

Testimony on Kansas S.B. 169

Thank you, Madam Chairwoman and distinguished members of the committee for the invitation to speak today. I appreciate the opportunity to present our non-partisan research and analysis on income taxes and economic competitiveness in the states. My name is Nick Stark. I am Director of the Task Force on Tax and Fiscal Policy at the American Legislative Exchange Council (ALEC).

As you may know, ALEC is the nation's largest non-partisan, voluntary membership organization of state legislators. Comprised of nearly one-quarter of the country's state legislators and stakeholders from across the policy spectrum, ALEC members represent more than 60 million Americans and provide jobs to more than 30 million people in the United States. We believe all Americans deserve an efficient, effective and accountable government that puts the people in control.

Today I will provide a review of the 2022 State Flat Tax Revolution and how income tax reform boosts economic performance and outlook.

The drive for a flat tax, started by the great Steve Forbes many years ago, has stalled at the federal level, but the Flat Tax Revolution is finding new life in the 50 "laboratories of democracy." In the approximately 110 years of the personal income tax at the state level only four states have made the switch from a progressive structure to a flat rate: Colorado (1987), Utah (2008), North Carolina (2014) and Kentucky (2019).

In 2022, a total of five new states — Iowa, Arizona, Mississippi, Georgia and Idaho—made the leap from a progressive tax on personal income to a flat tax. In early March, several hours before giving her rebuttal to President Biden's State of the Union address, Iowa governor Kim Reynolds signed into law aggressive tax cuts, which consolidated Iowa's nine personal income tax brackets into a single rate and lowered the rate from 8.53 percent to 3.9 percent. These historic changes resulted in a \$2 billion tax cut for Iowans.

In 2021, legislators in Arizona passed a historic \$1.9 billion tax cut in response to Proposition 208, which was passed on the November 2020 ballot. Proposition 208 implemented a 3.5 percent surtax on personal income that would have made Arizona's top rate effectively 8 percent. The tax cuts passed in 2021 implemented a plan to gradually reduce and flatten the personal-income tax, while offsetting the surtax and making the top rate effectively 4.5 percent. However, a March 2022 decision by the Arizona Supreme Court overturned the Proposition 208 surcharge. As a result, Arizona now has a flat tax of 2.5 percent – the lowest in the nation.

In Mississippi, lawmakers passed a plan in early April to lower and flatten the state's personal income tax. Mississippi Speaker of the House Philip Gunn called the plan "a huge win" for the state of Mississippi, as it provided a \$525 million tax cut, the largest in the state's history. The cuts lower the top marginal rate from 5 percent to 4 percent by 2026 and eliminates the bottom two brackets.

Again in early April, legislators in Georgia approved, and Governor Brian Kemp signed into law, a plan to flatten and gradually lower the Peach State's tax rate from 5.75 percent to 4.99 percent. The plan is contingent on meeting revenue triggers year after year through 2030, but the reform could result in a tax cut of over \$1 billion for Georgia taxpayers.

In February of 2022, the Idaho Legislature passed and Governor Brad Little signed H.B. 436 which lowered the top marginal personal income tax rate to 6% from 6.5% and reduced the number of brackets from five to four. But the Gem State wasn't finished. In September, the Idaho Legislature convened for a one-day special session and used a \$2 billion surplus to give \$500 million back to taxpayers through a tax rebate and provide a \$150 million tax cut. Idaho's four personal income tax brackets were consolidated into a flat rate of 5.8%, which went into effect in January 2023.

These tax cuts – the \$2 billion in Iowa, the \$1.9 billion in Arizona, the \$525 million in Mississippi, the \$1 billion in Georgia and the \$150 million in Idaho – were all the result of unprecedented budget surpluses, as states have seen an unprecedented growth in tax revenues over the past few years. Critics have warned of future budget crises, claiming the surpluses are only temporary products of the funding doled out to the states through the federal American Rescue Plan Act (ARPA). To be sure, tax revenues always ebb and flow — especially when states are overly dependent on capital-based revenue sources, like income taxes. However, the prudent policy choice for states is to enhance competitiveness, then examine spending priorities and create policies to prepare for the proverbial rainy days, rather than relying on the federal government to save the day during revenue shortfalls.

Many states are seeing significant levels of natural tax revenue growth, creating the surpluses even apart from the federal government's multiple state aid packages, which are generally counterproductive due to burdensome federal requirements (e.g., the attempt by the Biden administration to use ARPA to prevent states from cutting taxes). Additionally, the budgetary doomsday predicted by flat-tax naysayers has not come to pass in states like North Carolina and Utah.

Take the case of North Carolina. A decade ago, North Carolina had a progressive personal-income tax with a top rate of 7.75 percent. In 2014, the Tarheel state's personal income tax became flat, and North Carolina's economic outlook now ranks second-best in the 2022 edition of *Rich States, Poor States: ALEC-Laffer State Economic Competitiveness Index*. For 2023, the state has a flat tax rate of 4.75 percent, boasts robust in-migration from other states and still enjoys healthy personal income tax revenue growth.

In late 2021, North Carolina lawmakers passed legislation that would lower their flat personal-income tax rate to 3.99 percent and phase out the corporate-income tax entirely. That budget was signed into law by Democrat Governor Roy Cooper, proving pro-growth tax reform can and should be a bipartisan goal. With the phase-out of the corporate income tax, it is possible North Carolina legislators will aim to phase out the personal income tax next.

As economist Richard Vedder explained: Taxes do not redistribute income, they redistribute people. This is a trend that ALEC continues to cover in its annual publication *Rich States, Poor States*, where Kansas ranked 28th in 2022. In 2022, North Carolina, ranked 2nd overall in *Rich States, Poor States*, saw a net in-migration of nearly 100,000 people, while Kansas saw a net out-migration of 7,400.

Of course, even with all of the positive economic data from the many successful state tax reforms, some opponents of tax reform might suggest the 2012 Kansas tax cuts prove tax reform does not produce growth. In reality, the 2012 tax reform story is far from the abject failure some like to suggest. In fact, recent data suggest there were some very positive trends for hardworking taxpayers in Kansas before taxes were subsequently raised.

Perhaps the most important complexity to keep in mind is the 2012 tax reform plan was never fully implemented as intended. Many compromises gave us the fiscal policy patchwork that Kansas taxpayers now face. Taxes were lowered, but spending was not. Then, taxes were raised in a significant way. Some of the tax increases came in the form of broad-based retail sales taxes, while others were discriminatory taxes on consumers of specific products.

Many critics of the 2012 tax reform experience are quick to point to relatively lackluster economic growth and budget shortfalls in the years following tax reform as proof of the reforms' failure. However, like many other states at the time, the significant downturn in oil prices and agriculture prices hit Kansas especially hard. Controlling for these sectors, the rest of the Kansas economy enjoyed growth.

The 2012 Kansas tax reforms provide a number of important lessons. Most notably, broad-based tax relief must be paired with responsible prioritization of spending. After all, taxes and spending are opposite sides of the same fiscal coin. Much of the criticism about the 2012 tax reforms is based on preconception and myth, rather than empirical data. Pro-growth tax relief can be trusted to make states more competitive, but it takes time to develop and must be offset with appropriate spending reforms.

As is evident from 2022 tax reforms, the Flat Tax Revolution is alive and well, and it will continue to gather speed as more states begin to realize the competitive benefits earned by a simpler and fairer tax code. And should these cuts be the first steps to full elimination of the personal-income tax, the collective actions from Iowa, Arizona, Mississippi, Georgia, Idaho and others who switch to a flat tax could be the harbinger of an even greater tax-policy revolution.

I look forward to answering any questions.