

## Kansas Tax Policy Observations – Dennis W. Lauver - 1.27.12

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Any proposed changes to Kansas Tax Policy should be considered in light of how they will encourage quality job creation and private sector capital investment. This is the most significant measurement of any proposed public policy that impacts taxes.

### *It is About Jobs*

#### **The Promoting Employment Across Kansas (PEAK) program is a very effective tool to encourage job creation.**

PEAK is an effective economic development program with significant results in its short life. The positive attributes of PEAK are:

- It is formula driven, which keeps the government role to a minimum and avoids the government selecting “winners & losers”
- It is performance based and delivers incentives to businesses only after have met job creation, wage and investment thresholds
- By design, PEAK gives employers a reason to increase wage levels. The more they pay their employees, the better PEAK works
- PEAK applies statewide and does not create an unfair advantage for one location over another.

The first 24 PEAK projects in Kansas have impressive results:

- 3,871 new jobs with an average wage of \$59,861.24
- Total new annual payroll is 226,095,892.
- \$99,233,320 of capital investment

**Clearly, PEAK is an effective tool to encourage job creation and capital investment in Kansas.**

In Saline County, one employer used PEAK to add 20 jobs with a \$60,000 salary. Three other Saline County growth projects currently have PEAK proposals as part of their financing proposal as they finalize their plans. Together, these four Saline County projects will:

- Add 237 new jobs with an average payroll of \$50,741.22
- Create total new annual payroll of \$12,025,671.

The sole funding source for PEAK is individual income taxes. Without a replacement funding source, legislators should avoid voting to cut a proven job creating program – especially in this economy.

The first proposal detailed in the 2012 session will save the average Kansas tax filer \$17.79 a month – before pressure is put in place to raise property taxes. Other legislative proposals will also reduce and/or eliminate the use of this very effective program that creates high quality jobs.

We believe the better public policy is to help create high quality jobs via PEAK. We believe that creating high quality jobs is more important and will do more to help Kansas grow than an additional \$17.79 per month.

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### *Listen to the Accountants – not the Economists*

When business owners consider investment decisions, they turn to their accountants for counsel because **accountants understand a key principle: how the tax rate is applied is more important than the rate itself.**

There is a better way to encourage manufacturing employers to locate in Kansas. Switching to a “single factor sales” apportionment formula will make Kansas more attractive to employers.

Currently, income tax for C Corporations in Kansas is determined by factoring the following into a “triple weighted” formula that considers:

- The percentage of total corporate property located in the state of Kansas
- The percentage of total corporate payroll located in the state of Kansas
- The percentage of total corporate sales to customers in the state of Kansas.

The current apportionment method creates a reason to NOT locate property or payroll in Kansas because it uses property and payroll to consider income tax. Switching to a “single factor sales” formula will only use the amount of sales occurring in the state of Kansas to determine corporate tax liability.

Thirty years ago, nearly every state used the same “triple weighted” formula to apportion corporate income taxes. States have moved away from this approach. In 2014, states with only 9.02% of the population will still be using the method currently used in Kansas.

In 2014, the most common approach used in America will be the single factor sales because it is proven to create capital investment, payroll and jobs. In 2014, states with 37% of the population will have the single factor sales formula.

Assume a manufacturing firm with \$500,000 income. 100 percent of its property and 100 percent of its payroll is in Kansas and 20 percent of sales are to customers in Kansas.

- Current Kansas tax policy = Taxable income is \$365,000
- Kansas single factor formula = Taxable income is \$100,000

When current tax rates are applied:

- Current Kansas tax policy = Tax liability is \$24,325
- Kansas single factor formula = Tax liability is \$5,525

Iowa has a higher RATE (which is what the economist focuses on) and a single factor sales formula (which is what the accountant focuses on). The same firm located in Iowa has an tax liability of \$7,500. Even though the Iowa rate is high, single factor sales means that the same firm has a 227.60 percent less tax liability than if Kansas.

Between 1980 and 2010, Minnesota’s population has increased by 30.1 percent despite its high income tax rate. In 2014, Minnesota will switch to a single factor sales formula. The same firm that today pays \$24,325 in Kansas will pay \$22,250, an 8.79 percent decrease over Kansas.

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### *Going Forward*

We encourage the Kansas legislature to implement a tax policy that encourages job creation and capital investment. Recognize that employees do not create jobs; employers do.

We encourage you to:

1. Maintain the very effective PEAK program that creates high quality jobs and encourages capital investment. Avoid voting to weaken what helps create high wage jobs.
2. Encourage C Corporations to locate in Kansas and to hire people. They make up a small percentage of Kansas employers but they employ a high percentage of Kansans. C Corporations are typically publicly traded entities and are large and more stable. Switching to a single factor sales formula will make Kansas more attractive to these firms.

A statewide approach is best. If the political will does not exist to mandate this change, we suggest a voluntary approach be used. Allowing C Corporations the chance to decide which apportionment they want to use will allow C Corporations maximum flexibility as they make strategic decisions about adding jobs and capital investment in Kansas.

Based on the fact that single factor sales formula is proven to help states grow, I predict that within a decade, pressure will be on the legislature to make the formula statewide.

3. Encourage S Corporations and LLC's to locate in Kansas to grow. Eliminate the income tax on most small business income. We should allow small business owners to retain non-wage profits and encourage them to invest funds back into their business and help create jobs.