Positive Testimony on SB 377
Increasing the Standard Deduction, Sales Tax Relief, Exempt Social Security Income from all State Income Tax, Increasing the Property Tax Exemption for 20 Mills Property Tax, and Doubling the Childcare Tax Credit.

Donna K. Ginther
Director, Institute for Policy & Social Research
Roy A. Roberts & Regents Distinguished Professor of Economics
University of Kansas

January 31, 2024

Background and Summary:

I have served as the chief academic adviser to the Governor's Tax Reform Council starting in 2019. This testimony addresses the provisions of SB 377 including the exemption of social security; increasing the standard deduction for income taxes; sales tax relief including eliminating the state food sales tax and including diapers and feminine hygiene product as well as adding a back-to-school sales tax holiday; increasing the residential property tax exemption; and doubling the childcare tax credit.

This testimony is **Positive** on Senate Bill 377 because it provides broad based income, sales and property tax relief while providing targeted relief for older adults and households with children. That said, I do have some concerns about phasing out the income tax on Social Security and the overall fiscal note of the bill.

The *Governor's Council on Tax Reform Final Report* made several recommendations that are directly related to SB377. The recommendations included:

The Council strongly endorses Governor Kelly's Axe the Food Tax proposal and calls on the state legislature to immediately seize this historic opportunity to eliminate the state sales tax on food.

Expand the $20,000 homestead exemption from the statewide mill levy to target property tax reduction to residential homeowners.

Expand the standard deduction to provide additional income tax relief. Expanding the standard deduction impacts the largest number of Kansas individual income taxpayers.

Senate Bill 377 enacts these key recommendations, and I mostly support these changes to the Kansas tax code. My testimony discusses the specific provisions of the bill.

Positive: Expanded Sales Tax Relief

Kansas is one of 13 states that levies a sales tax on food, and the state currently taxes food at 2%. Of the surrounding states, only Oklahoma charges a higher sales tax rate on food. These figures do not include local sales taxes. Six states (including Missouri) which totally or partially exempt food from state sales taxes allow for the imposition of local taxes on food, according to the Federation of Tax Administrators.

Food purchases in Kansas increase with family size and income. Lower income households spend a higher share of their total income on food and other goods that are more frequently taxed, and thus pay a higher share of their income on the food sales tax than high-income households. Food is a necessity, and Kansas households cannot avoid paying the food sales tax. Likewise, diapers are a necessity for young children and feminine hygiene products are a necessity for women. Lower income families will spend a larger share of their income on these products and pay a higher share of their income in taxes for these necessities. All sales taxes, and especially grocery sales taxes, are regressive, meaning that low-income families spend a larger share of their total income on food. The lowest income households considered in the *Governor's Council on Tax Reform Final Report* spend 29% of their income on food, whereas higher income households spend closer to 6% - 8% of income. Thus, low-income households will spend more of their income on the grocery, diaper, and feminine hygiene sales tax than higher income households.

It follows that the elimination of food, diaper, and feminine hygiene sales taxes immediately at the state level will be good for all households.

I am **Neutral** on the **back-to-school sales tax holiday**. Sales tax holidays do not stimulate business growth and development. They merely shift the timing of purchases to take advantage of the sales tax holiday. The Tax Foundation argues that sales tax holidays are gimmicks that distort consumer behavior.[1] However, since Missouri has a back-to-school holiday, perhaps the Kansas version will increase overall expenditures in the state.

Positive: Increasing the School Levy Property Tax Exemption

Property values increased significantly in Kansas following the COVID-19 pandemic. According to Redfin, median Kansas housing prices have increased by almost 17% since December 2020. Housing prices peaked in Kansas in July 2023 and have come down to being unchanged since December 2022. SB 377 would increase the residential exemption from $42,049 to $100,000 beginning in Tax year 2024. This would decrease State General Fund revenues by $84.8 million in FY 2025, $81.3 million in FY 2026, and $77.5 million in FY 2027. This provision would provide much-needed property tax relief to property owners whose valuations have increased dramatically these past three years.

Positive: Increasing the Standard Deduction

Compared to surrounding states, Kansas has a low standard deduction. Table 1 shows the standard deductions and personal exemptions by state in tax year 2023:

[1] https://taxfoundation.org/data/all/state/sales-tax-holidays-2022/

Table 1: Comparison of Standard Deductions and Personal Exemptions, Tax Year 2023

	Standard Deduction		Personal Exemption		
State	Single	Couple	Single	Couple	Dependent
Colorado	$13,850	$27,700			
Iowa (a)			$40	$80	$40
Kansas	$3,500	$8,000	$2,250	$4,500	$2,250
Missouri	$13,850	$27,700			
Nebraska (a)	$7,900	$15,800	$157	$314	$157
Oklahoma	$6,350	$12,700	$1,000	$2,000	$1,000

(a) These are tax credits in Iowa and Nebraska.
Source: Tax Foundation.

Kansas has the second-lowest standard deduction while having the highest personal exemption. Increasing the standard deduction will providing meaningful tax relief for all Kansans.

SB 377 would increase the standard deduction to $5,000 for individuals, $10,000 for married filing jointly, and $7,500 for head of household. The Department of Revenue estimates that SB 377 would decrease State General Fund revenues by $90.5 million in FY 2025, $70.4 million in FY 2026, and $71.7 million in FY 2027. This would be one way to provide tax relief to Kansans who may be paying a higher income tax rate as a result of increased incomes.

Neutral: Social Security State Income Tax Elimination

Kansas completely exempts Social Security income from taxation for most senior taxpayers. Kansas employs a taxable-nontaxable switch for Social Security income. If federal adjusted gross income (AGI) is less than or equal to $75,000, none of the Social Security payment is taxable. If AGI exceeds $75,000, the amount of Social Security that is taxable at the federal level is also taxable in Kansas. A difference of even $1 in federal AGI can mean a difference of several thousand dollars in Kansas AGI. The sudden jump in Kansas AGI income is known as a tax "cliff." A tax cliff will exist for any AGI cutoff level because the Kansas tax system does not ease in the taxability of Social Security income. Clearly the legislature should consider adjustments to ameliorate or eliminate the Social Security tax cliff.

Instead, SB 377 eliminates the income tax on Social Security income. As a result, the fiscal note is the highest of all policies proposed. The fiscal note starts at $152.1 million in FY2025 and levels out to $128.1 million in FY 2028. Approximately 93,000 Kansans would have a tax break from this provision (7% of the taxpayers in the state). I am concerned about the overall price tag of this provision.

Positive: Doubling the Child and Dependent Care Tax Credit

I called the childcare center in Lawrence, Kansas that took care of my children when they were in pre-school. This facility charges $15,720 per year for infant care and $13,740 per year for toddler care. The price has doubled since my children were enrolled. In-state tuition at KU is $11,167 and for K-State is $10,448. In other words, it is more expensive to put your infant or toddler in daycare than to send them to college in Kansas. SB 377 doubles the child and dependent care tax credit to be 50% of the federal tax credit. This provides significant relief for families paying a larger share of their income for childcare expenditures.

<u>Hypothetical Taxpayers</u>

We created six hypothetical households to show the impact of this package of tax reductions on the total tax owed. We assume every household owns a house worth more than $100,000. Our households have the following characteristics:

1. Married, no children, $60,000 in gross income.
2. Married, no children, $125,000 in gross income.
3. Married, 2 children, one in diapers, both children in daycare, $60,000 in gross income.
4. Married, 2 children, one in diapers, both children in daycare, $125,000 in gross income.
5. Senior, no children, $80,000 in gross income.
6. Senior, no children, $125,000 in gross income.

Figure 1 shows the tax cuts accruing to the hypothetical married households in Kansas. The tax cuts benefit higher income, senior households. Households with two children requiring childcare and one requiring diapers, receive over $800 in tax cuts. Households without children receive about $400 in tax cuts.

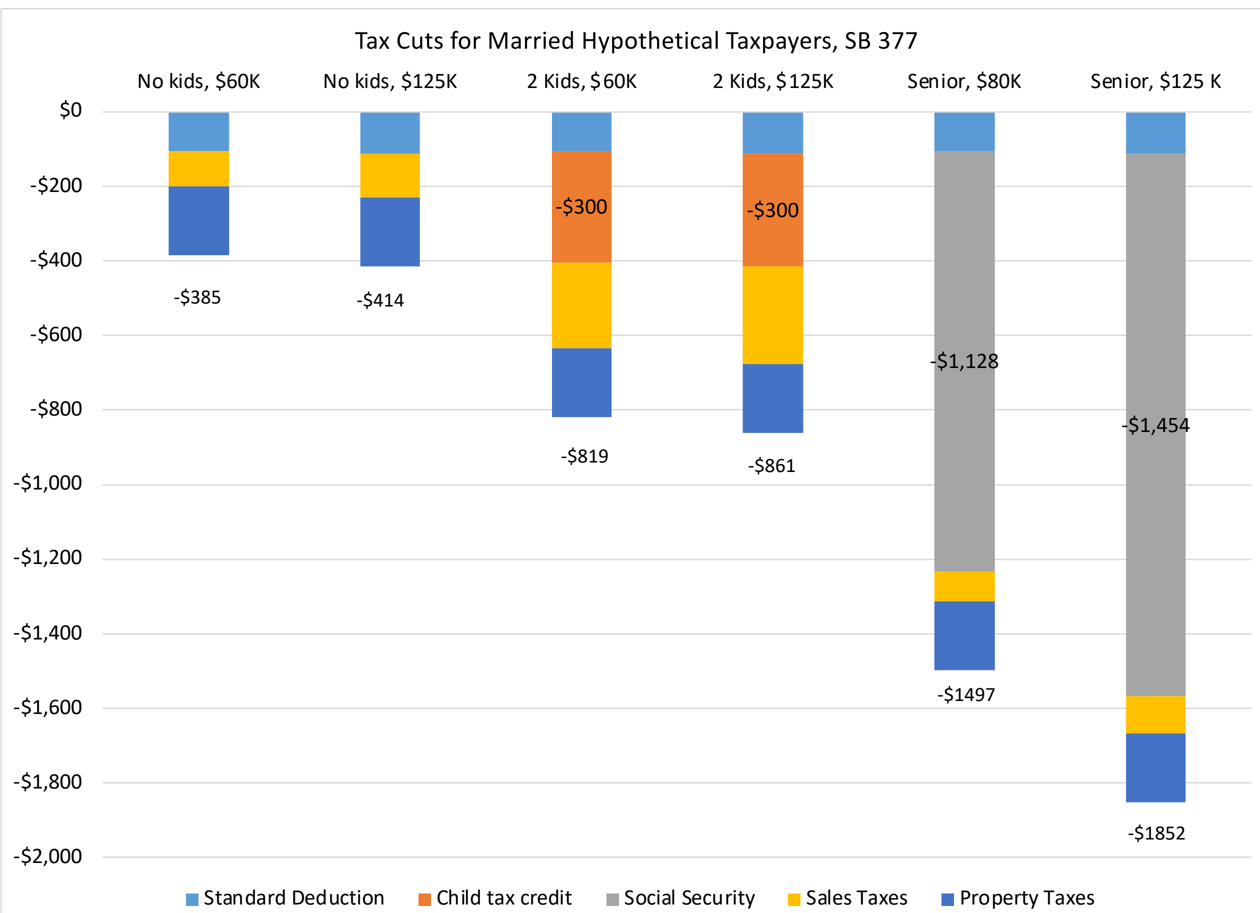
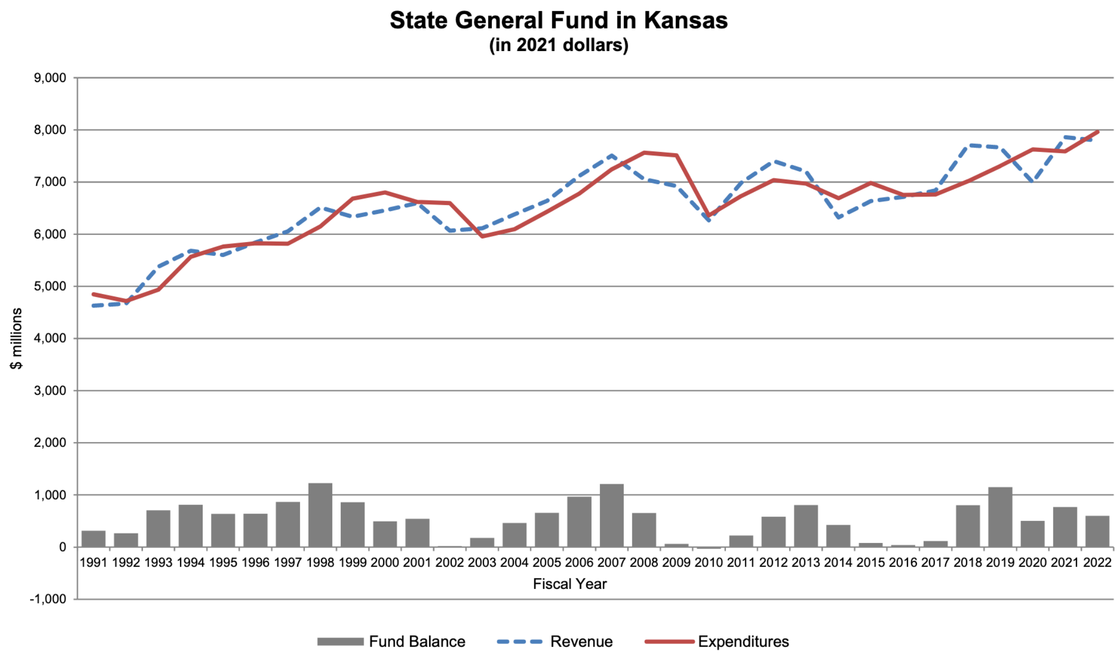


Figure 1: Impact of SB 377 on Hypothetical, Married Households.

Guidelines for Sound Tax Policy

The Governor's Council on Tax Reform suggested the preservation of the three-legged stool of Kansas taxes, where the state should strive to balance revenues from the regressive sales tax, the moderately regressive property tax, and the progressive income tax. Regressive taxes mean that households with lower incomes pay a disproportionately higher share of their income in taxes relative to households with higher incomes.



Source: Kansas Division of the Budget, *Governor's Budget Report,* various years, https://budget.kansas.gov/budget-report/ (accessed July 14, 2021);
National Bureau of Economic Research, U.S. Business Cycle Expansions and Contractions, http://nber.org/cycles/cyclesmain.html (accessed July 14, 2021).

Recession Periods: July 1990 - March 1991; March 2001 - November 2001; December 2007 - June 2009; and February 2020 - present.

Figure 2: State General Fund Balances, Revenue and Expenditures. Source: The *Governor's Council on Tax Reform Final Report.*

Recent Kansas history illustrates the danger of extreme tax cuts. Figure 2, reproduced from the *Governor's Council on Tax Reform Final Report* shows the precipitous decline in the State General Fund after 2014 due to the Brownback Tax Cuts. Beginning in 2014, expenditures outstripped revenues and by 2017, the Brownback tax cuts were largely reversed. Given the problems with the State General Fund, to balance the budget, the Governor and Legislature would "raid the bank of KDOT" by eliminating previously scheduled transfers from the SGF to support the state's transportation program. Kansas ranks fourth in the nation in terms of roads and highways. It is estimated that as much as $2.6 billion dollars was swept from the Kansas Department of Transportation (KDOT) budget to pay for the Brownback tax cuts.[2] It took four years for Governor Kelly to finally close the bank of KDOT.

In addition, there is no evidence that tax cuts like the flat tax or the Brownback tax cut contribute to economic growth. Many economists have analyzed the economic impact of the Brownback tax cuts.

[2] https://www.cjonline.com/story/news/politics/state/2019/01/18/gov-laura-kelly-offers-plan-to-gradually-downsize-bank-of-kdot/6255101007/

DeBacker, Heim, Tramnath and Ross (2019) found no evidence that the Brownback tax cuts resulted in increased economic activity. Turner and Blagg (2018) examined whether the tax cuts resulted in increases in employment compared to states that did not enact tax cuts. They found that tax cuts did not result in any net increase in private-sector employment. Tax and budget policy analysts from groups as diverse as the Tax Foundation and the Center[3] for Budget and Policy Priorities[4] agreed that the "Tax Experiment" in Kansas was a failure in public policy.   Furthermore, these tax cuts put Kansas' improved credit rating at risk, ultimately increasing debt service costs and costing Kansans more money.

References:

Jason DeBacker, Bradley T. Heim, Shanthi P. Ramnath, Justin M. Ross, "The impact of state taxes on pass-through businesses: Evidence from the 2012 Kansas income tax reform," in *Journal of Public Economics* 174 (June 2019): 53-75. https://doi.org/10.1016/j.jpubeco.2019.03.008 5

Tracy M. Turner and Brandon Blagg, "The Short-term Effects of the Kansas Income Tax Cuts on Employment Growth," in *Public Finance Review* 46; 6 (November 2018): 1024-1043. https://doi.org/10.1177/1091142117699274

Governor's Council on Tax Reform Final Report. https://kuscholarworks.ku.edu/handle/1808/32852.

Kansas Housing Market: https://www.redfin.com/state/Kansas/housing-market

[3] https://taxfoundation.org/every-tax-cut-kansas/

[4] https://www.cbpp.org/research/state-budget-and-tax/kansas-provides-compelling-evidence-of-failure-of-supply-side-tax