Negative Testimony on Senate Bill 259

Providing that Future Tax Rate Decreases be Contingent on Exceeding Revenue Estimates

Donna K. Ginther
Director, Institute for Policy & Social Research
Roy A. Roberts & Regents Distinguished Professor of Economics University of Kansas
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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 SB 259 on changing the Kansas tax code. This bill attempts to keep state general fund tax revenues at an inflation adjusted level of approximately $10 billion (the FY 2024 level) or less for as long as the provisions are in place. The bill caps real tax revenue is capped at 2024 levels.

State general fund revenues are not anticipated to reach the $10 billion threshold in FY2025 or FY2026, according to the Governor's budget. So the fiscal note on this bill will not change expected revenues and the impacts of SB 259 may not be felt immediately. Even when the threshold is met, the difference for several years may be small, so the reduction of the income taxes will be not very visible for the general public for several years.

Even though the fiscal note is small at this time, I am giving **negative testimony** on SB 259 because it adds permanent constraints on the current budget and relies on the accurately forecasted and stable revenues for many years from now.

The provisions of SB 259 make the state vulnerable to unanticipated surges in revenue, such as from a huge payment of estimated taxes by a corporation. This surge could push revenues over the limit, triggering rate reductions in the near future.

In the longer term, SB 259 presents three serious problems:

SB 259 creates **permanent tax reductions in response to temporary revenue increases**. Suppose, for example, that the economy booms in calendar year 2027. As a result, tax payments made in FY 2028 receipts rise substantially. Under SB 259, rate reductions are triggered. Now suppose that the economy slows down after the boom. Revenues, after adjusting for inflation, fall below 2024 levels. But tax rates are permanently lower, so the state will be required to make serious spending cuts. Every economic boom will trigger rate cuts, but those rate cuts will come back to haunt the state when the economy slows down.

Related to the previous point, **SB 259 will make it difficult for the state to maintain essential services during periods of weak economic performance**. When tax rates are stable, the state can accumulate balances during economic booms and spend them during economic slowdowns. Under SB 259, boom periods will quickly trigger rate reductions, dissipating the funds that otherwise could have stabilized state spending.

SB 259 removes flexibility that was needed, for example, during COVID, recession, or when KPERS needed improvement. It also prioritizes income tax reductions over other tax reductions such as property and sales tax.

It also can restrict availability of the upfront tax incentives to the companies, which has been one of the tools used by the Department of Commerce to attract businesses (IRB, PEAK, etc), where companies get an incentive/tax exemption for certain number of years to grow the business, so the tax revenues from expansion are coming years later than population/job growth that needs to be supported by additional state expenditures.

SB 259 seems to be **contrary to the goals of economic development.** Suppose that the state's economic development efforts are successful, that employment increases, new people move into the state, existing businesses expand, and new businesses are formed. The expanding economic activity will put pressure on the state for increased government services of many types-- higher education, more parks, more local schools. Note that the single largest state general fund expenditure is K-12 education. But with revenues capped, the state may lack flexibility to meet the needs of a growing economy. Similarly, for businesses to come to Kansas, there needs to be infrastructure, and well-trained labor force upfront and this requires investments upfront.

By capping revenues at 2024 level, SB 259 assumes that under 2024 budget there were no underfunded items in the expenditures. At the same time there are examples of underfunded programs like historically inadequate funding for special education that has not met the 92% funding requirement since 2011. Special education is in the process of a five-year plan of funding increase to meet the requirements. Other underfunded programs include early childhood education, broadband, health care services.

Because base year revenue is compared to revenue from taxes in that year, which does not include other transfers to and from the state general fund, it limits the option for those transfers as they have result in the budget deficit even when tax revenue is more that the adjusted base year. In the past, these included transfers into Budget Stabilization Fund, KPERS improvement, School Capital Improvement Aid. Looking at the historical data, if SB 259 was already in effect in 2022 the tax revenue would have been above adjusted base year revenue, which would have triggered tax cut. At the same time, the budget was in deficit because of the transfers.

With the intention of the federal government to cut federal expenditures, **the state faces uncertainty of the federal funding and might need to have flexibility to adjust to the decreased federal funds/transfers through more targeted appropriation** of the excess tax revenues instead of general reduction of the income taxes.