Amended Testimony Comparing SB 377 & HB2284

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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 HB 2284 in comparison with SB 377. HB 2284 includes the exemption of social security; indexing the standard deduction for income taxes; sales tax relief including eliminating the state food sales tax; increasing the residential property tax exemption and indexing it.

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.

This testimony is **Negative** on House Bill 2284 because the fiscal note is higher, and I am negative on the flat tax for reasons explained below.

Here, I turn my attention to specific provisions of HB 2284.

Positive: Expanded Sales Tax Relief

Eliminating the sales tax on groceries as soon as possible is an excellent policy decision because it eliminates a regressive tax.

Positive: Increasing the School Levy Property Tax Exemption

This is a good idea given the rise in property values. I am **Neutral** on indexing (more below).

Neutral: Indexing the Standard Deduction

Indexing matters in times of high inflation. In **Figure 1** below, I graph the percentage change in average hourly wages of non-production workers and the percentage change in the Consumer Price index. Indexing the standard deduction to the CPI matters in times of high inflation (like we had in 2022—mid 2023). During that time period, wages were growing more slowly than inflation. Indexing the standard deduction to inflation would mean that people would not be paying additional taxes when their real wages are declining. That said, in a time of stable prices, indexing to inflation (or average residential property values) will not appreciably change the real value of taxes paid.

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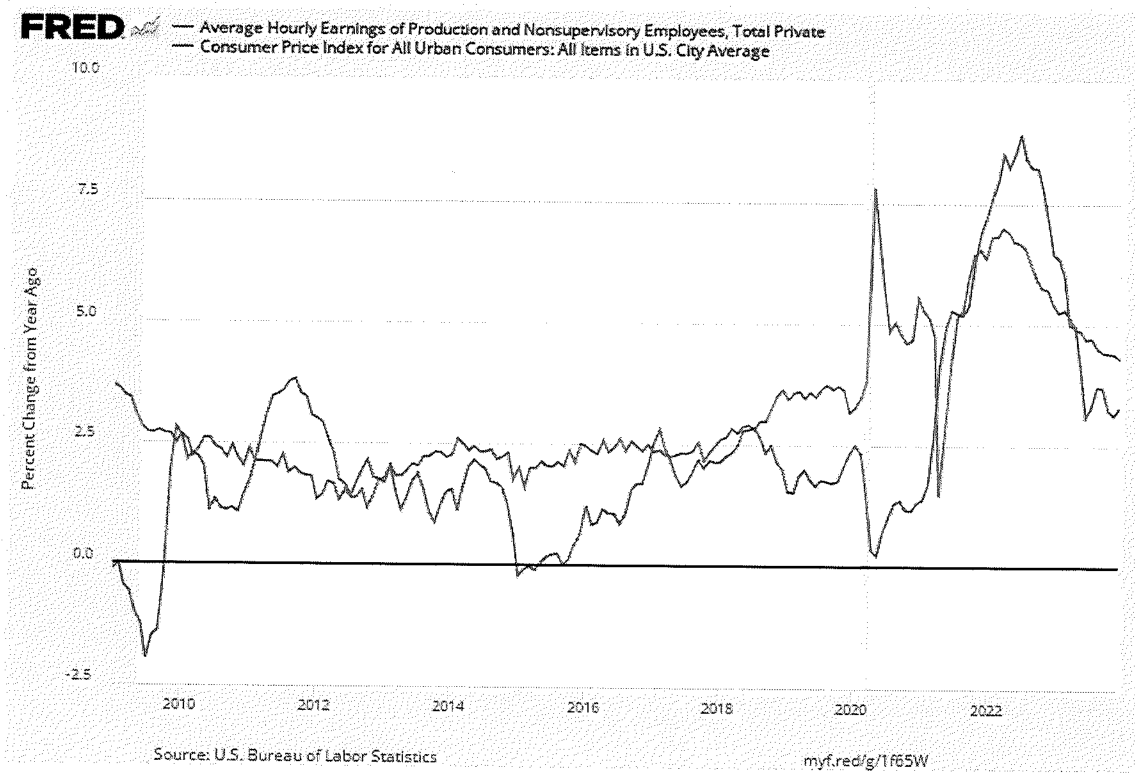

Figure 1: Percentage change in CPI and Percentage Change in Real Wages

In my estimation, indexing these measures is akin to fighting last year's battles and needlessly complicates the tax code. In the past decade it would have resulted in higher taxes in some years.

Neutral: Social Security State Income Tax Elimination

As I mentioned previously, the tax cliff needs to be addressed. The fiscal note on this is rather high at about $128 million.

Negative: Providing an Income Tax Rate of 5.25%

First, the flat tax benefits the very top earners in Kansas compared to those with average income or below. Figure 2 shows the average tax cut by taxable income bracket for married couples filing jointly. The median married household has $102,000 in KAGI. Under HB 2284, they will receive approximately an average of $200 tax cut. The richest households will receive an average of $3000 tax cut (15 times those at the median). Figure 3 compares the distribution of taxpayers to the distribution of tax cuts. 68% of taxpayers below $120,000 in income will receive only 18% of the flat tax cut while 31% of those above $120,000 will receive 82% of the flat tax cut. Clearly, the flat tax cut favors the richest taxpayers in the state.

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Figure 2: Average Tax Cut by Income Bracket, Married Filing Jointly. Brackets in Thousands of Dollars, Kansas Taxable Income

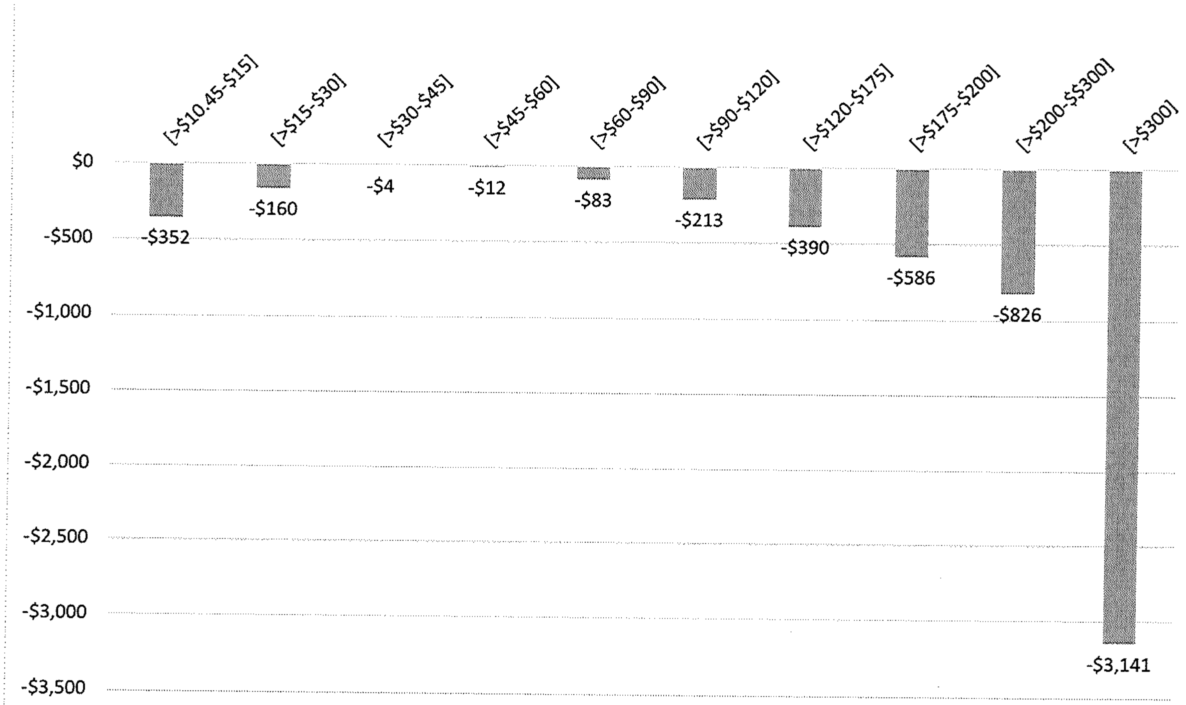
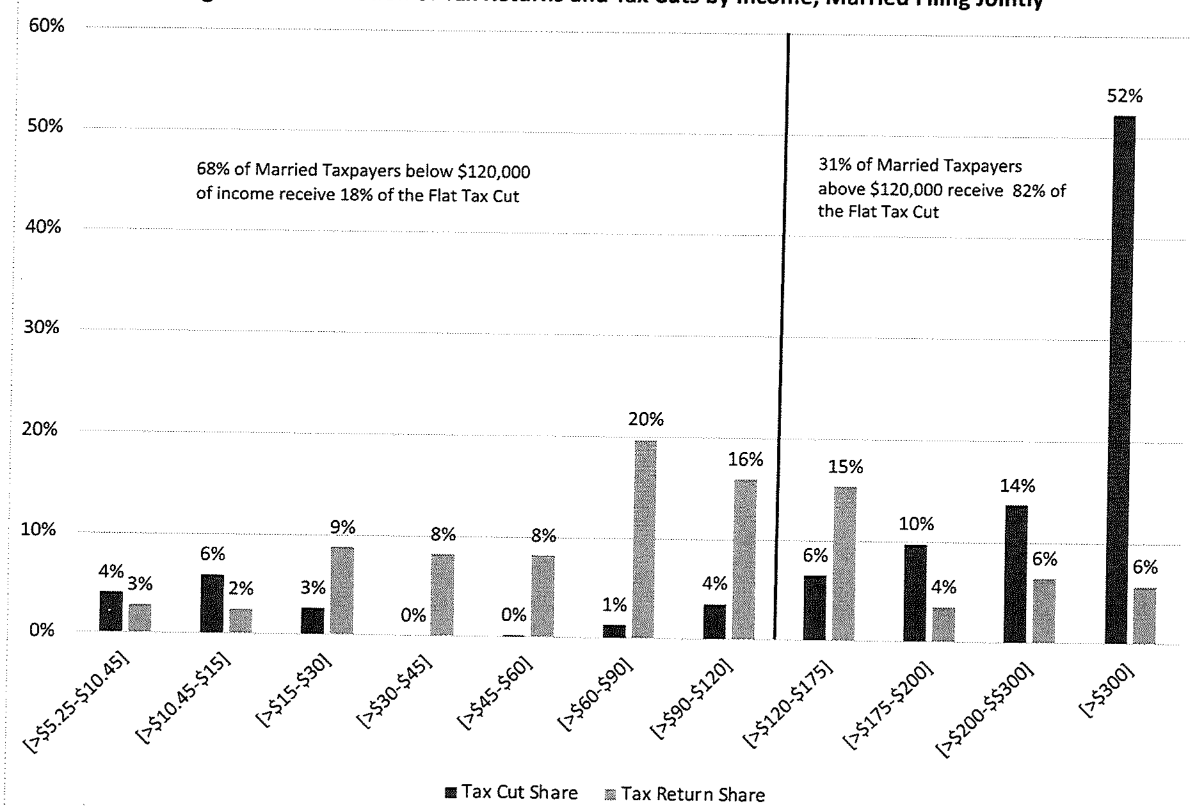


Figure 3: Distribution of Tax Returns and Tax Cuts by Income, Married Filing Jointly



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Second, HB 2284 is expensive. In FY 2026, the bill reduces the state general fund by $559 million. That grows to $635 million in FY2029. SB 377 reduces the state general fund by $300 million in FY2026 and remains at that level through FY2029.

Hypothetical Taxpayers Assumptions and Procedures

Income Tax Assumptions

We created nine 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 unless they are at the poverty line. For the non-senior households, we assume taxpayer age is 25-64 and income is earned income: wages and salaries plus self-employment. For the senior households, the taxpayer unit receives Social Security income. Senior households have additional income, primarily from retirement income sources.

Our households have the following characteristics:

1. Married, no children, $20,000 in gross income—approximately the poverty line.
2. Married, no children, $60,000 in gross income.
3. Married, no children, $125,000 in gross income.
4. Married, 2 children, one in diapers, both children in daycare, $30,000 in gross income—approximately the poverty line. One child age 0-5; second child is 6-12.
5. Married, 2 children, one in diapers, both children in daycare, $60,000 in gross income. One child age 0-5; second child is 6-12.
6. Married, 2 children, one in diapers, both children in daycare, $125,000 in gross income. One child age 0-5; second child is 6-12.
7. Married, 2 children, one in diapers, both children in daycare, $300,000 in gross income. One child age 0-5; second child is 6-12.
8. Senior, no children, $80,000 in gross income. $25,000 in Social Security income.
9. Senior, no children, $125,000 in gross income. $30,000 in Social Security income.

Sales Tax Assumptions

Sales tax expenditures for groceries depend on household size and income. We used 2021 values for annual food expenditures from the Survey of Consumer Expenditures and inflated those expenditures by 13.4%, the amount of food-price inflation between 2021 and 2023. We used online sources to find monthly costs of diapers for children[1] ($70) and feminine hygiene products[2] ($20). We annualized these values and calculated the impact of eliminating the 2% sales tax on food and the 6.5% sales tax on diapers for children and feminine hygiene products.

Property Tax Assumptions

Every median and high-income household is assumed to own a house worth at least $177,000. The current household mill levy exemption is $42,049. Under both SB 377 and HB 2284 the new mill levy exemption is $100,000. Married households with no children earning $20,000 and Married households with 2 children earning $30,000 are assumed to not own a home.

[1] https://www.totalcareaba.com/statistics/diaper-facts
[2] https://now.org/blog/female-homelessness-and-period-poverty/

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Tables 1 and 2 summarize the married household characteristics and expenditure assumptions of the hypothetical taxpayers used in this analysis. Grocery expenditures increase with income and household size. We assume that each household pays the same amount for children's diapers for one child and feminine hygiene products for one person. Total Social Security income varies across the two senior households.

Table 1: Married Hypothetical Taxpayers, Ages 25-64, Household Characteristics

Household Characteristics							
Total Income	$ 20,000	$ 60,000	$ 125,000	$ 30,000	$ 60,000	$ 125,000	$ 300,000
Number of Dependents	0	0	0	2	2	2	2
Annual Expenditures Assumptions							
Grocery Expenditures	$ 4,000	$ 4,000	$ 5,040	$ 7,300	$ 7,990	$ 9,630	$ 11,000
Feminine Hygiene	$ 240	$ 240	$ 240	$ 240	$ 240	$ 240	$ 240
Children's Diapers	$ 840	$ 840	$ 840	$ 840	$ 840	$ 840	$ 840
Federal Child Tax Credit				$ 1,200	$ 1,200	$ 1,200	$ 1,200
Owns Home worth >$177,000	No	Yes	Yes	No	Yes	Yes	Yes

Table 2: Married Hypothetical Taxpayers, Ages 65+
Household Characteristics

Household Characteristics		
Total Income	$ 80,000	$ 125,000
Total Social Security Income	$ 25,000	$ 30,000
Number of Dependents	0	0
Annual Expenditures Assumptions		
Grocery Expenditures	$ 4,000	$ 5,040
Owns Home worth >$177,000	Yes	Yes

Calculating the Change in Taxes Under the Two Bills

To calculate the change in tax policy for the two bills, we took the following steps:

1. Calculate the federal income tax for each of the nine households.
2. Calculate the baseline state income tax for tax year 2024. Assumptions for the current law:
    a. The current exemption from the 20 mill state property tax is $42,049.
    b. The standard deduction for a married couple is $8,000.
    c. The Kansas childcare is 25% of the federal credit (federal max is $1200 for 2-child families with income > $43,000).
    d. The family with two children and income = $30,000 owes no state taxes, so the non-refundable childcare credit cannot be used.
    e. Households with federal AGI over $75,000 must pay state income taxes on all of their Social Security income.
    f. The sales tax on food is 2% and the state sales tax on diapers and feminine hygiene products is 6.5%.

3. Calculate the state income tax with SB 377 provisions for tax year 2024.

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a. The exemption from the 20 mill state property tax will rise to $100,000. The exemption is not indexed for housing price inflation.
b. The standard deduction for the Kansas income tax will increase to $10,000 for a married couple. This amount is not indexed for inflation.
c. State income tax rates and brackets are unchanged.
d. The Kansas childcare credit rises to 50% of the federal credit (federal max is $1200 for 2-child families with income > $43,000).
e. The family with two children and income = $30,000 owes no state taxes, so the non-refundable childcare credit cannot be used.
f. Social security income is exempt from state income tax.
g. The sales tax on food is 0%.
h. Children's diapers and feminine hygiene products are exempt from the state sales tax.

4. <u>Calculate the state income tax with HB 2284 provisions</u>.
   a. The exemption from the 20 mill state property tax will rise to $100,000. The exemption is indexed for housing price inflation. This means that the exemption will rise in the future in line with housing prices.
   b. The rate is 0% up to $12,300 taxable income for a married couple. Tax rate is a flat 5.25% for income in excess of $12,300 for a married couple.
   c. The childcare credit remains at 25% of the federal credit.
   d. Standard deductions are indexed for inflation. Using an inflation rate of 3.5%, we estimate that the 2024 deduction will be $8280 for a married couple in 2024. The standard deduction will rise in the future in line with inflation.
   e. The family with two children and income = $30,000 owes no state taxes, so the non-refundable childcare credit can't be used.
   f. Social security income is exempt from state income tax.
   g. The sales tax on food is 0%.
   h. Children's diapers and feminine hygiene products remain taxed at 6.5%.

5. <u>Calculate the change in income taxes between the baseline and SB 377; change in income taxes between the baseline and HB 2284</u>.

Based on these assumptions and tax calculations, we find the following changes in taxes from the two bills in Table 3 (for married households, ages 25-64) and Table 4 (for married households, ages 65+). The income tax savings for SB377 come from the increase in the standard deduction and the doubling of the child tax. The income tax savings for HB 2284 come from the 5.25% rate and the greater amount of income that is not taxed. Sales tax benefits are higher under SB 377 because of the elimination of taxes on children's diapers and feminine hygiene products. The property tax savings are the same in TY 2024, but will grow with the indexation of the $100,000 exemption in future years under HB2284. The elimination of taxes on Social Security will provide a large tax breaks for households with older adults.

Table 3: Estimated Tax Reductions for Married Hypothetical Taxpayers, Ages 25-64, Household Characteristics

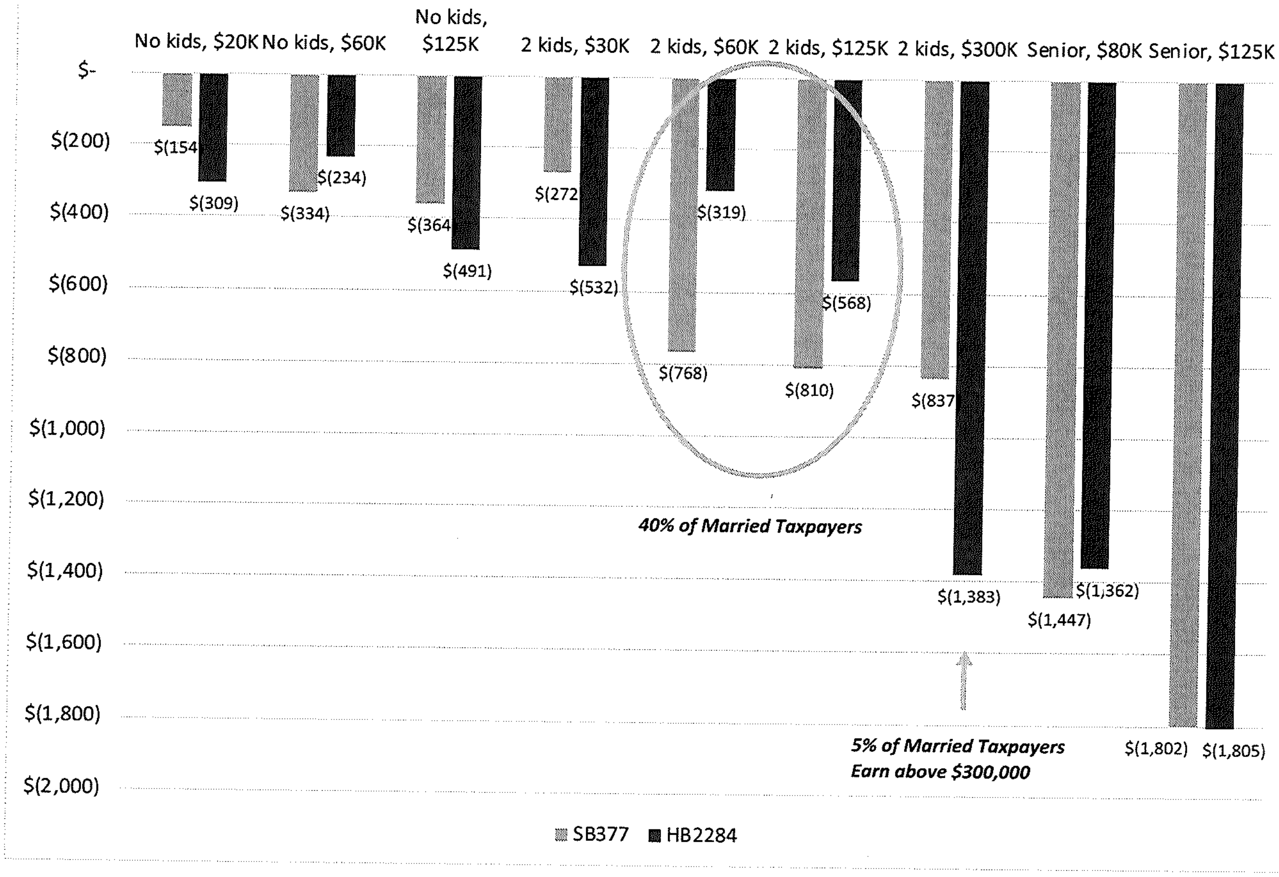
Household Characteristics							
Total Income	$ 20,000	$ 60,000	$ 125,000	$ 30,000	$ 60,000	$ 125,000	$ 300,000
Number of Dependents	0	0	0	2	2	2	2
Tax Reductions SB 377							
SB377 Income (standard deduction & child tax credit)	-$63	-$105	-$114	-$62	-$405	-$414	-$414
SB377 Sales	-$92	-$96	-$116	-$210	-$230	-$263	-$290
SB377 Property	$0	-$133	-$133	$0	-$133	-$133	-$133
SB377 Total	**-$154**	**-$334**	**-$364**	**-$272**	**-$768**	**-$810**	**-$837**
Tax Reductions HB 2284							
HB2284 Income (5.25% rate; no income tax on first $12,300)	-$233	-$21	-$257	-$392	-$26	-$242	-$1,029
HB2284 Sales	-$76	-$80	-$101	-$140	-$160	-$193	-$220
HB2284 Property	$0	-$133	-$133	$0	-$133	-$133	-$133
HB2284 Total	**-$309**	**-$234**	**-$491**	**-$532**	**-$319**	**-$568**	**-$1,383**

Table 4: Married Hypothetical Taxpayers, Ages 65+ Household Characteristics

Household Characteristics		
Total Income	$ 80,000	$ 125,000
Total Social Security Income	$ 25,000	$ 30,000
Number of Dependents	0	0
Tax Reductions SB 377		
SB377 Income	-$1,233	-$1,568
SB377 Sales	-$80	-$101
SB377 Property	-$133	-$133
SB377 Total	**-$1,447**	**-$1,802**
Tax Reductions HB 2284		
HB2284 Income	-$1,149	-$1,571
HB2284 Sales	-$80	-$101
HB2284 Property	-$133	-$133
HB2284 Total	**-$1,362**	**-$1,805**

Figure 4 shows the tax cuts accruing to the hypothetical married households in Kansas. The tax cuts benefit higher income and senior households. Households with two children requiring childcare and one requiring diapers, receive over $800 in tax cuts under SB377 but half of that from HB2284 if they have $60,000 in income. Households without children receive about $300 in tax cuts from SB337. However, families at the poverty line, with $20,000 in income with no children or $30,000 in income with 2 children receive $150 more in tax cuts under HB2284. A household earning $300,000 with 2 children receives $1383 in tax cuts under HB2284, 1.66 times what SB377 provides. About 40% of married taxpayers earn between $60,000 and $125,000 per year. In contrast, only 5% of married taxpayers earn more than $300,000 per year.

Figure 4: Hypothetical Married Taxpayers, Reductions in Taxes by Bill



Differences in Two Bills:

1. SB377 provides more sales tax relief due to eliminating the sales tax on feminine hygiene and diapers.

2. SB377 provides more income tax relief to families with children in the middle of the distribution because of the $10,000 standard deduction combined with the child and dependent care tax credit. ***It is important to note that this is where we find the majority of married taxpayers.***

3. HB2284 provides about $150 more in tax relief for the lowest income taxpayers than SB377. However, it also provides the bulk income tax relief to the highest earning households. ***It is important to note that this is where we find a much smaller number of taxpayers.***

Share of Taxpayers Paying Zero Taxes

Given the higher level of earnings disregard, more households will pay zero taxes under HB 2284. Based on data from tax year 2021, 85,509 additional households would pay zero taxes if HB 2284 were enacted. Figure 5 shows the additional number of taxpayers who will pay zero taxes by filing status (in red). The majority are single filers (52,710). Under current law, close to 132,000 single

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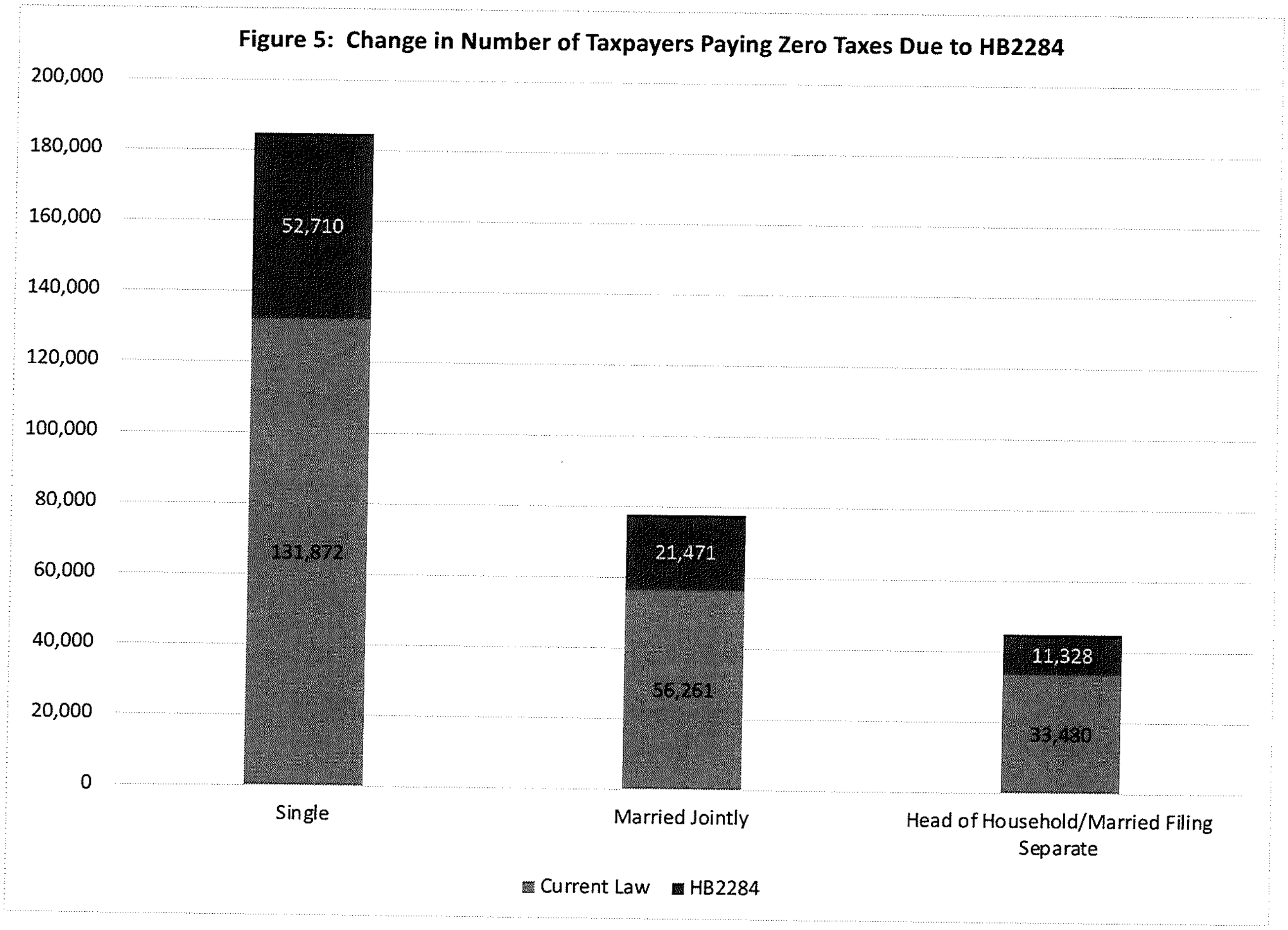
filers already pay zero taxes (in blue). Fewer married filers filing jointly will pay zero taxes from HB 2284 (21,471). Based on these numbers we can calculate the additional number of adults who will no longer pay taxes under HB 2284: 106,980. Under current law, that number is 277,874 adults.[3]



Conclusion

As I mentioned previously, 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. 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[4] for Budget and Policy Priorities[5] agreed that the "Tax Experiment" in Kansas was a failure in public policy.

[3] This is calculated as single filers + head of household/married filing separate + 2 x married filing jointly.
[4] https://taxfoundation.org/every-tax-cut-kansas/

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

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

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