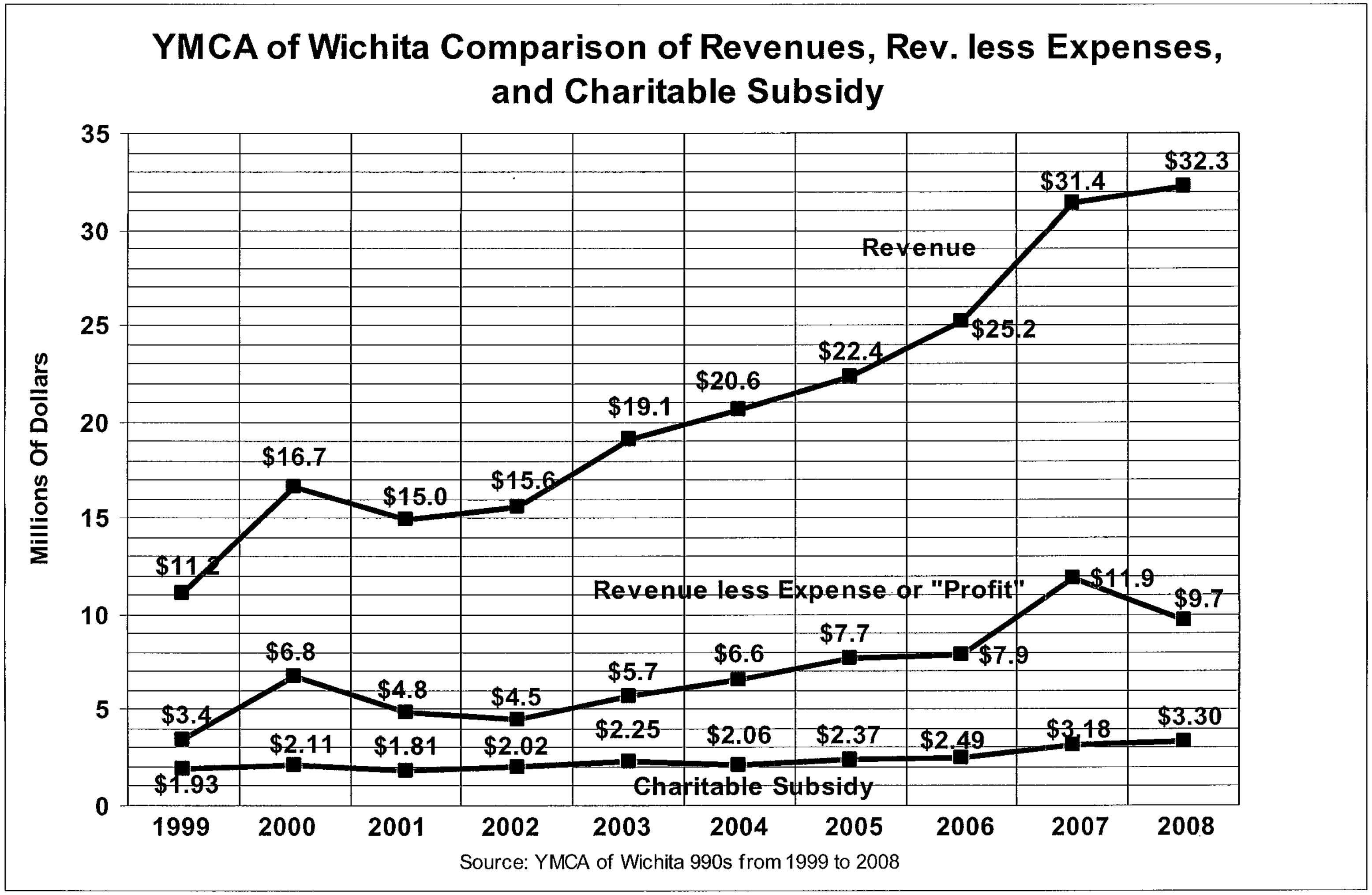
26-3


Average Income of 2-Mile Radius around Wichita Area YMCAs
Average Income in Dollars
$100,000
$90,000
$80,000
$70,000
$60,000
$50,000
$40,000
$30,000
$20,000
$10,000
$0
$44,891
$72,402
$72,790
$98,815
$84,760
$61,105 = Sedgwick County Average Income
South YMCA
East YMCA
Northeast YMCA
Northwest YMCA
Andover YMCA
Source for income numbers is Claritas, Inc., Copyright 2009

26-4


Wichita YMCA Property & Sales Taxes Not Paid
$4,500,000
$4,000,000
$3,500,000
$3,000,000
$2,500,000
$2,000,000
$1,500,000
$1,000,000
$4,117,934
$3,800,099
$3,043,407
$2,397,505
$2,087,371
$1,832,879
$1,599,042
$1,511,617
2003
2004
2005
2006
2007
2008**
2009**
2010**
* Source: Wichita YMCA 990s and Country Appraiser
** Projected

26-5



YMCA of Wichita Comparison of Revenues, Rev. less Expenses, and Charitable Subsidy
Millions Of Dollars
35
30
25
20
15
10
5
0
Revenue
$11.2
$16.7
$15.0
$15.6
$19.1
$20.6
$22.4
$25.2
$31.4
$32.3
Revenue less Expense or "Profit"
$3.4
$6.8
$4.8
$4.5
$5.7
$6.6
$7.7
$7.9
$11.9
$9.7
Charitable Subsidy
$1.93
$2.11
$1.81
$2.02
$2.25
$2.06
$2.37
$2.49
$3.18
$3.30
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
Source: YMCA of Wichita 990s from 1999 to 2008

Testimony to the Special Committee on Assessment and Taxation
Gregory Ferris
Kansas Health and Fitness Association
September 16, 2010

Mr. Chairman, members of the Committee: My name is Greg Ferris. The Kansas Health and Fitness Association has members throughout the State of Kansas. These are taxpaying clubs in cities from Kansas City to Garden City. These clubs feel it is unfair for the State to continue to collect sales tax on the membership dues paid by their members while you allow members of health clubs who do not pay property taxes a free pass. You recently raised the sales statewide. This just makes the inequity greater.

This exemption granted through KSA 79-3603 (n)(1) exempts non-profits from collecting this tax. The Legislature has wrestled with tax policies for non-profits for several years. I understand the complexities and difficulties that this entails. However, removing this one exemption from the Statutes would not be difficult. It would not affect non-profits or their delivery of services. It taxes members, not non-profits. Aside from the $2 million annually in additional revenue it would generate; it would provide equitable treatment for all Kansas users of fitness facilities.

Kansas is one of only fifteen states in the country that treat the members of non-profit health clubs and tax paying health clubs differently. The other thirty five states either charge both or charge neither. Those states include our neighbors of Colorado, Oklahoma, Nebraska and Arkansas. The exemption for one citizen over another because of where they spend their money simply makes no sense.

You require Goodwill to collect sales tax on the products it sells. Why is the YMCA allowed to sell its products, fitness memberships, in direct competition with tax paying businesses without collecting sales tax? Sales, unless directly tied to limited fund raising activities, should be taxable.

Your agenda asks for public input on encouraging additional capital investment in the private sector. The practice of allowing non-profit businesses to directly compete with tax paying businesses, without paying any taxes, discourages investment in the private sector. Once a YMCA, or another non-profit health club, builds in an emerging market, it drives existing and future businesses out of that market. I know of areas where businesses have closed as a direct result of the YMCA expansion into the market. I also know of millions of dollars that was not invested for the same reason. The result is simple, the tax base shrinks.

Please don't wait to fix the whole sales tax problem to fix this one. KSA 79-3603 (n)(1) should be removed from the Statues as soon as possible.

Thank you and I would be happy to answer any questions.

KANSAS ASSOCIATION OF SCHOOL BOARDS
1420 SW Arrowhead Road • Topeka, Kansas 66604-4024
785-273-3600

Testimony before the
Special Committee on Assessment and Taxation
On

Kansas Tax Structure

By
Mark Tallman, Assistant Executive Director/Advocacy

September 16, 2010

COMMITTEE CHARGE:
Kansas Tax Structure. Review the Kansas tax structure and ways it can be improved and simplified. Study the overall tax structure and policy of the state and local units of government by reviewing the relationship of the various taxes imposed to each other and to the economy. Review ways to identify a fair, simple and effective tax structure that operates in the best interests of all Kansas citizens. Also, study ways to decrease tax rates by broadening tax bases, as well as studying the potential effects of a fair and flat consumption tax and a flat and simplified income tax. Finally, review what current taxes could be eliminated if a new such tax were to be imposed.

Chairman's Charge:
Chairperson Carlson requests all interested parties prepare suggestions for simplifying and improving the state and local tax structure; and for encouraging additional capital investment in the private sector and economic development through significant income and/or property tax reform.

Mr. Chairman, Members of the Committee:

KASB would first like to express our appreciation to legislative leadership for establishing this committee. For several years, our Delegate Assembly has called for a comprehensive study of state and local tax policy, and supported legislation in the 2010 session to create such a study. Our goal is very similar to what is expressed in the charge to the committee: a fair, simple and effective tax structure that operates in the best interest of all Kansas citizens. We have repeatedly suggested Kansas should seek to lower tax rates by broadening tax bases – which is exactly the opposite direction of recent tax policies.

We respectfully offer the following recommendations and observations from the perspective of tax policy regarding public education.

Special Committee on Assessment and Taxation
September 16-17, 2010
Attachment #28

Recommendation 1 – The tax system must support the state's constitutional responsibility for public education

Education is one of the few specific constitutional duties required by the Kansas Constitution. Article 6 of the constitution is quite explicit:

> **"The legislature shall provide for intellectual, educational, vocational and scientific <u>improvement</u> by establishing and maintaining public schools,** educational institutions and related activities which may be organized and changed in such manner as may be provided by law."

Article 6 provides that local school boards – the members of our association – are responsible for "maintaining, developing and operating public schools." The constitution further specifies the ***Legislature*** has the duty to provide suitable financing for those schools. Because educational funding is a constitutional duty, the judicial system has, from time to time, been called upon to interpret what that duty entails, and there is an emerging definition of what constitutes "suitable finance." <u>The state tax system must be able to support that duty</u>.

A. Suitable finance for public education supports economic development

The duty to provide suitable educational finance need not be onerous to the taxpayer or economic development. CNBC's "America's Top States for Business Report" states it very well:

> "Education and business go hand in hand. Not only do companies want to draw from an educated pool of workers, they want to offer their employees a great place to raise a family. Higher education institutions offer companies a source to recruit new talent, as well as a partner in research and development."

Our public schools have carried out their share of responsibility for "improvement." Decade by decade, high school completion rates have increased. Kansas students have never been more prepared, even as Kansas schools are faced with far more challenging students. The percent of Kansans successfully completing college has also reached an all-time peak. This has been critical to raising income levels in our state, because the economic benefits of additional education is growing. In a knowledge-based economy, it is absolutely vital educational attainment continues to improve. There will always be cheaper places in the world to send low-skill jobs. Our hope must be to develop people with higher skills than are available elsewhere.

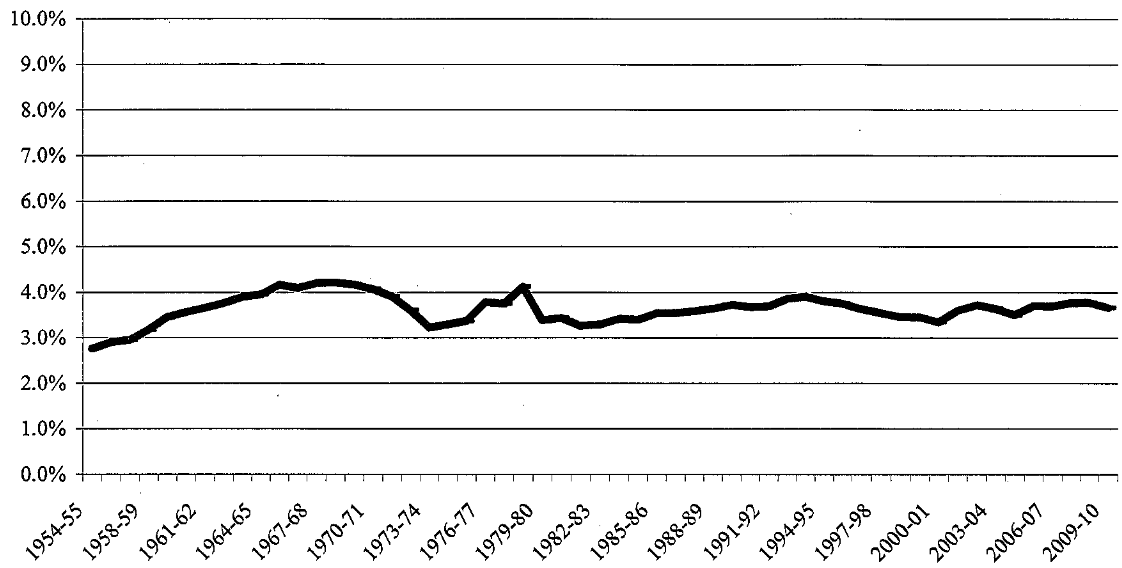
B. Educational costs increase with higher achievement

Kansas has a long tradition of striving to improve educational attainment by investing more resources. Over the past half century, districts added kindergarten, then all-day kindergarten, then preschool programs. We consolidated small schools and districts to offer more comprehensive – and expensive – programs. We mandated equal opportunities first for African-Americans (desegregation), then females (Title IX), then disabled children (special education) and moved the most seriously disabled from institutions to regular classrooms. We keep far more students enrolled through high school and prepare more for college. We raised standards for teachers and reduced class sizes. We added educational and instructional technology. We added special programs and services for at-risk children. Three things are quite clear: these efforts are necessary, they cost more money, and they work. Legislators need look no further than their own Post Audit studies and Kansas State Department of Education reports for evidence.

C. Increasing educational funding has not increased the overall tax burden

Despite all of these changes in education and all the additional funding they require, school district expenditures have not significantly changed *as a percentage of Kansas personal income* in 50 years. KASB has found records of school district general fund expenditures – essentially, the operating budgets – going back to the mid-1950s, which was nearly the last year these costs were less than 3.0 percent of personal income.

District General Fund Expenditures as Percent of Kansas Personal Income



As educational expectations rose in the 1960s, Kansas revised the educational article of its constitution, enacted school unification and passed a sales tax increase to fund a new school finance system. (For those who think consolidation saves money, please note school spending was at its *highest* relative levels during that period.)

Spending compared to income then dropped in the mid-70s, but rose following the passage of the School District Equalization Act, special education laws and mandatory teacher bargaining – only to fall again in the early 1980s. When the 1983 *Nation At Risk Report* warned of declining education performance, Kansas responded by gradually increasing school funding compared to Kansas incomes until it peaked in 1993-94 with another new school finance act. Yet even after the Legislature's response to the *Montoy* lawsuit, school district general funds are less than 4.0 percent of personal income, about at the historical average of the past half-century.

This does not include school district expenditures outside of the general fund and local option budgets: primarily capital outlay and debt service on school construction bonds. These costs aren't included for several reasons. First, we don't have the information going back that far. Second, these expenditures are primarily funded by local revenues, and are either subject to direct voter approval or protest petition. Third, there is nothing to suggest they have made a significant difference in the total Kansas tax burden, which has also changed very little over past decades.

Just as school spending as a percentage of Kansas personal income has changed very little over the past 50 years, total state and local taxes as a percentage of KPI has changed very little over the past ***80 years***. Let's be very clear: despite all the talk about the growing size of government and growing tax burden, the real tax burden as measured against total income, has consistently remained between 10.5 and 12.0 percent. The idea that Kansas government spending is taking a bigger share of income just isn't supported by the facts. Spending on K-12 education – a combination of state and local revenue – has increased at just about the same rate as overall state and local tax revenue, which has risen at just about the same rate as Kansas income. In fact, the evidence suggests that spending on education has been one of the most important contributors ***to*** the rise in income.

D. K-12 Education can likely be funded by maintaining an historic ratio to income

The demands on education will continue to increase, and so will the cost. The State Board of Education announced that more schools and districts failed to make Adequate Yearly Progress this year – not because performance declined, but because AYP standards increased ***faster***. History indicates that if Kansas maintains K-12 funding at around 4.0 percent compared to income, performance improves. To simplify the system, a "fair and flat" tax on ***all*** personal income of approximately 4.0 percent would have funded school district operating budgets without ***any*** sales or property tax. (Of course, this means all income should be taxed, not just "adjusted" income.) Most important, tax reform should not be used to lower this commitment to education.

Recommendation 2: Address reasons for concerns about tax policy and education funding

If the cost of education and other services isn't really taking a bigger bite of incomes, why are there so many complaints about the level of taxation? Is it really because the tax rates have been so oppressive for 80 years? Are that many people really longing for the good old tax rates of the early 1920s?

Some people will certainly feel taxes are too high no matter how low they are – after all, America was, in large measure, founded over a tax revolt that involved a tea party in Boston. But at least three major factors are also at work.

A. The rise in income has not been shared equally

Recent decades have seen a major shift in wealth to the highest income levels. Since 1970, average income for individuals with less than a bachelor's degree has actually declined compared to the cost of living, while those with higher education levels have increased. Although the percentage of Kansans with college and advanced degrees has increased every decade, it is still a minority of the population. Despite the *overall* rising tide, many Kansans are being left behind. If we allow educational attainment to decline, the situation will grow even worse. It also indicates the need to reduce the regressive nature of some taxes.

B. Tax policy has shifted the tax burden and led to higher rates

The vast expansion of tax abatements, exemptions, credits and now outright payments of tax money for economic development purposes has resulted in significant tax shifting. Because the cost of government has remained constant compared to overall income, every change in the tax code that has lowered someone's relative share of the cost of government has resulted in an increase for someone else. If someone's taxes have gone up relative to their income, someone else is paying less.

State and local tax as a percentage of personal income dropped from 11.1 percent in 2000 to 10.8 percent in 2009. But the percentage of tax revenue from sales taxes actually dropped from 28.6 percent in 2000 to 25.6 percent in 2009 – despite an increase in the state rate and likely increases in local rates as well. Income tax revenues dropped from 27.0 to 25.5 percent. But property tax revenues rose from 28.0 to 33.6 percent – not because ***overall*** taxes grew more than income, but because sales and income taxes declined ***compared*** to income.

C. Efforts to reduce property tax reliance have been undercut

The shift to the property tax since 2000 reverses one of the most significant long-term trends in state and local tax policy. In 1930, over 80 percent of Kansas government revenues came from property taxes and authority for sales and income taxes were just beginning. In 1970, property taxes were still over 50 percent of local revenues, but dropped to about 30 percent in 2000 – the last year Kansas had an almost equal balance of sales, income and property tax revenue. A major reason for the drop in property taxes was the state assumption of funding previously provided by local governments. This is certainly true of K-12 education. Prior to the School District Finance and Quality Performance Act of 1992, a majority of school general fund revenues and all capital outlay and debt service came from local property taxes. Now, about two-thirds of school funding comes from the state.

Although overall reliance on the property tax has been reduced, Kansas Department of Revenue studies have shown major shifts within this category. Most notable, there has been a shift toward real estate taxes and in particular, residential real estate. Therefore, home owners have had less benefit from these reductions.

In addition, the Legislature choose to reduce the statewide mill levy for school districts from 35 mills, as approved in the 1992 Act, to the current 20 mills as part of a number of tax reductions in the late 1990s. The reduction of state revenue meant that base aid support of school districts fell far behind district costs, requiring districts to turn to Local Option Budgets. The increase in the LOB has more than offset the reduction in the statewide levy in many districts, and has meant that residents in lower-property-wealth districts now face a higher tax rate than those in wealthier districts. These policies have also led to an increase in special weightings and taxing authorities that have vastly complicated both school finance and state tax policy.

The more the Legislature allows school finance to shift back to local revenue sources to meet state educational requirements, which are vastly unequal across Kansas communities, the harder it will be to provide constitutionally suitable funding to meet the state's education outcomes for all students, regardless of where they live. More unequal local funding will lead to more school finance litigation.

Recommendation 3: Simplify the tax system by improving the school finance system

Providing a stable revenue source for education does not solve the problem of how to distribute funding authority among districts. There is another special legislative committee studying school finance issues, and KASB has appointed its own special committee to develop recommendations in this area. But several issues are obvious. When basic state support for school districts doesn't keep up with education costs and state requirements, school districts must seek local revenues, special weightings or other aid programs from the state, or both. That is why local option budgets have increased, new weightings have been added, and some districts push for additional local taxing authority, which adds to the complexity of the tax system, as well.

There are two steps to simplify the school finance system. First, provide a mechanism for adequate base funding for a "suitable" education. This could decrease reliance on the property tax, which most Kansans probably favor – but only if legislators are willing to increase offsetting state taxes. Essentially, this means funding more of school district budgets through a higher state base, rather than local option budgets and weightings.

Second, maintain an improved local option budget system to allow school districts that wish to spend more to enhance their budgets with local revenues to do so, with a mechanism to assist lower wealth districts in raising comparable revenues with a comparable tax effort. Providing more local funding authority, which some of our members strongly favor, requires a system to equalize revenues raised at the local level. If not, there will be significant disparity in educational opportunity and constitutional challenges based on equity will rise.

Recommendation 4: Consider broadening the tax base and lowering rates

We agree there is a legitimate reason for every exemption the Legislature has passed. But taxpayers need to consider not the increase in taxes they face for losing their particular favorite exemption, but also the *savings* they will realize from lower rates on everything else.

There is also the issue of tax fairness. Everyone benefits from the educational system, which increases the productively of the economy and allows democracy to function. Everyone benefits from public safety: police, fire and corrections. Everyone benefits from a public infrastructure. Everyone benefits from a social safety net. Therefore, fairness argues everyone should contribute to the cost of government services in the same proportionate manner. Surely that was the reason our state's founders provided for uniform and equal taxation in the Kansas Constitution, so special interests couldn't seek benefits in the tax code for their special advantage.

Recommendation 5: Economic development policies must balance tax rates with services

Our members understand the importance of economic development. They know Kansas is in competition with other locations that may offer tax advantages. But they also know tax policies are only one of many factors used in making business decisions. Kansas is usually in the middle of the states in terms of tax burden, but frequently rates in the top 10 or 15 for business development. Many of the other factors involved require public expenditures that rely on taxes. KASB appreciates those business organizations that supported a tax increase last session in order to protect important public investments in education and infrastructure. Isn't it possible that a system of broad-based taxes, lower, predictable and consistent rates and stable funding for education and government services could be as attractive to business as targeted tax breaks?

Conclusion

Thank you for the opportunity to share these views with the committee. KASB will be sharing with our members the additional information you receive during this hearing and your recommendations. We look forward to working with you to improve our state's tax system for the benefit of all Kansans. As education increases in importance, we believe this generation should invest as much of our income for our children and grandchildren as our parents and grandparents were willing to invest in us.

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300 SW 8TH AVENUE, STE. 100
TOPEKA, KS 66603-3951
P: (785) 354-9565
F: (785) 354-4186
WWW.LKM.ORG

To: Special Committee on Assessment and Taxation

From: Don Moler, Executive Director

Re: State and Local Tax Policy

Date: September 16, 2010

First, I would like to thank the committee for allowing the League to testify today concerning the issue of local tax policy and tax base erosion. Historically there has been a three-legged stool upon which local government in Kansas has been financed. The first of the three legs were the Demand Transfers, the second were local property taxes, with the third being the local sales tax. With the removal of the Demand Transfers several years ago, local government in Kansas is relying almost exclusively on the local property tax and the local sales tax to maintain city services. The League, over a period of years, has continued to ask the Legislature how we are going to fund local government in the 21st Century in Kansas, when we see an ever greater strain on local budgets, coupled with the increasing pressure on the two central funding sources for local government; those being the property tax and the sales tax.

We see, on a yearly basis, further exemptions and limitations on the ability of the sales tax to be collected in Kansas. This has the net effect of further limiting the amount of funds available for both state and local sales taxes. This is coupled with an ongoing attempt to limit the ability of local governments to levy property taxes. The most recent example of this would be the removal of the property tax on new equipment and machinery. When you look at both of these taxes, it becomes clear that we will be facing a crisis at the local level in the very near future. The question, which unfortunately does not have a simple answer, is what the State of Kansas, and local governments, are going to do about this situation. For the purpose of illustrating the impact of state policy on local government when considering Demand Transfers and the Machinery and Equipment property tax exemption, please see the attached article from the January 2010 edition of the *Kansas Government Journal.*

The League, on behalf of our member cities, has over the past few years repeatedly asked the Kansas Legislature for increased taxation authority. We have asked for this increased authority because we realize that we cannot forever depend on the property tax, and the local sales tax, to adequately support local governmental services which our local citizens need and demand. We have asked, and continue to ask the Kansas Legislature for the ability to impose local income taxes, local earnings taxes, local motor fuel taxes, and local excise taxes, among others. The

League would renew these requests again today, and we would suggest that the current state tax policy is taking us down the road to inevitable problems in the not too distant future.

We would suggest that the answer lies in several areas, with one being allowing local governments to levy taxes appropriate to the needs and level of services required within their communities. We further suggest that the ability for various governmental entities to combine, either functionally or actually, for the purposes of streamlining local government, should be made easy and not prohibited by the State. The more impediments that are put in place which limit the ability of local governments to merge simply exacerbate the problem and continue to strain the ability of local governments to provide the services necessary for our public. Finally, as provided in the recent legislation concerning gaming, the state should allocate gaming monies toward "property tax reduction" in the form of LAVTR monies as was promised in the original legislation. (See K.S.A. Supp. 74-8768) We do not believe there is a magical solution to this problem, but we do believe that by working together, State and local units of government in Kansas can find a solution to this difficult problem. Thank you very much for allowing me to testify today concerning state and local tax policy and the erosion of the sales and property tax bases.

SCCHF (Special City-County Highway Fund)

Established under K.S.A. 79-3425(I), this portion of the Special City-County Highway Fund is funded by the motor vehicle property tax. The other portion of SCCHF is funded by the motor fuels tax and transfers from that portion of the fund have not been reduced to date.

Table 3. Reductions in SCCHF

Year	Statutory	Distribution	Loss
1991	$9,972,000	9,052,000	$920,000
1992	$9,846,000	9,768,000	$78,000
1993	$10,389,000	9,631,000	$758,000
1994	$11,722,000	9,743,000	$1,979,000
1995	$14,008,000	10,036,000	$3,972,000
1996	$15,683,000	10,407,000	$5,276,000
1997	$15,998,000	10,553,000	$5,445,000
1998	$15,683,332	10,737,000	$4,946,332
1999	$16,124,589	10,995,000	$5,129,589
2000	$17,920,464	11,182,000	$6,738,464
2001	$18,068,010	10,343,000	$7,725,010
2002	$15,729,000	10,447,000	$5,282,000
2003	$19,498,652	10,063,000	$9,435,652
2004	$20,454,000	5,032,000	$15,422,000
2005	$22,056,000	10,064,000	$11,992,000
2006	$25,811,513	10,064,000	$15,747,513
2007	$29,031,000	10,064,000	$18,967,000
2008	$29,685,531	10,064,000	$19,621,531
2009*	$22,000,000	0	$22,000,000
2010*	$22,000,000	0	$22,000,000
	$361,680,091	178,245,000	$154,931,170
*estimated			

M&E Impact (Machinery and Equipment)

In 2006, the Kansas Legislature exempted new machinery and equipment from property taxation (Kansas Session Laws, Chapter 205, 2006). Because it was understood at the time that this would have a devastating impact on local budgets, certain mitigation was included as part of the final bill. Such mitigation included "slider" payments to offset losses as well as a partial reinstatement of LAVTRF funds. While some slider monies were received in 2007 and 2008, the mitigation for this tax policy has dried up.

As a result of the loss of property taxes on new machinery and equipment, cities and counties have lost significant revenues both as a result of the loss on the tax itself and the loss of the promised mitigation (slider payments).

Table 4. Loss resulting from M&E Policy

Year	Difference Between Current Year & 2005 M&E	Expected Slider	Slider Mitigation Received	Total Impact of M&E loss and loss of slider
2007	$28,733,733	$25,860,360	$25,860,360	$2,873,373
2008	$76,422,937	$53,496,056	$25,009,406	$51,413,531
2009	$90,526,000	$45,263,000	$0	$90,526,000
2010	$106,610,000	$31,983,000	$0	$106,610,000
				$251,422,904

Table 5. Total of All Losses Since 1991

LAVTR	$538,183,354
CCRS	$459,094,540
SCCHF	$154,931,170
M&E Impact	$251,422,904
Total	**$1,403,631,968**

Kimberly Winn is the Director of Policy Development & Communications for the League of Kansas Municipalities. She can be reached at kwinn@lkm.org or (785) 354-9565.

29-4

A History of Demand Transfers

by Kimberly Winn

Budget and tax decisions made by the Kansas Legislature have a serious impact on local governments. This article recounts the history of several key revenue sources and the impact of losses in the last 20 years. These losses have forced cuts in local budgets, cuts in services to citizens, and property tax increases in some cases.

Since 1991, cities and counties in Kansas have lost a total of $1,403,631,968 as a result of state budget decisions and tax policies. It is very important to note that while some of these monies are often referred to as "state aid" in budget documents, the history of these funds does not support that classification. The LAVTRF and the CCRS funds (explained below) were a part of an agreement between the State and local governments that involved the loss of local revenue sources in exchange for the establishment of these funds.

LAVTRF (Local Ad Valorem Property Tax Reduction)

Established under K.S.A. 79-2959, LAVTRF is currently supposed to transfer 3.63% of state sales and use taxes to cities and counties. Revenue sharing in this manner dates back to the 1930s with the current statutory framework being established in 1965. At that time, the local share of certain cigarette revenue stamp taxes and cereal malt beverage taxes were rolled into the state general fund and a direct transfer was made into the LAVTRF to replace the loss of these funds (Kansas Session Laws, Chapter 530, 1965).

Table 1. Reductions in LAVTRF

Fiscal Year	Statute	Actual	Actual
1991	$37,164,000	$37,164,000	$0
1992	$38,966,000	$38,576,000	$390,000
1993	$40,540,000	$39,324,000	$1,216,000
1994	$41,971,000	$40,293,000	$1,678,000
1995	$44,649,000	$44,649,000	$0
1996	$47,054,000	$46,301,000	$753,000
1997	$48,661,000	$46,949,000	$1,712,000
1998	$50,688,000	$47,771,000	$2,917,000
1999	$55,122,000	$55,122,000	$0
2000	$57,903,000	$57,903,000	$0
2001	$60,315,000	$54,139,000	$6,176,000
2002	$61,980,000	$54,680,000	$7,300,000
2003	$62,431,000	$26,247,000	$36,184,000
2004	$64,636,000	$0	$64,636,000
2005	$66,521,000	$0	$66,521,000
2006	$66,682,000	$0	$66,682,000
2007	$71,233,000	$0	$71,233,000
2008	$71,063,598	$0	$71,063,598
2009	$69,860,878	$0	$69,860,878
2010*	$69,860,878	$0	$69,860,878
			$538,183,354
* estimated			

CCRS (County City Revenue Sharing)

Established under K.S.A. 79-2964, CCRS is supposed to transfer 2.823% of state sales and use taxes to cities and counties. CCRS was established in 1978 as part of an agreement between the State and local governments regarding a number of different taxes. In particular, the local share of cigarette and liquor enforcement tax revenues was traded for the establishment of the CCRS (Kansas Session Laws, Chapter 401, 1978).

Table 2. Reductions in CCRS

Fiscal Year	Statutory	Actual Distribution	Loss
1991	$28,351,000	$28,351,000	$0
1992	$29,461,000	$29,166,000	$295,000
1993	$31,153,000	$30,218,000	$935,000
1994	$31,905,000	$30,629,000	$1,276,000
1995	$33,375,000	$33,375,000	$0
1996	$36,070,000	$34,610,000	$1,460,000
1997	$37,117,000	$35,095,000	$2,022,000
1998	$38,570,000	$35,709,000	$2,861,000
1999	$41,376,000	$36,566,000	$4,810,000
2000	$44,359,000	$36,932,000	$7,427,000
2001	$46,004,000	$34,531,000	$11,473,000
2002	$46,901,000	$34,876,000	$12,025,000
2003	$47,868,000	$16,741,000	$31,127,000
2004	$51,564,063	$0	$51,564,063
2005	$53,422,952	$0	$53,422,952
2006	$56,609,567	$0	$56,609,567
2007	$57,920,881	$0	$57,920,881
2008	$55,206,431	$0	$55,206,431
2009	$54,329,823	$0	$54,329,823
2010*	$54,329,823	$0	$54,329,823
		$416,799,000	**$459,094,540**
*estimated			

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Supporting Regional Economic Development through Analysis and Education

Expensing: A Competitive Leap for Kansas Tax Policy

By Arthur P. Hall, Executive Director, Center for Applied Economics.

Kansas is on a roll when it comes to good tax policy. One simple, inexpensive step can sustain the momentum and produce a competitive leap in terms of bang for the buck: Permit all businesses to take an immediate income tax write-off for new investments made in Kansas. This step—called "expensing"—would complement the recent competitive reforms related to property and franchise taxation—and further distinguish Kansas as a go-to destination for capital investment, a key driver of high-wage jobs. As a bonus, expensing would make taxes fairer, because it results in equal tax treatment among businesses of all types and sizes.

The existence of an income tax makes the Kansas government a *de facto* silent partner in every Kansas business. In light of this partnership, the appropriate tax policy question is this: Does the government want to act like a partner that invests in the business or a partner that draws cash out of the business whenever possible?

Kansas income tax law, because it operates as an extension of U.S. income tax law, makes the Kansas government act like a cash-hungry partner rather than an investment-driven partner. Expensing would reverse the situation and turn the government into an investment-driven partner—for the economic benefit of all Kansans.

Economic Fundamentals

Well-constructed tax policy does not interfere with taxpayers' decision-making calculations. Economists refer to this outcome as "tax neutrality." It represents a challenging goal for policymakers to attain. Most tax instruments influence economic decision-making.

Fortunately, policymakers can attain the goal of tax neutrality with regard to the income tax treatment of saving and investment. Unfortunately, most income tax systems in the U.S. do not attain this worthy goal. Instead, they create an inherent tax bias against saving and investment. No one intended this destructive outcome. It is a historical artifact that has endured from the economically misinformed structure of the first income tax laws.[1]

In the modern-day economy, saving and investment represent the same thing from different perspectives. Virtually all saving becomes an investment somewhere in the world. Few people—in developed economies, at least—store cash under their mattress. Saved funds tend to flow to where they earn the highest (risk-adjusted) rate of return.

From a business perspective, the income tax bias against investment is embedded in the (frequently arcane) rules associated with capital cost recovery—that is, the rules associated with the depreciation of capital investments. Expensing is a little used depreciation procedure (sometime called cash-flow depreciation) that removes the tax bias—and greatly simplifies income tax administration for both the taxpayer and the tax authorities.

The Bias of Double Taxation

The income tax bias against saving and investment results from an inherent double counting—and, therefore, double taxation—that results from an economically flawed definition of taxable income. To grasp the mechanics of this double counting, focus on the equal sign in the present value formula shown in *Exhibit 1*. This formula is a foundational

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element of finance. It indicates that the economic value of an investment can be represented in one of two equivalent ways—as a point-in-time value (*PV*) or as a flow-through-time value (*CFs*). The formula is embedded in financial calculators for analyzing investments, pricing financial products, or calculating loan payments.

Exhibit 1: The Present Value Formula

The Foundation of Investment Analysis

$$PV = \frac{CF_1}{(1+r)^1} + \frac{CF_2}{(1+r)^2} + \frac{CF_3}{(1+r)^3} + \frac{CF_4}{(1+r)^4} + \frac{CF_5}{(1+r)^5}$$

- The formula above depicts a 5-year investment. A 30-year investment would have 30 elements on the right-hand side of the formula.
- *PV* stands for "present value." It represents the market value (or perhaps purchase price) of an investment, regardless of whether the investment is a machine, a building, a stock, or a bond.
- *CF* stands for "cash flow." It represents the cash flow that an investment generates, like profits, dividends, interest, rent payments, or capital gains. Normally, investments are valued using free cash flow, the cash flow available to the investment owner after all investment-related costs have been paid, including taxes.
- *r* stands for the "discount rate," which is often the interest rate or the expected rate of return on an alternative investment. The quantity (1+*r*) is raised to a power that represents time. A fundamental tenet of finance is that a dollar received immediately is more valuable than a dollar received in the future. Thus, future cash flows are "discounted."
- Two basic types of investment analysis flow from the above equation: First, **net present value** equals *PV* (with an assigned value for *r*) minus the cost of an investment; if the result is positive, the investment will be evaluated positively. Second, **internal rate of return** equals the value of *r* that equates the estimated values of *CF* with the known (or estimated) cost of an investment. Investors typically want to make investments with the highest internal rate of return.

The mathematical equality represented by the present value formula means that double counting occurs when money represented on both sides of the equal sign counts as taxable income. The same economic value is taxed twice: double taxation. Taxing money represented by the left-hand side of the formula (the money paid for an investment) effectively means that the tax authority is pre-taxing money represented by the right-hand side of the equation (the money generated by the investment). Alternatively, taxing the money represented on right-hand side of the equation is effectively a deferral of taxation on the money represented by the left-hand side.

An example related to retirement saving will help make the double tax problem clearer, because U.S. income tax law has eliminated the problem for personal retirement investments, when channeled through approved procedures. In the United States, people typically save for retirement using individual retirement accounts (IRAs) and employer-sponsored retirement plans, like 401(k)s. Generally, people have a choice between two types of IRAs—traditional IRAs or Roth IRAs (named after the late U.S. Senator, William V. Roth). Both types of IRAs solve the double tax problem but in different ways (401(k)s solve the problem the way traditional IRAs do).

Suppose someone wanted to save for retirement by investing in a bond (or a mutual fund that offered the bond). Using the 5-year present value formula in *Exhibit 1*, if the interest rate is eight percent (8%) and the bond promised to pay $1,000 at the end of each year, one bond would cost almost $4,000. The money to make the investment came from salary or small business earnings, which is subject to income tax. A traditional IRA allows the saver to immediately write-off the $4,000, eliminating tax on the left-hand side of the present value formula; the $1,000 interest payments on the right-hand side will be taxed later. A Roth IRA does not allow for an immediate write-off, so it taxes the $4,000 on the left-hand side of the present value formula; but the $1,000 interest payment will never be subject to income tax. A person that buys the bond without using approved retirement saving procedures must pay income tax on the $4,000 and the $1,000 payments—a double tax on money used for saving.

Expensing operates just like a traditional IRA—for businesses. Expensing eliminates the double taxation of business investment by allowing for an immediate income tax

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write-off of the money used for investment.[2] A business investment and the bond investment example described above have the same finance fundamentals. Of course, there are practical differences. The pay-off provisions of a bond are set by contract. The pay-off provisions of a business investment are risky and uncertain; businesspeople must estimate them based on experience and expectations.

Expensing Removes Tax Bias: A Simple Example

The force of habit creates perhaps the biggest obstacle to acknowledging the bias of double taxation. The common way people think about the idea of income—encoded into the income tax laws a century ago—forces them to see IRAs and expensing as a grant of privilege rather than a liberation from penalty.

A different type of example further reveals the penalty-removal perspective of expensing. *Table 1* illustrates the cash flow of a hypothetical $100,000 investment using two different income tax rules for capital cost recovery—straight-line depreciation and expensing. The example assumes that the investment will generate $30,000 of free cash flow (pre-tax income) per year for five years. The income tax rate is seven percent (7%). *Table 1* also reports the rate of return on the investment—the internal rate of return, calculated using the present value formula in *Exhibit 1*—based on the different rules.

Table 1
The Tax Implications of Depreciation versus Expensing

		Straight-Line Depreciation		Expensing	
	No Tax	Tax Owed	After Tax	Tax Owed	After Tax
Investment	-100,000	0	-100,000	-7,000	-93,000
CF 1	30,000	700	29,300	2,100	27,900
CF 2	30,000	700	29,300	2,100	27,900
CF 3	30,000	700	29,300	2,100	27,900
CF 4	30,000	700	29,300	2,100	27,900
CF 5	30,000	700	29,300	2,100	27,900
Rate of Return	15.24%		14.24%		15.24%

Note the different rates of return reported in *Table 1*. This result captures the essence of the tax bias that results from current income tax rules. The straight-line depreciation rule results in a rate of return one percentage point lower than the no-tax and expensing scenarios. This differential measures the penalty (double tax) on investment. The expensing rule generates a rate of return equal to the no-tax scenario; it generates income tax revenue for the government but attains tax neutrality. (An investment tax credit equal to seven percent (7%) has economic properties identical to the expensing scenario.)

The expensing rule—full tax write-off of the investment in the year in which the business makes it—attains tax neutrality because it does not tax the quantity on the left-hand side of the equal sign defining the present value formula. The straight-line depreciation rule (or any other depreciation rule that has guided U.S. income tax policy) permits taxation on both sides of the present value formula.

Expensing expresses a policy consistent with a government that wants to behave as an investment-driven silent partner. Depreciation expresses a policy consistent with a government that wants to behave as a cash-hungry silent partner. (Note that the government's tax stream under the expensing scenario generates a 15.24 percent rate of return, a rate identical to the taxpayer's, indicating a genuine partnership.)

Table 1 illustrates this viewpoint in the "Investment" line. The economic value of any income tax write-off is the write-off amount times the tax rate ($100,000 x 7% = $7,000)—the government's participation in the investment. By not taxing the investment amount—that is, by effectively reducing the after-tax cost of the investment in a manner consistent with the taxation of future income—the expensing rule preserves the no-tax pattern of costs and benefits. The depreciation rule, even though it results in a lower annual tax liability, only crudely approximates the pattern of costs and benefits.

As a practical matter, the economic elegance of the expensing rule holds only if the taxpayer can realize the full benefit of the write-off in the investment year. Under standard administrative procedures related to deductions, this outcome will not prevail if the taxpayer has an insufficient level of taxable income in the investment year. However, in a real-world scenario of uncertain cash flows and graduated tax rates, providing for an unlimited carry-forward of unused deduction amounts offers a sound administrative solution.

A Note on "Tax Expenditures"

Stanley S. Surrey, a U.S. Treasury official, coined the term "tax expenditure" in the 1960s. He wanted to draw attention to the many elements of the U.S. tax code that simulated spending programs by reducing tax liabilities in exchange for engaging in specified economic activities. The Kansas Department of Revenue produces an annual report on Kansas tax expenditures.

The concept of tax expenditure is useful, but it can be misapplied. Many tax expenditure items in the income tax code manifest themselves as items that pervert the tax base from what people believe to be the proper definition of a comprehensive income tax base. The problem comes when people define as a tax expenditure (special tax preference) policy steps that correct the economically flawed concept of income built into the traditional definition of a comprehensive income tax base. For example, many tax analysts view the deductions allowed for contributions to individual retirement accounts as tax expenditures; but they actually represent the correct income tax treatment of saving. Likewise, many analysts will put the label of tax expenditure on expensing, because it deviates from the historical practices of capital cost recovery (see Appendix); but expensing (or economically equivalent tax credits) represent the correct income tax treatment of capital investment.

Here is an example relevant to Kansas. Kansas law grants a 10 percent investment tax credit to qualifying business taxpayers. The Kansas Department of Revenue identifies this credit as a tax expenditure. However, this identification is only partially correct.

Removal of a penalty should not count as a privilege. The expensing procedure eliminates a penalty—the inherent double tax on capital investment. The top corporate tax rate in Kansas is 7.35 percent (the top partnership and S-Corporation rate is 6.45 percent). The value of a deduction is equal to the tax rate times the deduction, so expensing is economically equivalent to a tax credit rate equal to a taxpayer's marginal tax rate. Accordingly, the tax expenditure component of the Kansas investment tax credit equals 2.65 percent of the investment for corporations (3.55 percent for partnerships and S-Corporations) not the full 10 percent.

Appendix: A Brief History of Tax-Related Depreciation Accounting[3]

People have understood the income tax bias against saving and investment for a long time. They have also understood how certain capital cost recovery procedures (depreciation rules) can either exacerbate or mitigate the bias. That the problem has endured for decades in light of this understanding offers a case study in how difficult it is to change complex administrative systems once they begin.

The tax-bias problem started largely as a result of historical accident, inexperience-based ignorance, and intellectual fashion at the time lawmakers codified the U.S. income tax. Kansas inherited the problem when it adopted the income tax in 1933. The federal system had functioned for about 20 years by then. Like most states, Kansas piggybacked (and continues to piggyback) on federal law.

Depreciation accounting, as a business practice, was not widespread before the implementation of the income tax. The advent of the income tax, which embraced the practice, helped codify it and accelerate its acceptance. This history helps explain why business people largely accepted the procedures promulgated by the Bureau of Internal Revenue (now the Internal Revenue Service) without giving much thought to the economic consequences of their actions. The income tax had operated for several decades before savvy business managers began to keep at least two sets of books—one for the tax authorities and one for business decision-making.[4]

Depreciation accounting generated a lot of controversy among accountants during the latter half of the 19th century. The theory and practice began developing in the 1830s with the advent of capital-intensive industry—particularly railroads and public utilities. In general, the controversy pitted those practitioners committed to the age-old practice of realization (booking income or expenditures when validated by an actual transaction) against those that wanted to reckoned depreciation (wear and tear) as a bookkeeping operation. From the viewpoint of income tax administration, the tax bias against business investment might have not materialized if the realization side had prevailed.

The controversy over depreciation accounting generated a few lawsuits that made it to the Supreme Court. The Court decisions generally reflected the state of professional opinion at the time the cases were heard. The Court rejected the concept of depreciation accounting in cases heard in 1876 and 1878; opined that the concept deserved consideration in a case heard in 1899; and acknowledged the concept in a case heard in 1909. Somewhat coincidently, in the same year, the concept became codified into U.S. tax law with the Corporation Tax Act of 1909—the same year that Congress submitted to the states for ratification the 16th Amendment to the Constitution (which authorized an income tax).

Depreciation accounting became a feature of the Tariff Act of 1913—essentially, the beginning of the income tax in the United States. The Revenue Act of 1918 specifically stipulated, for the first time, that certain compliance procedures—depreciation accounting among them—must harmonize with generally accepted accounting procedures.

The authors of a 1989 U.S. Treasury study titled "A History of Federal Tax Depreciation Policy" nicely set up the relevance of accounting protocols for the economics of investment:

> Depreciation controversies have most often centered on the suitability of depreciable lives [of tangible assets] and methods used by taxpayers. . . . Originally, taxpayers were given considerable discretion in the choice of depreciable lives, asset salvage values, and depreciation accounting methods. However, this policy ultimately placed a costly burden on the Bureau of Internal Revenue and taxpayers to verify the "reasonableness" of the deductions taken. Over time, administrative and statutory changes lessened this burden by creating more uniform depreciation rules. Today, most property is depreciated using a small number of recovery periods established by statute; salvage value is no longer a factor in the determination of depreciation deductions for most property; and the method of allocating deductions over recovery periods is prescribed by statute. Consequently, taxpayer discretion with respect to tax depreciation has been virtually eliminated.[5]

The creation of pre-defined rules and timetables may have reduced compliance costs, but they created economic distortions. It undermined the fundamental precepts of depreciation accounting, which sought to accurately match the time flow of wear and tear with income generation. The arbitrary timetables altered the economic analysis of cash flows. Expensing (sometimes referred to as cash-flow depreciation) represented a viable alternative that promised even greater administrative simplification without the economic distortions.

The federal government's demand for tax revenue perhaps best explains the motive responsible for codifying pre-defined timetables—and promulgating the notion that expensing (or other accelerated depreciation methods) represented a tax preference rather than economically superior tax policy. Making depreciation timetables longer, under the rationale of better matching the "useful lives" of capital investments—created a larger business income tax base in the short run. The bias toward long depreciable lives became further entrenched when adherence to the pre-defined timetables became a regular feature of income tax audits. The burden of proof shifted to the taxpayer to demonstrate why a particular capital asset did not fit into the prescribed timetable. Disparities in administration—given auditor discretion—exacerbated the tax-bias problems.

By the mid-1950s, a growing number of tax scholars, business people, and lawmakers began to recognize the economic problems with the existing tax depreciation methods.[6] (Marginal tax rates of more than 50 percent made the problems much worse.) The legislative tendency was to grant businesses more operational latitude and faster depreciation methods. The Internal Revenue Code of 1954—the first major re-write of the income tax code—explicitly allowed for accelerated depreciation methods. The record shows that lawmakers consciously intended for the 1954 changes to improve the economics of investment.

Many sophisticated commentators began to argue that it made no sense to keep the timetable depreciation methods in place. Accelerated depreciation methods simply represented administratively complex measures to mitigate the negative economics of an anachronistic (and mistaken) set of rules. Expensing—100 percent acceleration of depreciation—offered the best economics (and the simplest administration). Economist Vernon L. Smith, native son of Wichita, Kansas and 2002 Nobel Laureate in Economics, argued in a scholarly journal in 1963:

> The common practice is to permit capital costs to be written off or depreciated over time in accordance with some specified set of tax depreciation rules. We will show that this practice leads to bias in the form of investment decision rules different from those prevailing in the absence of a tax, that the bias is likely in the direction of delaying optimal investment timing, and that such biases can be

removed by expensing investment outlays in the computation of taxable income. . . .Our analysis suggests that the write-offs should be fully accelerated, not to give anyone an advantage, but to eliminate an existing disadvantage in the sense that investment decision rules are distorted.[7]

Yet lawmakers have never taken this compelling step. The system has remained wedded to depreciation timetables that will always produces some degree of distortion because of the inherent double tax on investment. The year before Smith published the findings quoted above, the Kennedy Administration enacted the first of a seemingly never-ending set of income tax reforms that have created complexity, uncertainty, and often self-contradictory policies related to investment.

The Revenue Act of 1962 liberalized depreciation rules and enacted the first-ever investment tax credit. The Tax Reform Act of 1969 sought to improve the economics of the depreciation rules on the one hand yet on the other hand further enshrined accelerated depreciation as a tax preference in the context of the Alternative Minimum Tax. The Tax Reform Act of 1981 enacted an entirely new set of accelerated depreciation measures, which were modified in 1982 and 1984. The Tax Reform Act of 1986 (such a significant set of reforms that it created the Internal Revenue Code of 1986) modified depreciation rules yet again and terminated the ever-varying investment tax credit. Depreciation issues surfaced again as a policy concern around 2000.[8] The only change to result from this concern was "bonus depreciation," enacted in 2002.

Throughout history, expensing as a universally applicable cost recovery procedure has arisen as a logically consistent alternative only in the context of radical tax reform. There is one *ad hoc* exception—the (capped and limited) expensing provisions for small businesses embodied in Section 179 of the Internal Revenue Code. Kansas law conforms to Section 179.

Endnotes

1 For a detailed discussion of the issues involved, see Arthur P. Hall, "Competing Concepts of Income and the Double Taxation of Saving," Technical Report 05-0926, Center for Applied Economics, School of Business, University of Kansas, September 2005. Available at: http://cae.business.ku.edu

2 A responsible discussion of expensing must address the issue of the prevailing income tax deduction for interest expense. Under a debt-finance scenario, using the present value formula approach, one can see that the money used for investment does not derive from (potentially) taxed earnings. The interest deductions that come later reduce the level of taxable cash flow generated by the investment. However, the interest deduction argument does not address the inherent double tax problem. Additionally, tax analysts have always known that the interest deduction creates a bias toward debt finance rather than equity finance.

3 This section draws liberally from: David W. Brazell, Lowell Dworin, and Michael Walsh, "A History of Federal Tax Depreciation Policy," OTA Paper 64, Office of Tax Analysis, U.S. Treasury Department, May 1989. Available at: http://www.treasury.gov/offices/tax-policy/library/ota64.pdf

4 Joel Dean, "Four Ways to Write Off Capital Investment: Management Should Have a Wider Tax Choice," *The Journal of Business*, Vol. 29 (2), April 1956, pp. 79-89.

5 Brazell, *supra* note 3, pp. 1-2.

6 Dean, *supra* note 4; Robert R. Milroy, Donald F. Istvan, and Ray M. Powell, "The Tax Depreciation Muddle," *The Accounting Review*, Vol. 36(4), October 1961, pp. 539-547.

7 Vernon L. Smith, "Tax Depreciation Policy and Investment Theory," *International Review of Economics*, Vol. 4(1), January 1963, pp. 81 & 91.

8 C. Eugene Steuerle, "Is it Time to Rationalize Depreciation Policy?" *Tax Notes*, August 20, 2001, p. 11109. Available at: http://taxpolicycenter.org/publications/template.cfm?PubID=9701

KU
THE UNIVERSITY OF KANSAS

Center for Applied Economics
University of Kansas School of Business
Summerfield Hall, 1300 Sunnyside Avenue
Lawrence, KS 66045-7585
www.cae.business.ku.edu
(785) 864-5134

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Embracing Dynamism: The Next Phase in Kansas Economic Development Policy

Arthur P. Hall, Ph.D.
Executive Director
Center for Applied Economics
University of Kansas School of Business
arthall@ku.edu

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Attachment #31

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List of Figures, Tables and Maps

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Executive Summary

Embracing dynamism provides the theme for this report in describing the next phase of economic development policy in Kansas.

- **Embracing dynamism suggests an economic development model that works with the mega trends that continue to shape the Kansas economy.**
- **Embracing dynamism suggests that economic development efforts discard the traditional industry-centric focus and replace it with a region-centric focus.**

A state-level economic development model that embraces dynamism should create a set of policies that work well across the whole array of regions, regardless of their development stage. In brief, state-level policies should:

1) **Treat all business and investment opportunities equally,**
2) **Facilitate business development in the unique context of the regional economy, and**
3) **Embrace rather than impede the continuing patterns of structural change.**

Almost every state offers economic development incentives. Yet, in general, benchmarking literature suggests that these incentives do not have a significant impact on economic growth. Benchmarking literature also suggests that states must continue to offer such incentives to remain competitive.

This report challenges key elements of that conclusion: Kansas can break out of the benchmarking race by developing a strategy built on embracing dynamism. Such a strategy can distinguish itself by building unique capabilities that create a different mix of value to all business seeking to thrive in Kansas—a mix of value that can enhance the probability of long-term economic success through enhanced opportunity. **Embracing dynamism can change how Kansas plays the economic development game.**

The goal of embracing dynamism is simply stated: **Create the conditions necessary to induce as much commercial experimentation as possible on Kansas soil.** Proper execution of the embracing dynamism strategy will create an environment where all manner of people—inside and outside the state—feel motivated to commit their time and treasure to Kansas soil. The policy challenge centers on promoting dynamism by establishing a business environment that induces business birth and expansion without bias related to the size or type of business. **Every business matters.**

Embracing dynamism starts with a change in vision—the state government of Kansas should abandon its prevailing policy of the State as an active investor in targeted businesses or industries and instead adopt the policy vision of the State as a caretaker of a competitive platform that seeks to induce as much commercial experimentation as possible. This vision implies the state government need not commit scarce resources to the enormously difficult task of predicting the outcome of competition if it focuses on the much more manageable task of creating the **platform** on which the competition takes place.

Measures of Success

This report suggests the following measures of performance for a change in vision. Conspicuously absent from the list is job count. The economic development process is job destroying as well as job creating, with patterns that shift over time. If Kansas performs well in the measures provided, it will also perform well in terms of job count.

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- **Income Growth** – State or regional income growth occurs in some combination of 1) an increase in the number of people earning income, or 2) an increase in the income earned per person.

- **Population Density and Population Migration** – Measuring the change in population (or employment) density and the prevailing trend of population migration can augment the income measure, which can sometimes produce ambiguous interpretations—especially at the sub-state level. Growing population density and net population in-migration offer clear measures of growing regional economies.

- **Productivity** – Productivity growth is the ultimate goal of economic development. Productivity growth tends to happen in geographic areas characterized by population density. Tracking the patterns of productivity growth across the geography of Kansas will offer an approximate measure of successful economic development.

- **Capital Investment** – The act of investment by Kansas businesses must precede sustainable increases in productivity. A measurable increase in the rate of capital investment in Kansas offers a clear signal that Kansas has established a sound strategy related to economic development.

- **Gross Business Starts and Expansions** – A strategy of embracing dynamism must look beyond the inevitable failures of particular businesses. A higher gross volume of business starts and expansion will mean more people have selected Kansas as the platform of choice to take business risks, a clear signal that Kansas has established a sound strategy related to economic development.

- **Customer Service and Throughput Measures of State Economic Development Agencies** – A strategy of embracing dynamism recommends that state resources be shifted away from the management of incentive programs and towards a package of hands-on business assistance services that induce business formation by lowering the cost of business birth and expansion. Maintaining current levels of customer satisfaction at double the throughput rate would signal strong progress toward a model of embracing dynamism.

Recommendations to Animate the Strategy

The following set of recommendations seek to capture the spirit of an economic development model consistent with 1) a strategy of embracing dynamism, and 2) the prevailing spirit of Kansas law. The set of recommendations illustrate a prototype model that allows Kansas to remain a strong competitor against other states in the competition for economic development while shifting the policy emphasis from 'targeting" to "embracing dynamism" in a manner that offers logical consistency, simplicity, transparency and equality.

Recommendation #1: Replace the list of state-level economic development incentive programs and investment-related tax credits on page 3 with the following three policies (which assume the continuation of the property tax exemption for machinery and equipment, the elimination of the business franchise tax, and the elimination of the estate tax).

1) Implement a system of 100 percent accelerated depreciation for all capital investments—equipment and structures—made in Kansas.

2) Allow all new business firms (and new business establishments from expanding firms) started in Kansas to retain 100 percent of their payroll withholding tax for the first 12 months of operation upon hiring the business's first non-owner employee(s).

3) Exempt from capital gains taxation the proceeds from the sale of Kansas-based business assets and Kansas-based business enterprises (and the equity investors in said business enterprises that must pay Kansas income taxes).

Prototype Plan Would Eliminate These Programs and Tax Credits *(but grandfather current participants)*

Programs

- Kansas Industrial Training (KIT)
- Kansas Industrial Retraining (KIR)
- Investments in Major Projects and Comprehensive Training (IMPACT)
- Kansas Economic Opportunity Initiative Fund (KEOIF)
- Kansas Enterprise Zone
- Sales Tax and Revenue Bonds (STAR)

Tax Credits

- High Performance Incentive Program Credits (HPIP)
- Business and Job Development Credit
- Biomass-to-Energy Credit
- Electric Cogeneration Facility Credit
- Environmental Compliance Credit
- Alternative-Fuel Tax Credit
- Integrated Coal Gasification Power Plant Credit
- Nitrogen Fertilizer Plant Credit
- Petroleum Refinery Credit
- Qualifying Pipeline Credit
- Storage and Blending Equipment Credit
- Swine Facility Improvement Credit
- Research and Development Credit
- Angel Investor Credit

This recommendation illustrates a **prototype** set of specific changes to current law that capture the vision related to embracing dynamism. Naturally, other combinations of specific changes could work too. Consistent with the vision, the key ingredients of any combination should: **a) provide a set of transparent and predictable policies that induce business experimentation via investment and risk-taking, and b) allow access by all current or future Kansas businesses equally and automatically with minimal compliance costs for both businesses and the state.**

Recommendation #2: With the resources made available by eliminating the menu of current state-level economic development programs and tax credits from Recommendation #1, the Department of Commerce should focus its resources on developing the most cost-effective economic development ombudsman program in the nation.

This recommendation relates primarily to established businesses in expansion mode. (Recommendation #4 deals with assistance activities related to new businesses). Department of Commerce personnel already engage in much of the activity suggested by this recommendation.

Recommendation #3: Statutorily name the Secretary of Commerce to serve as the chair of the Board of Directors of the Kansas Enterprise Technology Corporation, Kansas Bioscience Authority, Network Kansas; and the chair of the Advisory Board of the Small Business Development Center. Make the Secretary of Commerce a non-voting member of the Kansas, Inc. Board of Directors.

Over the past two decades, Kansas has chosen to build an economic development model that primarily relies on free-standing agencies governed by independent Boards of Directors. This model offers a sound operational foundation: it provides for strong stakeholder input and offers continuity in the context of the transient executive leadership inherent to the state government of Kansas. This model presumes that the agencies will undertake effective voluntary coordination. Evaluations by Kansas, Inc. indicate that some cooperation takes place; however, the evaluations also indicate that the agencies operate too much as independent silos.

Recommendation #4: Develop a task force to better align and manage the resources, activities, and geographical accessibility of the regional components of the Kansas economic development model. The end goal, as suggested by a strategy of embracing dynamism, should be to create a nationally-recognized system of business consulting, training, networking, and incubation services to induce as much business formation and expansion as possible – in the context of the many unique regional economies in Kansas.

The strategy of embracing dynamism will ultimately place stress on many hands-on business services related to inducing business start-ups and expansions, such as providing world-class business consulting, training services, partnerships, collaboration, individualized counseling, expertise, technical and financial assistance.

Embracing Dynamism: The Next Phase in Kansas Economic Development Policy

"It is inherent in any dynamic capitalist economy that some firms thrive and grow while others decline and sometimes fail. . . . Sorting successful business endeavors from unsuccessful ones is, in fact, a central and necessary part of our market economy, and it is essential that the public and policy makers understand this process."

— Kauffman Foundation report[1]

Determining [the] future is a matter of perpetual small scale experiment, mostly unsuccessful, and we will all be surprised to discover which developments turn out to be future opportunities. It is almost self evident that committees of wise people from . . . industry, and consultations dominated by vested interests and their followers, will not include those who are likely to be the important players.

— John Kay[2]

"The most fundamental problem is that many public officials appear to believe that they can influence the course of their state and local economies through incentives and subsidies to a degree far beyond anything supported by even the most optimistic evidence. We need to begin by lowering expectations about their ability to micro-manage economic growth and making the case for a more sensible view of the role of government—providing foundations for growth through sound fiscal practices, quality public infrastructure, and good education systems—and then letting the economy take care of itself."

— Alan Peters and Peter Fisher[3]

[1] Steven J. Davis, John Haltiwanger, and Ron Jarmin, "Turmoil and Growth: Young Businesses, Economic Churning, and Productivity Gains," Kauffman Foundation, June 2008, p. 2.
[2] John Kay, 2009 Wincott Lecture, "The Future of Markets," October 20, 2009. Reprinted here: http://www.johnkay.com/2009/10/20/the-future-of-markets/
[3] Alan Peters and Peter Fisher, "The Failure of Economic Development Incentives," *Journal of the American Planning Association*, Vol. 70, No. 1, 2004, p. 35-36.

Introduction and Historical Context

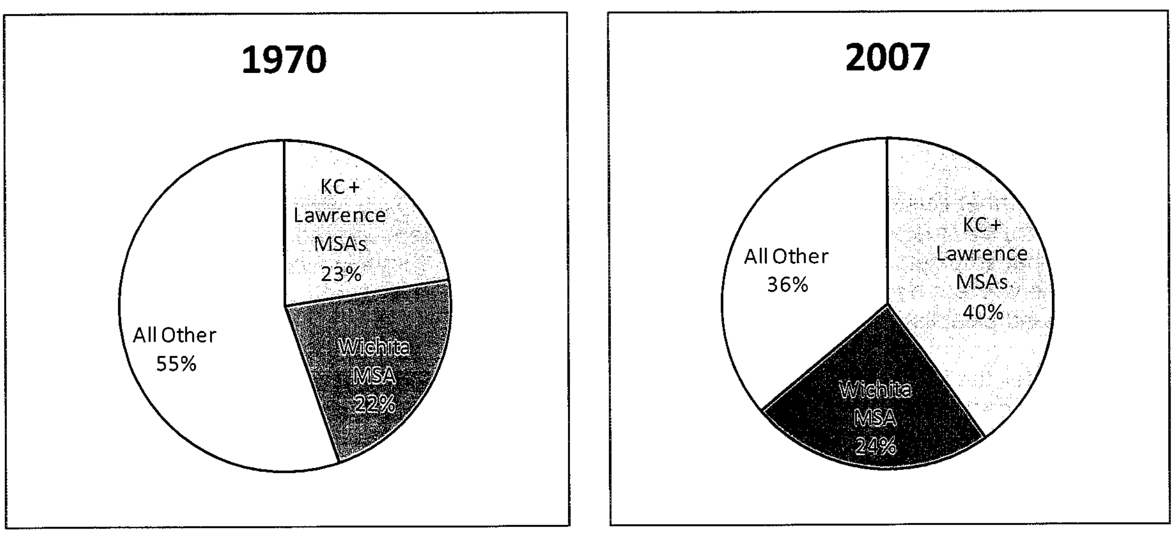
The Kansas economic development model dates back decades. The state created the Kansas Industrial Development Commission in 1939. In 1963, the legislature of Kansas adopted the following statutory language (in connection to what is now known as the Department of Commerce):

> "The legislature declares it necessary and to be the public policy of this state to promote, stimulate and encourage development of the general economic welfare and prosperity of the state through the promotion and development of industry, commerce, agriculture, labor and natural resources in this state. Such promotion and development requires that cognizance be taken of the continuing migration of people to the urban areas in search of job opportunities, and the fact that Kansas is making a needed transition to a diversified economy which creates new challenges for its people. Greater diversification and attraction of additional industry, accelerated development of natural resources, expansion of existing industry, creation of new uses for agricultural products, greater emphasis on scientific research, development of new markets for the products of the state and the attainment of a proper balance in the overall economic base are all necessary in order to create additional employment opportunities, increase personal income and promote the general welfare of the people of this state. To attain these goals, and to coordinate the activities of groups, public and private, which are engaged in these efforts, the organization, consolidation, coordination and arrangements herein provided have been established." (K.S.A 74-5002)

In 1986, when the so-called Redwood-Krider report[4] offered recommendations for augmenting the state's economic development model, the essence of the 1963 statement had not changed. In 2010, more than two decades after implementation of the Redwood-Krider recommendations, and several subsequent augmentations, the essence of the 1963 statement still has not changed, and the contours of the stated goals in 1963 largely capture the economic development goals of 2010.

The 1970s and 1980s were economically tough years for Kansas (and the Plains states in general). In that context, the Redwood-Krider report stated a concern of the times: "Unabated, a continuation of existing trends will result in an on-going and relative erosion of the state's economic base." But the existing trends and the natural economic dynamism of the transforming state economy was evolving in ways that may not have been fully appreciated at the time. Northeastern Kansas, especially around the Kansas City metro area, was becoming one of the fastest growing and most prosperous regions in the nation, a trend that essentially began after the 1973 recession and accelerated after the 1982 recession.

Figure 1: Shift in Kansas Regional Earnings, 1970 vs. 2007



Source: U.S. Bureau of Economic Analysis; Center for Applied Economics, KU School of Business

[4] Anthony Redwood and Charles Krider, "Kansas Economic Development Study: Findings, Strategy, and Recommendations," Institute for Public Policy and Research, University of Kansas, Report No. 108, June 1986. A summary is available here: http://www.ipsr.ku.edu/resrep/pdf/m108.pdf

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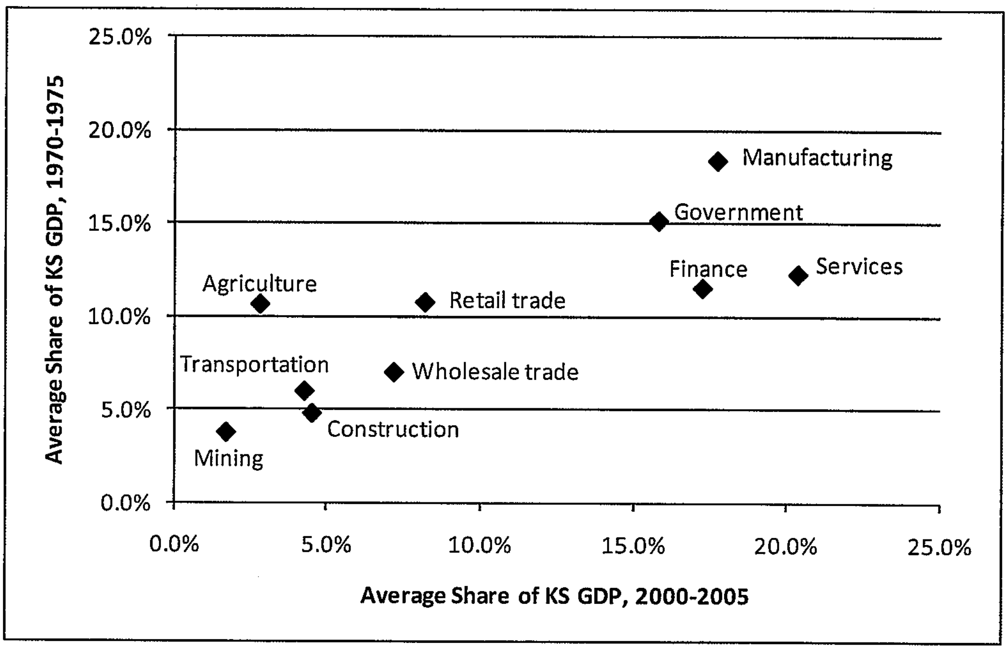
The state's economic base did not erode. It grew—while shifting in terms of composition and geography. Generally speaking, the shifting occurred for the reasons identified by the legislature in its 1963 statement. Kansas, like the Plains states generally, has been urbanizing since at least the 1930s—a trend still underway, with a long way to go. Figure 1 on page 5, illustrates that most of the geographic shift in Kansas has been eastward toward Kansas City.[5] Figure 2 shows that the urbanization trend also helps explain the compositional shifts. Over the past three decades, the GDP from agriculture has become much less important and the GDP from services and finance has become much more important. The "economic base" in most other broad industry categories has remained relatively stable—in value terms, not necessarily geographic terms or compositional terms. The operational details and productivity levels associated with the industry categories have modernized and increased substantially. Enhanced productivity and diversity in the basic industries has helped fuel the growth and diversity in service-related industries.

Figure 2: Industry Shares of Kansas GDP, 1970-75 vs. 2000-05



Source: U.S. Bureau of Economic Analysis

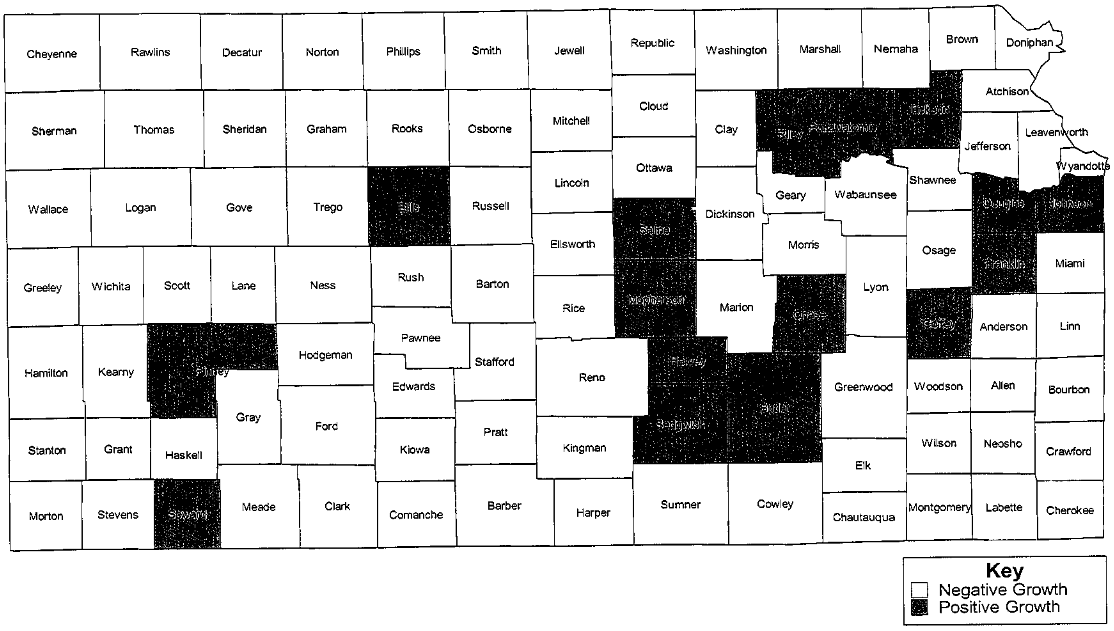
Maps 1 and 2, in combination with Figures 1 and 2, help set the stage for *embracing dynamism*—the theme in this report for the next phase of economic development policy in Kansas. Embracing dynamism suggests an economic development model that works with the mega-trends that continue to shape the economic platform in Kansas.

Map 1 helps to further illustrate the urbanization theme. Population density facilitates productivity-driven economic growth, the true economic definition of economic development and the cause of higher family incomes. Map 1 shows that employment shares (a measure of relative density) have grown the most in the eastern half of Kansas, but the western half also has pockets of increasing density. The growing relative density has primarily happened around established urban centers.

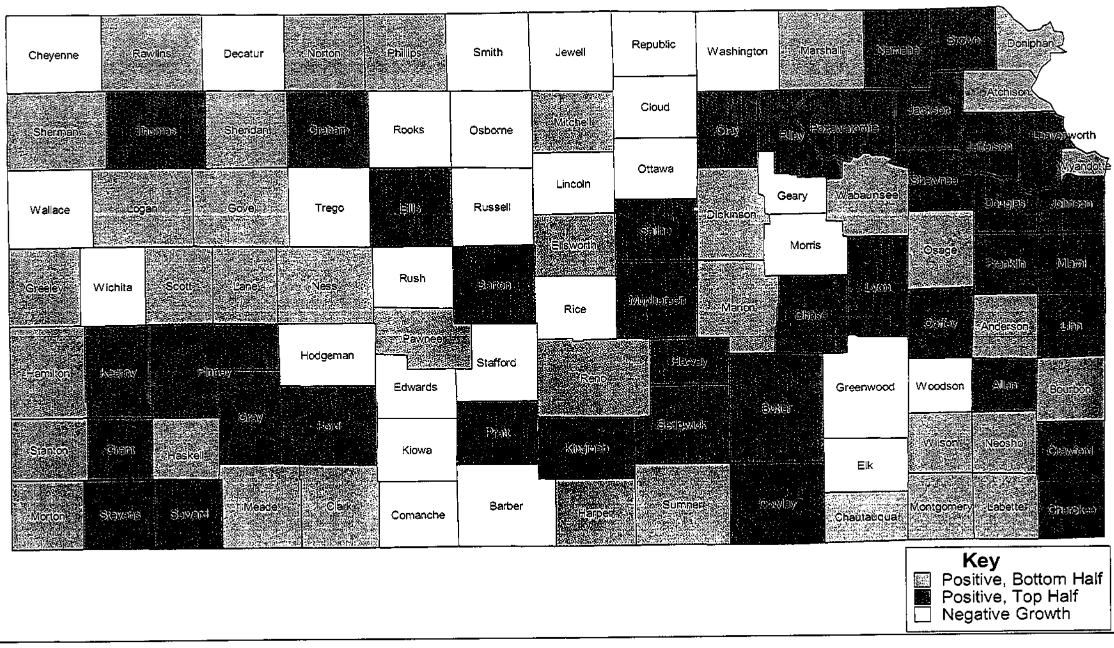
Map 2 helps to tell the Kansas story as one of relative concentration (density) not general decline. An evaluation of actual employment growth, as opposed to the growth of shares in Map 1, shows that three-quarters of Kansas counties have experienced employment growth over the past four decades—and that, among the counties with positive growth, those in the top half have a broad statewide distribution.

[5] For detailed analysis on the population migration trends, see Arthur P. Hall, Scott Moody, and Wendy Warcholik, "The County-to-County Migration of Taxpayers and Their Incomes, 1995-2006," Technical Report 09-0306, Center for Applied Economics, University of Kansas School of Business, March 2009.

Map 1: Growth in Shares of Kansas Employment, 1970-2007



Map 2: County-Level Employment Growth, 1970-2007



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Embracing dynamism suggests that economic development efforts discard the traditional industry-centric focus and replace it with a region-centric focus. Based on inter-county commuting patterns, Kansas hosts at least 25 regional economies. Each one of these regional economies has its own unique economic history that establishes the economic foundation for how it might further develop. Each region may be experiencing different stages of transition in the Great Plains mega-trend toward urbanization. The different stages matter because—to use two common but misleading terms—some parts of Kansas are growing into or through an "old economy" stage and some parts have entered the "new economy" stage.

A state-level economic development model that embraces dynamism should create a set of policies that work well across the whole array of regions, regardless of their development stage. In brief, state-level policies should: **1) treat all business and investment opportunities equally, 2) facilitate business development in the unique context of the regional economy, and 3) embrace rather than impede the continuing patterns of structural change.**

Embracing Dynamism: Moving from Benchmarking to Strategy

The evolution of the Kansas economic development model has not occurred in a vacuum. State economic development models have evolved since the late 1930s. Along the way, "economic development" has become its own (mostly taxpayer funded) industry, complete with hard-working professionals and professional associations. As in all competitive endeavors, economic development professionals (all incented by similar metrics) have aggressively "benchmarked" against one another. Consequently, scholars can document "waves" in the evolution of economic development policy and practice.[6]

Table 1 on page 10, provides a checklist for site locators developed by Conway Data, the publisher of *Site Selection Magazine*, the official publication of the Industrial Asset Management Council. Generally speaking, most states have most economic development "tools" as a result of decades of benchmarking. The details of how states deploy them may differ, but competition has made the overall packages competitive from state to state.

The general uniformity from a business perspective, in part, helps explain why economic research has had difficulty determining the success of economic development incentives. The overall lack of variation creates few "natural experiments" to aid in evaluation. It also helps explain why the benchmarking process has, in important respects, evolved essentially into bidding wars for large employers. In many ways, the process has taken on the characteristics of a zero-sum game leveraged by industry for financial advantage (and understandably so, from a business perspective). Yet true economic development is a positive-sum game, a win-win for all parties.

In the mid-1990s, Michael Porter, the renowned scholar of business strategy, argued that business managers had become so focused on benchmarking against competitors in terms of operational effectiveness that they had lost sight of competitive strategy, to the detriment of their companies. In Porter's words: "The more benchmarking companies do, the more they look alike. . . . Competitive strategy is about being different. It means deliberately choosing a different set of activities to deliver a unique mix of value."[7]

In many ways, the economic development industry has arguably fallen victim to the same over-emphasis on benchmarking at the expense of strategy. That helps explain why the 2008 Kansas Legislative Post Audit report on economic development programs argued that:[8]

> Almost every state offers economic development incentives. And although the literature we reviewed suggests that, in general, these incentives don't have a significant impact on economic growth; it also suggests that states have to continue offering such incentives to remain competitive.
>
> Officials from Kansas economic development agencies have repeatedly stated that economic development assistance must be offered. In essence, they said, "you can't afford to not play the game" or the State loses out on economic development opportunities.

The evidence presented in this report challenges key elements of that conclusion. Kansas can break out of the benchmarking race by developing a strategy built on embracing dynamism. Such a strategy, far from losing opportunity, can distinguish itself by building unique capabilities that create a different mix of value that can enhance the probability of long-term economic success through enhanced opportunity. Embracing dynamism can change *how* Kansas plays the game.

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[6] Andrew M. Isserman, "State Economic Development Policy and Practice in the United States: A Survey Article," *International Regional Science Review*, Vol. 6, p.63. Also see, Keon S. Chi and Daniel J. Hofmann, "State Business Incentives: Trends and Options for the Future, 2nd Edition," Council of State Governments, 2000.
[7] Michael E. Porter, "What is Strategy?" *Harvard Business Review*, November-December 1996, p. 64.
[8] Kansas Legislative Post Audit, "Economic Development: Determining the Amounts the State Has Spent on Economic Development Programs and the Economic Impacts on Kansas Counties," August 2008, p. 31.

Table 1: State Economic Development "Tools"	Number of States	Used in Kansas
Financial Assistance for Industry		
State-Sponsored Industrial Development Authority	42	N
Privately Sponsored Development Credit Corporation	39	N
State Authority or Agency Revenue Bond Financing	45	Y
State Authority or Agency General Obligation Bond Financing	24	Y
City and/or County Revenue Bond Financing	47	Y
City and/or County General Obligation Bond Financing	38	Y
State Loans for Building Construction	41	N
State Loans for Equipment, Machinery	42	N
City and/or County Loans for Building Construction	45	Y
City and/or County Loans for Equipment, Machinery	45	Y
State Loan Guarantees for Building Construction	30	N
State Loan Guarantees for Equipment, Machinery	34	Y
City and/or County Loan Guarantees for Building Construction	18	N
City and/or County Loan Guarantees for Equipment, Machinery	18	N
State Financing Aid for Existing Plant Expansion	44	Y
State Matching Funds for City and/or County Industrial Financing Programs	27	Y
State Incentive for Establishing Industrial Plants in Areas of High Unemployment	43	Y
City and/or County Incentive for Establishing Industrial Plants in Areas of High Unemployment	38	Y
Tax Incentives for Industry		
Corporate Income Tax Exemption	41	Y
Personal Income Tax Exemption	37	Y
Excise Tax Exemption	28	N
Tax Exemption or Moratorium on Land, Capital Improvements	40	Y
Tax Exemption or Moratorium on Equipment, Machinery	44	Y
Inventory Tax Exemption on Goods in Transit (Freeport)	49	Y
Tax Exemption on Manufacturers' Inventories	47	Y
Sales/Use Tax Exemption on New Equipment	49	Y
Tax Exemption on Raw Materials Used in Manufacturing	50	Y
Tax Incentive for Creation of Jobs	45	Y
Tax Incentives for Industrial Investment	45	Y
Tax Credits for Use of Specified State Products	8	N
Tax Stabilization Agreements for Specified Industries	12	N
Tax Exemption to Encourage Research and Development	42	Y
Accelerated Depreciation of Industrial Equipment	41	Y

Source: Site Selection Magazine, Nov. 2009

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Embracing Dynamism: Economic Evidence in Support of a New Strategy

A substantial amount of economic research has taken place during the evolution of the economic development industry. Data and research techniques have steadily improved. It has allowed scholars to have a much greater appreciation of the huge volume of change and diversity that works to continuously shape the United States economy—and, by extension, the many regional economies of Kansas.

The data in Table 2 shows that without the birth of brand new business establishments, Kansas would have experienced negative net job growth in 22 of the 28 years represented in the data. The Kansas job market is in continual flux from four sources: business births, business deaths, business expansions, and business contractions. [9] Figure 3 on page 13 provides a visual aid for understanding the overall statewide dynamics of job change. On average, Kansas businesses create about 149,000 jobs each year and eliminate about 139,500. (A picture of business establishments instead of jobs would show a similar pattern. On average, each year in Kansas, about 7,000 businesses start; 6,750 close; 18,750 expand; and 17,950 contract. Those numbers represent businesses with employees. Kansas had about an additional 183,000 businesses currently without employees undergoing dynamic change. Many of them will become employers as the businesses mature.)

Table 3 on page 14 reinforces the story told by Table 2 and reveals that the size of the firm (in terms of the number of people it employs) is much less important to job creation than the start of a new business establishment. Over the five-year period from 2000 to 2005, age-zero firms created almost all of the net new jobs. Smaller firms had a higher propensity to add net new jobs than larger firms, but the age of the firm dominates that pattern.

[9] Table 2 works by starting with all firms in existence in 1977, with an emphasis on those born in that year. The table then tracks net job creation by age of firm. "Left Census" tracks net job creation from business establishments that already existed before 1977.

3/-15

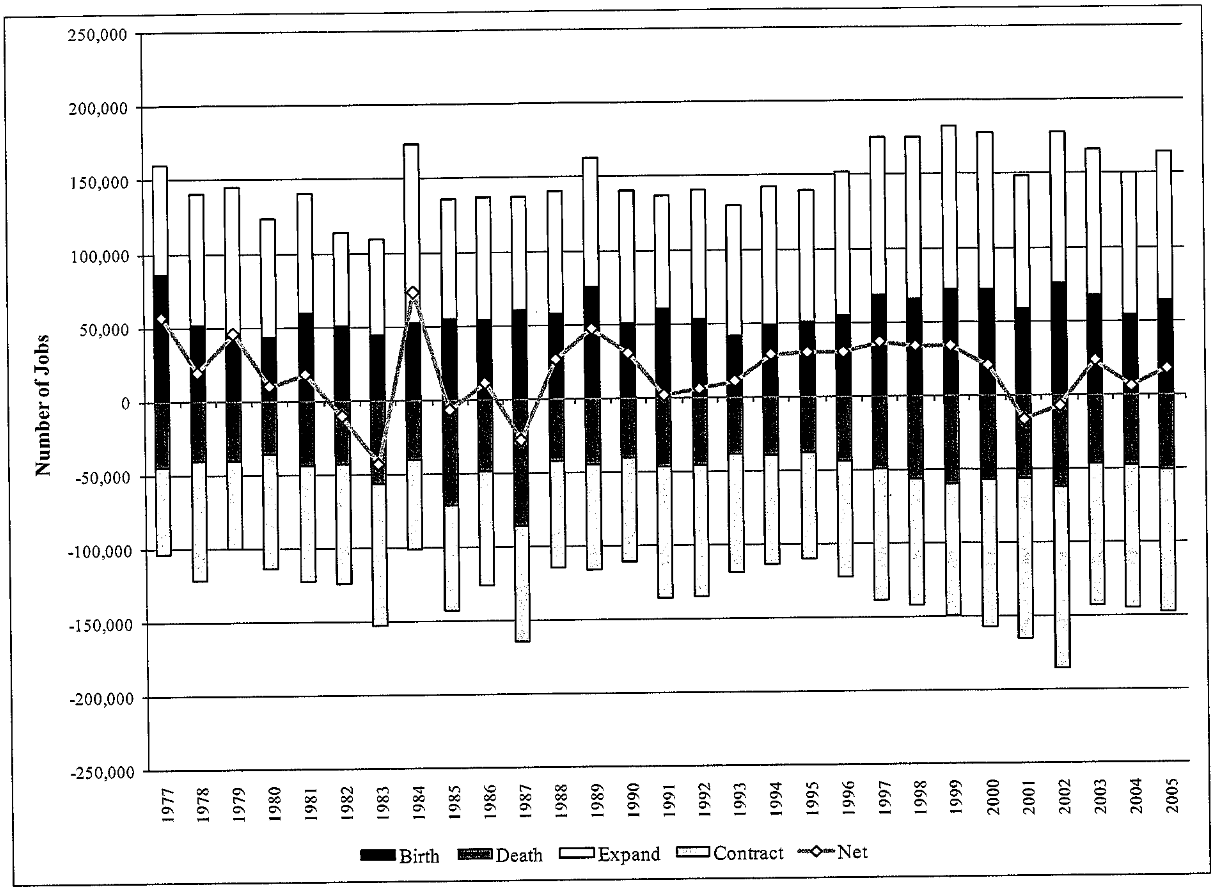
Table 2: Kansas Net Job Creation by Business Establishment by Age of Firm that Owns the Establishment

(Bolded figures show positive net job growth)

	Age of Firm in Years													
Year	0	1	2	3	4	5	6-10	11-15	16-20	21-25	26+	Left Censored	Total Net Job Creation	Net Job Creation without Age Zero
1977	**62,303**	0	0	0	0	0	0	0	0	0	0	-5,709	56,594	-5,709
1978	**32,173**	-21,808	0	0	0	0	0	0	0	0	0	**8,704**	19,069	-13,104
1979	**29,584**	-3,999	-1,378	0	0	0	0	0	0	0	0	**21,161**	45,368	15,784
1980	**27,468**	-3,382	-4,057	-2,263	0	0	0	0	0	0	0	-8,002	9,764	-17,704
1981	**34,166**	-1,765	-1,637	-2,380	-1,588	0	0	0	0	0	0	-8,955	17,841	-16,325
1982	**27,794**	-2,778	-2,837	-2,875	-2,776	-1,445	0	0	0	0	0	-25,605	-10,522	-38,316
1983	**25,415**	-3,313	-4,400	-2,891	-1,402	-1,234	-1,067	0	0	0	0	-54,496	-43,388	-68,803
1984	**31,454**	**43**	-1,286	2,366	-168	-100	-2,272	0	0	0	0	**42,755**	72,792	**41,338**
1985	**29,734**	**388**	-3,758	-1,075	-3,346	-1,397	-1,109	0	0	0	0	-26,398	-6,961	-36,695
1986	**30,385**	-3,951	-3,021	-2,659	-1,677	-355	-1,573	0	0	0	0	-6,097	11,052	-19,333
1987	**32,653**	-2,038	-2,842	-2,593	-842	-2,434	-5,746	0	0	0	0	-44,050	-27,892	-60,545
1988	**27,183**	-1,503	-300	-1,568	-1,255	-812	-1,248	**1,521**	0	0	0	**4,453**	26,471	-712
1989	**25,257**	-1,628	-2,893	-1,890	-1,757	**381**	-3,213	**176**	0	0	0	**32,695**	47,128	**21,871**
1990	**27,141**	1,791	-1,173	-2,244	-1,001	-1,629	-2,624	**938**	0	0	0	**9,019**	30,218	**3,077**
1991	**24,336**	**835**	-2,891	-1,805	-2,538	-1,399	-2,751	-2,906	0	0	0	-9,255	1,626	-22,710
1992	**26,142**	-1,275	-4,193	-920	-451	**29**	-5,835	**428**	0	0	0	-8,160	5,765	-20,377
1993	**25,239**	-1,175	-2,537	-1,203	-221	-2,309	-1,843	-616	**696**	0	0	-5,217	10,814	-14,425
1994	**27,704**	-689	-1,388	-444	**1**	-1,609	-517	425	**1,271**	0	0	**3,887**	28,641	**937**
1995	**28,559**	-208	-1,210	-959	-1,003	-135	-1,697	-296	**604**	0	0	**6,117**	29,772	**1,213**
1996	**26,645**	**993**	-1,487	-1,249	-488	**401**	-2,381	**174**	-1,404	0	0	**8,654**	29,858	**3,213**
1997	**31,155**	-1,270	-2,158	-1,147	-836	-1,632	-790	**484**	**196**	0	0	**12,521**	36,523	**5,368**
1998	**34,435**	**943**	-1,670	-2,464	-1,095	-617	-3,223	-3,629	-1,708	**1,201**	0	**11,444**	33,617	-818
1999	**30,550**	**2,442**	-637	-700	-1,309	**533**	-4,135	**373**	-224	-767	0	**7,415**	33,541	**2,991**
2000	**30,559**	-389	-169	-783	-646	-1,153	-1,264	**-2,125**	-278	-2	0	-3,394	20,356	-10,203
2001	**25,964**	-1,404	-4,140	-703	-3,588	-1,089	-5,170	-4,931	-4,842	-2,397	0	-14,417	-16,717	-42,681
2002	**30,126**	-1,287	-229	-1,433	-2,814	-750	-5,369	-2,426	-2,039	-4,037	0	-17,239	-7,497	-37,623
2003	**27,891**	-3,189	-2,232	-321	-432	**265**	-1,121	-1,094	-1,511	1,932	-88	**3,226**	23,326	-4,565
2004	**26,274**	-1,505	-3,420	-1,599	-811	-645	-461	-1,101	-1,913	-1,040	**793**	-8,884	5,688	-20,586
2005	**28,377**	-371	-1,109	-1,041	-1,306	-390	-3,030	-2,761	1,454	-1,407	**2,177**	-3,141	17,452	-10,925

Source: U.S. Census Bureau, Center for Applied Economics, KU School of Business

Figure 3: Kansas Job Dynamics, 1977-2005



Source: U.S. Census Bureau, Center for Applied Economics, KU School of Business

One important caveat to the data reported in Tables 2 and 3 requires comment. Nothing in the data suggests that large, mature business have no importance for economic growth. Large, mature businesses tend to offer higher wages, better employee benefits, and general stability of employment opportunities.[10] They also tend to spawn entrepreneurs with important industry knowledge and established professional networks.

The important economic development issue concerns business birth and expansion to redirect the employment of talented Kansans released because of inevitable business death and contraction. Generally speaking, dynamism represents persistent, annual change in about one-third of Kansas jobs. Job creation may be a key goal of economic development policy but job creation is a residual economic outcome of business dynamism. **The policy challenge centers on promoting dynamism by establishing a business environment that induces business birth and expansion without bias related to the size or type of business.**

[10] See, for example, Kelly Edmiston, "The Role of Small and Large Businesses in Economic Development," Federal Reserve Bank of Kansas City, *Economic Review*, 2007, 2nd Quarter, pp. 73-97.

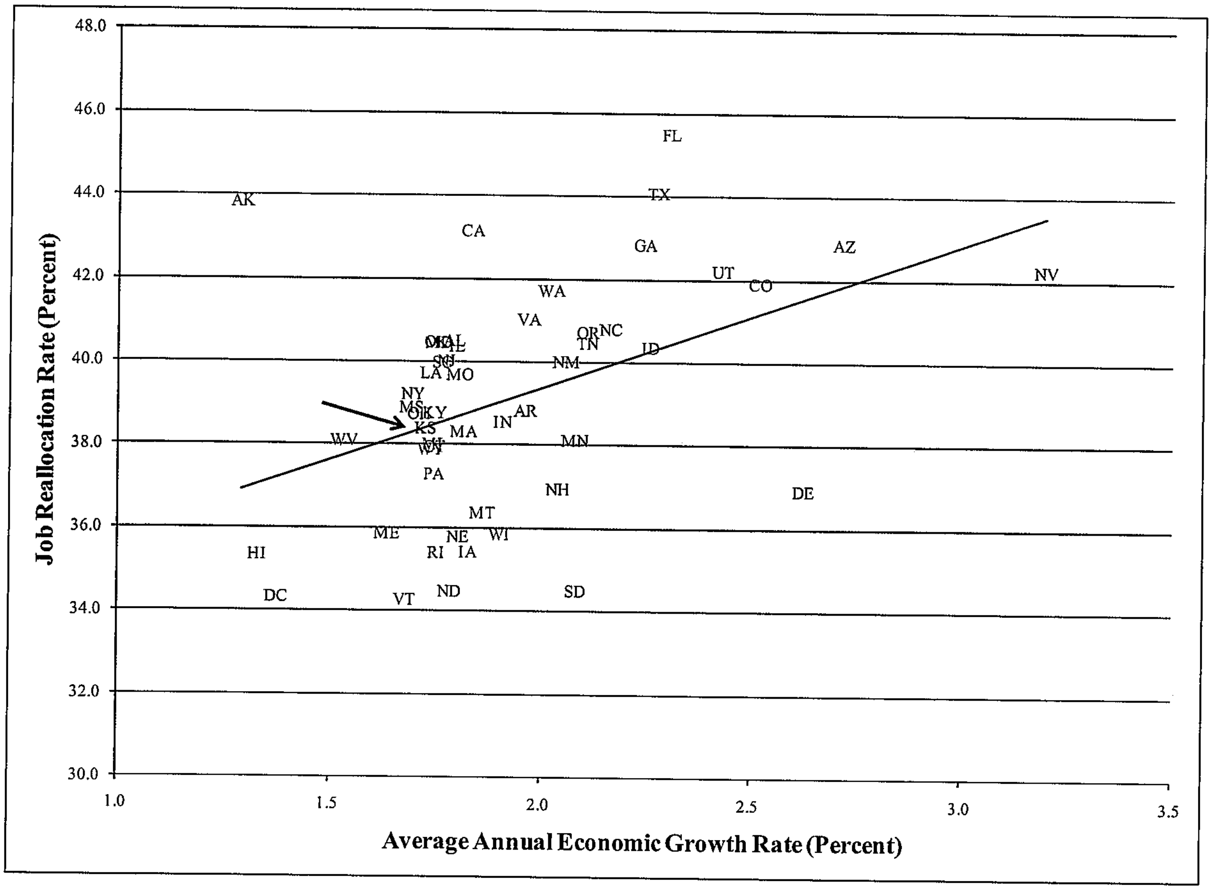
Table 3: Average Annual Net Job Creation by Firm Age and Size, 2000-2005

(Bolded figures show positive net job creation)

	Firm Size by Number of Jobs (not Business Establishment Size)												
Firm Age	1-4	5-9	10-19	20-49	50-99	100-249	250-499	500-999	1000-2499	2500-4999	5000-9999	10K +	Total
0	**6,361**	**4,546**	**4,508**	**5,260**	**3,141**	**1,973**	**1,052**	**2,100**	**75**	0	0	0	**29,015**
1	**401**	-240	-464	-358	-53	-393	-710	-17	-47	0	0	0	-1,881
2	**45**	-278	-437	-412	-164	-357	**70**	**275**	-1,883	0	0	0	-3,141
3	**148**	-270	-265	-433	-104	**16**	**201**	-75	-92	0	0	-42	-916
4	**5**	-159	-277	-426	-198	-86	-162	-236	**115**	-5	0	**89**	-1,340
5	**143**	-226	-300	-327	-210	**3**	-52	**413**	-65	0	0	0	-621
6-10	**135**	-679	-959	-643	-699	-199	-107	-39	**472**	-322	**91**	**108**	-2,840
11-15	**207**	-493	-513	-704	-460	-151	-186	-7	**136**	-13	**356**	-535	-2,363
16-20	**101**	-326	-88	-558	-486	-307	-170	-127	-40	**164**	**77**	**238**	-1,522
21-25	**105**	-188	-248	-403	-223	-229	**133**	-323	-26	-7	-112	**361**	-1,159
26+	**60**	-113	-124	-183	**13**	**167**	-20	**53**	**144**	**323**	-63	**703**	**961**
Left Censored	**390**	-263	-520	-715	-453	-528	-328	-125	-249	**392**	-994	-3,916	-7,308
All	**8,100**	**1,312**	**315**	**97**	**106**	-90	-280	**1,893**	-1,459	**532**	-645	-2,994	6,887

Source: U.S. Census Bureau, Center for Applied Economics, KU School of Business

Figure 4: Economic Growth vs. Job Dynamism, 1990-2005



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

Figure 4 reveals one final dimension to the empirical support for a strategy of embracing dynamism: High growth economies tend to have high levels of dynamism, and vice versa. Figure 4 compares each state's average annual growth rate over 15 years with its average job reallocation rate among firms five years old and younger.

The job reallocation rate sums together the rates of job change associated with business birth, death, expansion, and contraction.

The important lesson from Figure 4 is that growth and change go together. The causality runs in both directions.[11] "When a door shuts a window opens." That proverb holds for economic development as well as personal development. An economic development strategy built around embracing dynamism acknowledges that business birth and expansion are the goals but that business death and contraction are vital to the dynamic process that promotes growth. Policies of business and job "retention" may inadvertently work in a manner contrary to the goals of economic development if the policies shelter businesses from dynamism rather than motivating (or assisting) them to cope with dynamism.

The following list summarizes the consistent findings of academic research relevant for a strategy of embracing dynamism:

- Large-employer businesses have no measurable net economic effect on local economies when properly measured. To quote from the most comprehensive study: "The primary finding is that the location of a large firm has no measurable net economic effect on local economies when the entire dynamic of location effects is taken into account. Thus, the siting of large firms that are the target of aggressive recruitment efforts fails to create positive private sector gains and likely does not generate significant public revenue gains either."[12]

- Expansion of existing business establishments have a strong multiplier effect on employment (in the range of two for one) while the multiplier effect of newly-sited large employers is weak or negative (much less than one for one).[13]

- Industry mix does not influence economic development as much as commonly believed. Targeting specific business or "hot" industries is an inferior strategy to volume-driven diversity caused by dynamism.[14] However, concentrations of existing industries tend to reinforce themselves.

- Dynamism drives productivity growth as the process of trial and error replaces inferior business models with superior ones.[15] Policies of "retention" work against this positive attribute of dynamism.

- New information provided by several recent Kauffman Foundation surveys designed to better understand entrepreneurs and the ventures they start suggest that a strategy which embraces dynamism may yield greater success. Table 4 provides a select list of survey responses from 549 successful company founders—about 60 percent of them started multiple companies.[16] Table 5 provides a list of the sources of funds for the first year of operation of 4,163 start-up companies.[17] In both cases, the survey results indicate that government programs play a minor role in overall business formation. However, the results also indicate that well-crafted business coaching and incubation services (as well as enhanced opportunities for professional networking) might improve the odds of inducing people to start a business or improve the odds of success for those people that choose to start a business. Access to capital is important, but there is no reason to expect that good business plans cannot obtain the financing they require in the absence of taxpayer-funded capital programs.

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[11] See, for example, Edward L. Glaeser and William R. Kerr, "Local Industrial Conditions and Entrepreneurship: How Much of the Spatial Distribution Can We Explain?" *Journal of Economics and Management Strategy*, Vol. 18, No. 3, 2009, pp. 623-663.
[12] William F. Fox and Matthew N. Murray, "Do Economic Effects Justify the Use of Fiscal Incentives?" *Southern Economic Journal*, Vol. 71, No. 1, 2004, p. 79. Also see, Todd M. Gabe and David S. Kraybill, "The Effect of State Economic Development Incentives on Employment Growth of Establishments," *Journal of Regional Science*, Vol. 42, No. 4, 2002, pp. 703-730; and Dafna Schwartz, Joseph Plezman, and Michael Keren, "The Ineffectiveness of Location Incentive Programs: Evidence from Puerto Rico and Israel," *Economic Development Quarterly*, Vol. 22, No. 2, 2008, pp. 167-179.
[13] Kelly D. Edmiston, "The Net Effects of Large Plant Locations and Expansions on County Employment," *Journal of Regional Science*," Vol. 44, No. 2, 2004, pp. 289-319.
[14] Stephen Malpezzi, Kiat-Ying Seah, and James D. Shilling, "Is it What We Do or How We Do It? New Evidence on Agglomeration Economies and Metropolitan Growth," *Real Estate Economics*, Vol. 32, No. 2, 2004, pp. 265-295. Also see: Maryann P. Feldman and David B. Audretsch, "Innovation in Cities: Science-Based Diversity, Specialization, and Localized Competition," *European Economic Review*, Vol. 43, 1999, pp. 409-429; and Mark D. Partridge and Dan S. Rickman. "A Note on the Benefits to Current Residents of State Employment Growth: Is There an Industry Mix Effect on Migration?" *Journal of Regional Science*, Vol. 39, No. 1 (1999), pp. 167-181.
[15] Steven J. Davis, et al., "Turmoil and Growth: Young Businesses, Economic Churning, and Productivity Gains," Kauffman Foundation, June 2008.
[16] Vivek Wadhwa, et al., "The Anatomy of an Entrepreneur: Family Background and Motivation," Kauffman Foundation, July 2009; and "The Anatomy of an Entrepreneur: Making of a Successful Entrepreneur," Kauffman Foundation, November 2009.
[17] Alicia M. Robb and David T. Robinson, "The Capital Structure Decisions of New Firms," Kauffman Foundation, November 2008.

Table 4: Select Survey Responses from 549 Successful Entrepreneurs
86% said assistance by the state or region was not at all or only slightly important.
78% said lessons from failure were important; 40% said "extremely important."
52% said lack of financial capital was a challenge; 11% "extremely big" challenge.
52% said lack of experience was a challenge; 4% "extremely big" challenge.
70% said personal savings was the main source of capital.
75% said they had worked as employees at other companies for more than six years before starting their companies; about 25% had worked for more than 15 years.
73% said professional networks were important to the success of their current business.
40 years of age was the average and median age of the company founders at the times of their first start-up.
95% had a bachelor's degree and 47% had more advanced degrees.
67% ranked their academic performance in the top 30% of their undergraduate class; 37% ranked it in the top 10%.
70% of respondents were married and 60% had at least one child when they started their companies.
Source: Kauffman Foundation, "The Anatomy of an Entrepreneur," 2009

Table 5: Capital Structure Choice in Initial Year of Operation: 4,163 Start-Ups

	Average: All Firms	Average: Firms > 0	Number of Firms
Owner Equity	**$27,365**	**$34,509**	**3,292**
Insider Equity	$1,695	$34,984	186
Spouse	$479	$28,697	67
Parents	$1,217	$34,509	3,292
Outsider Equity	$6,979	$150,733	223
Other informal investors	$2,736	$101,718	121
Businesses	$1,807	$162,097	61
Government	$401	$81,821	26
Venture Capitalists	$1,655	$335,868	28
Others	$380	$183,295	10
Owner Debt	**$3,506**	**$11,695**	**1,221**
Personal CC balances, respondent	$3,179	$10,899	1,185
Personal CC balances, other owners	$304	$10,008	133
Personal owner loan	$23	$15,853	5
Insider Debt	**$7,605**	**$51,221**	**564**
Personal family loan, respondent	$2,798	$28,656	350
Personal family loan, other owners	$276	$34,689	28
Business loan from family	$1,258	$42,610	116
Business loan from owner	$1,732	$118,065	64
Business loan from employees	$66	$19,349	9
Other personal loan, respondent	$592	$30,046	78
Other personal debt, respondent	$883	$69,567	51
Outsider Debt	**$31,255**	**$85,681**	**1,487**
Personal bank loan, respondent	$11,066	$65,154	669
Business CC balance, respondent	$1,358	$9,710	556
Personal bank loan, other owners	$1,430	$62,251	97
Business CC balance, other owners	$190	$11,929	62
Business CC balances, business	$856	$7,417	463
Business bank loan	$9,357	$150,704	242
Credit line	$3,237	$62,156	216
Non-bank business loan	$2,033	$123,622	75
Government business loan	$721	$80,333	37
Other business loan	$163	$61,586	20
Other individual loan	$246	$52,529	21
Other business debt	$597	$122,512	21
Total	$78,406		
Number	4,163	see column	
Source: Kauffman Foundation, "The Capital Structure Decisions of New Firms," 2009			

- Rural areas have lower levels of dynamism than urban areas. Business births take place at a slower rate but so do business deaths. If a business fails in the relatively "thin" markets of a rural area, it may be harder for the business owner to cut his or her losses by selling the assets of the business. According to economists at Iowa State University: "The implied lower salvage value of rural firms suggests that firms sorting into rural markets must have a higher probability of success in order to leave their expected profits equal to what they could earn in an urban market."[18]

- State and local tax burdens seem to have a strong inverse relationship to a state's income growth. The channels through which taxes seem to effect income growth are: investment, employment, and population. Tax policy seems to have a more immediate (e.g., a five-year time frame) on investment and employment and a more delayed effect on population growth.[19] Since tax policy takes time to work its effects on economic growth, stability and consistency of tax policy improves the ability of businesses to make plans.

Figures 5 and 6 show that the normal business and jobs dynamics in Kansas typically dwarf the amount of activity reported by the state's formal economic development programs. (As with Table 2 and Figure 3, only businesses with employees are included.) The hands-on, active-management approach that characterizes a significant portion of the economic development policy (and delivery model) in Kansas cannot hope to adequately deal with the normal volume of economic activity. The current model cannot fulfill a strategy of embracing dynamism. Despite the worthiness of the anecdotal success stories, the results reported by Kansas economic development agencies do not rise to a level above the "statistical noise" of the high-volume economic dynamics that takes place across the state on a regular basis.

The business and jobs data reported in Figures 5 and 6 for the Kansas economic development agencies come from the 2008 Kansas Legislative Post Audit, arguably the most thorough accounting of results available.[20] The report states that: "Taken together, agencies' reported results would suggest that Kansas' economic development programs have had a major impact on the State's economy over the past five years."[21] Placed in a dynamic context, that conclusion seems less plausible than it seems in the isolated context of the report—especially since the report adds these qualifications to the conclusion:

- The data likely contains substantial duplications. (The report cites the Business and Jobs Development Credit—BJDC in Figure 6—as one probable source of duplication.)

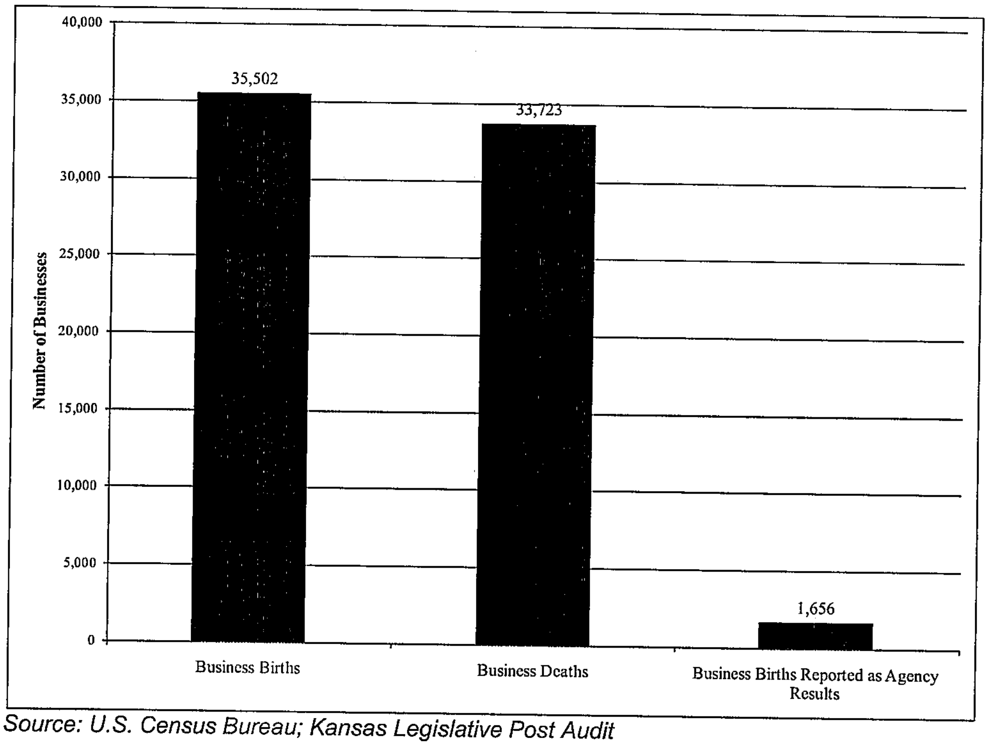
- "The number of new jobs reported isn't always the 'net' amount."

- "Companies report some of their results on surveys or tax returns without any supporting documentation, and agencies generally don't or can't verify that information."

- "Some agencies take credit for all accomplishments their clients report, even if the agencies provided only minimal or partial assistance."

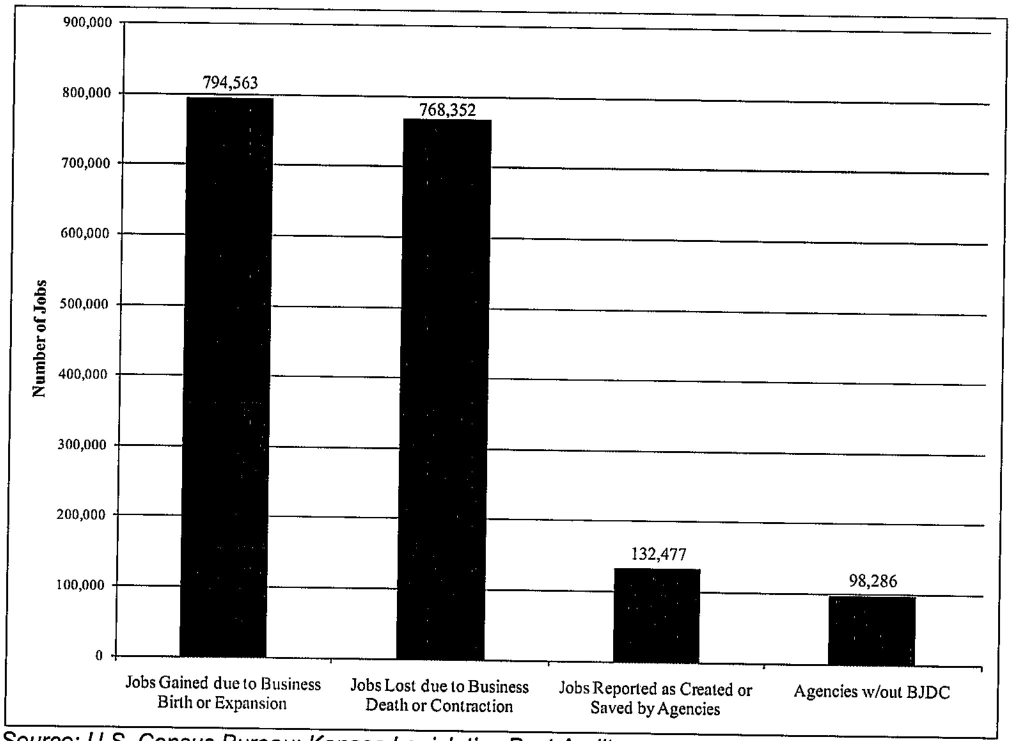
[18] Li Yu, Peter F. Orazem, and Robert Jolly, "Why Do Rural Firms Live Longer?" Working Paper No. 09013, Iowa State University Department of Economics, July 2009.
[19] W. Robert Reed, "The Robust Relationship between Taxes and U.S. State Income Growth," *National Tax Journal*, Vol. 61, No. 1, March 2008, pp. 57-80.
[20] Kansas Legislative Post Audit, "Economic Development: Determining the Amounts the State Has Spent on Economic Development Programs and the Economic Impacts on Kansas Counties," August 2008, p. 41.
[21] *Ibid.*

Figure 5: Business Births and Deaths in Kansas over Recent 5-Year Period



Source: U.S. Census Bureau; Kansas Legislative Post Audit

Figure 6: Kansas Job Dynamics and Agency Results over Recent 5-Year Period



Source: U.S. Census Bureau; Kansas Legislative Post Audit

Embracing Dynamism: A Strategy to Induce Maximum Commercial Experimentation

The goal of embracing dynamism is simply stated: Create the conditions necessary to *induce* as much commercial experimentation as possible. As a practical matter, that means creating an environment where all manner of people—inside and outside the state—feel motivated to commit their time and treasure to Kansas soil. The strategy seeks to strive for volume with regard to new business starts and business expansions. Every business matters.

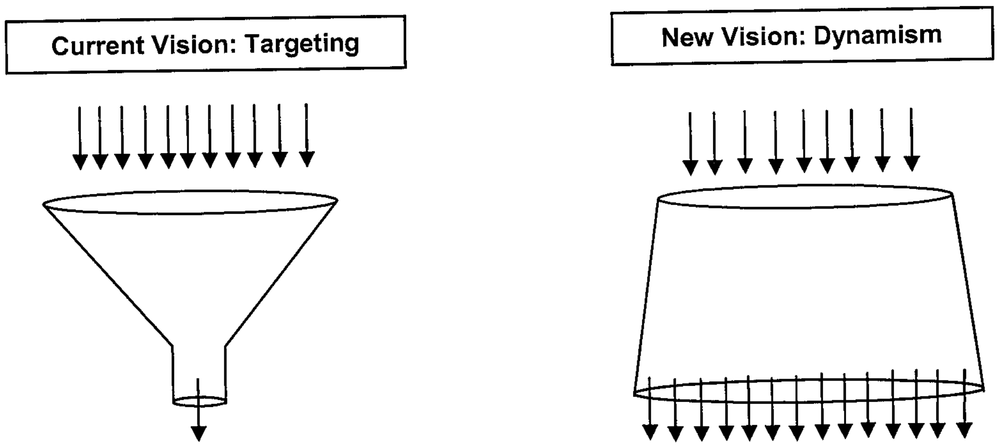
The mission statement of every state-level Kansas economic development agency is consistent with this fundamental goal. More often than not, however, the legislative directives that agencies must administer are not consistent with the fundamental goal. The operational model of economic development practice necessarily follows from the policy mandates imposed upon it.

Kansans would be hard pressed to find anyone in the state who does not share the sentiment that every business matters. Yet Kansas economic development policy tends to work as if only a small sub-set of businesses matter.

To a great extent, the conflict between the goals and operation of Kansas economic development policy results from a specific vision of economic development encoded into the statutes that dictate agency operations. That vision puts the state government in the role of being an active investor in specific businesses or industry sectors. The word "target" recurs (or is implied) frequently throughout the statutory guidance given to agencies. Targeting, a time- and labor-intensive activity, works against the goal of inducing as much commercial experimentation as possible.

Embracing dynamism starts with a change in vision. Simply stated, the state government of Kansas should abandon its prevailing policy vision of the State as an active investor in businesses or industries and instead adopt the policy vision of the State as a caretaker of a competitive "platform"—a platform that seeks to induce as much commercial experimentation as possible. By way of analogy, the platform-caretaker vision says: The State of Kansas runs tournaments; it does not field players. Creating a platform to host world-class tournaments will attract world-class players. The platform will endure but players will come and go. The platform-caretaker vision implies that the state government need not commit scarce resources to the enormously difficult task of predicting the outcome of competition if it focuses on the much more manageable task of creating the platform on which competition takes place.

Figure 7: A Profile of Two Visions for Kansas Economic Development Policy



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Current Vision:	New Vision:
• Dedicate considerable human and financial resources to the difficult task of predicting the "right" technologies or businesses. • Determine winners based on criteria like job count or specified wage levels—criteria often at odds with the goal of inducing profitable new business starts and expansions. • Reward winners with special privileges or resources at the expense of non-winners.	• Dedicate human and financial resources to promoting maximum experimentation through volume and diversity. • Establish stable policies that treat all investments and businesses equally, thereby liberating resources from the costly and economically dubious task of targeting. • Focus state resources on important activities that the state can do best: supply the "public goods" parts of the economic development process.

Replacing the prevailing direct approach represented by the active-investor vision with the indirect approach represented by the platform-caretaker vision will alter what it means for the state government of Kansas to "target" its limited resources:

- "Target" in the active-investor context requires state agencies to dedicate a considerable amount of human and financial resources to the difficult task of determining the "right" investments. The primary thrust of current Kansas economic development policy encourages or mandates state government agencies to act as a gatekeeper by essentially screening business deals the same way an active investor might. This vision of policy limits the state's potential in three basic ways. First, it does not scale; that is, it cannot handle the volume of economic activity that takes place in Kansas. Second, the active-investor approach gives rise to the perennial (and usually irresolvable) questions related to the state government's economic development "return on investment." Third, official notions of "return on investment" usually have an explicit jobs-count component, which directly conflicts with the end goals of: a) productivity growth, and b) enabling profitable new business births or expansions.

- "Target" in the platform-caretaker approach requires the state government to establish policies that induce a maximum amount of commercial experimentation across the regions of Kansas. This experimentation takes place among tens of thousands of geographically dispersed organizations, all with unique goals and operating perspectives. No active-investor approach to policy can hope to intelligently handle the volume. However, few organizations other than the state government have an incentive to competently commit human and financial resources to certain parts of the economic development process. These parts represent the "public goods" components the process. In addition to infrastructure provision and law and order activities, the public good parts include: 1) site location and permitting assistance services for mature businesses, 2) incubation and coaching services for aspiring entrepreneurs that help lower the cost of business creation (services that cannot survive unaided in the "thin" markets that characterize much of Kansas), and 3) expanded networking and educational opportunities that create knowledge sharing and a greater awareness of business opportunity throughout the state. The competent provision of each of these three items, combined with appropriate investment policies open to all businesses, defines the platform-caretaker vision, which can substantially increase the productivity of the state government's resources by inducing greater volume and diversity with regard to commercial experimentation. Greater volume and diversity can increase the probability of successful economic development.

Measures

This report suggests the following measures of performance. Conspicuously absent from the list is: job count. As the data herein illustrates, the economic development process is job destroying as well as job creating, with patterns that shift over time. Job creation is a residual measure that derives from profitable business births and expansions. If Kansas performs well in the measures below, Kansas will also perform well in terms of job count.

Income Growth

State or regional income growth occurs in some combination of: 1) an increase in the number of people earning income or 2) an increase in the income earned per person. Technically, "economic growth" means a sustained increase in per-person inflation-adjusted income. However, "economic development" can encompass both measures. For example, in many rural parts of Kansas, an absolute growth in income would measure successful economic development even if income measured on a per person basis remained constant. Such an outcome would indicate an increasing density of economic activity, which works as a precursor to the economic conditions that drive higher per-person incomes.

The U.S. Bureau of Economic Analysis regularly reports two measures of income: "gross domestic product by state" and "earnings by place of work." Gross domestic product is a state-level measure (although the BEA has begun to make GDP calculations for metropolitan areas). The earnings-by-place-of-work measure offers a county-level measure useful for assessing the many regional economies of Kansas.

Population Density and Population Migration

Measuring economic development strictly by income has important limitations—particularly when the measurement focuses on sub-state regions. Put in simplest terms, people often trade quality of life for income, so the growth in income or the levels of income per person may embody such trade-offs.

Measuring the change in population (or employment) density and the prevailing trend of population migration offer measures that avoid the ambiguities associated with sub-state income measures. Growing population density and net population in-migration offer clear measures of growing regional economies (and vice versa). The U.S. Internal Revenue Service compiles data annually on the county-to-county migration patterns in the United States.[22]

Productivity

Productivity growth is the ultimate goal of economic development. Productivity growth—the volume and value of output per worker—drives the growth of wages and wealth. Productivity growth results from a risky trial and error process on the front lines of individual businesses, which is why Kansas economic development strategy should focus on embracing dynamism—a focus virtually indistinguishable from widespread business investment and risk-taking.

Productivity growth tends to happen in geographic areas characterized by density. This pattern shows up in Kansas. The dense population centers demonstrate superior productivity growth. Tracking the patterns of productivity growth across the geography of Kansas will offer an approximate measure of successful economic development across the regions of Kansas.

Capital Investment

The act of investment by Kansas businesses must precede sustainable increases in productivity. From a business perspective, expected rates of return drive investment decisions. Most of the economic development programs offered to businesses in Kansas work to help improve the expected rate of return on business

[22] For a sample of population migration patterns in Kansas, see Arthur P. Hall, et al., "The County-to-County Migration Patters of Kansas Taxpayers, 1985-2004," Kansas, Inc. Research Report, October 2006. Also see, Arthur P. Hall, et al., "The County-to-County Migration of Taxpayers and Their Incomes, 1995-2006," Technical Report 09-0306, Center for Applied Economics, University of Kansas School of Business, March 2009.

investment. But these programs tend to be selective rather than broad-based, and therefore work against the driving force of dynamism articulated in this report.

Every business matters. Establishing policies that increase the expected rate of return on investment for all businesses, without bias, works with the driving force of dynamism. A measurable increase in the rate of capital investment in Kansas offers a clear signal that Kansas has established a sound strategy related to economic development.

The U.S. Census Bureau regularly undertakes a state-level survey of manufacturing investment. Otherwise, investment data on state-level investment patterns is not readily available. The state government of Kansas could fill this void with its own, broader-based survey program—a program modeled after the Annual Capital Expenditures Survey conducted for the nation by the U.S. Census Bureau.

Gross Business Starts and Expansions

On average, each year in Kansas, about 7,000 businesses start; 6,750 close; 18,750 expand; and 17,950 contract. This tight symmetry of birth-death and expansion-contraction characterizes all parts of the U.S. economy. Failure, though unfortunate, represents a vital part of the evolutionary process related to sustainable economic development (and productivity growth).

A strategy of embracing dynamism must look beyond the failures (and, thereby, the net number of new business) and focus on the gross volume of business starts and expansions. A higher gross volume of business starts and expansion will mean more people have selected Kansas as the "platform" of choice to risk their time and treasure—a clear signal that Kansas has established a sound strategy related to economic development.

Customer Service and Throughput Measures of State Economic Development Agencies

As discussed in the Recommendations section, the strategy of embracing dynamism suggested by this report recommends that state resources be shifted away from the management of incentive programs and towards a package of hands-on business-assistance services that induce business formation by lowering the cost of business birth and expansion. The state's economic development agencies should evaluate themselves as service business from the perspective of their clients. A substantial amount of this type of measurement occurs now. A strategy of embracing dynamism seeks to dramatically expand the volume of the client throughput while increasing customer-service measures related to program quality. (For example, the Kansas Small Business Development Center, which currently operates a network of 19 offices around the state, coaches at least 2,000 small business clients annually. Client evaluations indicate a high level of satisfaction with the services offered by the Center. Maintaining current levels of customer satisfaction at double the throughput rate would signal strong progress toward a model of embracing dynamism.)

Recommendations

The following set of recommendations endeavor to capture the spirit of an "economic development model" consistent with: 1) a strategy of embracing dynamism and 2) the prevailing spirit of Kansas law. The set of recommendations illustrates a prototype model that allows Kansas to remain a strong competitor against other states in the competition for economic development while shifting the policy emphasis from "targeting" to "embracing dynamism" in a manner that offers logical consistency, simplicity, transparency, and equality.

The recommendations strive to make a clear distinction between "incentives" and "business assistance." Incentives should become automatic and available to all businesses equally. Assistance should focus on getting new businesses up and running as quickly and cost-effectively as possible (consistent with community standards of health, safety, and environmental stewardship). Generally, business assistance breaks down into two categories: 1) Kansans seeking to start new business ventures and 2) existing businesses that have decided to expand their operations within or into Kansas.[23]

Recommendation #1: Replace the following list of state-level economic development incentive programs and investment-related tax credits with the following three policies (which assume the continuation of the property tax exemption for machinery and equipment, the elimination of the business franchise tax, and the elimination of the estate tax).

This recommendation illustrates a prototype set of specific changes to current law that capture the vision related to embracing dynamism. Naturally, other combinations of specific changes could work too. Consistent with the vision, the key ingredients of any combination should:

- Provide a set of transparent and predictable policies that induce business experimentation via investment and risk-taking.
- Allow access by all current or future Kansas businesses equally and automatically with minimal compliance costs (for both businesses and state government agencies).

Implementation of this recommendation will allow every Kansas business to receive an economically sound package of "incentives" to help underwrite their success but it will eliminate the opportunity for select businesses to receive a huge incentive package. More specifically, as sound tax policy, implementation of this recommendation will have four benefits: First, it will honor the perspective that every business matters. Second, it will provide an attractive—yet transparent and logically consistent—set of incentives for Kansas to remain competitive with other states. The more stable and predictable the state government can make the policy environment the more the state government can help induce business formation and expansion: uncertainty works against risk-taking and investment. Third, it will eliminate the need for businesses and state government to pay for needless negotiation and recordkeeping (outside of the normal process of tax compliance). Fourth, it establishes a set of policies that induces business formation and expansion while minimizing the downside risk from a state government budget (taxpayer) perspective.

Prototype Plan Would Implement These Three Policies:

A. Implement a system of 100 percent accelerated depreciation for all capital investments—equipment and structures—made in Kansas (a tax policy known as "expensing").[24] This recommendation became one component of the 2007 Kansas Economic Development Strategic Plan (p. 53). HB 2751 (2008 Session) captures the practical implementation of this idea, which offers expensing as a mutually-exclusive option to the many investment-related tax credits available in current law.

[23] For a set of recommendations related to technology-based economic development that complement the recommendations herein, see: Arthur P. Hall and Lee Lewellen, "Technology-Based Economic Development in Kansas: Issues, Opportunities, and Strategies," Kansas, Inc. Research Report, December 2009. (http://www.kansasinc.org/pubs/working/tbedks10.27.09.pdf)
[24] For a detail explanation of this policy, see: Arthur P. Hall, "Expensing: A Competitive Leap for Kansas Tax Policy," Technical Brief 07-0903, Center for Applied Economics, University of Kansas School of Business, September 2007. (http://www.business.ku.edu/_FileLibrary/PageFile/277/CAE--Expensing.pdf).

The option approach articulated in HB 2751 remains a viable alternative, if Kansans prefer it. This report recommends the replacement approach as a means to streamline and simplify Kansas law in a manner commensurate with the vision of embracing dynamism.

Appendix A provides a more detailed discussion of expensing (as implemented by HB 2751). Expensing shifts the time value of money from the state government to businesses undertaking investment. That shift explains the economic development "incentive" built into the recommendation; it improves the expected rate of return on every investment. Every investment-related tax credit works as an "incentive" for the same reason—they work to improve the expected rate of return on the investments they target. This recommendation seeks to make the "incentive" logically consistent and universally available rather than *ad hoc*. Expensing provides equal treatment for all investments across businesses of all sizes while simultaneously placing a logical limit on the state government's budgetary exposure. With expensing, the state government's return on investment will equal the business's return on investment, so the state no longer needs to spend resources evaluating the return on investment—at least not for the current programs, listed on pages 25-27.

As drafted, HB 2751 applies to tangible assets only. The structure of expensing can also capture investment in research and development and intangible assets, like intellectual property or the going-concern value ("goodwill") of a business. Inclusion of such items can create some measure of complexity but they can have strong economic development benefits for the same reasons discussed above related to the time value of money. Intangible assets should receive consideration for inclusion in any well-crafted expensing policy.

B. Allow all new business firms (and new business establishments from expanding firms) started in Kansas to retain 100 percent of their payroll withholding tax for the first 12 months of operation upon hiring the business's first non-owner employee(s). This idea expands and generalizes the Promoting Employment Across Kansas program enacted by the Legislature in 2009 (SB 97). Other Kansas economic development programs also use the mechanism of allowing businesses to retain some portion of payroll withholding taxes. This procedure offers a relatively efficient administrative mechanism for allocating incentives related to employment, a mechanism consistent with making incentives automatic.

   A strategy of embracing dynamism places stress on business experimentation by emphasizing business birth and expansion. This recommendation will help induce risk-taking on the formation of new business establishments. It complements the investment-related expensing recommendation by helping to underwrite job creation (and labor intensive establishments) in a manner that offers an automatic procedure to help all new businesses with one of their biggest challenges: cash flow. Implementation of this idea will require well-defined compliance and administrative procedures on the part of the Kansas Department of Revenue to prevent fraud or manipulation by those that may attempt to portray on-going business concerns as "new."

C. Exempt from capital gains taxation the proceeds from the sale of Kansas-based business assets and Kansas-based business enterprises (and the equity investors in said business enterprises that must pay Kansas income taxes). The law should not set a minimum holding period for taxpayers to qualify for the exemption. A strategy that promotes dynamism should not create any tax-induced barriers to the sale of business assets or businesses. The state of Kansas should not discourage serial entrepreneurs (and their investors) from starting businesses and selling them (or the equity shares) to others.

   An income tax on capital gains is economically equivalent to a transactions tax on the allocation of venture capital and the exchange of capital investments. Accordingly, elimination of the income tax on capital gains assists a strategy of embracing dynamism: to promote entrepreneurship and innovation both within and among Kansas businesses by inducing the maximum amount of business experimentation at the least possible cost. The free-flow of capital trying to find its best possible deployment drives a vibrant, innovative economy. Successful entrepreneurs quit as quickly as possible the projects that they perceive as losers and pursue new projects that they perceive as winners. Often, because of different visions and skill-sets, one entrepreneur's perceived loser is another entrepreneur's perceived winner. A tax on capital gains, because of its economic attributes, unduly increases the cost of this vital discovery process.

   An income tax on capital gains is also economically equivalent to a tax on the returns to entrepreneurial risk-taking. A strategy seeking to induce as much business experimentation as possible should allow entrepreneurs—and their investors—to (automatically) realize the maximum upside of implementing their

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ideas. Harvard Business School professors Paul A. Gompers and Josh Lerner, leading scholars on the venture capital industry, discovered that:

> Capital gains tax rates have a significant effect at the industry, state, and firm levels. Decreases in the capital gains tax rates are associated with greater venture capital commitments. *The effect, however, appears to occur through the demand for venture capital*: rate changes affect both taxable and tax-exempt investors. Similarly, R&D expenditures, especially expenditures by industrial firms, are positively related to venture investments in particular states.[25]

<u>Prototype Plan Would Eliminate These Programs and Tax Credits (*but grandfather current participants*)</u>:

Programs	**Description and Average Assistance (2002-2006)***	**Reason(s) for Recommended Elimination**
Kansas Industrial Training (KIT)	• For companies involved in "net new job" creation. • Average firms helped per year: 43 • Average dollar allocation per year: $1.6 million	• As Figure 3 makes clear, there is no way to know what businesses will be responsible for "net new jobs" from a Kansas perspective. • The per-business average of $37,200 can be reallocated to underwrite policies that help thousands of businesses per year—automatically, with no management expense.
Kansas Industrial Retraining (KIR)	• For companies involved in restructuring or retraining their workforce. • Average firms helped per year: 56 • Average dollar allocation per year: $1.6 million	• The expensing provision will automatically apply to key restructuring-based requirements of this program. • The per-business average of $28,200 can be reallocated to underwrite the assistance inherent in Recommendations #2 and #4 of this report.
Investments in Major Projects and Comprehensive Training (IMPACT)	• Financial assistance to new and expanding businesses that are creating or retraining a large number of jobs paying higher than the average wages. • Operates by allowing firms to retain state withholding taxes, as per item B in this recommendation. • Average firms helped per year: 9 • Average dollar allocation per year: $16.7 million	• The expensing provision will automatically apply to a substantial amount of the investment activity related to this program—automatically, with no management expense. • New establishments will be eligible to retain 100% of first-year withholding taxes, per item B of this recommendation—automatically, with no management expense. • As indicated by Figure 4 of this report, an abundance of small suppliers is a good predictor of future growth. Large firms are attracted to areas of economic dynamism. • The per-business average of $1,855,555 can be reallocated to underwrite policies that help thousands of businesses per year, including the assistance inherent in Recommendations #2 and #4 of this report.
Kansas Economic Opportunity Initiative Fund	• Financial assistance to a business that may have substantial impact on the Kansas economy, as determined by the Department of Commerce. • Average firms helped per year: 15 • Average dollar allocation per year: $1.6 million	• All reasons stated for the previous three programs. ($106,700 per-business average)
Kansas Enterprise Zone	• Designed to encourage businesses to create new jobs. • No operating details available.	• The combined effect of this recommendation (items A, B, C) will make the entire state of Kansas an enterprise zone.

[25] Paul A. Gompers and Josh Lerner, "What Drives Venture Capital Fundraising?" *Brookings Papers on Economic Activity—Microeconomics*, 1998, p. 150. Emphasis added.

Sales Tax Revenue (STAR) Bonds (State participation)	• Sales Tax Revenue (STAR) Bonds provide Kansas municipalities the opportunity to issue bonds to finance the development of major commercial, entertainment and tourism areas and use the sales tax revenue generated by the development to pay off the bonds.	• STAR bonds establish taxpayers as a non-recourse lender in a commercial venture. Evidence indicates that Kansas can attract financing to develop worthy commercial, entertainment, and tourism areas. They are businesses like other businesses. Items A, B, and C of this recommendation will help improve the financial viability of any project (and eliminating state participation in STAR bonds will allow the state to retain sales tax revenue to help underwrite Recommendations #1 through #4 of this report): • The expensing provision will automatically apply to all investments related to a development. Taxpayers share in the investment when the project is a success; they are not exposed if the project fails. • All business establishments that may populate a development—and thereby help make it economically viable—will be eligible for the expensing provision and the ability to retain first-year withholding taxes.

** Kansas, Inc.'s "Evaluation of the Kansas Department of Commerce," November 2007, p. 29*

Tax Credits	Description and 2007 Number of Filers and Fiscal Note*	Reason(s) for Recommended Elimination
High Performance Incentive Program Credits	• An investment tax credit of 10% for investments above $50,000 and credit for training up to $50,000. • Filers: 133 • Fiscal note: $37.4 million	Expensing achieves the same goal as the investment tax credit (the driving force of HPIP). True, expensing is less valuable for those taxpayers that qualify for HPIP by approximately three percentage points, but it is available to all business—automatically without management expense.
Business and Job Development Credit	• A 1% investment tax credit and a specified dollar credit for certain job counts. • Filers: 567 • Fiscal note: $11.3 million	Expensing achieves the same goal as the investment tax credit (with greater expected taxpayer value) and the first-year retention of withholding taxes achieves the same goal as the jobs credit.
Biomass-to-Energy Credit	• 10% tax credit for building or expanding a facility. • Filers: 0 • Fiscal note: $0	Expensing automatically applies to this type of investment.
Electric Cogeneration Facility Credit	• 10% tax credit for first $250 million of Investment; 5% for amounts above $250 million; must take credit in 10 annual installments. • Filers: 0 • Fiscal note: $0	Expensing automatically applies to this type of investment.
Environmental Compliance Credit	• 100% tax credit for refineries to meet environmental regulations. • Filers: 0 • Fiscal note: $0	Expensing automatically applies to this type of investment.
Alternative-Fuel Tax Credit (businesses not individuals)	• Allows for a credit for the establishment of alternative-fuel fueling stations. • Filers: 68 • Fiscal note: $163,703	Expensing automatically applies to this type of investment.
Integrated Coal Gasification Power Plant Credit	• 10% tax credit for first $250 million of Investment; 5% for amounts above $250 million; must take credit in 10 annual installments. • Filers: 0 • Fiscal note: $0	Expensing automatically applies to this type of investment.

Nitrogen Fertilizer Plant Credit	• 10% tax credit for first $250 million of Investment; 5% for amounts above $250 million; must take credit in 10 annual installments. • Filers: 0 • Fiscal note: $0	Expensing automatically applies to this type of investment.
Petroleum Refinery Credit	• 10% tax credit for first $250 million of Investment; 5% for amounts above $250 million; must take credit in 10 annual installments. • Filers: less than 5 • Fiscal note: confidential	Expensing automatically applies to this type of investment.
Qualifying Pipeline Credit	• 10% tax credit for first $250 million of Investment; 5% for amounts above $250 million; must take credit in 10 annual installments. • Filers: 0 • Fiscal note: $0	Expensing automatically applies to this type of investment.
Storage and Blending Equipment Credit	• 10% tax credit for first $10 million of Investment; 5% for amounts above $10 million; must take credit in 10 annual installments. • Filers: 0 • Fiscal note: $0	Expensing automatically applies to this type of investment.
Swine Facility Improvement Credit	• Tax credit for capital improvements. • Filers: 0 • Fiscal note: $0	Expensing automatically applies to this type of investment.
Research and Development Credit	• 6.5% tax credit for expenditures made for qualifying research and development activities. • Filers: 179 • Fiscal note: $2.3 million	• Expensing automatically applies to any capital expenditures related to R&D. • Labor costs are already available for expensing. • As mentioned above, certain intangible assets should be evaluated for inclusion in the expensing provision.
Angel Investor Credit	• Tax credit of 50% for equity investments in firms pre-qualified by the Kansas Technology Enterprise Corporation, with a maximum credit of $250,000 per taxpayer. • Filers: 68 • Fiscal note: $1.1 million	• Evidence presented in Kansas, Inc. report "Technology-Based Economic Development in Kansas" indicates that good business ideas in Kansas can attract capital. • The Angel Credit is a good tool. But elimination of capital gains taxation is similar and better: All investments qualify without the requirement of pre-qualification. It moves the investment "incentive" from the front end to the back end of all venture investment (so Kansas taxpayers effectively participate in the successful ventures not the unsuccessful ones).
**Legislative Post Audit, "Kansas Tax Revenues, Part I: Reviewing Tax Credits," February 2010, pp. 17-20.*		

Recommendation #2: With the resources made available by eliminating the menu of current state-level economic development programs and tax credits from Recommendation #1, the Department of Commerce should focus its resources on developing the most cost-effective economic development ombudsman program in the nation.

This recommendation relates primarily to established businesses in expansion mode. (Recommendation #4 deals with assistance activities related to new businesses.) Department of Commerce personnel already engage in much of the activity suggested by this recommendation.

A strategy of embracing dynamism does not imply that Kansas should stop promoting itself to the world as a first-class platform from which to operate a business. Nor does it suggest that the focus of economic development policy should shift from a concentration on large-employer businesses (which is the current focus, intended or not) to small businesses. Instead, the recommended shift in strategy aims to establish a better value proposition from the perspective of all businesses. This particular recommendation emphasizes a greater focus on creating valuable business service for large-employer businesses instead of a focus on negotiation and compliance related to business incentives. An ombudsman will act as a dedicated service representative to expanding businesses.

The ombudsman program should excel at:

- Site location consulting and positive relations with the community of professional site locators.
- Permit acquisition and compliance, which implies a liaison role with all permitting agencies.
- Physical infrastructure planning.
- Minimizing the time and cost of starting (or opening) a new business or operation.

Recommendation #3: Statutorily name the Secretary of Commerce to serve as the chair of the Board of Directors of the Kansas Enterprise Technology Corporation, Kansas Bioscience Authority, Network Kansas; and the chair of the Advisory Board of the Small Business Development Center. Make the Secretary of Commerce a non-voting member of the Kansas, Inc. Board of Directors.

Over the past two decades, Kansas has chosen to build an economic development model that primarily relies on free-standing agencies governed by independent Boards of Directors. This model offers a sound operational foundation: it provides for strong stakeholder input and offers continuity in the context of the transient executive leadership inherent to the state government of Kansas. However, the Governor's Office may not have a degree of influence over the operation of the overall model commensurate with its presumed level of accountability. Figure 8 provides a snapshot of the current economic development model in Kansas.

Kansas, Inc., established in 1986 in connection with the Redwood-Krider report, was created to operate as the primary coordinating agency, as indicated by the statutory appointment of the Governor to co-chair the Board of Directors. The original vision for Kansas, Inc. remains sound: it is an independent, public-private instrumentality responsible for crafting research-driven economic development policy ideas and monitoring the effectiveness of the ideas (and delivery models) that the state implements. Kansas, Inc. is the only agency in the state in which the sitting Governor is statutorily appointed to co-chair the Board of Directors. This appointment is intended to facilitate coordination across industries and agencies, and to put executive strength behind the Kansas, Inc. evaluations of other economic development agencies—including the Department of Commerce, which is why the recommendation acknowledges the importance of the Secretary of Commerce serving on the Kansas, Inc. Board but suggests removing the Secretary's current voting privileges.

The Department of Commerce, as inferred from a reading of economic development-related statutes, holds the position in the state's model as the lead agency with regard to the implementation of economic development policy. Yet the Department of Commerce appears as an oddity in the Kansas economic development model. It is the only executive agency and it has limited official means to act as the lead economic development agency with respect to the Board-directed agencies.

The current model presumes that the agencies will undertake effective voluntarily coordination. Agency evaluations by Kansas, Inc. indicate that some cooperation takes place. However, the evaluations also indicate that the agencies operate too much as independent "silos."

Aside from the power of appointment to Boards, the Governor of Kansas has no formal mechanism to direct the focus and coordination of the agencies based on state strategies or shifting priorities. Naming the Secretary of Commerce as the chair of each of the Boards of the free-standing agencies offers a simple step that can:

1. Formalize the somewhat informal presumption that the Department of Commerce acts as the lead economic development agency (under the direction of the Governor).

2. Maintain the continuity of purpose offered by agencies under the direction of independent Boards.

3. Provide a management model capable of evaluating and motivating continuity and coordination of action from a statewide policy perspective.

4. Improve accountability to the citizens of Kansas through the oversight functions provided by their elected state representatives.

Figure 8: Current Economic Development "Model"

Kansas, Inc.

- Strategic Planning, Policy Development, Agency Evaluation
- 3 FTEs, $350,000 Budget (excludes Information Network of KS)
- 17 Member Governing Board
  - Governor = Co-Chair by Statute
  - Secretary of Commerce has seat on Board
  - Specific industries must have Board representation

Department of Commerce

- Business Development, Trade Development, Rural Development, Travel & Tourism, Operations, Workforce Services
- 301 FTEs, $109.5 Million Budget
- Workforce Services is about 95% federally funded and represents about 60% of FTEs and 56% of budget.
- Regional and International Offices
- Cabinet Secretary

Kansas Technology Enterprise Corporation

- Venture Funding, Research Funding, Entrepreneurship Support
- 13 FTEs, $12.7 Million Budget (about 18% federally funded)
- Affiliated Regional Business Incubators
- 20 Member Governing Board
  - Governor has a seat on Board, participation optional
  - Specific industries must have Board representation

Kansas Bioscience Authority

- Venture Funding, Research Funding, Entrepreneurship Support
- 18 FTEs, Approximately $45 Million Budget
- 11 Member Governing Board
  - Governor has appointment authority only
  - Specific industries must have Board representation

Network Kansas

- Information Clearinghouse, Entrepreneurship Support
- 5 FTEs, $400,000 Budget (via Commerce)
- 11 Member Governing Board
  - Secretary of Commerce has appointment authority
  - Specific industries must have Board representation

Small Business Development Center

- Business Consulting and Management Training
- 37 FTEs, $1.2 Million Budget (40%) from State (via Commerce)
- Regional Offices
- 16 Member Board of Advisors

Sources: Governor's Budget (2009 actual, all funding sources); Agency web sites and Annual Reports.

Recommendation #4: Develop a task force to better align and manage the resources, activities, and geographical accessibility of the regional components of the Kansas economic development model. The end goal, as suggested by a strategy of embracing dynamism, should be to create a nationally-recognized system of business consulting, training, networking, and incubation services to induce as much business formation and expansion as possible—in the context of the many unique regional economies in Kansas.

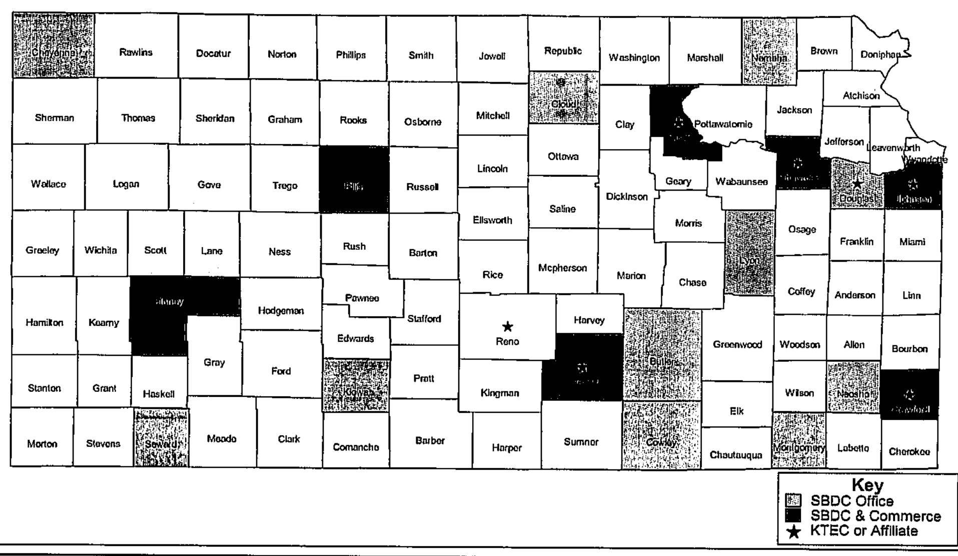
The strategy of embracing dynamism places stress on the many hands-on business services related to inducing business start-ups and expansions. These services are captured by the:

- Small Business Development Center offices that provide business consulting and training services to thousands of current and aspiring small business owners.
- Network Kansas Entrepreneurial Communities ("E-Communities") Partnerships that strive to "create a more entrepreneurial environment in each community."
- Department of Commerce regional offices—especially in the context of Commerce's Rural Development Division and Trade Development Division. According to the Department of Commerce, the "Rural Development Division is designed to elevate Commerce's focus on rural development and encourage seamless collaboration among existing rural development organizations. The Division comprises an array of technical and financial assistance programs and services for rural developers and agricultural producers." The Trade Development Division "provides individualized counseling and expertise to Kansas companies expanding their export markets."
- The regional business incubators affiliated with the Kansas Technology Enterprise Corporation—including Pipeline (a creative entrepreneurship fellowship program).

These services are inherent to the "platform-caretaker" approach to economic development. They should receive sound and stable funding and be available conveniently to Kansans in all regions of the state—so as to help induce as much commercial experimentation as possible. These services should excel at providing: core strategy analysis, understanding market dynamics, systems thinking, finance tools, research tools, business transitions, compliance, database searching, and geographical information systems.

Map 3 shows the current geography associated with the Kansas economic development agencies. The recommendation defers to a task force to better synthesize the activity implied by Map 3 because the large number of people involved will have the best knowledge about how existing resources can be better used to improve the cost-effectiveness and overall quality—on a regional basis—of the full package of services provided.

Map 3: Locations of Agency Offices



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Appendix A: Reprint of Legislative Testimony on HB 2751 (2008 Session)

Implementation of Expensing in Kansas:
A Primer on the Expensing Proposal in the Kansas, Inc. Strategic Plan

Prepared for Kansas, Inc. by
Art Hall, Executive Director
Center for Applied Economics, KU School of Business

Presented to the House Committee on Taxation
February 5, 2008

Overarching Goals:

- Every business matters—strive for inclusive policies and a level playing field among businesses of all types and sizes.
- Build on the pro-investment initiatives passed in recent legislative sessions—namely, the exclusion of business machinery and equipment from property taxation and the phase-out of the franchise tax. These policies apply to all businesses equally—and automatically.
- Minimize the cost and complexity of accessing pro-investment tax policies. Kansas, Inc. proposes expensing as an automatic **option** in lieu of other, select investment tax credits, which typically have restrictions or require application procedures with state agencies.

What is "Expensing"?

- Expensing is a procedure related to the calculation of business income tax. Whenever a business makes a capital investment (whether equipment or structure), it is allowed to take a deduction against income tax for the depreciation of the investment. Expensing is one form of depreciation deduction. Expensing allows for an immediate deduction of the full investment amount instead of requiring a prescribed schedule of smaller deductions over multiple years.
- Expensing is a pro-investment tax policy that does not subsidize businesses. Expensing improves the expected rate of return on almost any investment relative to other types of depreciation procedures, because it allows the taxpayer to capture the time value of money embedded in the investment. Importantly, from a tax policy perspective, expensing generates a higher expected investment return by removing a tax bias built into the current depreciation rules rather than granting the business taxpayer a special privilege.
- Expensing, properly implemented, is a tax policy that treats *all* businesses equally. By allowing business taxpayers to capture the time value of money related to an investment, expensing results in uniform income tax treatment for investments of all types and sizes, given the tax rate faced by the business taxpayer.

What is the Kansas, Inc. Proposal?

- Kansas, Inc. suggests that Kansas, as of date certain, offer business taxpayers the automatic **option** of choosing to expense capital investments made within the state. This policy change will make Kansas unique among the states (with income taxes).
- Kansas, Inc. suggests that the expensing proposal offer business taxpayers a **mutually-exclusive option** between expensing and other investment-related tax credits available under Kansas law. The table below lists those tax credits that a Kansas taxpayer could not take on a particular investment if they choose the expensing option for that investment.

Taxpayer Option: Automatically Expense an Investment or Take the Allowable Tax Credit(s)

Type of Credit	2004 Process Year		2006 Process Year	
	Returns	Dollars	Returns	Dollars
Alternative-Fuel Tax Credit (K-62)*	15	12,000	68	54,793
Business and Job Development Credit (K-34)	1,193	8,485,000	2,114	14,046,665
Cellulosic Alcohol Plant Credit (K-79)	n/a	n/a	n/a	n/a
Disabled Access Credit (K-37)**	9	2,000	6	1,321
Nitrogen Fertilizer Plant Credit (K-78)	n/a	n/a	n/a	n/a
High Performance Incentive Program Credits (K-59)	276	16,993,000	1,265	24,098,727
Integrated Coal Gasification Power Plant Credit (K-80)	n/a	n/a	n/a	n/a
Petroleum Refinery Credit (K-73)	n/a	n/a	n/a	n/a
Qualifying Pipeline Credit (K-77)	n/a	n/a	n/a	n/a
Research and Development Credit (K-53)***	154	554,000	223	833,891
Swine Facility Improvement Credit (K-38)	0	0	0	0
Environmental Compliance Credit (K-81)	New in 2007			
Electric Cogeneration Facility Credit (K-83)	New in 2008			
Storage and Blending Equipment Credit (K-82)	New in 2008			
Total	**1,647**	**26,046,000**	**3,676**	**39,035,397**

* Any business investment in a vehicle or fueling station would naturally fall under the procedures for expensing.
** Business property modifications would naturally fall under the procedures for expensing; household modifications would not. The dollar figure represents corporate returns only.
*** Expensing would apply to the machinery and equipment component of this credit only.

Source: Kansas Department of Revenue

Many Businesses in Growth Mode Apparently Do Not Seek Credits
Estimated Number of Kansas Businesses Starting Up or Expanding, 1994-2004

Year	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	Average
Birth	13,644	8,603	13,229	8,894	10,835	8,843	11,860	18,028	14,984	8,780	9,502	11,564
Expand	2,831	5,051	5,576	6,230	6,699	7,370	4,669	5,779	4,980	5,213	6,067	5,497
Total	16,475	13,654	18,805	15,124	17,534	16,213	16,529	23,807	19,964	13,993	15,569	17,061

Other Important Features of the Kansas, Inc Proposal

- *Definition of eligibility:* The cost of any tangible asset, including fabrication and installation, that is, or under the federal internal revenue code will become, eligible for depreciation, amortization, or accelerated cost recovery for federal income tax purposes.
- Unlimited carry forward of unused balances.
- Taxpayers may elect the expensing deduction on an asset-by-asset basis.
- For multi-state taxpayers, the expensing deduction is directly allocable to Kansas income and not subject to apportionment.
- Recapture rules for taxpayers that buy eligible property and move it out of Kansas.
- Rules for calculating the gain or loss of an asset that has been expensed and subsequently sold.
- Expensing, because it is a deduction, automatically applies to a "consolidated group" under current Kansas law.

How Does Expensing Compare with Investment Tax Credits?

- Expensing is an "above the line" deduction from taxable income. The economic value of an income tax deduction equals the deduction amount times the tax rate.
- An investment tax credit is a "below the line" subtraction from income tax liability. The economic value of an income tax credit equals the investment amount times the tax credit percentage.
- All else equal, if a taxpayer faces an income tax rate of 10%, the expensing option and a 10% investment tax credit will have the same economic value.

Comparison of Expensing and Tax Credits
Hypothetical Business Operating Solely within Kansas

Assume a $100,000 Investment in 7-Year Property

Examples:
- Furniture and fixtures for a call center
- Agricultural machinery
- A new natural gas gathering pipeline
- Manufacturing equipment for many industries

	Year 1 Income Tax Calculation		
	Full Expensing	**Kansas, Inc. Expensing**	**HPIP Tax Credit**
Gross Receipts	500,000	500,000	500,000
Less: Cost of Goods Sold	310,000	310,000	310,000
Less: Federal Depreciation (on above investment)	14,290	14,290	14,290
Equals: Net Profit (Federal Taxable Income)	175,710	175,710	175,710
Plus: Kansas Additions to Federal Taxable Income	0	0	0
Less: Kansas Deductions from Federal Taxable Income	0	0	0
Equals: Apportionable Business Income to Kansas	175,710	175,710	175,710
Less: Kansas Expensing Deduction	100,000	22,300 *	0
Equals: Kansas Taxable Income	75,710	153,410	175,710
Kansas Income Tax (at 4% + 3.35% Surtax over $50,000)	3,928	9,756	11,428
Less: HPIP Tax Credit (10%)	0	0	5,000
Equals: Kansas Tax Liability	3,928	9,756	6,428

* The adjustment factor is explained below: "What is the Kansas, Inc. Solution for Implementing Expensing?"

Expected Rate of Return on Identical Hypothetical Investments (7-Year Property, Full Value of Incentive Captured in Year 1)			
	$1 Million Investment	**$100,000 Investment**	**$50,000 Investment**
No Credit or Expensing	9.20%	9.20%	9.20%
Full Expensing (7.35% Tax Rate)	11.28%	11.28%	11.28%
Kansas Inc. Expensing (7.35% Tax Rate)	9.78%	9.78%	9.78%
HPIP Investment Credit	11.92%	10.60%	9.20%
Business& Jobs Credit (Rural, 5 Jobs)	9.20% (9.82%)	9.20% (13.14%)	9.20% (17.27%)

Formulas for Calculating Taxpayer Value	
Full Expensing	Investment Amount x Tax Rate
Kansas, Inc. Expensing	Investment Amount x Kansas Adjustment Factor x Tax Rate
HPIP Investment Tax Credit	(Qualifying Investment Expenditure - $50,000) x 10%
Business & Jobs Credit	(Qualifying Investment Expenditure x 1%) + (Number of qualifying employees x credit per employee)

What is the Kansas, Inc. Solution for Implementing Expensing?

Kansas, like many states, piggybacks on the procedures in the federal income tax code. This fact makes the implementation of expensing in Kansas slightly more complicated than it would be at the federal level. In brief, it would require a Kansas business tax preparer to spend about 5-10 minutes to perform one additional calculation.

The purpose of the additional calculation is to keep undisturbed the Kansas procedure of using federal taxable income as the starting point for Kansas corporate income tax calculations (and federal adjusted gross income as the starting point for proprietorships, partnerships, and S-Corporations). These starting-point measures of income already have federal depreciation built in. The Kansas, Inc. expensing proposal does not seek to double-count the federal deductions; it seeks to allow Kansas business electing the expensing option to capture the additional time value of money generated by expensing.

<u>An Example</u>

- Federal depreciation procedures rely on a set of prescribed rules.
- When a business taxpayer makes a capital investment, the tax preparer must make a decision about (1) how to classify the property for depreciation purposes and (2) what depreciation method to use. Once the tax preparer makes those decisions, all of the details about the depreciation schedule become known.
- Kansas, Inc.'s suggested implementation plan for expensing in Kansas relies on the decision that the tax preparer makes for federal depreciation purposes.

Acme Call Centers has a state-of-the-art facility in Hays, Kansas. Acme purchases $100,000 worth of new furniture to expand its call center. The CFO of Acme knows that furniture is classified as a 7-year form of property for federal depreciation purposes. She decides to use the 200% Declining Balance depreciation method (employing the half-year convention).

Acme Call Centers' Federal Depreciation Deduction Schedule								
Year	1	2	3	4	5	6	7	8
Amount ($)	14,290	24,490	17,490	12,490	8,930	8,920	8,930	4,460

- Kansas expensing amount if there were no federal depreciation rules: $100,000
- Kansas expensing amount under Kansas, Inc. proposal: $100,000 x 0.223 = $22,300.

The Kansas, Inc. proposal would provide Acme an additional $22,300 income tax deduction—in Year 1 only. That amount captures the time value of money difference between the federal depreciation schedule and the full expensing amount of $100,000.

Where did the 0.223 number come from? It was (hypothetically) published by the Kansas Department of Revenue. It was calculated by taking the difference between the investment amount ($100,000, in this case) and the discounted present value of the federal depreciation schedule (years 2-8) using an interest rate of eight percent (8%). Mathematically, the adjustment factor of 0.223 remains invariant for any investment in 7-year property that a taxpayer depreciates using the 200% Declining Balance method under the half-year convention.

The same procedure used in the Acme Call Centers example would apply for any investment made in Kansas. Different adjustment factors would apply to the several different combinations of property classifications and depreciation methods available to taxpayers under the federal tax rules.

What is the Fiscal Note for the Kansas, Inc. Expensing Proposal?

- The table below illustrates a likely range of revenue (tax liability) reductions that would result from implementing the expensing system suggested by Kansas, Inc.—*assuming that every business opted to expense its investments.*

- The calculations assume that a fully mature expensing system applied to the actual Kansas income tax data recorded for the years 2005 and 2004.

- The estimates do not include the revenue offsets that would result from replacing the tax credits specified above with the expensing option—about $39 million in 2006.

Estimated Fiscal Note for Kansas, Inc. Expensing Proposal
(Assumes a Fully Mature System Applied to Tax Years 2005 and 2004)

Dollars in Millions	**2005**	**2004**
KS Business Income Tax Collections	$474.4	$315.1
Fiscal Note Estimates*		
Low Range	44.1	34.5
Medium Range (Likely)	55.1	43.2
High Range	69.1	54.4

* Includes machinery and equipment investments only. If structures are also included, which Kansas, Inc. suggests, add to an estimate: $35 million for 2005 or $23.3 million for 2004.

Source: Center for Applied Economics, KU School of Business using data from the Kansas Department of Revenue, the U.S. Internal Revenue Service, the U.S. Census Bureau, and the U.S. Bureau of Economic Analysis. (The Kansas Department of Revenue reported income and privilege tax collections for corporations and financial institutions. The Center for Applied Economics estimated the income taxes paid by proprietorships, partnerships, and S-Corporations.)

Methodological Points Related to the Fiscal Note Calculations

- The calculations for machinery and equipment use data compiled for the U.S. by the U.S. Census Bureau's Annual Capital Expenditure Survey. This data is reported for many different industry sectors. Census categorizes capital expenditures as either Equipment or Structures.

- The U.S. Capital Expenditure Survey equipment data is allocated to Kansas, by industry sector, based on the Kansas share of U.S. gross domestic product in each industry sector. In effect, this procedure assumes that Kansas businesses invest at the U.S. average rate, based on value-added. (Note: Based on the data for structures reported by the Kansas Department of Revenue for property tax purposes, as discussed below, this is a conservative assumption, because Kansas invests substantially below what the average rate would suggest.)

- For structures, the fiscal note calculations rely on property tax data collected and reported by the Kansas Department of Revenue; specifically, the appraised value of new commercial and industrial real property placed in service in 2005 and 2004. The U.S. Capital Expenditure Survey data for structures was used to gross-up the new-property amount to account for business investment in "used" structures.

- Capital expenditure amounts are allocated to businesses based on reported income. Guided by IRS data, 5-15 percent of capital expenditure amounts are allocated to businesses with no *taxable* income, depending on industry sector.

- The fiscal note estimates explicitly ignore the limited expensing rules allowed by Section 179 of the federal tax code. Incorporating this element into the calculations would *reduce* the Kansas fiscal note associated with expensing. Public data is too imprecise to warrant including Section 179 elections in the analysis.

- Federal tax rules allow for several choices of depreciation method for equipment-like property. Further, equipment-like property is classified into several categories: 3-, 5-, 7-, 10-, 15-, and 20-years. There is less flexibility regarding structures.

  For the equipment calculation, the fiscal note used the 200% Declining Balance method. Under each scenario, utility property was assumed to be 15-year property for depreciation purposes. Otherwise, Low Range assumed 5-year property, Medium Range assumed 7-year property, and High Range assumed 10-year property.

  For structures, the fiscal note assumed the straight-line depreciation method. Structures related to commercial residential real estate used a 27.5-year life. All other structures assumed a 39-year life.

  A discount rate of eight percent (8%) applied to all adjustment calculations. In each case, year-1 depreciation deductions were not discounted to keep them time-consistent with the full-expensing option.

Appendix B: About the Center for Applied Economics

About the Center for Applied Economics

The mission of the Center for Applied Economics at the University of Kansas School of Business is to help advance the economic development of the state and region by offering economic analysis and economic education relevant for policy makers, community leaders, and other interested citizens. When elected officials, community leaders, and citizens discuss issues that may have an impact on the economic development potential of the state or region, they can benefit from a wide array of perspectives. The Center focuses on the contributions that markets and economic institutions can make to economic development. Because credibility is, in part, a function of economic literacy, the Center also promotes economics education.

Arthur P. Hall
Executive Director
Center for Applied Economics

Art Hall is the founding Executive Director of the Center for Applied Economics at the University of Kansas School of Business. Before joining the KU School of Business, Hall was Chief Economist in the Public Affairs group of Wichita, KS-based Koch Industries, Inc. In that capacity, he worked with business leaders to help define how public policy initiatives would influence the structure of the markets in which the company participates. Koch sponsored Hall's directorship of Kansas Governor Sebelius' Budget Efficiency Savings Teams from April 2003 until his departure from the firm in February 2004.

Before joining Koch Industries in May 1997, Hall was Senior Economist at the Washington, D.C.-based Tax Foundation, where he produced quantitative and qualitative research pertaining to the economics of taxation, and acted as an economic advisor to The National Commission on Economic Growth and Tax Reform. Before that, he worked as a financial economist at the U.S. General Accounting Office. Hall has taught university economics at both the undergraduate and MBA level. He received his Ph.D. in economics from the University of Georgia and his B.A. in economics from Emory University.

Selected Publication List

Academic Journals

"The Challenge of Incentive Alignment in the Application of Information Markets Within an Organization," *The Journal of Prediction Markets*, Vol. 3, N0. 1, April 2009, pp. 13-16

Trade Journal Publications

"Investment Climate in the Republic of Kazakstan," Tax Notes International, July 1, 1996, pp. 53-57. (with Daniel A. Witt)

"Compliance Costs of Alternative Tax Systems," Tax Notes, May 20, 1996, pp. 1081-1089. (Reprint of Tax Foundation Special Brief (House Ways and Means Committee Testimony), Washington, D.C., March 1996.)

"Issues in the Indexation of Capital Gains," Tax Notes, May 1, 1995, pp. 675-678. (Reprint of Tax Foundation Special Report No. 47, Washington, D.C., April 1995.)

"Fifty Years of the Federal Capital Gains Tax Burden," Tax Notes, April 24, 1995, pp. 553-562. (Reprint of Tax Foundation Special Report No. 45, Washington, D.C., March 1995.)

"Growth of Federal Government Tax 'Industry' Parallels Growth of Federal Tax Code," Tax Notes, November 28, 1994, pp. 1133-1138. (Reprint of Tax Foundation Special Report No. 39, Washington, D.C., September 1994.)

"The Cost of Unstable Tax Laws," Tax Notes, November 7, 1994, pp. 759-768. (Reprint of Tax Foundation Special Report No. 41, Washington, D.C., October 1994.)

"The High Cost of Tax Compliance for U.S. Business," Tax Notes, May 16, 1994, pp. 887-893. (Reprint of Tax Foundation Special Report No. 25, November 1993.)

Research Reports

"A Comprehensive Retail Sales Tax as a Single Tax for the State of Kansas," Technical Brief 09-1218, December 2009, Center for Applied Economics, University of Kansas School of Business.

"Technology-Based Economic Development in Kansas: Issues, Opportunities, and Strategies," Kansas, Inc. Research Report, October 2009 (with Lee Lewellen).

"The County-to-County Migration of Taxpayers and their Incomes," Technical Report 09-0360, March 2009, Center for Applied Economics, University of Kansas School of Business (with Scott Moody and Wendy Warcholik).

"Expensing: A Competitive Leap for Kansas Tax Policy," Technical Brief 07-0903, Center for Applied Economics, University of Kansas School of Business, September 2007.

"Economic Growth and Productivity in the Regions of Kansas, 1969-2003," *Kansas Policy Review*, Vol. 26, No. 1, Spring 2006, pp. 12-20.

"Property Tax Comparisons Among Kansas Localities and Select Cities of the United States, Kansas, Inc., May 2006.

"Competing Concepts of Income and the Double Taxation of Saving," Center for Applied Economics, School of Business, University of Kansas, Technical Report 05-0926, September 2005.

"A Brief Economic History of Kansas, 1969-2003," Kansas, Inc. Research Report, August 2005 (with Peter F. Orazem).

"Business Climate Indexes: Which Work, Which Don't, and What Can They Say About the Kansas Economy?" Kansas, Inc. Research Report, June 2005 (with George Bittlingmayer, Liesel Eathington, and Peter F. Orazem).

"Exaggerated Tales of Rural Economic Decline," Center for Applied Economics, School of Business, University of Kansas, Technical Report 05-0225, September 2005 (with Georganne M. Artz and Peter F. Orazem).

"The Kansas Productivity Puzzle," Center for Applied Economics, School of Business, University of Kansas, Technical Report 04-1118, September 2005 (with Peter F. Orazem).

"A Half Century of Small Business Federal Income Tax Rates and Collections," Tax Foundation Special Report No. 61, October 1996. (with Gary Leff).

"Tax Reform and the Foundations of Federal Taxation," Madison Review, Vol. 1, No. 3 (Spring 1996), pp. 4-12.

"Growth of the Earned Income Tax Credit," Tax Foundation Special Report No. 53, Washington, D.C., September 1995 (with Jeffrey Scott Moody).

"How Will Alternative Tax Reform Plans Affect the Jones Family?" Tax Foundation Special Report No. 49, Washington, D.C., May 1995.

"The Compliance Costs and Regulatory Burden Imposed by the Federal Tax Laws (House Ways and Means Committee Testimony)," Tax Foundation Special Brief, Washington, D.C., January 1995.

"Individual Effective Tax Rates in the United States," Tax Foundation Special Report No. 35, Washington, D.C., June 1994.

"Uncompensated Reserve Requirements: The Hidden Tax on Our Banks," Tax Foundation Background Paper No. 6, Washington, D.C., November 1993.

KANSAS POLICY INSTITUTE
Advocating for free markets and the protection of personal liberty

Testimony Presented to Special Committee on Assessment and Taxation
Modifying the State and Local Tax Structure to Promote Economic Growth

Dave Trabert, President, Kansas Policy Institute
September 17, 2010

Chairman Carlson, Vice Chairman Donovan and esteemed Committee Members:

Let me start by thanking the Committee for inviting me to speak on behalf of Kansas Policy Institute today. I welcome the opportunity to work with you to promote economic growth and explore how Kansas' tax policy can be optimized to create jobs and spur economic development. As you know, tax policy has a major impact on the economy, and especially so on economic development. We can learn a great deal about creating an environment that encourages greater economic activity and job creation by studying the comparative performance of states with the lowest and highest tax burdens.

Individual taxpayers and employers have finite resources; spending more money on, say, a new car, means they must reallocate their resources and spend less on something else. The same applies to taxes; the more taxpayers must pay in taxes, the less they have to spend on goods and services. In order to maximize economic activity and encourage growth, it's therefore extremely important that taxes be kept low and that state and local tax burdens are competitive with other states.

Kansas Policy Institute (KPI) compared how the ten states with the lowest combined state and local tax burdens compared to the ten with the highest burdens on several key performance measures. We used the tax burden rankings from the non-partisan Tax Foundation, which calculated the burden as taxes paid per capita as a percentage of per capita income for each state. The Tax Foundation used Fiscal 2008 data for their comparisons, the most recent nationwide data available when the study was published earlier this year.

We first looked at private sector job growth over ten-year periods and found that the low-burden states had remarkably better performance. The first ten-year period used was 1998 – 2008; then we looked at 1999 – 2009 to see how each group's performance changed a year into the recession.

250 N. WATER, SUITE 216 | WICHITA, KS 67202 | P (316) 634-0218 | F (316) 440-4

Special Committee on Assessment and Taxation
September 16-17, 2010
Attachment #32

Table 1: Private Sector Job Growth

State / Local Tax Burden Rank	1998-2008	1999-2009
10 lowest burden states(41-50)	16.5%	7.0%
10 highest burden states (1-10)	6.1%	-2.2%
National average	7.8%	-0.3%

Source: Tax Foundation, U.S. Dept. of Labor, Bureau of Labor Statistics.

The low-burden group of states was well above the national average and outperformed the high-burden group many times over. It's particularly interesting that the low-burden group is weathering the recession much better. In the 1998-08 time frame, the low-burden group outperformed the high-burden group by 2.7:1 (16.5% compared to 6.1%); a year later, they outperformed them by 4.2:1. Every state was affected by the recession, but private sector employment in the lowest-burden states is still well better than it was ten years ago – a claim that higher burden states cannot make.

Next we looked at population change, since having a broad and expanding tax base is critical to keeping tax burdens low. We specifically looked at net domestic migration over the last ten years – U.S. residents moving into and out of states – with the net change measured as a percentage of current population.

Again, the low-burden states were the big winners. The ten states with the lowest state and local tax burden averaged a 3.8% gain from domestic migration; that includes Louisiana, which suffered significant population loss following Hurricane Katrina. Excluding Louisiana, the other nine states averaged a 5.0% gain. The ten states with the highest combined tax burden all had net losses, averaging a 3.3% decline.

Both performance comparisons (private sector job growth and domestic migration) make perfect sense. Given the means and opportunity, we all tend to gravitate toward what we perceive to be the best 'deal.' Human and financial capital is no different; it will go where it is treated the best. People want to retain more of their earnings and states with the lowest state and local tax burdens let them keep more of their hard-earned money to spend as they wish.

The Tax Foundation doesn't put Kansas in the ten highest or lowest rankings, listing it as having the 21st highest state and local tax burden in the country. Kansas is likely moving closer to having one of the highest tax burdens, however, as the rankings don't include any changes enacted since FY 2008. This year alone, Kansans are paying nearly $500 million more in sales tax, unemployment tax and property tax, and Kansas was the only state in the region that balanced its FY 2011 budget with a large tax increase.

Kansas' performance on private sector job growth and domestic migration is a little better than the states with the ten states with highest combined tax burden but considerably below that of the lowest-burden states. The state's performance is also well below most neighboring states.

Table 2: Regional States Comparison to Lowest and Highest Tax Burden States

	Private Sector Job Growth		Domestic Migration
State / Local Tax Burden Rank	1998-2008	1999-2009	2000-2009
10 lowest burden states(41-50)	16.5%	7.0%	3.8%
low burden states w/o Louisiana			5.0%
10 highest burden states (1-10)	6.1%	-2.2%	-3.3%
National average	7.8%	-0.3%	0.0%
Kansas (21)	5.2%	-0.6%	-2.5%
Missouri (32)	3.2%	-3.1%	0.7%
Colorado (34)	13.3%	2.7%	4.2%
Oklahoma (19)	9.6%	2.6%	1.1%
Nebraska (17)	10.2%	4.5%	-2.3%
Texas (43)	18.7%	11.4%	3.4%

Source: Tax Foundation; U.S. Dept. of Labor, Bureau of Labor Statistics; U.S. Census Bureau.

The results for Kansas aren't surprising, as the state and local tax burden has been rising. The Kansas Legislative Research Division (KLRD) says otherwise, but they are using the federal government definition of personal income to calculate the tax burden. The problem is that that definition includes money in 'income' that is not available to pay taxes, such as employer contributions toward pension funds, health insurance, social security and Medicare.

Table 3: State and Local Tax Burden Rises Over the Last Ten Years

Kansas State and Local Tax Revenue (in thousands)

	FY 1999	FY 2009	% Change
Counties	721,936	1,695,437	134.8%
Cities	476,521	1,171,894	145.9%
Townships	39,785	66,424	67.0%
Schools	1,013,147	1,902,438	87.8%
Special Districts	118,027	290,383	146.0%
Not allocated	475,120	0	-100.0%
Total Local government	2,844,536	5,126,576	80.2%
State government	4,555,513	6,640,963	45.8%
Total State and Local taxes	**7,400,049**	**11,767,539**	**59.0%**

Income Available to Pay Taxes (in thousands)

	1999	2009	% Change
Wages and salaries	39,441,538	55,882,122	41.7%
Proprietors' income	6,916,893	9,995,816	44.5%
Dividends, Interest and Rent	13,547,971	17,103,886	26.2%
Employee contributions for gov't. social ins.	(3,249,213)	(4,754,418)	46.3%
Total Income	**56,657,189**	**78,227,406**	**38.1%**
Combined Tax Burden (taxes ÷ income)	**13.1%**	**15.0%**	

Source: KLRD, Kansas Tax Facts; U.S. Dept. of Commerce, Bureau of Economic Analysis.

Over the ten year period ending June 30, 2009, income available to pay taxes went up 38% but state and local taxes shot up 59%, resulting in a significant jump in the tax burden.

And the combined tax burden will continue to rise until the Legislature takes substantive action to reduce taxes. The domestic migration net loss noted in Table 2 has occurred for eleven consecutive years. Kansas has experienced a net gain in international migration but the main reason that our overall population has increased is that more people are being born than are dying. But newborns don't pay taxes for a long time, so each year there are fewer of us to pay higher and higher taxes.

The pattern is pretty clear – states with low tax burdens are growing and people and jobs are leaving those with high tax burdens. Kansas had the 21st highest tax burden at the end of FY 2008 and is now likely a few spots higher. There is no question that Kansas has a number of strong attributes (highway system, quality of life, etc.) but we need to be realistic about competing states. Most of them can also rightfully claim to have good highways, schools, health care availability, quality of life and maybe a few natural attributes that Kansas will never have, such as deep water ports and year-round warm weather. Competition is not just about having the right strong attributes, it's also about lack of negative attributes.

We believe the change that would have the greatest impact on the state's economy is to gradually eliminate the income tax, both on individuals and on corporations. The corporate income tax would be easier to eliminate (it only accounted for 4.5% of General Fund tax revenue in FY 2010) and doing so immediately or over a short period of years would send a very strong message about the State's intention to retain and attract jobs.

But just eliminating the corporate income tax is not enough. Continuing to tax individual income would send a very wrong message. Also, many business owners' income is taxed at personal income (partnership, subchapter S, proprietorship) to avoid the double taxation on corporate income (net income is taxed at corporate rates and again at individual rates when distributed as dividends). Large corporations may get most of the headlines but small employers are the backbone of every economy.

Eliminating the income tax would certainly be a challenge. It would require the implementation of serious cost containment and eliminating many or all of the tax credits and exemptions that have been granted over the years, but nothing would boost the state economy and create prosperity like eliminating income taxes.

Seven states have no income tax – Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming. Two others, New Hampshire and Tennessee, tax only dividend and interest income. At least two other states – Missouri and South Carolina – are trying to move in that direction and both are specifically setting their sights on attracting Kansas residents and aviation jobs.

Kansas would also benefit enormously from property tax reform. Not only have property taxes skyrocketed – increasing 93% since 1997 – the property tax is the tax most removed from taxpayers' ability to pay. We've heard from countless low-to-moderate income people who say they are being taxed out of their homes. Here's a sampling of verbatim comments we collected in our statewide public opinion poll last September:

- *I am a senior and taxes keep going up, it will run me out of my home….*
- *I live in a small town and an older house and yet the taxation on it is eating us up….*
- *It seems that the older my house gets, the higher my taxes get. We have to limit home improvements because our taxes are already way too high. So instead of having nice looking homes, we have to let our homes look "crappy" to avoid more tax increases.*

A few people did share some positive comments. Of the 318 people who made comments, 5% had good things to say about the property tax system, 12% made neutral comments and 83% made negative comments. The full report runs seventeen pages and I'd be to provide copies to anyone who would like them.

The tax increases shown in Table 4 show that residential property is also carrying a much larger share of the property tax burden, with most of the shift coming from State assessed property and farm real estate.

Table 4: Statewide Property Tax Collections (excludes Penalty Tax)

	Tax Dollars (in millions)			Tax $ % of Total	
	1997	2009	% Chg.	1997	2009
Real Estate					
Residential	772.8	1,833.8	137.3%	39.3%	48.3%
Comm. & Indust.	400.6	908.8	126.9%	20.4%	24.0%
Ag Land	136.2	156.7	15.1%	6.9%	4.1%
Ag Improvement	13.6	31.0	127.9%	0.7%	0.8%
Vacant Lots	15.1	32.9	117.9%	0.8%	0.9%
Not-for-Profit	4.2	2.7	-35.7%	0.2%	0.1%
Other	3.0	1.3	-56.7%	0.2%	0.0%
	1,345.5	2,967.2	120.5%	68.5%	78.2%
Personal Property					
Res. Mobile Home	5.0	7.3	46.0%	0.3%	0.2%
Mineral Leasehold	122.4	246.8	101.6%	6.2%	6.5%
Motor Vehicles	21.4	23.4	9.3%	1.1%	0.6%
M & E	174.4	155.0	-11.1%	8.9%	4.1%
State Assessed	284.4	375.7	32.1%	14.5%	9.9%
Other	11.7	17.9	53.0%	0.6%	0.5%
	619.3	826.1	33.4%	31.5%	21.8%
Total - All Property	1,964.8	3,793.3	93.1%	100.0%	100.0%

Source: Kansas Department of Revenue, Property Valuation Division

The burden share attributed to Machinery & Equipment dropped several points but was mostly offset by the share increase for Commercial & Industrial real estate.

Some property has been exempted over the last twelve years and caused a very minor amount of shift, but that is not the central issue (nor is lifting those exemptions the cure, as that would only cause taxes to be even higher). Rather, it's that taxes have been allowed to increase more than three times the rate of inflation and nearly eleven times the increase in population.

There are several ways to fix this legislatively and provide taxpayers with much-needed relief, listed in descending order of ability to deliver taxpayer-focused relief:

- Enact a Constitutional amendment that limits the annual increase in property taxes on each parcel.
- Statutorily limit the annual rate of increase in property taxes (e.g., inflation plus population or a fixed amount) without taxpayer approval.
- Require city and county officials to vote on the overall tax increase rather than the current practice of approving the mill rate.

The sales tax is the third leg of the so-called tax stool. The increase in the state rate that went into effect on July 1 propelled Kansas to having the 12th highest average state and local sales tax rate in the country according to the Tax Foundation. Previously, Kansas was ranked #23.

Both studies conducted on the impact of that increase said it would result in job loss this year, so strong consideration should be given to repealing the sales tax increase. That said, sales taxes have proven to be a better means of public finance than income taxes and phasing out the income tax might mean the temporary increase enacted last session would have to remain in place. This type of system would function much more clearly and fosters more economic competitiveness and job creation.

There is one other change to the sales tax to consider that would be revenue neutral, however. Kansas went to a destination-based sales tax in 2003 for online purchases, which means that sales tax collected on online purchases are based on where the merchandise is shipped in Kansas, not the city in which the retailer is located. Kansas has 837 separate taxing districts for sales tax purposes, so online retailers must spend considerable time and money setting up order processing systems capable of matching orders to the appropriate jurisdiction. This represents a barrier to entry that employers don't face in many states. The concept was created by the National Governor's Association (NGA) and the National Conference of State Legislatures (NCSL) to "...simplify sales tax collection..." according to StreamlinedSalesTax.org, an association representing participating states. Many online retailers believe it is really intended to pave the way for a national sales tax.

Finally, we would like to touch on tax credits and exemptions, which we recommend against as a matter of policy. Our position has nothing to do with the merits of the intended outcome or the nature of services provided by recipients. Rather, in keeping with the constitutional intentions of the founding fathers of this country, we do not believe government should be in the business of picking winners and losers. It may well be an unintended consequence, but it is a consequence nonetheless. Not only do recipients get a benefit, but all other taxpayers pick up the tab unless government spending is reduced by the amount of the credit or exemption.

And ironically, incentives aren't high on employers' wish list. They'll certainly take them if offered but according to a recent survey conducted by Site Selection Magazine, a low tax burden is a much higher priority. Participants listed 'state and local tax scheme' as their #3 priority (transportation infrastructure and existing workforce skills were #1 and #2, respectively) but 'flexibility of incentives' was ranked #7 and 'availability of incentives' came in at #9.

Reducing the overall state and local tax burden is paramount to economic growth. Regardless of how it's done, the key is to reduce spending. It won't be easy but it can be done. Further, it must be done, as no state has ever spent, borrowed or taxed its citizens to prosperity.

Kansas can become one of the most prosperous states in the nation if we adopt policies that increase personal economic freedom.

Low Tax Burdens Attract Jobs and People

State / Local Tax Burden Rank	Private Sector Job Growth 1998-2008	Private Sector Job Growth 1999-2009	Domestic Migration[3] 2000-2009
10 lowest burden states(41-50)[1]	16.5%	7.0%	3.8%
low burden states w/o Louisiana			5.0%
10 highest burden states (1-10)[2]	6.1%	-2.2%	-3.3%
Kansas (21)	5.2%	-0.6%	-2.5%
Missouri (32)	3.2%	-3.1%	0.7%
Colorado (34)	13.3%	2.7%	4.2%
Oklahoma (19)	9.6%	2.6%	1.1%
Nebraska (17)	10.2%	4.5%	-2.3%
Texas (43)	18.7%	11.4%	3.4%

[1]Alaska, Nevada, Wyoming, Florida, New Hampshire, South Dakota, Tennessee, Texas, Louisiana, Arizona
[2]New Jersey, New York, Connecticut, Maryland, Hawaii, California, Ohio, Vermont, Wisconsin, Rhode Island
[3]Net U.S. residents moving into or out of the state, expressed as % of 2009 population.

Source: Tax Foundation, State and Local Tax Burden as a Percentage of State Income for FY 2008; U.S. Dept. of Labor, Bureau of Labor Statistics; U.S. Census Bureau.

Tax Burden Rising, Tax Growth More Than Double Inflation

Kansas State and Local Tax Revenue (in thousands)

	FY 1999	FY 2009	% Change
Counties	721,936	1,695,437	134.8%
Cities	476,521	1,171,894	145.9%
Townships	39,785	66,424	67.0%
Schools	1,013,147	1,902,438	87.8%
Special Districts	118,027	290,383	146.0%
Not allocated	475,120	0	-100.0%
Total Local government	2,844,536	5,126,576	80.2%
State government	4,555,513	6,640,963	45.8%
Total State and Local taxes	**7,400,049**	**11,767,539**	**59.0%**
Consumer Price Index	**162.7**	**204.1**	**25.4%**

Source: Kansas Legislative Research Dept, Kansas Tax Facts; U.S. Dept. of Labor, Bureau of Labor Statistics, Midwest Urban Cities annual (calendar) index, seasonally unadjusted.

Income Available to Pay Taxes (in thousands)

	1999	2009	% Change
Wages and salaries	39,441,538	55,882,122	41.7%
Proprietors' income	6,916,893	9,995,816	44.5%
Dividends, Interest and Rent	13,547,971	17,103,886	26.2%
Contributions for gov't. social insurance	(3,249,213)	(4,754,418)	46.3%
Total Income	**56,657,189**	**78,227,406**	**38.1%**
State / Local Tax Burden (taxes ÷ income)	**13.1%**	**15.0%**	

Source: U.S. Dept. of Commerce, Bureau of Economic Analysis, SA05N Personal Income by major source accessed June 15, 2010. Federal calculation of Personal Income includes employer contributions for health care and pension, current transfer receipts and adjustment for residence but all or most of those amounts are not available to pay taxes and are therefore excluded from this calculation.

Statewide Change in Assessed Values and Property Tax
(In Millions)

	Assessed Value			Tax Dollars			Tax $ % of Total	
	1997	2009	% Chg.	1997	2009	% Chg.	1997	2009
Real Estate								
Residential	6,863.8	14,516.0	111.5%	772.8	1,833.8	137.3%	39.3%	48.3%
Comm. & Indust.	3,311.5	7,009.9	111.7%	400.6	908.8	126.9%	20.4%	24.0%
Ag Land	1,302.5	1,197.6	-8.1%	136.2	156.7	15.1%	6.9%	4.1%
Ag Improvement	131.1	229.7	75.2%	13.6	31.0	127.9%	0.7%	0.8%
Vacant Lots	124.9	250.4	100.5%	15.1	32.9	117.9%	0.8%	0.9%
Not-for-Profit	34.7	20.9	-39.8%	4.2	2.7	-35.7%	0.2%	0.1%
Other	28.5	23.4	-17.9%	3.0	1.3	-56.7%	0.2%	0.0%
	11,797.0	23,247.9	97.1%	1,345.5	2,967.2	120.5%	68.5%	78.2%
Personal Property								
Res. Mobile Home	53.9	61.1	13.4%	5.0	7.3	46.0%	0.3%	0.2%
Mineral Leasehold	1,622.8	2,391.1	47.3%	122.4	246.8	101.6%	6.2%	6.5%
Motor Vehicles	186.3	172.0	-7.7%	21.4	23.4	9.3%	1.1%	0.6%
M & E	1,468.3	1,177.9	-19.8%	174.4	155.0	-11.1%	8.9%	4.1%
State Assessed	2,897.8	3,126.7	7.9%	284.4	375.7	32.1%	14.5%	9.9%
Other	99.2	135.4	36.5%	11.7	17.9	53.0%	0.6%	0.5%
	6,328.3	7,064.2	11.6%	619.3	826.1	33.4%	31.5%	21.8%
Total - All Property	18,125.3	30,312.1	67.2%	1,964.8	3,793.3	93.1%	100.0%	100.0%
C&I Summary								
Real estate	3,311.5	7,009.9	111.7%	400.6	908.8	126.9%	20.4%	24.0%
M & E	1,468.3	1,177.9	-19.8%	174.4	155.0	-11.1%	8.9%	4.1%
	4,779.8	8,187.8	71.3%	575.0	1,063.8	85.0%	29.3%	28.0%
Ag Summary								
Ag Land	1,302.5	1,197.6	-8.1%	136.2	156.7	15.1%	6.9%	4.1%
Ag Improvement	131.1	229.7	75.2%	13.6	31.0	127.9%	0.7%	0.8%
	1,433.6	1,427.3	-0.4%	149.8	187.7	25.3%	7.6%	4.9%

Source: Kansas Department of Revenue, Property Valuation Division

Kansas Property Tax Detrimental to Economic Development

Wichita: 8th Highest Effective Tax Rate among U.S. Urban Cities on Commercial & Industrial Property

Assessed Valuations	Wichita	U.S. Average	Wichita Disadvantage
$100,000 land & building, $20,000 fixtures			
net tax	$3,361	$2,280	47.4%
effective tax rate	2.801%	1.900%	
$1,000,000 land & building, $200,000 fixtures			
net tax	$33,611	$23,049	45.8%
effective tax rate	2.801%	1.921%	
$25,000,000 land & building, $500,000 fixtures			
net tax	$840,263	$581,525	44.5%
effective tax rate	2.801%	1.938%	

Source: Minnesota Taxpayers Association, "50-State Property Tax Comparison Study"; Wichita's ranking among the largest urban cities in each state plus Washington, DC, Aurora, IL and Buffalo, NY based on taxes due in 2009.

Note: the primary reason for Wichita's, and likely most Kansas cities', disadvantage is the fact that Commercial & Industrial property is taxed at 25% of appraised value. Residential property is taxed at 11.5% of appraised value.

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COST
COUNCIL ON STATE TAXATION

Testimony to the
Kansas Special Committee on Assessment and Taxation
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Joseph R. Crosby
COO & Senior Director, Policy
Council On State Taxation (COST)

Chairman Carlson and Members of the Special Committee on Assessment and Taxation ("the Committee"), thank you for inviting me to provide the Council On State Taxation's views on Kansas's tax system. My testimony covers three related issues: 1) the current state and local tax burden on Kansas's businesses; 2) the impact on jobs and investment in Kansas of policy options that have been suggested for Kansas or that are being considered in other states, including the expansion of the sales tax base; and 3) suggestions to improve tax administration that will benefit Kansas taxpayers regardless of the type or level of taxes imposed by the state.

About COST

COST is a nonprofit trade association based in Washington, DC. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of nearly 600 major corporations engaged in interstate and international business. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

Measuring the State Business Tax Burden

Ernst & Young, in conjunction with COST, annually estimates the total state and local tax burden imposed on businesses in each state. Our seventh annual report was released in March, 2010.[1]

[1] Phillips, Andrew, Robert Cline and Tom Neubig, *"Total State and Local Business Taxes: 50-State-by-State Estimates for Fiscal Year 2009,"* March 2010, http://www.cost.org/WorkArea/DownloadAsset.aspx?id=76116.

122 C Street, N.W., Suite 330 • Washington, DC 20001-2109 • Tel: 202/484-5222 • Fax: 20

This "State Tax Burden" study provides estimates of the taxes paid by businesses in each state, which is an important first step in any evaluation of business taxes or tax reform. To enable comparisons across states, the study expresses business taxes as a share of total state and local taxes and as an effective tax rate on private sector economic activity (taxes as a share of gross state product).

These comparative measures were developed to answer questions from legislators asking, "Are businesses paying their fair share of taxes?" The study estimates business property taxes, sales and excise taxes paid by businesses on their input purchases, gross receipts taxes, corporate income and franchise taxes, business and corporate license taxes, unemployment insurance taxes, individual income taxes paid by owners of noncorporate (pass-through) businesses and other state and local taxes that are the statutory liability of business taxpayers.

In FY 2009 Kansas businesses paid $5.6 billion in state and local taxes. $5.6 billion is equivalent to more than 48% of all state and local taxes paid in Kansas in FY 2009.

In order to compare Kansas' business tax burden to that found in other states, the study computes a "total effective business tax rate" (TEBTR) imposed on business activity in each state. The TEBTR is measured as the ratio of state and local business taxes to private-sector gross state product (GSP), the total value of a state's annual production of goods and services by the private sector. The average TEBTR across all states is 4.7%; Kansas' TEBTR is 5.4%.

Kansas's TEBTR of 5.4% is the 12th highest in the country (compared to the other 49 states and the District of Columbia). Excluding the resource-rich states—Alaska, Montana, North Dakota and Wyoming receive a significant share of their business taxes from extraction taxes—Kansas has the 8th highest TEBTR in the country.

Kansas's TEBTR is also high relative to its neighboring states. Colorado's TEBTR is 3.9%, Indiana's is 4.1%, Iowa's is 4.6%, Missouri's is 4.0% and Nebraska's and Oklahoma's are both 5.0%.

The primary drivers of Kansas' high TEBTR are the property and sales taxes. Almost 45% of all business taxes paid in Kansas are derived from the property tax. Sales taxes imposed on business inputs—purchases businesses make for their own use in the course of producing goods and services—generate 23% of state and local business taxes paid in Kansas. Taken together, property taxes and sales taxes account for more than two-thirds of all state and local business taxes in Kansas.

TEBTRs provide a starting point for comparing burdens across states, but they do not provide sufficient information to fully evaluate a state's competitiveness. A state with an average overall TEBTR may impose relatively high taxes on capital intensive manufacturers, while imposing relatively low taxes on labor-intensive service industries. As a result, a state with such a tax structure and composition may create disincentives for locating new plant and equipment in the state and hinder economic growth. State legislators and policy-makers need to look closely at the structure and composition of business taxes and the composition of economic activities when evaluating their state's business tax competitiveness. A new study being prepared by Ernst & Young, again in conjunction with COST, will focus on the issue of business tax competitiveness.

What is the Rationale for Business Taxation?

Increasing economic competition among states and countries around the globe has transformed the initial question into a more fundamental query: "What is the basis or rationale for business taxation at the state or local level?" The basic rationale for business taxes, recognizing that the economic burden of business taxes are ultimately borne by consumers or owners of factors of production (including workers), is to pay for government services that directly benefit businesses.

If state and local business taxes were equal to the value of the benefits business received from state and local public services, they could be considered a payment for services, and taxes would not influence business location decisions or impact competitiveness. However, if state and local business taxes exceed the value of the benefits received from government services, the difference represents an excess cost to business that will reduce profitability in the absence of shifting the tax through higher prices or lower payments to labor. When such excess costs exist, they can affect a company's choice of locations.

In FY 2007 (the latest year for which both tax and expenditure data is available), the COST/E&Y study estimates that Kansas businesses paid $5.3 billion in state and local taxes while benefitting from only $3.1 billion in state and local expenditures (mid-point estimate). In other words, the state and local tax burden on Kansas businesses is more than 70% higher than justified by the services government provides to businesses. The economic impact of these excess taxes falls on consumers through higher prices, workers through lower pay or reduced employment, or shareholders through reduced profits.

Sales Taxes on Business Inputs

Sales tax imposed on business inputs in Kansas generated $1.3 billion in tax revenue in FY 2009.[2] Almost 44% of all sales tax revenue in Kansas comes from impositions on business inputs.[3]

Imposing sales taxes on business inputs violates several tax policy principles and causes significant economic distortions. Taxing business inputs raises production costs and places businesses within a state at a competitive disadvantage to businesses not burdened by such taxes. Taxes on business inputs, including taxes on services purchased by businesses, must be avoided.

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[2] Phillips et al. This figure includes sales taxes paid on business purchases of operating inputs and capital equipment; it does not include taxes collected on sales to final consumers.

[3] Cline, Robert, John Mikesell, Tom Neubig and Andrew Phillips, *"Sales Taxation of Business Inputs: Existing Tax Distortions and the Consequences of Extending the Sales Tax to Business Services,"* January 2005 (http://www.cost.org/WorkArea/DownloadAsset.aspx?id=69068).

Imposing sales tax on business inputs violates several tax policy principles—equity, simplicity and efficiency—and causes a number of economic distortions. Notably, these distortions result from pyramiding, where a tax is imposed at multiple levels, such that the effective tax rate exceeds the retail sales tax rate. Companies are forced to either pass these increased costs on to consumers or reduce their economic activity in the state in order to remain competitive with other producers who do not bear the burden of such taxes.

All states that impose sales tax currently tax business inputs to some extent, but few states tax services principally purchased by businesses. Proposals to eliminate existing sales tax exemptions for business inputs or to extend the sales tax to services purchased primarily by businesses further exacerbate the adverse economic distortions from the current taxation of business purchases. For example:

- Taxing business inputs encourages companies to self-provide business services to avoid the tax rather than purchasing them from more efficient providers and paying tax. Thus it inordinately impacts small businesses, which lack the resources to provide such services in-house;

- Taxing business inputs places companies selling in international, national and regional markets at a competitive disadvantage to many of their competitors, leading to a reduction in investment and employment in the state;

- Taxing business inputs unfairly and inefficiently taxes some products and services more than others by imposing varying degrees of tax on inputs in addition to a general tax rate on final sales; and

- Taxing business inputs unfairly hides the true cost of government services by embedding a portion of the sales tax in the final price of goods and services.

Efforts to extend the sales tax to services purchased primarily by business also suffer from the significant administrative complexities associated with determining where such services are "used" or consumed. This determination is much more complicated for services purchased primarily by business than it is for tangible goods.[4]

Numerous attempts to extend the sales tax to services purchased primarily by businesses have failed, including broad efforts by Florida and Massachusetts and narrower, more recent efforts in Michigan and Maryland. Not only have these efforts been hindered by the administrative complexity of such taxes but also by the recognition that such taxes are fundamentally flawed and increase the cost of doing business in a state.

When considering any changes to Kansas's existing sales tax base, the Committee would do well to understand the economic burdens associated with taxing business inputs, including the

[4] *Ibid.*

relatively high level of such taxes already imposed by the state.

Fair, Efficient and Customer-Focused Tax Administration:

Regardless of the types of taxes utilized in any state's revenue system, taxpayers deserve fair, efficient and customer-focused tax administration. In COST's most recent survey of state tax administration systems, Kansas earned a middle-of-the pack grade: B-.[5] The Committee should consider the following changes to improve the laws governing tax administration:

- Reestablish an even-handed statute of limitations for sales taxes;
- Provide that interest on tax overpayments begins to accrue from the date of the overpayment;
- Define "final determination" for the purposes of reporting federal tax changes to Kansas; and
- Limit state tax adjustments following the expiration of the statute of limitations only to those items changed on the state return as a result of federal tax changes.

Even-Handed Statutes of Limitations: Statutes of limitation should apply even-handedly to both assessments and refund claims. Forcing taxpayers to meet one statute to apply for a refund while granting the tax administrator additional time to issue an assessment is unfair and should not be tolerated in a voluntary tax system. A three-year statute of limitations for assessments should be accompanied by a three-year statute of limitations for refund claims. Kansas recently reduced the period for refund claims without adjusting the period for assessments; Kansas' previous even-handed statute of limitations should be restored.

Equalized Interest Rates: Interest payments are meant to compensate for the lost time-value of money and should apply equally to both parties. Although Kansas imposes equal interest rates on underpayments and overpayments, it uses different dates to determine when interest begins to accrue. Kansas imposes interest on underpayments from the date the tax was due, but does not pay interest on overpayments until the refund claim is filed, rather than from the date the overpayment was made. Interest should accrue from the date the overpayment is made. A reasonable period of time when no interest accrues—for example, 60 days—is acceptable to allow state processing of the payment. For separate refund claims, interest should be paid from the date of overpayment of the tax – typically the due date of the original return – and not the date of the filing of the refund claim. Refunds and liabilities for the same taxpayer should also offset each other in calculating the amount of interest and penalty due.

"Final Determination": All states imposing a corporate income tax require a taxpayer to report changes in federal taxable income to the state. In the majority of states the requirement is triggered by the date a "final determination" is made regarding the federal income tax return (*e.g.*, issuance of a Revenue Agent's Report). However, some states have no such definition or

[5] Lindholm, Douglas L. and Fredrick J. Nicely, *"The Best and Worst of State Tax Administration: COST Scorecard on Tax Appeals and Procedural Requirements,"* February 2010, http://www.cost.org/WorkArea/DownloadAsset.aspx?id=75910.

an imprecise definition; Kansas falls into this category. The lack of a clear definition of "final determination" creates compliance difficulties and wrongfully subjects taxpayers to concomitant penalties and interest for noncompliance. COST suggests the following "best practice" as a workable definition, primarily based on the statutory definition of "final determination" used by New Hampshire. "A 'final determination' is deemed to occur when the latest of any of the following activities occurs with respect to a federal taxable year: (1) The taxpayer has made a payment of any additional income tax liability resulting from a federal audit, the taxpayer has not filed a petition for redetermination or claim for refund for the portions of the audit for which payment was made and the time in which to file such petition or claim has lapsed. (2) The taxpayer has received a refund from the U.S. Treasury that resulted from a federal audit. (3) The taxpayer has signed a federal Form 870-AD or other IRS form consenting to the deficiency or consenting to any over-assessment. (4) The taxpayer's time for filing a petition for redetermination with the U.S. Tax Court has expired. (5) The taxpayer and the IRS enter into a closing agreement. (6) A decision from the U.S. Tax Court, district court, court of appeals, Court of Claims, or Supreme Court becomes final."

State Statutes Waived Only for Federal Tax Changes: Some states, including Kansas, allow every aspect of the state return to be open for adjustment following a change in federal income tax liability even though the state's normal statute of limitations has expired. When the normal time period for the state DOR to assess additional tax and for a taxpayer to claim a refund has expired, only those items that are changed as a result of a federal income tax change should be open for adjustment at the state level (regardless of whether the change results in a tax due or a refund).

Conclusion

In reviewing the existing tax system, the Committee should seek opportunities to minimize obstacles to investment and job creation. Proposals that would further exacerbate Kansas' current excess business taxation, including suggestions to impose sales tax on services purchased primarily by businesses, should be avoided. Finally, regardless of the recommendations the Committee makes with respect to the Kansas' tax structure, the Committee should recommend changes that will make the tax administrative system fairer, more efficient and customer-focused.

AMERICAN LEGISLATIVE EXCHANGE COUNCIL

WRITTEN TESTIMONY OF JONATHAN WILLIAMS

DIRECTOR OF THE TAX AND FISCAL POLICY TASK FORCE

THE AMERICAN LEGISLATIVE EXCHANGE COUNCIL

BEFORE THE 2010 SPECIAL COMMITTEE ON ASSESSMENT AND TAXATION

SEPTEMBER 17, 2010

Dear Chairman Carlson, Vice-Chairman Donovan, and Members of the Committee:

By way of background, I serve as the Director of the Tax and Fiscal Policy Task Force at the American Legislative Exchange Council (ALEC). As many of you know, ALEC is the nation's largest non-partisan, individual membership organization of state legislators. As Task Force Director, I work with our members to develop sound tax and budgetary policies that promote competitiveness, efficiency, and economic growth.

In April, ALEC's Tax and Fiscal Policy Task Force overwhelmingly passed a statement of principles for sound tax policy. This was the result of nearly a year-long process to identify the essential components of an effective tax system. I have provided copies of this document to members of this committee, but I will briefly summarize our guiding principles of tax reform here:

- Simple – The tax code should be easy for the average citizen to understand, and it should minimize the cost of complying with the tax laws. Tax complexity adds cost to the taxpayer, but does not increase public revenue. For governments, the tax system should be easy to administer, and should help promote efficient, low-cost administration.
- Transparent – Tax systems should be accountable to citizens. Taxes and tax policy should be visible and not hidden from taxpayers. Changes in tax policy should be highly publicized and open to public debate.
- Economically Neutral – The purpose of the tax system is to raise needed revenue for core functions of government, not control the lives of citizens or micromanage the economy. The tax system should exert minimal impact on the spending and decisions of individuals and businesses. An effective tax system should be broad-based, utilize a low overall tax rate with few loopholes, and avoid multiple layers of taxation through tax pyramiding.
- Equitable and Fair – The government should not use the tax system to pick winners and losers in society, or unfairly shift the tax burden onto one class of citizens. The tax system should not be used to punish success or to "soak the rich," engage in discriminatory or multiple taxation, nor should it be used to bestow special favors on any particular group of taxpayers.

- Complementary – The tax code should help maintain a healthy relationship between the state and local governments. The state should always be mindful of how its tax decisions affect local governments so they are not working against each other – with the taxpayer caught in the middle.
- Competitive – A low tax burden can be a tool for a state's private sector economic development by retaining and attracting productive business activity. A high-quality revenue system will be responsive to competition from other states. Effective competitiveness is best achieved through economically neutral tax policies.
- Reliable – A high-quality tax system should be stable, providing certainty in taxation and in revenue flows. It should provide certainty of financial planning for individuals and businesses.

Earlier this year, I co-authored ALEC's 2010 edition of *Rich States, Poor States: ALEC-Laffer State Economic Competitiveness Index*. This publication offers a roadmap to state economic recovery based on sound fiscal policy reform. *Rich States, Poor States* presents rankings of the 50 states based on the relationship between policies and performance – revealing which states are best positioned to make a recovery, and which are not. Together with my co-authors, Dr. Arthur Laffer, the "father of supply-side economics," and Steve Moore of *The Wall Street Journal*, we analyze how economic competitiveness drives income, population and job growth in the states. We found that states with a high and rising tax burden (e.g. California and New York) are more likely to suffer through economic decline, while those with lower and falling tax burdens are more likely to enjoy robust economic growth.

One of the key findings from our research shows that state income taxes are particularly damaging to state competitiveness and growth. We compare economic growth in the nine states without a personal income tax, to the nine states with the highest income tax rates, and the results are stunning. Average 10-year gross state product growth is 59.81 percent in the high income tax states, but a considerably higher 86.28 percent in the states without income taxes. Population growth numbers over the past decade tell the same story – high income tax states grew at 6.32 percent, while the no income tax states grew a remarkable 15.95 percent. People do vote with their feet.

The no income tax states enjoyed 18.2 percent job growth, while the high income tax locations only realized job growth of 8.44 percent. Even more remarkably, state tax receipt growth was more than 20 percentage points higher in the states without income taxes. These are clear examples of the consequences of high income tax rates. I could continue to give these statistics, but in the interest of brevity, I encourage you to read your provided copy of *Rich States, Poor States* and visit www.alec.org for additional information.

The top performing states in *Rich States, Poor States* keep taxes, spending, and regulatory burdens low, while the biggest losers in the report tend to share similar policies of high tax rates, unsustainable spending and regulation. State governments that believe they can bring about

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economic recovery by growing government and increasing taxes are sadly mistaken. I like to summarize the report's findings in one simple sentence: States cannot tax their way into prosperity.

Furthermore, the new study shows how the recent federal stimulus dollars are not a panacea for state budget problems. Federal dollars always come with federal strings attached. Stimulus dollars may simply encourage states to ratchet up spending, without requiring them to make the tough decisions needed to bring about financial stability.

Rich States, Poor States gives all policymakers an important blueprint to make Kansas more competitive in the months and years to come. Since the first edition of the report three years ago, Kansas' economic outlook improved from 29th to 25th nationally. Much of this modest improvement was a result of pro-growth legislation, such as the elimination of the "death" tax and the franchise tax. However, after ALEC released the 2010 edition of *Rich States, Poor States*, Kansas taxpayers faced the sales tax increase. This will certainly have a detrimental impact on Kansas's economic outlook in future editions of the publication, since the sales tax burden is one of the 15 factors we consider when determining a state's economic outlook.

High property tax burdens, along with one of the highest ratios of public employees per capita, hurt Kansas' economic outlook. Also of particular concern is the state's lack of a meaningful tax and spending limitation. To address this, I have included ALEC model legislation to create a supermajority requirement for future tax increases. Nearly a dozen states use this rule when voting on net tax increases. Not only does it give taxpayers an important safeguard, recent academic research shows that supermajority requirements can be an effective deterrent to future budget deficits.

Among bordering states, Oklahoma ranks 14th in economic outlook, Missouri ranks 15th and Nebraska ranks 34th. Colorado boasts the 2nd best economic outlook in America. With competitors like Colorado just across the border, it should remind every policymaker in Topeka that changes to policy are not created in a vacuum. It is also very important to note that none of these neighboring states increased their income or sales taxes in 2010.

Mr. Chairman, we applaud you for holding these important hearings to discuss ideas for making Kansas more competitive through tax reform. Every time a state changes its tax and economic policies, it directly and immediately influences that state's competitive position for personal and business investment. As this committee considers recommendations, I hope you will consider the evidence we found in *Rich States, Poor States*, which clearly outline the roadmap to state economic recovery through competitiveness.

Thank you for allowing me to share my thoughts with you today and I look forward to entertaining any questions.

AMERICAN LEGISLATIVE EXCHANGE COUNCIL

ALEC Principles of Taxation

The proper function of taxation is to raise money for core functions of government, not to direct the behavior of citizens or close budget gaps created by overspending. This is true regardless of whether government is big or small, and this is true for lawmakers at all levels of government.

Taxation will always impose some level of burden on an economy's performance, but that harm can be minimized if policymakers resist the temptation to use the tax code for social engineering, class warfare and other extraneous purposes. A principled tax system is an ideal way for advancing a state's economic interests and promoting prosperity for its residents.

The goal of American tax policy should be to raise revenue for functions of government in a way that minimizes distortions, so as to grow the overall economy and facilitate commerce.

Guiding principles of taxation

The fundamental principles presented here provide guidance for a neutral and effective tax system; one that raises needed revenue for core functions of government, while minimizing the burden on citizens.

- Simplicity – The tax code should be easy for the average citizen to understand, and it should minimize the cost of complying with the tax laws. Tax complexity adds cost to the taxpayer, but does not increase public revenue. For governments, the tax system should be easy to administer, and should help promote efficient, low-cost administration.

- Transparent – Tax systems should be accountable to citizens. Taxes and tax policy should be visible and not hidden from taxpayers. Changes in tax policy should be highly publicized and open to public debate.

- Economic Neutrality – The purpose of the tax system is to raise needed revenue for core functions of government, not control the lives of citizens or micromanage the economy. The tax system should exert minimal impact on the spending and decisions of individuals and businesses. An effective tax system should be broad-based, utilize a low overall tax rate with few loopholes, and avoid multiple layers of taxation through tax pyramiding.

- Equity and Fairness – The government should not use the tax system to pick winners and losers in society, or unfairly shift the tax burden onto one class of citizens. The tax system should not be used to punish success or to "soak the rich," engage in discriminatory or multiple taxation, nor should it be used to bestow special favors on any particular group of taxpayers

- Complementary – The tax code should help maintain a healthy relationship between the state and local governments. The state should always be mindful of how its tax decisions affect local governments so they are not working against each other – with the taxpayer caught in the middle.

- Competitiveness – A low tax burden can be a tool for a state's private sector economic development by retaining and attracting productive business activity. A high-quality revenue system will be responsive to competition from other states. Effective competitiveness is best achieved through economically neutral tax policies

- Reliability – A high-quality tax system should be stable, providing certainty in taxation and in revenue flows. It should provide certainty of financial planning for individuals and businesses.

Benefits of a principled tax burden

Since taxes lower the economic welfare of citizens, policymakers should try to minimize the economic and social problems that taxation imposes. Citizens then directly gain the benefits of a low tax burden. These benefits are summarized below:

- Greater economic growth – A tax system that allows citizens to keep more of what they earn spurs increased work, saving and investment. A low state tax burden would mean a competitive advantage over states with high-rate, overly progressive tax systems.

- Greater wealth creation – Low taxes significantly boost the value of all income-producing assets and help citizens maximize their fullest economic potential, thereby broadening the tax base.

- Minimize micromanagement and political favoritism – A complex, high-rate tax system favors interests that are able to exert influence in the state capitol, and who can negotiate narrow exemptions and tax benefits that help only limited taxpayers and not the general economy. "A fair field and no favors" is a good motto for a strong tax system.

Please contact Jonathan Williams, ALEC's Tax & Fiscal Policy Task Force Director, at jwilliams@alec.org or (202) 742-8533 if you have any questions or concerns about ALEC's model legislation.

AMERICAN LEGISLATIVE EXCHANGE COUNCIL

Super-Majority Act
An ALEC Model

Summary

Super-majority requirements are based on the premise that tax increases fuel excessive government spending. Therefore, to more effectively control the budgetary process, the ability to raise taxes or enact new taxes should be made as politically difficult as possible, require broad consensus, and be held to a high standard of accountability. This Act calls for a constitutional provision requiring all tax and license fee impositions and increases to be approved by two-thirds of all members of each House. It provides for an exemption if there are insufficient revenues to pay interest on the state's debt.

Model Legislation

"An Act concurring in a proposed amendment to the Constitution of the State relating to the imposition of taxes or license fees."

WHEREAS, an amendment to the Constitution of the State was proposed in the (session number) Legislature, being Chapter (number), Volume (number), as follows:

This Act may be cited as an amendment to the State Constitution relating to the imposition of taxes or license fees.

Be it enacted by the Legislature (two-thirds of all members elected to each House thereof concurring therein):

Section 1. Amend Article (number) of the Constitution of the state by adding a new Section thereto as follows:

(A) Imposition or levy of new taxes or license fee.

(1) No tax or license fee may be imposed or levied except pursuant to an act of the legislature adopted with the concurrence of two-thirds of all members of each House.

(2) This amendment shall not apply to any tax or license fee authorized by an act of the legislature which has not taken full effect upon the effective date of this bill.

(B) Limitation on increase of rate of taxes and license fees.

(1) The effective rate of any tax levied or license fee imposed may not be increased except pursuant to an act of the legislature adopted with the concurrence of two-thirds of all members of each House.

(C) Exemption to meet obligation under faith and credit pledge; allocation of public monies to meet such an obligation if revenues are not sufficient to meet such pledge.

(1) Prior to the beginning of each fiscal year of the state, the legislature shall appropriate revenues to pay interest on its debt to which it has pledged its faith and credit and which interest is payable in the year for which such appropriation is made and to pay the principal of such debt, payable in such year, whether at maturity or otherwise. To the extent that insufficient revenues are provided to pay the principal and interest on such debt when due and payable, the first monies thereafter received by the state shall be set aside and applied to the payment of the principal and interest on such debt. To make up for such insufficient revenues, the legislature may increase the rate of taxes and fees without regard to the limitations of Subsection (A) and Subsection (B) of Section 1, hereof after the failure to pay when due the principal of and interest on such debt; and

WHEREAS the said proposed amendment was adopted by two-thirds of all members elected to each House of the (session number) legislature;

NOW THEREFORE, BE IT RESOLVED BY THE LEGISLATURE (two-thirds of all members elected to each House thereof concurring therein) said proposed amendment is hereby adopted, and shall forthwith become a part of the Constitution of the state.

Section 2. {Severability clause.}

Section 3. {Repealer clause.}

Section 4. {Effective date.}

Please contact Jonathan Williams, ALEC's Tax & Fiscal Policy Task Force Director, at jwilliams@alec.org or (202) 742-8533 if you have any questions or concerns about ALEC's model legislation.

Hill's Pet Nutrition, Inc. and Subsidiaries
P. O. Box 148
Topeka, Kansas 66601-0148
(785) 354-8523

September 17, 2010

Mr. Chairman and members of the Special Committee on Assessment and Taxation:

My name is Denise Walsh. I am the Director of Corporate Taxes for Hill's Pet Nutrition here in Topeka. I appreciate the opportunity to testify today and provide some comments and suggestions on how to encourage additional capital investment in the private sector and economic development through tax reform.

In the past few years the world has been going through a significant economic down turn which has negatively impacted all sectors of the economy, including pet food. Yet Hill's Pet Nutrition has just completed this summer a major investment in the state of Kansas by building a new $213 Million, 525,000 sq.ft. state of the art manufacturing facility in Emporia, Kansas. This facility has started operations and has created over 100 new jobs with employees at this facility earning an average wage of over $45,000 per year (plus benefits). The passage of SB240 in 2007(as extended by HB 2270) played a key role in this major investment going forward here in Kansas amidst the uncertain economic situation globally. This demonstrates that when done correctly, Kansas can proactively provide a viable tax environment through tax incentives and generate a win-win-win scenario for the state of Kansas, local communities and the private sector.

I have mentioned the word "global" previously on purpose as Kansas is not only competing for these investments in facilities and employment with other states in the US, but also globally as companies grow and supply their products to a world market. This globalization means however, that Kansas can attract investments in capital and employment from across the world. However, when comparing the Kansas Income Tax/Economic Development incentive environment with other locations globally some immediate disadvantages come to light.

- When a group of corporations (as in Hill's case) conducts a unitary business both within and without Kansas, under Kansas law the income of the entire family of companies must be reported and apportioned to Kansas. However, the use of any tax credits or incentives is only allowed on a separate company basis. While there is no Unitary Concept for Individuals, these concepts can be quite complicated in the corporate tax arena. To try to illustrate how the Unitary concept works here is a simple example using the analogy of a regular family being taxed under the Unitary concept:
    - John lives and works only in Kansas but John has a son in New York and a daughter in Kentucky. Working with the Kansas Dept of Commerce John decides to expand his local business in Kansas and make a capital investment for which he is granted investment tax credits in Kansas. Based on the Kansas Unitary Concept, which is applied to corporations with related operations and common ownership, John would have to file a return in Kansas and report not only his income but also the income of his son in NY and his daughter in KY. This larger "family" income is then apportioned as a percentage to Kansas. John thinks that he won't owe more taxes because he could use some of the investment tax credits he earned to offset this larger "family" tax liability. However, that won't be possible as Kansas does not allow the same unitary concept in the use of credits so in this case John will have an investment tax credit carryover and the tax liability associated with the income of his son and daughter being reported in Kansas as part of his "family" income is still due and cannot be offset by John's unused credits.

While revoking the combined unitary concept would be too costly for the state at this time, leveling the field so that tax credits can be used to offset the combined tax liability of the entire group would be a very positive move towards making Kansas more competitive in attracting and retaining multinational companies.

- A number of other jurisdictions (Missouri, California, Oregon, Alaska, etc...) have leveraged economic development incentive credits and lowered an expanding Company's overall tax cost by allowing a "secondary market" where credits may be transferred, sold or assigned to other companies doing business with these states. In many situations the state sets up a minimum price but allows market pressures to dictate the selling price of the credits. In Missouri, for example, the state provides that a company's unused "New or Expanded Business Facility Credit" can not be sold for less than 75 percent of the stated value of the credits. This has proven very effective and cost efficient for companies rather than requiring unused credits to carryover to future years. This secondary market also becomes very important to drive economic development for small to medium size businesses which do not have enough in house expertise to deal with the complexity imposed by the regulations in first obtaining and utilizing investment tax credits.

- Kansas could also allow a company to monetize investment tax credits against employee and employer payroll liability associated with the creation of new jobs. Many states have found that refunding the employee and employer share of payroll taxes for new jobs creates a cash incentive for creating new jobs without an immediate hit to the state budget since the cash benefits for the credits are based on new positions which have not yet become part of the budget base. States, such as Kentucky and Missouri, for example utilize this strategy to attract new jobs and investment to their states.

These changes would have an immediate and positive impact in driving investments that create new private sector jobs in Kansas. It is important for investors to have certainty on what to expect when making investments in a particular location. Although Kansas in the recent past addressed and enhanced its locational advantages to facilitate major job-creating investments, such as the new Emporia facility of Hill's, it should do more because most investors would chose to invest, all other things being equal, in locations where the most favorable tax infrastructure is already in place. We encourage Kansas to act now on these issues for the benefit of all.

Thank you for your consideration and I would be pleased to answer any questions you may have.

FAIRTAXKC
FairTaxKC.org

The Kansas Jobs and Economic Recovery Plan 2011

OVERVIEW – The State of Kansas has a tax system that has evolved over many years, consisting of annual additions, subtractions, modifications, exemptions and rate changes, each of which was viewed as a short-term fix for a particular problem, crisis or populist political issue.

There are now 36 state-level taxes, many with conflicting purposes and results, requiring complex and expensive administrative rulings and audits. The Personal Income Tax is tied to the Federal Income Tax, which is experiencing a dramatic shortfall. The most recent budget legislation resulted in an 18.8% increase in the State sales tax rate, a continuation of large tax exemptions and maintenance of "sin" taxes that are substantially higher than surrounding states. Retail businesses near the Missouri border are seriously hurt by this tax increase.

This antiquated, politicized system can no longer be justified by more short-term rate changes, piecemeal exemptions, modifications, etc. Kansas has a serious budget problem with rising costs of compliance, rising demands for government services, declining revenues and loss of private-sector jobs.

Kansas needs to take a fresh look at a new "clean-sheet-of-paper, start-over-from-scratch," radically simple tax system. This then is a suggested working document of a plan to promote economic growth and prosperity in Kansas. The fundamental concept is that we have ONE TAX that collects income for the state through consumption.

We call this The ONE TAX Plan and it means this.

- Income taxes on individuals and corporations are eliminated.
- Inheritance, Estate and Gift taxes are eliminated.
- Majority of the State's tax revenue are derived from Sales and Excise taxes.
- The revenue lost due to the above are mostly recovered by eliminating the current Sales Tax exemptions.
- The above changes result in a greatly simplified sales tax system which taxes only personally consumed goods and services at retail.
- Business to Business transactions are not taxed.
- The states collect the majority of its revenue from sales tax,
- Every personal consumer pays the same rate.
- Provide a monthly family rebate (prebate) to pay the sales tax up to the poverty level.

The ONE TAX is an idea from a group of dedicated CPAs, business owners and volunteers. Dr Arthur Hall's paper "A Comprehensive Retail Sales Tax as the Single Tax for the State of Kansas" [1] is the road map to recover the economy of Kansas. Dr Hall is the Executive Director of the Center for Applied Economics at the University of Kansas, School of Business. In his paper he describes the basic academic foundation for a revival of the Kansas economy.

How States without Personal Income Taxes Raise Money (Average: 1999-2009)						High Income Tax
Tax Source	Florida	Nevada	South Dakota	Texas	Washington	Kansas
Property	1.1%	2.8%	0.0%	0.0%	11.3%	1.1%
Sales & Excise	77.8%	82.1%	80.3%	78.9%	78.3%	47.6%
License	5.6%	10.6%	13.3%	14.3%	5.1%	4.7%
Income	5.5%	0.0%	4.8%	0.0%	0.0%	43.8%
Other	9.9%	4.5%	1.7%	6.8%	5.3%	2.8%
Taxes per Capita	$1,995	$2,347	$1,564	$1,639	$2,631	$2,292

Note: Growth states derive the majority of their revenue from Sales and Excise taxes. Florida and South Dakota have no personal income tax. The small amount shown is for limited corporate income taxes.[7]

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Refer to the table above from Dr. Hall.[2] The States that create the most jobs and promote exceptional ecc : growth do not tax Income. Most of their revenue is raised from Sales and Excise Taxes. Ka has ... n going the wrong way. According the Legislative Post Audit Committee [3], "Over the last sev... decades, Kansas has become much more reliant on income taxes and less reliant on sales taxes to fund State operations." This trend is a major concern to investors because they want a stable and reliable tax system over a long time and Kansas does not appear to be attractive due to its tax system.

The percentage of State revenues provided by income taxes tripled between 1960 and 2009, rising from 15% to 45% of the total. During the same period, the percentage of State revenues from sales and excise taxes declined from 71% to 49%. This reduction occurred even though the States sales tax rate more than doubled from 2.5% in 1960 to 6.3% in 2010.

During this same period, the Sales and Property Tax exemptions have grown to over $4.5 Billion. This is a large percentage of the amount of revenue needed from taxes to properly fund the State. Between 1985 and 2009, the number of Kansas Sales tax exemptions grew from 30 to almost 100, more than triple. Tax exemptions shrink the tax base from which taxes are collected. Perhaps this has something to do with the lack of new business investment and the subsequent very large loss of private sector jobs, estimated to be 50,000 in the last few years.

This idea is referred to as **ONE TAX**.

1. The Income Tax on individuals and businesses would be completely eliminated.
   a. This will provide an immediate stimulus to the local economy.
2. The Inheritance, estate and gift taxes are eliminated.
   a. Private businesses will want to establish their corporate headquarters with their owners residency in Kansas.
3. The sales tax exemptions not protected by the Constitution or statutes will be phased out.
   a. This spreads the tax base to all personal consumers efficiently.
4. All personally consumed new products and services will be taxed at the same sales tax rate.
   a. Business to business transactions will not be taxed eliminating compounding tax on tax.
   b. The state will pay retailers a ¼% collection fee.
5. The tax on boat registration, new tires, motor vehicle rental, dry cleaning and laundry, clean water, private car companies, music dramatic tax, bingo enforcement, transient guest, and combative arts are eliminated. Many of these taxes collect small amounts, cost almost as much to collect and have negative business consequences.
6. Provide a monthly family rebate(prebate) to pay the sales tax at the poverty level.[1]
7. Eliminate the remaining Sales Tax exemptions that are not protected by the Kansas Constitution or statues.

A Constitutional Amendment would lock in the basic provisions making it very difficult to go back to a system which taxes capital rather than consumption. This final act would confirm that Kansas has a stable, reliable tax system where investors and employers know that their return on investment is not a variable from one legislative session to another.

The Kansas Legislature through its Tax and related Committees would research which exemptions to remove first. Many of these exemptions would be redefined not by statue but by falling in the category of business to business transactions.

1. Examples are Agricultural businesses where purchases of farm machinery used in the production of agriculture products currently listed as Public Policy: Agricultural Exemptions. Since these are business to business transactions the tax paid at retail would credited the following period as offsets to business sales.
2. Legally required exemptions include property purchased by a railroad or public utility used for interstate commerce.
3. Examples of Public Policy: Named Organizations such as non-profits, and those receiving targeted tax breaks, would not be taxed on their income but would pay the sales tax on new goods and services purchased at retail.

The following tables are examples of how this might be done however the Tax Committees would make better choices utilizing its access to information in the various State Agencies. **If this could be done in one year it would be even better.**

Th[illegible]mbers are estimates only and will change as more recent figures are available however our expe[illegible]nce is that these figures are very close to the current values and they don't change the conclusi[illegible]s or recommendations.

Column 2010 shows the current estimates from the Legislative Division of Post Audit [3]
Column Phase I are those taxes that will be eliminated first.
Column Phase II are those taxes eliminated in the final year.

Tax Collections

Revenues ($Millions)	**2010**	Phase I	Phase II
Individual	2,560.0	2,560.0	0.0
Corporation	245.0	245.0	0.0
Financial Institution	24.0	24.0	0.0
Sub Total	2,829.0	2,829.0	0.0
Retail Sales and Excise			
Retail Sales	1,660.5		
Compensating Use	222.0		
Cigarette	102.0		
Tobacco Products	6.0		
Cereal Malt Beverage	2.2		
Liquor - Gallonage	18.5		
Liquor - Enforcement	57.0		
Liquor - Drinking places	9.5		
Corporate Franchise	26.0		
Severance Gas	47.7		
Severance Oil	54.0		
Sub Total	**2,205.4**	**0.0**	**0.0**
Property Tax Revenues			
Motor Carriers	24.0		24.0
General Property	0.0		0.0
Motor Vehicle	0.0		0.0
Sub Total	**24.0**	**0.0**	**24.0**
Other Tax Revenues			
Insurance Premiums	117.5		117.5
Estate	14.5		14.5
Miscellaneous	2.0		2.0
Sub Total	**134.0**	**0.0**	**134.0**
TOTAL TAXES	**5,192**	**2,829**	**158**

Exemptions (Explanations below the Table)

EXEMPTIONS ($ Millions)	2010	Phase 1	Phase II
Legally Required			
Railroad and Public Utilities	16.1		
Railroad Companies	1.0		
Food Stamp Recipients	7.8		
Welfare Recipients	0.0		
Liquid Petroleum and gas pipeline	0.0		
Purchasers of Aircraft	7.6	7.6	
Sub Total	**32.5**		
Tax Policy			
Agricultural business	171.8	171.8	0.0
Products processed and sold	2,326.8	1,163.4	0.0
Products consumed in production	305.3	152.7	0.0
Motor fuels consumed by Biz	240.7	240.7	0.0
Out of state aircraft and motor vehicles	16.0	16.0	0.0
Sub Total	**3,060.6**	**1,744.6**	**0.0**
Government Exemptions			
Public Broadcasting	Not avail		
KS Insurance Guaranty Association	Not avail		
KS Health Insurance Guaranty Assoc	Not avail		
KS Bioscience Authority	Not avail		
KS Electric Transmission Authority	Not avail		
Federal government rentals	0.1	0.0	0.1
Federal government contractors	5.7	5.7	0.0
Local water districts	0.1	0.0	0.1
State and local government agencies	342.6	171.3	171.3
State and local govt contractors	123.1	61.6	61.6
Sub Total	**471.6**	**238.6**	**233.1**
Agricultural Exemptions			
Biz to Biz Equipment and Services	51.4		
Biz to Biz products used in final sales	1.0		
Sub Total	**52.4**	**0.0**	**0.0**
Business Exemptions			
Oil and gas exporters- Equip consumed	0.4	0.4	0.0
Movie Theaters - shown productions	1.8	1.8	0.0
Customized Software	5.3	5.3	0.0
Qualified biz sub contractors	67.9	67.9	0.0
Property Resellers	119.9	60.0	60.0
Broadcast stations for free public use	1.0	1.0	0.0
Warehouse distribution facilities	6.5	6.5	0.0
Restaurant Employees	3.9	3.9	0.0
Oil and gas exporters-Energy consumed	12.0	12.0	0.0
Sub Total	**218.7**	**158.8**	**60.0**
Charitable, Religious, etc Exemptions	**23.7**	**23.7**	**0.0**
Names Exempt Organizations			
Miscellaneous small amounts	24.4	24.4	0.0
Labor services for exempt organizations	188.2	188.2	0.0
Buyers of new mobile homes	3.4	3.4	0.0
Utility Customers	140.3	140.3	0.0
Sub Total	**356.3**	**356.3**	**0.0**
Educational Institutions	**61.5**		
Named organizations	**8.1**	8.1	0.0
Health Care Exemptions			
RX Drugs	72.8	72.8	0.0
Leases by providers	2.5	2.5	0.0
Miscellaneous small amounts	10.7	10.7	0.0
Sub Total	**86.0**	**86.0**	**0.0**
Exemptions	**4,371**	**2,616**	**293**
Additional Taxes to collect	**0**	**347.1**	**(269.0)**
Tax Rate	6.30%	0.48%	-0.35%
Consumption Base (without the prebate)	35,006	73,718	77,404
Consumption Base (with a prebate of 1.3%)		72,760	76,398
Additional Tax Rate		0.48%	-0.3%
Total New Tax Rate		6.78%	6.43%

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Exemptions in column 2010 are the estimates from LPA Report [3]
The es in column Phase I are those exemption that will be removed first.
The figures in column Phase II are those exemptions that will be removed last.
Below the Sub total line at the bottom of the table are the calculations showing the New Sales Tax Rate before and after each of the transition phases.

Note that in the Phase I, the major sources of Income based revenue are removed and more than replaced with a reduction in Sales tax exemptions for those industries that benefit the most. This results in an increase in the Sales tax rate of only 0.48% yet providing the bulk of the benefits to individual and business income tax payers. This plan gives the most immediate economic stimulus, gives everyone one year to adjust and yet maintains about the same sales tax rate. This calculation allows for a substantial amount of business to business transactions which are not taxed.

During the second phase the benefits really kick in. Removing the second half of exemptions further broadens the tax base and the incremental rate goes down 0.30% bringing the total to 6.43% a very competitive rate compared to other states. All of the personal and business benefits are in place and the sales tax rate is virtually unchanged.

Issues:

1. **Taxing of Professional Services** - Kansas currently taxes 74 different services categories. [5] The only category not taxed is defined as "Professional Services" such as lawyers, doctors, accountants, etc. More states are changing their tax system to include nine "Professional Services". It is frequently misunderstood that Professionals with clients that are other businesses, would not tax these services because they are treated as Business to Business transactions, discussed further below. Professionals actually benefit more from having no income tax to pay, compared to the minor task of collecting tax on their services. The collection would be paid for by the state at ¼%.
2. **Business to Business Transactions are not taxed**. Dr Hall [1] said that a tax on intermediate goods and services in the production of end use goods and services should not be taxed. He explains why this tax on tax would create a "tax pyramiding" effect and should be exempted. This applies to manufactured goods as well as services.
3. **Housing and Real Estate** – The ONE TAX system taxes only new personally consumed products and services. A new house for example would be taxed on the sale but a previously occupied house would be sold without a sales tax. This is consistent and fair for the following reasons.
    a. In today's real estate market the embedded taxes raise the cost of the house about 25%.
    b. A house built before ONE TAX includes the embedded cost all of the cost of the builder such as the costs of tax on labor, on materials and income of the builder. When that house was first sold, the buyer paid the price which included those taxes. Therefore those taxes have already been paid, referred to as "inclusive".
    c. A new house built before this ONE TAX goes into effect, but sold afterward contains those embedded tax costs and the tax would be waived for the first sale of the new house. An inventory would be taken (data is already in the county tax records) and those houses would be known to the buyer, the seller and the register of deeds. **This would instantly stimulate the market for new homes.**
    d. A house built after ONE TAX is in effect, would not have those embedded costs and therefore the inclusive price could be about the same as before the ONE TAX.
    e. **The removal of income taxes on corporations and individuals adds more discretionary spending in the pockets of consumers, which will create a rapid expansion of the housing market.**
    f. Rent would be thought of as a "housing service" and would be taxed each month as if it were purchased each month from a retailer.
4. **Tax Inclusive at the Point of Sale** – The taxes we pay now, (embedded in the cost and price but hidden) are referred to as "Inclusive", i.e. the price includes the tax. The same basis and calculation would be done for the ONE TAX system. The price on the Point of Sale receipt would already include the tax. The only difference is that under the new ONE TAX system the actual tax paid would also be printed on the receipt, not like the present system where the tax is hidden.

rebate – Designed to overcome the regressive (hurts low income people most) nature of a fl: sales tax system. The prebate is a cash benefit for citizens of every household with valid social security numbers. By paying the sales tax up to the poverty level, lower income people are tax free. If the State could take advantage of the power of electronic database and credit card processing, the State might actually receive a substantial benefit that would pay for the entire cost of the prebate administration.

If this could be done in one year it would be most beneficial to everyone and every business. The Tax rate would be lowest, there would be no uncertainty about investment and jobs creation, all of the business could make their procedural changes at one time, and the dramatic increase in discretionary spending would immediately stimulate the economy.

With the majority of the tax reforms in place, a constitutional amendment can lock it in, making it very difficult to change. Investors and employers will find the new Kansas tax code the State very favorable to economic growth and a reasonable return on their investment.

Kansas already has everything else to attract investors, i.e. an outstanding quality of life environment with excellent schools, the nation's top highway and transportation system, energy of all kinds, clean air, water, open spaces, people who want to earn what they have and the best place in the world to raise children and keep families together.

Sources:

[1] "A Comprehensive Retail Sales Tax As A Single Tax for The State of Kansas" By Dr. Arthur P. Hall, Executive Director, Center for Applied Economics, KU School of Business. http://www.business.ku.edu/_pdf/CAE_salestax.pdf

[2] How States without Personal Income Taxes Raise Money is from Dr Hall's presentation to the FairTaxKC organization on August 19th 2010.

[3] KS Legislative Post Audit committee report dated February 2010. http://www.kslegislature.org/postaudit/

[4] Bureau of Economic Analysis, US Department of Commerce, http://www.bea.gov/ (GDP forecast of the Private Sector times 70%).

[5] FTA Survey of Services Taxation – Update, dated July 2008 by Federal Transit Authority of DOT. http://www.taxadmin.org/fta/pub/services/services.html

[6] Federal Tax Administrators, http://www.taxadmin.org/fta/

[7] State Tax Collections By Source, http://www.taxadmin.org/fta/rate/09taxdis.html

Contacts:

Earl Long
913.956.4850
FairTaxKC@EverestKC.net

Lloyd Hanahan
913.897.2770
lbh6221@aol.com

KU SCHOOL OF BUSINESS
The University of Kansas

THE CENTER FOR APPLIED ECONOMICS

Supporting Regional Economic Development through Analysis and Education

A Comprehensive Retail Sales Tax as a Single Tax for the State of Kansas

By Arthur P. Hall, Executive Director, Center for Applied Economics

A well-crafted retail sales tax on all goods and services could replace all 36 other state-level taxes in Kansas—including the personal and corporate income taxes. The tax rate could be eight percent (8%) or less, after the state government makes budget adjustments related to the recent recession-driven revenue shortfalls. Such a bold move holds the promise of making Kansas one of the most growth-oriented state tax environments in the nation (without compromising retail competitiveness along the state's borders). A change of this magnitude would require substantial behavioral and administrative adjustments for everyone, but the technical aspects of such a transition are readily managed if Kansans chose to commit to the goal.

Tax Policy and Economic Growth

Tax policy debates can benefit from an understanding of economic fundamentals. The accumulated complexity of modern tax laws can camouflage a basic principle: Taxation represents a claim the government makes on the monetary value of either current or future production. The only way citizens can pay a tax is to divert current income from some other use or draw down current savings. Current income measures the value of current production. Savings (usually in the form of personal or business investments) measures the value of resources dedicated to future production.

Taxation of the resources used for future production may well lead to less future production—less economic growth. Policy makers should keep two fundamental elements of taxation separate when evaluating tax policy: (1) the dollar amount of taxes collected and (2) the economic efficiency with which each dollar is collected. Each component matters for different economic reasons. The dollar amount of taxes collected relates to the deployment of resources in the public sector versus the private sector, and the relative value added by each sector. The economic efficiency of tax collections is a tax policy design issue independent of how much tax money the public sector claims from the production stream. Some methods of taxation have better efficiency properties than others with regard to the private sector's incentive to produce.

A well-crafted retail sales tax has positive attributes from the perspective of economic growth. It represents one form of a consumption tax, a form familiar to most people. Generally, consumption taxes represent a class of taxes that do not tax money used for saving and investment, regardless of the source of that money. This feature of consumption taxation differs from traditional types of income taxation. Income taxes effectively double tax the money used for saving and investment (but tax only once the money used for consumption), thereby producing a tax bias against saving and investment, which generates a disincentive to dedicate money toward future production.[1] Because saving and investment are key elements of the growth process, consumption taxes can better promote economic growth, all else equal.

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A well-crafted retail sales tax would also tax all goods and services uniformly. Such uniformity can also assist the process of economic growth. When certain types of economic activity are taxed differently, it can lead to a misallocation of resources or malinvestments. Minimizing such tax-driven misallocations can improve the overall efficiency and effectiveness of the economic growth process. (HB 2348, 2009 Session, represents an example of model legislation to achieve greater uniformity in the application of the Kansas sales tax, a model that can help inform the legal details of a comprehensive retail sales tax.)

Basic Design of a Comprehensive Retail Sales Tax

The policy goal of a comprehensive retail sales tax—one that replaces all other state-level taxes—is to tax all items of "end use" consumption in the state of Kansas. The "end use" criterion would exclude from sales tax any business inputs used to produce other goods and services. The economic efficiency aspects of a comprehensive retail sales tax would dissolve if inputs (intermediate goods and services) incur taxation, because of a phenomenon called "tax pyramiding," the payment of tax on tax.

What would be taxed?

The purchase of all end use goods and services. An unconventional, but logical, element of a comprehensive retail sales tax base would include rented and owner-occupied housing.

What would not be taxed?

- The purchases of inputs by businesses (i.e., intermediate sales)—including purchases related to research and development. Farms, properly defined, would classify as businesses.
- Goods or services purchased on behalf of an insured person (policyholder). Such purchases would count as a business purchase. (A retail sales tax would be levied on insurance premiums.)
- Money used for saving or investment. (However, a retail sales tax would be levied on financial services.) The term "investment" means property purchased exclusively for purposes of appreciation of income or the production of income.
- Tuition expenses for education. Education is a form of investment. (Job training would count as a business input.)
- Tithes, dues, contributions, and similar payments to qualified not-for-profit organizations.
- Services provided pro bono by churches or not-for-profit organizations.

Select Policy Issues

No tax regime is as simple as people hope. Matters related to social policy will always interface with tax policy. Illegal tax evasion and legal tax avoidance create economic dynamics that require thoughtful administrative procedures that may increase administrative complexity. Simplicity is one among many policy goals that must be balanced against one another. (Kansas, among many other states, participates as a full member in the Streamlined Sales and Use Tax Agreement, a cooperative agreement among states with a stated mission of simplifying sales and use tax administration, especially as the administration relates to interstate transactions.[2] This agreement could factor into the particular details of implementing a comprehensive retail sales tax.)

Applying the Sales Tax to Rented or Owner-Occupied Housing

A comprehensive retail sales tax need not tax the consumption of housing services, but doing so follows logically from the economic principles associated with such a tax regime. First, uniformity in the taxation of all end use goods and services helps promote better resource allocation and tax equity. Second, and related, housing services represent a large component of consumption. Exempting this consumption from taxation requires a higher tax rate on other forms of consumption; the tax rate differential among different forms of consumption works against the economic goal of preventing tax-driven resource misallocation.

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Transition issues always loom large in fundamental tax reform. The most straight forward transition related to the sales taxation of housing services may be to specify a date certain after which all rental payments and all owner-occupied home sales would be subject to the new tax system. Tax uniformity recommends against distinguishing between existing and newly-constructed housing units. An unavoidable transition issue related to housing is the price effect created by the imposition of sales tax on rental payments and future home sales. From a taxpayer perspective, this effect is part of the price of eliminating other forms of taxation.

The consumption taxation of owner-occupied housing creates much greater policy challenges than does the consumption taxation of rental housing. If the goal of the new tax policy is to make no distinction between existing and newly-constructed housing units, policy makers must craft some type of method to include existing owner-occupied housing into the comprehensive sales tax base. Some measure of complexity is unavoidable in this process. Two procedural options suggest themselves: (1) include newly-built and existing houses in the tax base as they change owners or (2) include all existing houses at once and newly-built houses when Kansans buy them. Under either option, two policy questions arise: (1) should the full amount of the tax be due all at once (much like the sales tax on a car purchase) or should payment of the tax be spread out over time? and (2) should the comprehensive sales tax apply to every sale (turnover) of an owner-occupied housing unit or should every unit bear tax only once?

Arguably, the approach least disruptive to the Kansas housing market would include all existing owner-occupied housing units into the tax base at once and spread the payment of the tax liability out over time (for both existing and newly-built housing units). Here is one possible approach: As of date certain, all existing owner-occupied housing units would adopt as their "sales price" the appraised value they hold for property tax purposes. The legislated comprehensive sales tax rate would apply to that value to determine the tax amount. The taxpayer would pay the tax in equal increments over a 15-year period. The 15-year period is arbitrary; it derives from the convention of 30-year mortgages and offers an administratively simple method for splitting the time value of money between the taxpayer and the state government. A longer time period would make the transition more financially manageable and disrupt the market for housing less; but it would make the revenue-neutral tax rate higher. Buyers of newly-built houses would pay tax on the sales price and also pay the tax in equal installments over 15 years. Assuming an eight percent tax rate, an owner or buyer of a $200,000 house would owe $1,066 per year (but would owe no state-level income tax or car tax and, as explained below, might have some of the tax rebated). For comparison, that amount would be consistent with a renter that paid tax on rental payments of $1,110 per month.

The question of whether to tax every house sale is a matter of balancing policy trade-offs. There is a logical appeal to imposing a tax on each housing unit only once: the initial price is a measure of the consumption value of the house. Taxing each new house sale is a tax on mobility, which has undesirable attributes from an economic policy perspective. The state government will collect much more revenue over time if a tax is imposed on each new house sale (with a new 15-year payment period). Consequently, the taxation of each house sale could allow for a lower tax rate or a longer time period over which to pay the tax. (A procedure will be required to handle owner-occupied homes that become rentals.)

Taxes as a Share of Income

Critics of retail sales taxation often cite the "regressivity" of the tax burden, meaning that the tax burden as a share of income tends to be higher for citizens with lower income levels. Such critics may argue in favor of income taxation instead because they favor "progressivity" of the tax burden. Under an income tax regime, the tax authorities can more easily apply higher tax rates to higher levels of income—as they do under current U.S. and Kansas law—than they can under a sales tax. However, as illustrated in Table 1, the generation of tax progressivity does not require a structure of graduated tax rates.

Contrary to the critics' claims, a well-crafted comprehensive retail sales tax generates a proportional tax burden, as illustrated in Table 1. Proportionality provides a clear principle for the conduct of tax policy. Each citizen contributes the same proportion of their income to the funding of publicly provided goods and services, based on the amount that each citizen consumes. (Of course, those citizens with more income to spend on consumption pay a larger dollar amount.) Those citizens that save or invest more—meaning those citizens that contribute a larger share of their current income to the promotion of greater future production—defer a portion of their current tax burden into the future when they consume that portion of increased production they helped create.

If Kansans insist on establishing a progressive tax burden (how much progressivity is the "correct" amount?), a tax rebate approach offers a sound method from the perspective of controlling compliance costs and maintaining the integrity of the tax system. The alternative, practiced in many tax jurisdictions in the U.S., is to exempt certain goods and services from tax—typically those defined as "necessities," like food, clothing, and medicine. Exemptions ruin the uniformity feature of a well-crafted comprehensive retail sales tax and require increased recordkeeping and monitoring costs on the part of both the tax authority and sellers of exempt goods and services.

Current Kansas law offers a refund through the income tax code for lower-income citizens that pay sales tax on food. The refund procedure has several restrictions on who can qualify and, in the 2008 tax year, had a tax-filer income limit of $30,300. This approach imposes an administrative cost on the tax authority and those that qualify for a rebate, but not the seller of food.

A more comprehensive rebate program could follow the spirit of current Kansas law related to food sales, but have broader applicability. Assuming that the comprehensive retail sales tax replaced the Kansas income tax, an alternative—but similar—administrative procedure would allow citizens to seek a rebate.

A retail sales tax devised for use by the federal government as a replacement for all other federal taxes (HR 25, 111th Congress, 1st Session) bases its rebate plan on the federal poverty level. As devised in the legislation, all citizens would automatically receive a rebate based on a formula. In brief, the formula multiplies the sales tax rate by the federal poverty level designated for a specified family size. The details of this rebate are discussed below in connection with the derivation of tax rates for a comprehensive retails sales tax.

Table 1 shows the impact a rebate has on taxes paid as a share of income. The rebate generates a progressive tax burden. The rebate has a greater financial impact on the taxes paid by lower-income groups. Consequently, the tax burden as a share of income increases as income increases (assuming the income purchases the end use consumption of goods and service.)

The Economic Importance of Exempting Business-to-Business Transactions

Sound economic policy seeks to minimize the influence of policy on the relative level of prices. Prices that accu-

Table 1

Examples of Tax Burden as a Share of Income

	Taxpayer 1	Taxpayer 2	Taxpayer 3	Taxpayer 4
Gross Income	20,000	100,000	500,000	1,000,000
Income spent on consumption (assume 20% goes toward saving)	16,000	80,000	400,000	800,000
Tax paid with an 8% tax rate	1,280	6,400	32,000	64,000
Taxes as share of Gross Income	6.40%	6.40%	6.40%	6.40%
Hypothetical Rebate on Taxes Paid	1,000	1,000	1,000	1,000
Taxes as a share of Gross Income after rebate	1.40%	5.40%	6.20%	6.30%

rately reflect the market value of goods and services help to direct resource use in a manner consistent with the value consumers place on the goods and services.

A sales tax imposed on intermediate goods and services—the goods and services that work as inputs to the production of end use goods and services—would create false price signals. This outcome would result from the payment of tax upon tax—a process called "tax pyramiding" or "tax cascading."

A growing body of empirical research indicates that the retail sales tax has a strong negative impact on relative economic growth rates among the states.[3] The basic explanation for this finding is that current practices related to the retail sales tax in many states creates a significant amount of distortion in market prices. This distortion can be significantly magnified in the case of business-to-business transactions because of tax pyramiding, and the magnification can take place in unpredictable ways, depending on the details of particular production processes and their interaction with the retail sales tax.

Table 2 offers a hypothetical example of tax pyramiding. The key assumption in the table, which is uncertain in practice, is that the seller has the ability to fully pass on the amount of the sales tax to its customer. The line item labeled "Sales Tax on Sales Tax" demonstrates the tax-pyramiding phenomenon. The greater the number of business-to-business transactions in the production process that must pay the retail sales tax, the more the tax will generate relative-price distortions that negatively influence the growth and efficiency of the economy.

From the end-consumers' perspective, tax pyramiding increases the effective sales tax rate. The assumed statutory tax rate of 8.0 percent results only when the system taxes the economic value added: "Sales Tax on Real Value" divided by the sum of "Value Added" ($104/$1,300). The example of tax pyramiding illustrated in Table 2 results in an effective sales tax rate of 8.64 percent (($104 + $8.28)/$1,300). If the production process had more stages, the effective sales tax rate would increase further, as the tax pyramid grew.

From a business perspective, tax pyramiding can alter business-structure decisions. The above example uses small dollar values. However, given a large enough dollar volume of taxed business-to-business sales, the retail sales (and use) tax system can artificially motivate a firm to vertically integrate in order to minimize its tax exposure; business "transactions" *within* a firm would not be viewed as taxable transactions. Such an outcome would represent a vivid example of a business decision being made solely because of tax policy—a violation of sound economic policy.

Kansas exempts from retail sales tax many business-to-business transactions but not nearly all transactions. The Kansas Department of Revenue, in its 2008 *Annual Report*, provides retail sales tax collections from 98 different industry sectors. Only 12 of the reported sectors—representing about 58 percent of total collections—have a retail designation. It is difficult to know what share of total sales tax collections in Kansas, even from the 12 retail sectors reported, represent business-to-business

Table 2

An Illustration of Tax Pyramiding Using a Tax Rate of 8.0 Percent

	Industry Sector				
Item of Analysis	**Forestry & Logging**	**Wood Product Manufacturing**	**Furniture Manufacturing**	**Home Furnishings Stores**	**End Consumer**
Purchase Price		$1,000.00	$1,180.00	$1,374.40	$1,577.95
Sales Tax on Real Value		80	88	96	104
Sales Tax on Sales Tax		0	6.4	7.55	8.28
Value Added	1,000.00	100	100	100	
Final Sale Price	$1,000.00	$1,180.00	$1,374.40	$1,577.95	$1,690.24

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transactions (e.g., building contractors buy building materials from hardware stores). Calculations by the Center for Applied Economics estimate the Kansas business-to-business share of retail sales tax at about 27 percent (the share of the compensating use tax is closer to 80 percent). Other multi-state studies have placed the business-to-business share of the retail sales tax in Kansas at 33 percent and 44 percent.[4]

Kansas policy can resolve the tax pyramiding problem in two ways: (1) exempt certain transactions from sales tax at the point of purchase or (2) rebate the tax paid on certain purchases. Current law relies on the exemption-on-sale approach. Qualified purchasers present an exemption certificate to sellers. For a comprehensive retail sales tax, the rebate approach may represent a better overall method. All transactions would pay tax but qualifying purchases would receive a rebate upon proper application.

The rebate approach to the tax pyramiding problem relieves sellers of goods and services from the costs associated with tracking exempt sales from non-exempt sales (and policing illegal behavior related to tax evasion). True, collecting tax to rebate it seems like wasteful activity. However, the rebate approach puts the tax authority in charge of policing tax compliance. To claim a rebate, businesses would need to authenticate their legal status and, upon audit, present invoices for rebates claimed. With today's technology, the system could be

Table 3

Estimated Tax Base and Tax Rates for a Comprehensive Retail Sales Tax
(Dollars in Billions)

Year	2000	2004	2008
Revenue to Replace (from Table 4)	$4.9	$5.5	$7.2
Estimated Revenue-Neutral Tax Rate	8.05%	8.43%	8.69%
Derivation of Tax Base (a)			
Wages and Salaries	$41.3	$45.8	$57.5
Estimated Taxable Employment Benefits (b)	2.7	4.1	4.9
Farm Proprietors' Income	0.3	0.5	0.4
Nonfarm Proprietors' Income	5.7	7.6	9.9
Dividend Income	3.5	4.7	6.5
Interest Income	5.7	4.3	6.5
Capital Gains (c)	3.4	2.3	3.1
Government Transfer Payments	9.6	12.0	15.5
Total Spendable Income	72.2	81.4	104.3
Less: Estimated Saving or Untaxed Spending (d)	16.7	23.1	29.6
Plus: Estimated Taxable Rent (e)	1.5	1.7	2.0
Plus: Appraised Value of Owner-Occupied Homes ÷ 15 (f)	5.1	6.6	8.4
Estimated Gross Tax Base	62.1	66.7	85.1
Less: Estimated Automatic Family Rebate	1.6	1.8	2.3
Estimated Net Tax Base	60.6	64.8	82.8

(a) Unless otherwise specified, data comes from the U.S. Bureau of Economic Analysis.
(b) Primarily insurance premiums.
(c) Capital gains figure for 2008 equals the average from 2004 through 2007.
(d) Estimates derive from (1) Consumer Expenditure Survey ratio of total consumption expenditures (less tuition and rent) divided by before-tax income and (2) Kansas-specific Internal Revenue Service data for charitable contributions as a share of income. To create conservative estimates, no attempt is made to estimate the share of charitable contributions that will re-enter into the Kansas taxable spending stream. Tuition and charitable contributions are not taxed. Saving and investment is not taxed.
(e) U.S. Census Bureau—American Community Survey.
(f) Data source: Kansas Department of Revenue. Using the 30-year mortgage convention, the tax is assumed to spread over 15 years in equal payments as a simple way to split the time value of money between the taxpayer and the state government.

Table 4

Sources of Kansas Tax Revenue
(Dollars in Millions)

Year	2000	2004	2008
Property Taxes			
(excluding K-12 education funding)			
Educational Building	19.8	24.1	30.2
Institutional Building	9.9	12.0	15.1
State General	0.0	13.7	0.0
Mortgage Registration	0.8	1.1	1.1
Motor Carrier	16.1	19.5	29.0
Various Vehicle	3.8	4.4	4.8
Income and Priviledge Taxes			
Individual	1861.6	1899.3	2944.9
Corporation	250.1	141.2	432.1
Financial Institutions	22.3	25.4	33.2
Inheritance/Estate Tax	62.9	48.1	44.2
Sales, Use, Excise Taxes			
Retail Sales	1520.4	1706.7	1983.6
Compensating Use	223.4	225.2	281.2
Motor Fuels	358.6	423.9	431.3
Vehicle Registration	138.7	157.3	168.8
Ceral Malt Beverage	2.4	2.2	2.2
Liquor Gallonage	15.1	16.6	18.5
Liquor Enforcement	33.3	40.3	50.0
Liquor Drink	22.6	28.5	35.7
Cigarette	49.1	119.8	112.7
Tobacco Products	3.8	4.8	5.5
Corporate Franchise	16.8	36.8	46.7
Boat registration	0.6	0.8	1.0
Severance	57.0	91.0	159.3
New Tires	1.4	0.7	0.7
Motor Vehicle Rental	2.5	2.6	3.4
Dry Cleaning & Laundary	1.2	1.3	1.2
Clean Water	0.0	2.7	3.2
Insurance Premium Taxes			
Foreign Compamies	49.9	89.5	102.8
Domestic Companies	8.9	18.5	15.8
Firefighter Relief	5.2	8.4	9.4
Fire Marshall	3.6	5.5	5.9
Other Taxes			
Private Car Companies	0.9	0.7	0.9
Music Dramatic Tax	0.0	0.0	0.0
Bingo Enforcement	0.9	0.7	0.5
Transient Guest	0.3	0.4	0.6
Parimutual	4.2	3.5	1.9
Illigal Drugs	1.5	0.7	1.2
Combative Arts	0.0	0.0	0.1
Unemployment Compensation Taxes	107.7	282.6	223.3
TOTAL	4877.5	5460.4	7201.9

Source: Kansas Tax Facts, Kansas Legislative Research Department

Web-based and rely on electronic fund transfers. Properly designed, the rebate procedure could become a relatively simple routine for small business owners and business accountants.

Charitable and Nonprofit Activity

Kansas hosts approximately 11,000 public charities receiving revenues totaling almost $10 billion.[5] Approximately 90 percent of the revenue is paid out as expenses.

The bulk of the expenses probably represent wages and salaries and pro bono service activities, although exact details are unavailable. The wages and salaries paid by public charities would be subject to tax through a comprehensive retail sales tax as the employees spent their pay on goods and services.

Other expenses incurred by the expenditures of public charities may well represent end use consumption. In concept, such consumption should share in the Kansas tax burden. South Dakota, a state with one of the most comprehensive retail sales tax regimes, does not exempt purchases made by churches, membership organizations (like YMCAs, Boy Scouts, Jaycees, or Rotary Clubs), and civic and nonprofit organizations.

The basic tax design rules listed above place no sales tax on contributions made to nonprofit organizations or goods and services delivered at a zero price. In this context, a membership organization—like a YMCA—may operate like a business in that it uses business-like inputs to produce a valuable service, but it does not charge a price in the conventional sense of a retail transaction. By not exempting (rebating) the tax paid on the purchase of inputs used by charitable, membership, or nonprofit organizations, the end use consumption of the service also shares in the consumption tax burden.

Naturally, Kansans may prefer to exempt charitable organizations from tax despite the logic to include them suggested by a comprehensive retail sales tax regime. The cost of this preference would be a higher tax rate. From an administrative perspective, to the extent that Kansas policy exempts from tax the purchases made by charitable organizations, the most cost-effective approach would follow the same procedures used to rebate the tax paid on business inputs, as outlined above.

Derivation of Tax Rates

Table 3 uses historical data for three different years to estimate the size the of the tax base for a comprehensive retail sales tax and the revenue-neutral tax rates needed to meet all actual state-level tax revenue collections in the select years. Table 4 provides the list of tax revenues to replace. Note that the list excludes the state-level property tax dedicated to public school funding. The tax rates for the years 2000, 2004, and 2008 are, respectively: 8.05 percent, 8.43 percent, and 8.69 percent.

Table 5

Alternative Tax Rate Scenarios

	Alternative Tax Rates			Alternative Tax Rates less 5.3%		
Alternative Scenario	**2000**	**2004**	**2008**	**2000**	**2004**	**2008**
Revenue-Neutral Rates from Table 3	8.05%	8.43%	8.69%	2.75%	3.13%	3.39%
No Automatic Family Rebate	7.85%	8.19%	8.46%	2.55%	2.89%	3.16%
Automatic Family Rebated Limited to Incomes of $50,000 or Less	7.97%	8.33%	8.59%	2.67%	3.03%	3.29%
Replace Income Tax & Current Sales/Use Tax Only (full rebate)	6.33%	6.08%	6.77%	1.03%	0.78%	1.47%
Replace Income Tax & Current Sales/Use Tax Only; but No Tax on Rent or Housing (full rebate)	7.12%	7.00%	7.76%	1.82%	1.70%	2.46%
No Tax on Rent or Housing (full rebate)	9.07%	9.73%	9.99%	3.77%	4.43%	4.69%
Tax on Rent and only Newly Sold Houses ÷ 15 (full rebate)*	8.76%	9.31%	9.63%	3.46%	4.01%	4.33%

* National Association of Realtors (existing home sales); U.S. Census Bureau (estimated new home sales, using national ratio of: new sales to existing sales). Average state home price data comes from ratio study of Kansas Department of Revenue, based on a population-weighted average of county-level sales price samples.

The variation in Kansas income tax collections primarily drives the variation in the revenue-neutral tax rates. In the year 2004, inflation-adjusted income tax collections—especially corporate income tax collections—per Kansas job were meaningfully lower than the other two years. Sales tax collections on a per-job basis were higher in 2004. Twenty-seven other taxes were also higher on a per-job basis in 2004, but these smaller taxes amounted to about 21 percent of state revenue collections.

Each element in Table 3 has a straightforward interpretation except the "Automatic Family Rebate." The policy intent of this rebate is to assure that no family (or household) pays comprehensive retail sales tax on "essential" goods and services.

The mechanics of the rebate follow the one devised for a federal plan for a comprehensive sales tax (HR 25, 111th Congress, 1st Session), since the details are readily available. As used in the calculations for Table 3, every Kansas family (one or more family members sharing a common residence) would receive a rebate of the sales tax on consumption spending equal to the federal poverty level. The family would need to register with the tax authority to receive allowable rebates.

Each year, the U.S. Department of Health and Human Services designates the official poverty level for families of different sizes. HR 25 designed the rebate procedure to eliminate any penalty for marriage related to the official designation. To do that, it treats each spouse as a household of one and then subtracts from that poverty-level designation the poverty-level designation for a family of two. For example, if the annual poverty level for a family of one equaled $10,000 and the annual poverty level for a family of two equaled $13,000, the annual "marriage penalty elimination amount" would equal:

Table 6

Simulations of Growth of Select Economic Variables from Replacing All State-Level Taxes with a Comprehensive Retail Sales Tax

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Immediate Replacement:						
Private-Sector Employment	8.85%	8.80%	8.74%	8.68%	8.63%	8.57%
Private-Sector Investment	3.37	3.72	3.72	3.71	3.71	3.70
Take-Home Pay per Capita	2.94	2.92	2.90	2.88	2.87	2.85
Four-Year Phase-in:						
Private-Sector Employment	2.16	4.33	6.50	8.69	8.64	8.58
Private-Sector Investment	0.88	1.78	2.73	3.73	3.72	3.72
Take-Home Pay per Capita	0.78	1.53	2.25	2.92	2.90	2.89

Table 7

Simulations of the Growth of Select Economic Variables from Replacing Personal and Corporate Income Taxes with a Comprehensive Retail Sales Tax

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Immediate Replacement:						
Private-Sector Employment	6.93%	6.91%	6.88%	6.85%	6.81%	6.79%
Private-Sector Investment	3.10	3.11	3.13	3.14	3.15	3.16
Take-Home Pay per Capita	0.71	0.72	0.73	0.74	0.75	0.77
Four-Year Phase-in:						
Private-Sector Employment	1.72	3.43	5.14	6.84	6.81	6.78
Private-Sector Investment	0.78	1.55	2.34	3.13	3.14	3.15
Take-Home Pay per Capita	0.23	0.43	0.60	0.73	0.75	0.76

$20,000 - $13,000 = $7,000. The "marriage penalty elimination amount" of $7,000 is added to the published poverty level amount for a family of a specified size. Consequently, if the federal poverty level for a family of four equaled $22,000 and the Kansas comprehensive retail sales tax rate equaled eight percent (8%), the annual automatic family rebate (for a married couple) would equal: $22,000 + $7,000 = $29,000 x 0.08 = $2,320.

Table 5 provides a comparison of comprehensive retail sales tax rates under alternative design scenarios. For convenience, the table also provides the difference from the current Kansas retail sales and use tax rate of 5.3 percent.

Table 5 illustrates three noteworthy points. First, providing the automatic family rebate to all families instead of a smaller group of families with lower income does not alter the tax rate substantially. If the administrative costs of the rebate system increase from both the taxpayer and tax authority perspective by limiting the rebate to select families, it may make sense to provide it to all families. Second, the taxation of rented and owner-occupied housing substantially reduces the level of the tax rate. The novelty (and probable unpopularity) of applying the retails sales tax to rented and owner-occupied housing must be traded off against the higher rates and the elimination of all other state-level taxes. Third, if Kansans want to replace just the Kansas income tax system and the current sales tax with a comprehensive retail sales tax, the rate change is relatively small, with the taxation of rented and owner-occupied housing once again making a substantial difference in the level of the tax rate.

Economic Growth Dynamics

Tax reform of the magnitude defined by moving to a comprehensive retail sales tax as the single state tax will involve substantial political commitment and costly economic adjustments for the entire population of Kansas. One compelling reason for undertaking such a commitment is to reap the benefits of superior long-run economic performance of the Kansas economy, and the positive impact that will have on the citizens of Kansas. Economic simulation of the growth dynamics suggest that the major tax reform described by a comprehensive retail sales tax can help deliver superior economic performance. Table 6 and Table 7 illustrate the simulated economic performance results of two scenarios—a scenario in which a comprehensive retail sales/use tax replaces all taxes shown in Table 4 and a scenario in which a retail sales/use (using the comprehensive tax base) replaces the personal and corporate income tax and the current sales/use tax. Each scenario, in turn, shows an immediate switch and a four-year phase-in executed in equal parts for each of the four years (25 percent per year).

Simulations offer mere representations of reality used to acquire intuition about the effects of numerous and complicated interactive forces. One should not interpret simulations as forecasts. The computer model used to generate the simulations for Kansas in Table 6 and Table 7 attempts to provide intuition about how select economic variables will change when the impact of taxation on those variables changes.[6] A properly-implemented comprehensive retail sales tax would (1) eliminate all business-level tax payments, (2) eliminate the need for businesses to compensate individuals for the income tax on wages, and (3) remove the income tax bias against saving and investment. The result of this change in the structure of taxation, according to the simulation, would be a permanent increase in the growth path of private-sector employment and investment, as well as take home pay for Kansans.

Table 6 shows that an immediate shift to a comprehensive retail sales tax as a single tax has the potential to increase (above the level under the current tax structure) private-sector employment by almost nine percent, private investment by almost four percent, and take-home pay by almost three percent. The best way to think about this change is as a shift upward in the growth path of these three economic variables. The change in tax structure makes a larger amount of economic activity viable. Because economic growth works in a manner similar to the mechanics of compound interest, the larger base of economic activity made possible by the new tax structure will help accelerate the growth of the overall size of the Kansas economy. A phase-in on the new tax structure will have the same results once fully phased-in. The fully phased-in, revenue-neutral sales tax rate for the simulations in Table 6 is 8.35 percent (excluding the family rebate), quite close to the 2008 estimate of 8.69 percent reported in Table 5, which does not stimulate economic growth effects.

The simulation data in Table 7 has the same interpretations as those in Table 6. The effects are somewhat smaller because the simulation assumes that only personal and corporate income taxes (and the current sales/use tax) are replaced by the comprehensive retail sales/use tax. The fully phased-in, revenue-neutral sales tax rate for the simulations in Table 7 is 5.60 percent (excluding the family rebate). The 2008 rate of 6.77 percent reported in Table 5 includes the family rebate.

An important part of the simulation exercise not reported here relates to the tax revenues of local government in Kansas. The state-level tax change creates a substantial (simulated) increase in local government tax revenues. Changes in property taxes and other miscellaneous taxes and fees result indirectly from the surge in economic activity created by the change in state policy. But local sales tax collections change as a direct result of the change in state policy. Local governments piggyback on the state-defined sales tax base. Since the comprehensive retail sales tax substantially broadens the state sales tax base, local governments come along for the ride. For reasons related to cross-border shopping, Kansans may want to assure that local government sales tax rates adjust downward to be revenue neutral with regard to the expanded sales tax base.

A Comprehensive Retail Sales Tax and Cross-Border Shopping

A comprehensive retail sales (and use) tax in Kansas will work only if the combined state and local tax rates remain low enough to prevent a "substantial" amount of Kansans from having an incentive to cross the state line to shop for goods and services. About 40 percent of the Kansas population lives in counties that border a neighboring state. Counties on the border with Missouri account for about 32 percent of the state population—with counties considered to be part of the Kansas City metropolitan area accounting for 28.5 percent of the population. The eastern half of the border with Oklahoma (from Sumner County eastward) accounts for almost 5 percent of the Kansas population.

Implementation of a comprehensive retail sales tax as a single tax (using the state rates offered in this report) would keep Kansas competitive at the borders, especially since Kansas would impose no other taxes. Along most regions of the Missouri border and the eastern half of the Oklahoma border, combined state and local sales tax rates in Kansas are generally lower by a quarter to a full percentage point. (The border with southern Missouri is the most common exception, where rates are more equal.) A comprehensive retail sales tax—with local rates adjusted downward by about 45 to 50 percent to accommodate the broader tax base—would reverse the current situation, all else equal.

However, all else will not be equal. Kansas residents will no longer pay any other tax and businesses will operate tax-free. The key to Kansas competitiveness in the context of cross-border shopping is not the level of sales tax rates per se, but the final sales price of goods and services. Without any other taxes to pay (either directly or indirectly), the tax-related cost structure of Kansas businesses should allow for vigorous cross-border competition while maintaining profitability.

Endnotes

1 For a more in-depth discussion of this point, see Arthur P. Hall, "Competing Concepts of Income and the Double Taxation of Saving," Technical Report 05-0926, Center for Applied Economics, University of Kansas School of Business, September 2005.

2 For more information, see: http://www.streamlinedsalestax.org/

3 See, for example, W. Mark Crain, *Volatiles States: Institutions, Policy, and the Performance of the American States* (Ann Arbor: The University of Michigan Press, 2003), Chapters 4 and 5, and the citations therein.

4 Respectively, Raymond J. Ring, Jr., "Consumers' Share and Producers' Share of the General Sales Tax," *National Tax Journal,* Vol. 52 (1), March 1999, pp. 79-90 and Robert Cline, et al., "Sales Taxation of Business Inputs: Existing Tax Distortions and the Consequences of Extending the Sales Tax to Business Services," Council on State Taxation, January 25, 2005.

5 National Center for Charitable Statistics. http://nccs.urban.org/statistics/profiles.cfm

6 The model used is a so called computable general equilibrium model developed for the state of Kansas by the Beacon Hill Institute at Suffolk University in Boston, Massachusetts. For more information, see: http://www.beaconhill.org/STAMP_Web_Brochure/STAMP_IntroductionMS.html

KU
THE UNIVERSITY OF
KANSAS

Center for Applied Economics
University of Kansas School of Business
Summerfield Hall, 1300 Sunnyside Avenue
Lawrence, KS 66045-7585
www.cae.business.ku.edu
(785) 864-5134

Testimony before the Special Committee on Assessment & Taxation
Presented by J. Kent Eckles, Vice President of Government Affairs

achieve more

Friday, September 17th, 2010

The Kansas Chamber of Commerce appreciates the opportunity to present testimony on behalf of our members, who believe we must reform the State's tax structure to spur economic growth in Kansas.

Like you, we want Kansas to grow economically and ultimately generate more tax receipts. By lowering the right mix of taxes that presently discourage capital investment and job creation, the state can certainly grow its way to out of this economic downturn and further insulate itself from future recessions. There is ample evidence in other states of like-size to Kansas that shows just how to achieve economic growth.

According to the Council on State Taxation's 2010 study *Total State & Local Business Taxes*, Kansas employers paid $5.6B in taxes in 2009 and saw their business tax burden increase nearly 17% between 2005 & 2009. (See Attachment 1)

According to The Tax Foundation, Kansas ranks 32nd nationally in business tax burden, which of course is below average and shows there is room for improvement as a state. (See Attachment 2)

In the book Rich States, Poor States by economists Laffer, Moore & Williams, it is noted that between '98-'07, 400,000 people moved from the nine highest tax states to those without income taxes. Those recipient states grew 89% more jobs than the nine highest tax states combined and personal income increased 32%. The Kansas Chamber believes our state should capitalize on this economic climate!

What is the magic formula those states follow? They tax consumption (sales) rather than savings, investments & business profits (property, income). Unfortunately, Kansas' biggest source of tax receipts is via income taxes. Sales tax receipts have shown to be a more stable source of tax receipts than income or property, so states that derive a larger portion of their receipts from consumption taxes are more insulated from economic downturns.

As we all know, Kansas increased their consumption (sales) taxes by nearly 19% last legislative session and the Kansas Chamber opposed that because there was no trade-off on reducing income taxes, which we have had on our legislative agenda for two years, but did not ask for until we as a state were able to enact comprehensive tax reform, which is why we are all here today.

Per the Chairman's request, our specific proposal to this committee is to consider not sun-setting the recently enacted sales tax increase as written in law (in 2013) and continue to use those revenues to offset the elimination of the corporate income tax. That is the formula other states of like size to Kansas have used to grow their economies while at the same time maintaining and improving existing government services and infrastructure.

The bottom line is taxes matter to business and Kansas definitely has room to improve. Business taxes affect business decisions, job creation and retention, plant location, competitiveness, the transparency of the tax system, and the long-term health of a state's economy. Most importantly, taxes diminish profits. If taxes take a larger portion of profits, that cost is passed along to either consumers (through higher prices), workers (through lower wages or fewer jobs), or shareholders (through lower dividends or share value). Thus, a state with lower tax costs will be more attractive to business investment, and more likely to experience economic growth.

Special Committee on Assessment and Taxation

September 16-17, 2010

Attachment #38

Further, states do not enact tax changes (increase or cuts) in a vacuum. Every tax law will in some way change a state's competitive position relative to its immediate neighbors, its geographic region, and even globally. Ultimately it will affect the state's national standing as a place to live and to do business. Entrepreneurial states can take advantage of the tax increases of their neighbors to lure businesses out of high-tax states.

On a parting note, we would like to point your attention to an article that appeared in this Wednesday's *The Wall Street Journal* by Harvard University's political economist Alberto Alesina (See Attachment 3). He and his colleagues reviewed over 200 fiscal adjustments in 21 countries and the evidence clearly showed that spending discipline and tax cuts are the best ways to spur economic growth – as opposed to "stimulus" spending. When a state or federal government engages in "stimulus" spending, citizens and businesses know that spending will have to ultimately be paid for with higher taxes, which results in citizens and businesses reducing their spending and sitting on cash, which is exactly what both groups are doing presently nationwide.

The Kansas Chamber, with headquarters in Topeka, Kansas, is the leading statewide pro-business advocacy group moving Kansas towards becoming the best state in America to live and work. The Chamber represents small, medium, and large employers all across Kansas. Please contact me directly if you have any questions regarding this testimony.

THE KANSAS CHAMBER

835 SW Topeka Blvd. Topeka, KS 66612 785.357.6321

Att 'ment 1

Total state and local business taxes

State-by-state estimates for fiscal year 2009

March 2010

Ernst & Young

Quality In Everything We Do

COST

Council On State Taxation

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Attachment 1

Table 5. State and local business taxes, by major tax type, FY2009 (US$billions)

State	Property tax	Sales tax	Excise and gross receipts	Corporate income	Individual income tax on business income	Unemp. insurance tax	License and other	Total business tax
Alabama	$1.5	$1.3	$1.5	$0.5	$0.3	$0.2	$1.1	$6.5
Alaska	0.6	--	0.1	0.6	--	0.1	3.9	5.4
Arizona	4.1	3.5	1.0	0.6	0.2	0.3	0.6	10.3
Arkansas	1.0	1.2	0.5	0.3	0.3	0.3	0.3	3.9
California	18.8	18.4	8.2	12.3	6.7	4.7	8.1	77.2
Colorado	3.5	2.4	0.6	0.3	0.7	0.4	0.7	8.6
Connecticut	3.1	1.5	0.7	0.4	0.6	0.6	0.2	7.2
Delaware	0.3	--	0.2	0.2	0.1	0.1	1.1	2.0
Florida	14.4	6.6	8.4	1.8	--	0.9	2.3	34.5
Georgia	5.6	4.0	1.4	0.7	1.0	0.5	0.8	13.9
Hawaii	0.8	0.8	0.5	0.1	0.1	0.1	0.2	2.6
Idaho	0.7	0.3	0.2	0.1	0.2	0.1	0.2	1.9
Illinois	10.7	3.7	4.4	2.8	1.1	1.7	2.1	26.4
Indiana	4.4	2.0	0.5	0.8	0.6	0.5	0.4	9.3
Iowa	2.8	1.0	0.4	0.2	0.4	0.4	0.3	5.6
Kansas	2.5	1.3	0.5	0.4	0.4	0.2	0.3	5.6
Kentucky	1.6	1.3	1.3	0.5	0.5	0.4	0.7	6.3
Louisiana	2.4	4.2	0.8	0.6	0.5	0.2	1.4	10.1
Maine	1.6	0.4	0.2	0.1	0.2	0.1	0.2	2.8
Maryland	2.4	1.6	1.7	0.8	0.9	0.4	1.5	9.3
Massachusetts	5.9	1.5	0.8	1.9	1.2	1.5	0.5	13.3
Michigan	8.8	3.2	1.2	0.7	0.7	1.4	0.8	16.9
Minnesota	3.6	1.9	1.4	0.8	0.8	0.8	0.7	10.1
Mississippi	1.8	1.1	0.4	0.3	0.2	0.1	0.4	4.4
Missouri	2.8	2.1	1.2	0.3	0.6	0.6	0.8	8.4
Montana	0.8	--	0.2	0.2	0.1	0.1	0.5	1.9
Nebraska	1.6	0.9	0.3	0.2	0.3	0.1	0.3	3.7
Nevada	1.8	1.2	0.9	--	--	0.3	1.5	5.8
New Hampshire	1.6	--	0.3	0.5	0.0	0.1	0.2	2.7
New Jersey	8.3	3.2	1.9	2.4	1.1	1.9	1.2	20.0
New Mexico	0.6	1.5	0.4	0.3	0.1	0.1	1.1	3.9
New York	21.9	11.6	4.2	10.5	4.8	2.4	1.6	56.9
North Carolina	3.7	2.6	1.8	0.9	1.0	0.9	1.1	12.0
North Dakota	0.5	0.3	0.2	0.1	0.1	0.1	0.9	2.2
Ohio	8.4	3.8	2.7	1.2	1.4	1.1	2.5	21.2
Oklahoma	1.2	2.0	0.6	0.3	0.4	0.1	1.5	6.2
Oregon	2.0	--	0.5	0.3	0.6	0.6	0.9	4.9
Pennsylvania	8.0	3.4	3.0	1.7	1.5	2.1	3.1	22.8
Rhode Island	1.2	0.4	0.3	0.1	0.1	0.2	0.1	2.3
South Carolina	3.0	0.9	0.6	0.2	0.3	0.3	0.7	6.0
South Dakota	0.7	0.5	0.1	0.0	--	0.0	0.1	1.6
Tennessee	3.1	2.8	1.1	0.8	0.0	0.4	1.2	9.5
Texas	23.1	14.0	6.4	--	--	1.1	9.2	53.7
Utah	1.2	0.8	0.5	0.3	0.2	0.1	0.3	3.5
Vermont	0.8	0.1	0.2	0.1	0.1	0.1	0.0	1.4
Virginia	4.8	1.6	2.0	0.6	0.8	0.3	1.5	11.7
Washington	3.2	7.1	2.5	--	--	1.0	0.9	14.7
West Virginia	1.0	0.3	0.7	0.4	0.2	0.1	0.7	3.5
Wisconsin	4.5	1.6	0.8	0.7	0.5	0.7	1.0	9.7
Wyoming	1.0	0.5	0.1	--	--	0.1	1.3	3.0
District of Columbia	1.3	0.4	0.3	0.4	0.2	0.1	0.1	2.8
United States	$215.3	$126.9	$70.7	$50.6	$32.3	$30.7	$63.5	$590.0

Figures may not appear to sum due to rounding.
Source: Ernst & Young LLP calculations.

Attachment 1

Table 7. Change in state and local business taxes, FY2005 to FY2009 (US$billions)

State	Total S&L business taxes				Total S&L taxes		Business share of tax growth
	FY2005	FY2009	$Change	%Change	$Change	%Change	
Alabama	$5.6	$6.5	$1.0	17.3%	$1.8	15.1%	53.1%
Alaska	2.3	5.4	3.1	136.7	3.4	109.6	92.7
Arizona	9.1	10.3	1.2	13.3	1.4	7.4	88.1
Arkansas	3.3	3.9	0.6	17.2	1.3	15.1	45.6
California	66.3	77.2	10.9	16.5	21.1	13.9	51.8
Colorado	7.5	8.6	1.1	14.8	2.8	17.1	40.1
Connecticut	7.0	7.2	0.2	2.4	1.9	9.5	9.2
Delaware	1.8	2.0	0.2	13.1	0.3	10.1	67.4
Florida	28.4	34.5	6.0	21.2	8.4	13.8	71.9
Georgia	12.1	13.9	1.8	15.0	3.6	12.8	50.0
Hawaii	2.2	2.6	0.4	16.7	0.7	12.7	51.6
Idaho	1.8	1.9	0.1	4.9	0.3	7.1	29.3
Illinois	24.6	26.4	1.8	7.4	9.3	18.0	19.6
Indiana	8.2	9.3	1.2	14.2	2.8	14.2	41.0
Iowa	4.7	5.6	0.9	19.1	1.8	17.8	50.5
Kansas	4.8	5.6	0.8	16.9	1.9	19.6	42.8
Kentucky	5.7	6.3	0.6	10.6	1.7	13.3	35.9
Louisiana	8.9	10.1	1.2	13.4	2.0	14.1	58.1
Maine	2.6	2.8	0.2	8.3	0.4	6.6	60.2
Maryland	8.5	9.3	0.8	9.4	4.6	18.8	17.5
Massachusetts	12.0	13.3	1.2	10.2	2.9	9.7	41.7
Michigan	15.9	16.9	1.0	6.2	3.1	8.5	31.5
Minnesota	9.1	10.1	0.9	10.0	2.5	11.6	36.0
Mississippi	3.8	4.4	0.6	17.0	1.3	17.5	47.8
Missouri	7.5	8.4	0.9	11.8	2.0	11.5	43.3
Montana	1.4	1.9	0.5	31.2	0.7	25.5	63.1
Nebraska	3.3	3.7	0.4	11.6	0.7	10.4	54.3
Nevada	4.5	5.8	1.2	26.9	1.4	14.7	89.2
New Hampshire	2.4	2.7	0.3	11.6	0.5	11.9	54.1
New Jersey	17.2	20.0	2.7	15.9	8.6	19.4	32.0
New Mexico	3.3	3.9	0.6	18.5	0.6	10.0	98.8
New York	49.1	56.9	7.8	16.0	18.6	16.4	42.1
North Carolina	11.3	12.0	0.7	6.6	3.4	11.8	22.3
North Dakota	1.3	2.2	0.9	66.8	1.2	55.1	73.5
Ohio	18.1	21.2	3.1	17.0	5.5	12.8	56.2
Oklahoma	5.2	6.2	0.9	17.9	1.9	18.1	50.2
Oregon	4.5	4.9	0.4	8.1	1.5	12.5	24.6
Pennsylvania	21.1	22.8	1.7	8.2	6.2	12.7	27.9
Rhode Island	2.1	2.3	0.2	10.2	0.3	5.9	79.1
South Carolina	5.4	6.0	0.7	12.5	1.1	9.5	58.3
South Dakota	1.3	1.6	0.3	20.7	0.4	20.9	61.6
Tennessee	8.4	9.5	1.1	12.6	2.0	12.0	53.5
Texas	43.4	53.7	10.2	23.6	17.6	24.8	58.3
Utah	3.0	3.5	0.6	19.5	1.2	16.5	46.4
Vermont	1.3	1.4	0.1	10.5	0.2	7.8	64.2
Virginia	10.6	11.7	1.1	10.3	3.3	11.7	32.9
Washington	12.8	14.7	1.9	15.2	4.3	17.6	45.1
West Virginia	3.1	3.5	0.4	14.3	0.9	16.7	46.1
Wisconsin	8.9	9.7	0.9	9.8	1.6	7.1	55.7
Wyoming	2.0	3.0	1.0	47.0	1.2	45.0	78.3
District of Columbia	2.2	2.8	0.6	25.0	0.8	19.2	65.2
United States	$510.9	$590.0	$79.1	15.5%	$169.2	15.0%	46.7%

Figures may not appear to sum due to rounding.
Source: Ernst & Young LLP calculations.

Attachment 1

Ap Table A-3. Composition of state and local business taxes, by type,
FY.

State	Property Tax	Sales Tax	Excise and gross receipts	Corporate income	Unemployment insurance tax	Individual income tax	License and other	Total business taxes
Alabama	23.5%	19.8%	23.1%	7.6%	3.4%	5.2%	17.4%	100.0%
Alaska	11.5	0.0	2.3	11.7	2.3	0.0	72.3	100.0
Arizona	39.7	34.3	9.3	5.8	2.6	2.1	6.2	100.0
Arkansas	25.0	30.1	14.0	8.9	6.8	8.4	6.8	100.0
California	24.3	23.8	10.7	15.9	6.1	8.7	10.5	100.0
Colorado	40.4	28.1	7.0	3.8	4.4	8.0	8.4	100.0
Connecticut	43.4	20.4	9.7	5.8	8.4	8.8	3.5	100.0
Delaware	14.4	0.0	11.5	10.5	4.6	5.2	53.9	100.0
Florida	41.9	19.1	24.4	5.3	2.5	0.0	6.8	100.0
Georgia	40.4	28.5	10.1	5.0	3.6	7.0	5.4	100.0
Hawaii	32.5	31.1	19.9	3.0	2.2	5.2	6.1	100.0
Idaho	38.5	17.8	10.1	7.5	5.8	10.3	10.0	100.0
Illinois	40.5	14.0	16.6	10.4	6.3	4.1	8.0	100.0
Indiana	47.6	21.4	5.9	9.0	5.4	6.0	4.6	100.0
Iowa	50.0	18.2	6.9	4.3	6.5	7.9	6.2	100.0
Kansas	44.9	23.8	8.3	6.6	3.9	6.9	5.7	100.0
Kentucky	25.5	21.0	20.7	7.5	6.3	7.9	11.1	100.0
Louisiana	23.9	41.6	8.1	5.8	1.6	5.2	13.7	100.0
Maine	57.4	13.5	8.9	5.2	3.4	5.8	5.9	100.0
Maryland	26.1	16.7	18.2	8.7	4.4	9.9	16.0	100.0
Massachusetts	44.2	11.4	5.8	14.4	11.5	8.9	3.9	100.0
Michigan	52.0	18.7	7.1	4.2	8.6	4.4	5.0	100.0
Minnesota	36.2	19.2	13.9	7.8	7.9	7.9	7.1	100.0
Mississippi	40.8	25.6	9.3	7.4	2.4	4.8	9.7	100.0
Missouri	33.2	25.4	13.9	3.3	6.9	7.6	9.7	100.0
Montana	42.8	0.0	10.9	8.7	4.0	6.3	27.4	100.0
Nebraska	44.7	24.9	7.7	5.4	2.8	7.1	7.5	100.0
Nevada	30.9	21.2	15.4	0.0	5.7	0.0	26.8	100.0
New Hampshire	58.2	0.0	11.9	18.1	2.6	0.4	8.8	100.0
New Jersey	41.3	15.9	9.4	12.1	9.5	5.6	6.1	100.0
New Mexico	14.4	37.3	9.5	6.6	2.2	2.0	28.0	100.0
New York	38.5	20.4	7.3	18.4	4.2	8.4	2.8	100.0
North Carolina	30.9	21.9	15.3	7.5	7.1	8.0	9.4	100.0
North Dakota	24.8	13.9	8.3	5.9	2.3	3.7	41.1	100.0
Ohio	39.9	18.0	12.8	5.6	5.1	6.6	12.0	100.0
Oklahoma	20.1	32.3	9.2	5.6	2.3	7.1	23.5	100.0
Oregon	41.3	0.0	10.4	5.9	11.6	12.4	18.5	100.0
Pennsylvania	34.8	14.9	13.1	7.6	9.1	6.7	13.7	100.0
Rhode Island	51.2	16.0	12.6	4.6	7.9	4.3	3.4	100.0
South Carolina	49.9	15.6	9.7	4.0	4.4	4.2	12.2	100.0
South Dakota	42.4	34.2	9.4	3.1	1.7	0.0	9.3	100.0
Tennessee	32.8	29.6	11.2	8.6	4.7	0.4	12.6	100.0
Texas	42.9	26.0	11.9	0.0	2.0	0.0	17.1	100.0
Utah	34.0	22.1	14.6	9.8	3.6	6.2	9.6	100.0
Vermont	58.7	9.3	12.7	6.3	5.0	4.7	3.4	100.0
Virginia	41.3	13.5	17.0	5.4	2.8	7.0	13.0	100.0
Washington	21.7	48.2	17.0	0.0	7.0	0.0	6.1	100.0
West Virginia	29.6	9.2	20.2	12.0	4.1	5.0	19.9	100.0
Wisconsin	46.5	16.2	8.1	6.7	6.7	5.6	10.2	100.0
Wyoming	34.4	17.9	3.0	0.0	1.8	0.0	42.9	100.0
District of Columbia	47.4	12.9	10.4	13.8	4.3	8.6	2.7	100.0
United States	36.5%	21.5%	12.0%	8.6%	5.2%	5.5%	10.8%	100.0%

Figures may not appear to sum due to rounding.
Source: Ernst & Young LLP calculations.

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Attachment 2

TAX FOUNDATION Since 1937

Kansas

Tax Facts & Comparisons

KANSAS

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State Business Tax Climate Index

32nd

Kansas ranks 32nd out of the 50 states in the Tax Foundation's *2010 State Business Tax Climate Index*, which annually compares the states' tax systems on over 100 variables that impact business.

Neighboring states' ranks:
- Nebraska (33rd)
- Missouri (16th)
- Oklahoma (31st)
- Colorado (13th)

Tax Freedom Day® 2010

April 7

In 2010, Kansas taxpayers worked 97 days into the year until April 7 to pay their total tax bill, ranking 25th highest nationally.

That's 2 days before national Tax Freedom Day (April 9), the day when Americans finally have earned enough money to pay their total tax bill for the year.

State-Local Tax Burdens Rank

21st

Estimated at 9.6% of income, Kansas's 2008 state-local tax burden ranks 21st highest nationally, below the national average of 9.7%.

Kansas taxpayers pay **$3,911** per capita in state and local taxes.

Neighboring states' ranks:
- Nebraska (17th)
- Missouri (32nd)
- Oklahoma (19th)
- Colorado (34th)

Federal Taxes Paid *vs.* Federal Spending Received

Per dollar of federal tax collected in 2005, Kansas citizens received approximately **$1.12** in the way of federal spending. This ranks the state 22nd highest nationally.

Individual Income Tax

Number of Brackets	3
Top Income Tax Rate	6.45%
Collections per person (2008)	$1,057
Collections rank (2008)	15th

Sales Tax

State Sales Tax Rate	6.30%
State & Average Local Sales Tax Rate	7.95%
State & Average Local Sales Tax Rate Rank	12th
State Sales Tax Collections per person (2008)	$813
State Sales Tax Collections Rank (2008)	23rd

Property Tax

Collections per person (2007)	$1,251
Collections rank (2007)	18th
Median real estate tax as a percent of median home value (2008)	1.25%
Median tax percent rank (2008)	13th

Excise Taxes

Gasoline tax rate	25¢
Gasoline tax rank	21st
Cigarette tax rate	$1.34 per pack
Cigarette tax rank	25th

Updated July 1, 2010

Attachment 3

38-8

Tax Cuts vs. 'Stimulus': The Evidence Is In

By Alberto Alesina

Politicians argue for increased stimulus spending, as opposed to spending cuts, on the grounds that it would speed up economic recovery. This argument might have it exactly backward. Indeed, history shows that cutting spending in order to reduce deficits may be the key to promoting economic recovery.

In Europe today, the risk of a renewed recession comes not from the spending cuts that some governments have enacted, but from a sovereign debt overhang and multiple bank failures. July's stress tests were not reassuring because they didn't test the exposure of European banks to sovereign debt; had they done so, many banks would have failed. Those banks remain a threat to the European economy.

In the U.S., meanwhile, recent stimulus packages have proven that the "multiplier"—the effect on GDP per one dollar of increased government spending—is small. Stimulus spending also means that tax increases are coming in the future; such increases will further threaten economic growth.

Economic history shows that even large adjustments in fiscal policy, if based on well-targeted spending cuts, have often led to expansions, not recessions. Fiscal adjustments based on higher taxes, on the other hand, have generally been recessionary.

My colleague Silvia Ardagna and I recently co-authored a paper examining this pattern, as have many studies over the past 20 years. Our paper looks at the 107 large fiscal adjustments—defined as a cyclically adjusted deficit reduction of at least 1.5% in one year—that took place in 21 Organization for Economic Cooperation and Development (OECD) countries between 1970 and 2007.

> A review of over 200 fiscal adjustments in 21 countries shows that spending discipline and tax cuts are the best ways to spur economic growth.

According to our model, a country experienced an expansionary fiscal adjustment when its rate of GDP growth in the year of the adjustment and the next year was in the top 25% of the OECD. A recessionary period, then, was when a country's growth rate was in the bottom 75% of the OECD.

Our results were striking: Over nearly 40 years, expansionary adjustments were based mostly on spending cuts, while recessionary adjustments were based mostly on tax increases. And these results would have been even stronger had our definition of an expansionary period been more lenient (extending, for example, to the top 50% of the OECD). In addition, adjustments based on spending cuts were accompanied by longer-lasting reductions in ratios of debt to GDP.

In the same paper we also examined years of large fiscal expansions, defined as increases in the cyclically adjusted deficit by at least 1.5% of GDP. Over 91 such cases, we found that tax cuts were much more expansionary than spending increases.

How can spending cuts be expansionary? First, they signal that tax increases will not occur in the future, or that if they do they will be smaller. A credible plan to reduce government outlays significantly changes expectations of future tax liabilities. This, in turn, shifts people's behavior. Consumers and especially investors are more willing to spend if they expect that spending and taxes will remain limited over a sustained period of time.

On the other hand, fiscal adjustments based on tax increases reduce consumers' disposable income and reduce incentives for productivity.

American firms today are profitable and have large unspent resources. But their uncertainty over regulation and taxes discourages them from risk-taking, investment and consumption. In Europe, governments would strengthen the banking sector if they cut spending and reduced their default risk. This, in turn, would ease the flow of credit into the private sector.

The composition of fiscal adjustments is therefore critical. Based on what we know, the U.S. and Europe are currently at greater risk from increased stimulus spending than from gradual but credible spending cuts.

Europe seems to have learned the lessons of the past decades: In fact, all the countries currently adjusting their fiscal policy are focusing on spending cuts, not tax hikes. Yet fiscal policy in the U.S. will sooner or later imply higher taxes if spending is not soon reduced.

The evidence from the last 40 years suggests that spending increases meant to stimulate the economy and tax increases meant to reduce deficits are unlikely to achieve their goals. The opposite combination might.

Mr. Alesina is a professor of political economy at Harvard.

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