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March 14, 2012

To: Kansas House Committee on Taxation

Refer to House Bill HB2763 "The Kansas Economic Freedom Act of 2014"

Refer to change in timing of reductions of Kansas Income Tax

#### The Plan:

1. Completely repeals the Corporate Income Tax in CY 2013
2. Reduces the Personal Income by one third in FY2014
3. Completely eliminates the Personal Income Tax by FY2016
4. Is revenue neutral
5. Accommodates the sunset reduction of the sales tax rate to 5.7% in FY2014,
6. Maintains a positive cash flow balance in the State General Fund (SGF)
7. Does not remove the personal income tax deductions
8. Does not change the Federal Income Tax
9. Pays the Consumption Tax up to the poverty level for every legal Kansas citizen
10. Pays the retailers ¼% for their cost of collecting and remitting the tax
11. Completely removes the State from reliance on the Federal Income Tax system.
12. Grows the economy and create jobs in the private sector
13. Is Easy to understand
14. Greatly simplifies tax collection and auditing
15. The bill establishes a "Transition Committee" to work out the procedural details.

#### The Methods:

1. Repeal the Corporate Income Tax on January 1, 2013
2. Establish a broad Consumption tax on July 1, 2013 that utilizes the revenue from the existing sales/excise tax system and broadens the base the remove non-business exemptions.
3. Reduce the personal income tax by one third with a uniformly applied across the board personal income tax rate reduction in each of the next three years.
4. Use the 0.4% residual sales tax reduction for SGF rather than divert to highway funds.
5. Expand the base of consumption taxes to include non-business inputs.
6. Taxes the State's purchases of goods and services but not the local governments

#### The Numbers: Refer to Tables 1 and 2 (The data is generally from the Department of Revenue)

1. The first column shows the net cash flow from the corporate income tax reduction. The tax liabilities of \$250 million from CY2012 are payable in early CY2013 (last half of FY2013). Prepayments based on quarterly estimates are forecasted to be \$90 million already paid in CY2012 into the SGF. The balance of \$160 million (shown in Table 2) will be paid in the normal course of tax processing in CY2013.
2. The 2<sup>nd</sup> column shows the full FY2014.
  - a. There will be no Corporate Income tax revenue of \$250 million.
  - b. The sales tax estimate of \$2,704 million will be absorbed into the new Consumption tax estimate of \$3,519 million.
  - c. DOR added an additional \$616 million based on Dr. Hall's report published in 2009 however subsequent conversations with Dr. Hall indicate this is excessive and not what he intended.
  - d. When the existing sales tax exemptions are eliminated and the legitimate business inputs are re-qualified, the state will benefit from fewer exemptions and will therefore capture more revenue from these sources. The **Recovered Biz Inputs** (see Table 3) shows an estimate of 10% recovery which may be conservative.
  - e. The prebate calculation estimate is \$97 million. This may be too low, if everyone who qualifies applies.
  - f. The Retailers will appreciate, for the first time, being paid to collect state taxes. This will encourage compliance as will severe penalties for non-compliance.

3. The net change in Table 1 is similar to the Fiscal Note in format. This is intended to show what the change in SGF revenues will be for the proposed legislation.
  - a. There is a substantial surplus if 100% of the Personal Income tax were to remain. The surplus should be used to reduce the personal tax rates uniformly across the board for all categories. This estimate uses one third each year and is reflected in Table 1 the row titled "Refund Individual Income Tax".
  - b. The objective is to refund as much as possible to reduce the Personal Income Tax without causing revenue shortfalls. This model shows the results.
  - c. The growth factors used for revenue are 5% the first year and 7% thereafter. The budget growth is limited to 2%.
4. Table 2 shows the entire revenue budget. The values are from the Kansas Legislative Research Department note dated November 9, 2011. The details are from the research work done by Steve Brunkan in the Department of Revenue.
  - a. The bottom line, "Cumulative Surplus" shows the objective of make this revenue neutral has been achieved.

#### The Politics:

1. The benefits for the State of Kansas are impressive for all tax payers, business and the State Government. There is no tax reform plan that even comes close to achieving these benefits listed in the first paragraph.
2. The early opposition will be the typical misinformed special interest spokesman. The following facts are presented to help with the educational process.
3. The consumption tax exemptions are generally divided into two classes:
  - a. Business inputs of all kinds that are not taxed because the tax is collected later in the supply chain.
  - b. Personal consumption of goods and services when delivered in Kansas.
4. The list of exemptions is complex (the summary is five pages). These values, by major group, are shown in Table 3 indicating their exemption status.
  - a. **Conceptual Exclusions** include the major part of the business inputs, all excluded.
  - b. **Charitable, Religious Benevolent Exemptions.** The repeal of this exemption does not apply to donations or revenue received by these organizations. They will be paying a sales tax on whatever they buy because they do not pass their costs on to a personal consumer. They in effect are the personal consumer. This plan will be good for charities because overall economic growth will create more revenue. Their status under the Federal Income Tax code is unchanged by this plan.
  - c. **Charitable Organizations** by name is repealed for the same reasons as above.
  - d. **Consumer Exemptions** are primarily public utilities and construction contractors. Public utilities do not charge sales tax on residential customers for their services however now they will need to. This does not mean that a customer's bill will increase accordingly. The utilities are regulated monopolies whose return on investment is determined by the Kansas Corporation Commission. This plan untaxes the corporation's earnings which should be a very welcome change for the utilities. The "transition committee" will need to delve into this area because there is substantial inconsistency across all segments of the business community.
  - e. **Government Exemptions** will change at the state level only. The State of Kansas will be treated as a personal consumer on its purchases because the costs coming out of the supply chain will enable the state to buy goods and services for less money and there is no other way to collect the tax on their consumption. There will be no state tax on consumption by local governments. Government educational organizations for K-12 will be exempt from sales taxes.
  - f. **Educational Exemptions** remain.(See attachment)

- g. **Health Care Exemptions** will be repealed. Health care services are part of the broadening of the sales tax collection as an offset to grant relief of corporate and personal income taxes. It is generally apparent that health care is a profitable segment of the Kansas economy. The state wants to encourage economic growth. Innovation of medical services and research into new drugs is an industry that the state wants exceptional growth. Removing the state tax on capital investment by the private sector is the best way to promote this growth. This is also a targeted industry that will be marketed for outside talent and investment capital. Health care services are mostly paid for by health insurance plus a small copayment at the time of delivery. Insurance premiums will be tax when purchased. If a medical facility charges a copayment in addition to insurance coverage, the co-pay will be taxed when billed or collected.
  - h. **Agriculture Exemptions:** Virtually all agriculture in Kansas is done by business delivering harvested products to other businesses, the food processors. This category is exempt.
  - i. **Legal Exemptions:** This class is for food stamps, interstate commerce with businesses and will remain exempt.
  - j. **Exemption of Services:** This is an exemption for small special organizations which should be repealed.
  - k. **Exemption for Businesses:** This is primarily business inputs and the exemption will remain.
5. This entire concept is properly classed as “thinking outside the box”. Kansas must start thinking outside of the normal process of political maneuvering. If it continues to yield to grant special favors it will continue with its economic decline. Every of opponent this very beneficial tax reform plan must be challenged to first understand the plan. They must understand they are being granted a very large benefit of having no state income tax and business will enjoy financial and regulatory relief.

**The Intent of this legislation is to:**

1. Grow the Kansas real GDP by 3% or more with quickly.
  - a. Attract out of state investors in large numbers with private equity funds
  - b. Remove the burden of State Income Taxes from businesses
  - c. Make tax collection simple, transparent and uniformly applied
  - d. Encourage the Private sector to create jobs with their own capital.
2. Discourage the state from removing investment capital from the private investors.
3. Completely remove the state funding mechanism from the Federal Income Tax.
4. Discourage the state from interfering with the free market principles.

**The Fundamental Economic Principles** were best described by Louis Woodhill, a world class economist, who made two educational visits to Kansas. His work is described in two documents included as references.

1. “Kansas Desperately Needs Fundamental Tax Reform”, in Forbes.com on March 1, 2012
2. “Kansas, Tax Reform, and Economic Growth”. March 1, 2012.

Economic growth is perhaps 100 times more important than any other variable.

GDP growth is driven by capital investment

Kansas cannot afford to wait. This point is echoed by Dr. Hall (KU) and Dave Trabert, President of the Kansas Policy Institute.

The private sector can create GDP growth and jobs seven times faster than the State government.(See Woodhill slides)

Thank you for the opportunity to present this plan.

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Table 1 - Net Changes to SGF budget				
\$millions	FY 2013 Last Half	FY 2014	FY2015	FY 2016
<b>Revenue Source</b>				
Corporate Income repealed		(250)	(250)	(265)
loss of quarterly est	(90)			
Sales & use Tax repealed		(2,704)	(2,758)	(2,813)
Refund Individual Income Tax		(1,084)	(1,084)	(1,084)
Consumption Tax		3,519	3,765	4,028
Disputed Biz Consumption		616	628	641
Recovered Biz Inputs		406	421	437
Prebate		(97)	(104)	(111)
Retailers Rebate		(11)	(12)	(13)
SHF (0.4% portion of 5.7%)		395	422	452
<b>Net Change</b>	<b>(90)</b>	<b>789</b>	<b>1,029</b>	<b>1,272</b>
<b>Growth Factors</b>				
Revenue due to GDP growth		5%	7%	7%
Budget		2%	2%	2%
Table 2 - SGF Budget				
\$Millions	Jan-June 2013	Full Year FY2014	Full Year FY 2015	Full Year FY 2016
Sales	1,173			
Use	179			
Individual Income	1,626	2,168	1,084	0
Corporate Income	160			
New consumption		3,519	3,765	4,028
New from SHF		395	422	452
Disputed Biz Consumption		616	628	641
Recovered Biz Inputs		406	421	437
Prebate		(97)	(104)	(111)
Retailers Rebate		(11)	(12)	(13)
<b>Sub Total</b>	<b>3,138</b>	<b>6,995</b>	<b>6,205</b>	<b>5,435</b>
All Other				
Excise less Sales & Use	64	67	72	77
Motor Carrier Prop Tax	11	11	11	11
Other	178	178	178	178
<b>Sub total all other</b>	<b>252</b>	<b>256</b>	<b>261</b>	<b>266</b>
<b>Total receipts</b>	<b>3,390</b>	<b>7,251</b>	<b>6,466</b>	<b>5,701</b>
<b>Budget</b>	<b>3,146</b>	<b>6,417</b>	<b>6,546</b>	<b>6,676</b>
<b>Surplus</b>	<b>245</b>	<b>834</b>	<b>(80)</b>	<b>(976)</b>
<b>Cumulative Surplus</b>	<b>245</b>	<b>1,079</b>	<b>999</b>	<b>23</b>

Table 3 - Consumption Tax Exemptions

<b>Exemption or Exclusion (\$ in Millions)</b>	<b>FY2012</b>	<b>FY2013</b>	<b>FY2014</b>	<b>FY2015</b>	<b>FY2016</b>	<b>Repealed</b>
Conceptual Exclusions	\$3,859.56	\$4,004.29	\$3,758.79	\$3,899.74	\$4,045.99	No
Public Policy: Charitable, Religious, Benevolent Exemptions	29.91	31.03	29.13	30.22	31.35	Yes
Public Policy: Exemptions to Charitable Organizations by Name	\$2.90	\$3.01	\$2.82	\$2.93	\$3.04	Yes
Public Policy: Consumer Exemptions	\$449.34	\$466.19	\$437.61	\$454.02	\$471.05	Yes
Public Policy: Governmental Exemptions	\$594.71	\$617.01	\$579.18	\$600.90	\$623.43	Yes
Public Policy: Educational Exemptions	\$77.57	\$80.47	\$75.54	\$78.37	\$81.31	No
Public Policy: Health Care Exemptions	\$108.45	\$112.51	\$105.61	\$109.58	\$113.68	Yes
Public Policy: Agriculture Exemptions	\$66.04	\$68.52	\$64.32	\$66.73	\$69.23	No
Legal Exemptions	\$20.64	\$21.42	\$20.10	\$20.86	\$21.64	No
Public Policy: Exemption of Services	\$7.62	\$7.91	\$7.42	\$7.70	\$7.99	Yes
Public Policy: Exemptions for Businesses	\$270.94	\$231.60	\$217.40	\$225.55	\$234.01	No
<b>Totals</b>	<b>\$5,487.67</b>	<b>\$5,643.96</b>	<b>\$5,297.93</b>	<b>\$5,496.61</b>	<b>\$5,702.73</b>	
<b>Repealed</b>	<b>\$1,192.93</b>	<b>\$1,237.66</b>	<b>\$1,161.77</b>	<b>\$1,205.35</b>	<b>\$1,250.54</b>	Yes
<b>Retained</b>	<b>\$4,294.75</b>	<b>\$4,406.30</b>	<b>\$4,136.15</b>	<b>\$4,291.25</b>	<b>\$4,452.18</b>	No
Totals	\$5,487.68	\$5,643.96	\$5,297.92	\$5,496.60	\$5,702.72	OK
Retained business inputs	\$4,217.18	\$4,325.83	\$4,060.61	\$4,212.88	\$4,370.87	
Over stated business inputs %			10%	10%	10%	
<b>Recovered business inputs</b>			<b>\$406.06</b>	<b>\$421.29</b>	<b>\$437.09</b>	