

Senate Taxation Committee

Testimony of Secretary Nick Jordan: Gov. Brownback's Pro-Growth Tax Reform Plan
February 14, 2012

Chairman Donovan, thank you for inviting me to address your committee on the very important issue of tax reform and how we can create an environment in which Kansas citizens and businesses can flourish in the 21st century.

I'd like to begin by thanking you for your hard work on tax issues over the years. You have been an important advocate in the Senate for economic growth, free market principles, and limited government.

With your help, the conversation in Topeka truly has changed, and not just about whether to raise or lower taxes — but how we can work together to grow the Kansas economy and make the tax system fairer, flatter, and simpler for our citizens.

Numbers help tell the story of why this work is so important:

Private Sector Job Losses (Kansas Department of Labor)

- Private sector employment in Kansas fell by 39,700 jobs from 2001 to 2010.

Outmigration of Kansas Tax Filers (Kansas Department of Labor and Rich States, Poor States)

- From 2004 through 2010, within the U.S., there was net outmigration of 15,683 tax filers from Kansas with 17,640 dependents and a total adjusted gross income of \$1.09 billion.
- Texas gained the most from Kansas outmigration with 6,395 tax filers from Kansas moving to Texas along with 12,837 dependents and a total adjusted gross income of \$305.4 million.
- Only 10 states out of 50 had worse outmigration than Kansas from 2000 to 2009.

Kansas Tax Rankings Compared to Other States (Tax Foundation and Rich States, Poor States)

- State **Business Tax Climate Index** 2011: Kansas ranks 35th
- State **Corporate Tax Index** 2011: Kansas ranks 35th
- State **Sales Tax Index** 2011: Kansas ranks 32nd
- The **top marginal personal income tax rate** is 6.45 percent, which ranks 26th in the nation.
- The **top marginal corporate income tax rate** is 7 percent, which ranks 25th in the nation.
- The **property tax burden** ranks 33rd in the nation.
- The **sales tax burden** ranks 35th in the nation.
- **Debt service** as a share of tax revenue is 8.4 percent, which ranks 30th in the nation.

Capital Flow (Federal Reserve Bank of Kansas City)

In 2010, Nebraska was the regional winner in the ranking of states when comparing state gross domestic product to personal income ratio, which reflects **net capital inflow relative to other states**. Nebraska ranked 10th in the nation; Kansas ranked 32nd.

A recent *Wall Street Journal* titled “**The Heartland Tax Rebellion**” noted that states without an income tax perform better economically on average than do high-tax states. And on this point, the paper concluded, “It’s not a close contest.”

It is data such as this that has led Oklahoma Gov. Mary Fallin to propose cutting her state’s top income tax rate from 5.25 percent to 3.5 percent, with plans to phase out the income tax completely in the next 10 years. She said, “We’re going to have the most pro-growth tax system in the region.”

This *Wall Street Journal* article highlighted our work here in Kansas as well, along with income tax reduction plans taking shape in Missouri, South Carolina, Indiana, Idaho, Maine, Nebraska, New Jersey and Ohio.

The *Journal* wrote, “The tax competition in America’s heartland is an encouraging sign that at least some U.S. politicians understand that they can’t take prosperity for granted. It must be nurtured with good policy, as they compete for jobs and investment with other states and the rest of the world.”

With this healthy regional competition as our backdrop, I am happy to now highlight the key components of the Gov. Brownback’s pro-growth tax reform plan, which were designed to support the Road Map for Kansas goals of **increasing net personal income and private sector employment**, as well as the goal of increasing investment capital flow into the state.

With input from people from every corner of the state, we propose to:

1. **Lower individual income tax rates for all taxpayers by 14 percent to 24 percent and move from three tax brackets to two.** This would result in a top rate of 4.9 percent, down from 6.45, and a low rate of 3 percent, reduced from 3.5 percent.
2. **Eliminate individual income tax on non-wage business income** (as reported by LLCs, S-corps and sole proprietorships on lines 12, 17, and 18 of the federal form 1040 individual income tax return).
3. **Simplify and streamline the tax code** by eliminating itemized deductions and most credits and subtraction modifications.
4. **Bolster the safety net for low-income Kansans** while providing greater accountability by doubling the standard deduction (from \$4,500 to \$9,000) for head of household filers and investing an additional \$60 million in state social services and healthcare programs.
5. **Leave the corporate income tax rate unchanged.**
6. **Hold the sales tax rate steady** at 6.3 percent, with 4/10 of a cent going to the highway fund as planned in FY14.

7. **Eliminate the two-year severance tax exemption on new pool oil and gas wells, except for oil wells generating fewer than 50 barrels a day.**
8. **As state tax revenues grow more than 2 percent per fiscal year, excess revenues will be used to further reduce individual and corporate income tax rates in future tax years.**

By eliminating credits and deductions and lowering income tax rates for all state tax filers, **Kansas' top individual income tax rate will become the second lowest in the region**, and our state will take its first step toward a fairer and flatter tax code.

Top Rate Today	Change with Brownback Plan
Colorado 4.63	Colorado..... 4.63
Oklahoma.... 5.25	Kansas 4.9
Missouri..... 6	Oklahoma 5.25
Kansas 6.45	Missouri..... 6
Nebraska 6.84	Nebraska..... 6.84
Iowa 8.98	Iowa..... 8.98

Lowering the state income tax rate will give Kansas families and taxpayers an immediate raise in their paychecks as they decrease their state income tax withholding and keep more of the money they earn as they earn it. In fact, the median Kansas tax return uses the standard deduction, has income of \$65,430, and is filed married jointly with one child. **This family will see a state income tax reduction of \$425.43 per year under Gov. Brownback's plan.**

Further, thanks to the innovative approach of eliminating individual state income tax on non-wage business income earned by many small businesses, approximately 191,000 Kansas tax filers will have the opportunity to invest more in the growth of their small businesses. *This is a unique and highly targeted strategy to make Kansas an incubator for innovation and a national center for entrepreneurship.*

Now I will quickly address several elements of this plan that have been points of discussion.

Why We Should Lower Income Tax Rates

Data show states with zero personal income tax significantly outperform states with the highest personal income tax rates; experience larger than average population growth; and boost state tax revenues at a faster pace than high tax states. (Interestingly, sales tax rates have the least negative impact on economic growth relative to other tax types.) Do we want to be more like states that are growing, or do we want to be more like those losing population and struggling to generate sufficient funds to operate government? Individual income tax rates seem to play a strong role.

Our Tax Code Is Far Too Complicated

Taxes at the federal, state, and local levels are a hodge-podge of dozens upon dozens of taxes, credits, and special interests cobbled together during many decades. To state it bluntly, everyday citizens and small business owners are fed up with this complicated mess. In Kansas, we should be leading the way in modernizing tax policy in a strategic way that funds core government functions while emphasizing economic growth and encouraging greater financial investment in our state.

Taxation Should Be Fair

The Kansas tax code is overly complicated; picks too many winners and losers; and attempts too much social engineering. We should have a fairer, flatter and simpler tax code that broadens the base and lowers rates as much as possible for the benefit of the maximum number of Kansans. As we make changes such as eliminating credits and itemized deductions, some have expressed concerns that this creates "losers." The reality is that **the existing system is full of inequities**; the Governor's proposal seeks to make the playing field more level for more Kansans and lower everyone's individual income tax rates.

Federal Credits and Deductions Are Not Impacted by Kansas Tax Reform

In Kansas, as we make our tax code flatter, fairer, and simpler, we will not impact federal income tax rates, credits, or deductions. Those who claim mortgage interest deductions or receive federal earned income tax credits will continue to do so — and at the significantly higher benefit levels provided by the federal tax code.

In Kansas, our top tax rate today is 6.45 percent; it is 35 percent at the federal level. In that context, deductions are relatively much less meaningful at the state level, particularly when we significantly reduce rates. Further, the one third of Kansas tax filers who currently itemize deductions would take the standard deduction moving forward, providing an additional offset to itemized deductions now claimed. Simply put, as the Kansas Society of CPAs and others have noted, the tax benefit of mortgage interest and other deductions is minimized and then made obsolete as income tax rates move toward zero.

→ Communication is critical for the average taxpayer to understand what he or she is getting out of this bill. When two-thirds of Kansas tax filers do not itemize, the elimination of itemized deductions **is not** a factor to them. When 25 percent of Kansas tax filers pay no Kansas income tax, and 50 percent pay no federal income tax, the elimination of itemized deductions **is not** a factor to them. When 100 percent of the Kansas taxpayers will see a reduction in their marginal tax rate, the elimination of itemized deductions **may or may not** be a factor to them.

The Safety Net for Low-Income Kansans

There has been a meaningful discussion about the level of social welfare that should be provided to low-income Kansans. Any thoughtful debate on the earned income tax credit should be considered through two lenses: 1) whether welfare benefits belong in the tax code and 2) what is the full range of assistance provided rather than one item in isolation. On the latter, low-income and disabled Kansans receive more than \$3.5 billion in assistance annually through SRS and KDHE programs already in place, forming a sizable safety net. In the last fiscal year alone, more than \$442 million was provided in food assistance, benefiting an average of 296,000 people per month, and nearly \$71 million was provided in child care assistance. This \$3.5 billion existing safety net in Kansas (federal and state funding) does not include unemployment benefits or federal programs such as housing assistance that are available on top of other welfare assistance.

Most states do not provide an earned income tax credit on top of the federal income tax credit. Changes to the state EITC will not impact Kansans' federal EITC, which provides up to \$5,112 to a family with two qualifying children in the 2011 tax year. Almost two-thirds of taxpayers filing for the state EITC either have no tax liability or their liability is completely eliminated by the credit and they receive money back that was never paid in income tax.

And, importantly, the money now used to provide a state EITC was not used in the Governor's proposal to reduce income tax rates; rather, it was set aside for expansion of social services programs. If the legislature decides the state EITC is an effective tool for lifting Kansans out of poverty, it can keep the credit in place, and there would be no impact on the across-the-board individual income tax rate reductions proposed by the Governor.

Why We Should Take Action Now: The Lost Decade for Jobs

As Gov. Brownback reminds us regularly, "The last decade was a lost decade for jobs in Kansas. Fewer Kansans were working in private sector jobs in January 2011 than were in January of 2001. A growing government and a shrinking private sector are not sustainable. Fixing that is our top priority."

While there are certainly some factors a state cannot control when it comes to its economy, tax policy is one area a state controls completely. And when it comes to Kansas' tax policy, the state does not rank as high as it must compared to other states in order to be as competitive as possible in attracting new businesses and generating economic and private sector job growth.

Tax policy will play a crucial role in positioning Kansas for growth in the years ahead.

According to Kail Padgitt of the Tax Foundation, "Good state tax systems levy low, flat rates on the broadest bases possible, and they treat all taxpayers the same. Variation in the tax treatment of different industries favors one economic activity or decision over another. The more riddled a tax system is with politically motivated preferences the less likely it is that business decisions will be made in response to market forces."

With that understanding, we seek to change the dynamic that has led to average (or worse) economic results — so more Kansas families can achieve a meaningful increase in income and opportunity, and small businesses can enjoy more capital to invest in growth and new jobs.

We have a clear choice: Maintain the cobbled-together status quo that resulted in the lost decade for jobs, or take serious action to reform our state tax system.

This no doubt takes courage and hard work. But by making Kansas tax policy fairer, flatter and simpler, and by creating a pro-growth business environment that encourages financial investment in Kansas, the state can position itself as a top economic performer. This will reduce poverty and create economic opportunities for the maximum number of Kansans.

**The Nine States with the Lowest and the Highest Marginal Personal Income Tax (PIT) Rates
Ten-Year Economic Performance**
(performance between 2001 and 2010 unless otherwise noted)

State	Top PIT Rate*	Gross State Product Growth	Non-Farm Payroll Employment Growth	Population Growth	Net Domestic In-Migration as a % of Population***	State & Local Tax Revenue Growth****
Alaska	0.00%	77.0%	12.2%	12.1%	-2.0%	452.6%
Florida	0.00%	47.7%	0.2%	15.0%	6.5%	82.3%
Nevada	0.00%	58.9%	6.1%	28.9%	14.1%	100.1%
New Hampshire	0.00%	35.2%	-0.7%	4.7%	2.5%	59.6%
South Dakota	0.00%	58.5%	6.4%	7.3%	0.8%	51.2%
Tennessee	0.00%	38.6%	-2.8%	10.3%	4.2%	61.7%
Texas	0.00%	57.7%	8.7%	17.9%	3.4%	75.5%
Washington	0.00%	47.8%	3.0%	12.3%	3.4%	57.8%
Wyoming	0.00%	105.6%	15.2%	14.3%	4.3%	172.2%
9 States with No PIT**	0.00%	58.54%	5.36%	13.65%	4.12%	123.66%
U.S. Average**	5.47%	46.61%	0.51%	8.63%	0.86%	70.23%
Kansas	6.45%	42.35%	-1.90%	5.61%	-2.36%	62.87%
9 States with Highest Marginal PIT Rate**	9.92%	42.06%	-1.68%	5.49%	-1.91%	61.79%
Ohio	8.24%	24.8%	-9.3%	1.2%	-3.1%	44.5%
Maine	8.50%	35.4%	-2.5%	3.4%	2.3%	45.3%
Maryland	9.30%	50.9%	1.7%	7.4%	-1.5%	67.0%
Vermont	9.40%	36.1%	-1.6%	2.2%	-0.1%	64.5%
New York	10.50%	43.1%	-0.4%	1.5%	-8.3%	68.3%
California	10.55%	42.1%	-4.8%	8.0%	-3.9%	77.2%
New Jersey	10.75%	33.7%	-3.6%	3.6%	-4.8%	70.4%
Hawaii	11.00%	57.4%	5.7%	11.7%	-2.2%	72.1%
Oregon	11.00%	55.0%	-0.3%	10.4%	4.5%	46.8%

Data compiled by Laffer Associates

*Highest marginal state and local personal income tax rate imposed as of 1/1/2011 using the tax rate of each state's largest city as a proxy for the local tax. The deductibility of federal taxes from state tax liability is included where applicable. New Hampshire and Tennessee tax dividend interest income only.

**Equal-weighted averages

2000-2009, *1999-2008

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Senate Committee on Assessment and Taxation

Testimony in Support of Senate Bill 339

Presented by Richard Cram

Senator Les Donovan and Members of the Committee:

Governor Brownback's tax reform plan contained in Senate Bill 339, effective starting in Tax Year 2013, provides for:

- **Lowring individual income tax rates and moving from three brackets to two brackets:**
 - **3 percent** rate for income under \$15,000 (\$30,000 married filing jointly)
 - **4.9 percent** rate for income \$15,000 and over (\$30,000 married filing jointly)
 - *Note: Current rates are 3.5 percent, 6.25 percent, and 6.45 percent*
- **Eliminating individual income tax on non-wage business income** (as reported by LLCs, S-corps and sole proprietorships on lines 12, 17, and 18 of the federal form 1040 individual income tax return)
- **Simplifying and streamlining the tax code:**
 - Eliminating itemized deductions, the food sales tax rebate, homestead refund for renters, and some credits
 - Eliminating subtraction modifications for 529 education savings program and long-term care contract premiums
 - *Note: No impact on deductions or credits claimed at the federal level*
- **Doubling the standard deduction (from \$4,500 to \$9,000) for head of household filers** and investing an additional \$60 million in state social services and healthcare programs
- **Leaving the corporate income tax rate unchanged**

- **Holding the sales tax rate steady** at 6.3 percent, with 4/10 of a cent going to the highway fund as planned in FY14
- **Eliminating the two-year severance tax exemption on new pool oil and gas wells**, except for oil wells generating fewer than 50 barrels a day

OVERVIEW

Lowng individual income tax rates and moving from three brackets to two brackets, effective Tax Year 2013:

The imposition of Kansas income tax, and the rate of tax, is controlled by K.S.A. 79-32,110. The new rate structure for individuals, which moves from three brackets to two brackets and reduces the rates of tax, is found in Section 10, on page 11, of the Bill.

Eliminating individual income tax on non-wage business income:

For individuals, the starting point for calculating Kansas income tax is federal adjusted gross income. Then, in order to determine Kansas adjusted gross income, certain addition and subtraction modifications are made in accordance with K.S.A. 79-32,117.

In accordance with federal law, federal adjusted gross income includes non-wage business income. It is calculated by LLCs, S-corps and sole proprietorships on federal Schedules C, E and F, and then reported on lines 12, 17, and 18 of the federal form 1040 individual income tax return.

The Bill amends K.S.A. 79-32,117 to include new modifications to exempt non-wage business income from Kansas income tax. The new provisions are found in Section 12 of the Bill.

The subtraction modifications, which remove an individual's non-wage business income from federal adjusted gross income in determining Kansas adjusted gross income, are found in (c)(xiv) and (xix), on pages 18 and 19 of the Bill.

If non-wage business income is being subtracted from an individual's federal adjusted gross income, any business losses or deductions already excluded from federal adjusted gross income must be added back in. Otherwise, these losses and deductions flow through from the federal return to the Kansas return, giving the taxpayer a "double dip" which is not proper. The addition modifications include any losses ((b)(xix), page 15), any deductions for self-employment taxes ((b)(xx), page 16), any deduction for pension, profit sharing, and annuity plans of self-employed individuals ((b)(xxi), page 16), any deductions for health insurance ((b)(xxii), page 16), and any deduction for domestic production activities ((b)(xxiii), page 16).

Similarly, if non-wage business income is not subject to tax an individual should not be able to claim a net operating loss or a deduction for business expenses. Accordingly, Section 17,

page 22, amends K.S.A. 79-32,143 by adding subsection (g), (page 24) to restrict the ability to claim a net operating loss to C corporations. And Section 18, page 24 amends K.S.A. 79-32,143a by adding subsection (h), (page 26) to limit the use of an expense deduction to corporations.

The credit for taxes paid to other states, available to Kansas residents at K.S.A. 79-32,111, is amended at Section 11, page 12, to accommodate the non-wage business income exemption, limiting the credit only to income tax paid to another state, when that tax applied to income that is included in Kansas adjusted gross income. Since non-wage business income would be excluded from Kansas adjusted gross income pursuant to the business income exemption, the credit will not apply to income tax paid to another state on any non-wage business income.

A similar amendment (Section 15, page 20 of the bill) is made to K.S.A. 79-32,128, which provides a credit for taxes paid to other states to part-year residents. Again, the credit would not apply to taxes paid to another state on income not included in the taxpayer's Kansas adjusted gross income, i.e., no credit for tax paid to another state on non-wage business income, since it is exempt from Kansas income tax.

Because an individual's non-wage business income will not be subject to Kansas tax a question arises as to how a partners' or shareholder's basis in a partnership or S-corporation should be determined. New Section 19, page 27, resolves this question by providing the partner's or shareholder's basis for Kansas purposes will be the same as that used for federal income tax purposes.

Simplifying and streamlining the tax code:

In order to simplify and streamline the tax code, itemized deductions are eliminated by amending K.S.A. 79-32,118, which deals with deductions, to delete any reference to itemized deductions and retain only the standard deduction (Section 13, page 20), and by repealing K.S.A. 79-32,120 (Section 48, page 64), the statute which currently details the calculation of itemized deductions for individuals. The standard deduction is enhanced for heads of household (see below).

Subtraction modifications for 529 education savings program and long-term care contract premiums found in K.S.A. 79-32,117 are also eliminated. These amendments are part of Section 12 and are on page 18.

In order to both simplify and streamline the tax code and to recognize that non-wage business income will no longer be subject to tax, a number of income tax credits are eliminated or their use restricted to only C corporations. These include:

Abandoned Well Plugging Credit (K.S.A. 79-32,207)	Section 29, Page 35
Adoption Credit (K.S.A. 79-32,202)	Section 48, Page 64
Agritourism Liability Insurance Credit	

(K.S.A. 74-50,173)	Section 4, Page 3
Alternative Fuel Tax Credit	
(K.S.A. 79-32,201)	Section 27, Page 32
Angel Investor Credit	
(K.S.A. 74-8131 et seq.)	Section 48, Page 63
Assistive Technology Contribution Credit	
(K.S.A. 65-7107)	Section 3, Page 3
Child and Dependent Care Credit	
(K.S.A. 79-32,111a)	Section 48, Page 64
Child Day Care Assistance Credit	
(K.S.A. 79-32,190)	Section 22, Page 28
Community Service Contribution Credit	
(K.S.A. 79-32,196)	Section 23, Page 29
(K.S.A. 79-32,197)	Section 24, Page 30
(K.S.A. 79-32,197a)	Section 25, Page 30
Disabled Access Credit	
(K.S.A. 79-32,177)	Section 20, Page 27
Earned Income Credit	
(K.S.A. 79-32,205)	Section 48, Page 64
Environmental Compliance Credit	
(K.S.A. 79-32,222)	Section 33, Page 39
Historic Preservation Credit	
(K.S.A. 79-32,211)	Section 31, Page 37
Individual Development Account Credit	
(K.S.A. 74-50,208)	Section 5, Page 5
Law Enforcement Training Center Credit	
(K.S.A. 79-32,242)	Section 48, page 64
National Guard Employer Health Insurance Credit	
(K.S.A. 79-32,213)	Section 48, Page 64
Research and Development Credit	
(K.S.A. 79-32,182b)	Section 21, Page 27
Single City Port Authority Credit	
(K.S.A. 79-32,212)	Section 32, Page 39
Small Employer Health Benefit Plan Credit	
(K.S.A. 40-2246)	Section 2, Page 2
Swine Facility Improvement Credit	
(K.S.A. 79-32,204)	Section 28, Page 34
Telecommunications Credit	
(K.S.A. 79-32,210)	Section 30, Page 36
Temporary Assistance to Families Contribution Credit	

(K.S.A. 39-7,132)	Section 1, Page 1
(K.S.A. 79-32,200)	Section 26, Page 31
Venture Capital and Local Seed Capital Credits	
(K.S.A. 74-8206)	Section 6, Page 5
(K.S.A. 74-8304)	Section 7, Page 6
(K.S.A. 74-8316)	Section 8, Page 7
(K.S.A. 74-8401)	Section 9, Page 9

The question of how to handle non-refundable credits that are no longer available commencing in tax year 2013 is addressed in New Section 46, found on page 63. This Section provides that such credits may continue to be claimed, subject to any limitations applicable to such credit under the law in effect at the time the credit was earned.

Doubling the single head of household standard deduction:

The provision doubling the standard deduction (from \$4,500 to \$9,000) for head of household filers is the amendment to K.S.A. 79-32,119, found in Section 14 on page 20.

Leaving the corporate income tax rate unchanged:

The rate of Kansas income tax is found in K.S.A. 79-32,110. Though amended for individuals, the rate of tax for C corporations is not changed. See Section 10, page 12.

Calculation of the tax on a C corporation starts with federal taxable income. Because K.S.A. 79-32,138 mandates that the same modification used for individuals are also used to determine a corporation's Kansas taxable income, certain adjustments to the statute are required to ensure the new non-wage business income modifications available to individuals are not available to corporations. These amendments are found in Section 16, page 21 of the Bill.

Holding the sales tax rate steady:

The rate for Kansas sales tax is set by K.S.A. 79-3603. Effective July 1, 2010 the rate increased from 5.3% to 6.3%. Under current law it will be reduced to 5.7 percent effective July 1, 2013. The amendments to K.S.A. 79-3603 and K.S.A. 79-3620, found in Section 34, page 41, and Section 35, page 46, respectively, hold the sales tax steady at 6.3%, with 4/10 of a cent going to the highway fund as planned in FY14. Similarly, the amendments to K.S.A. 79-3703 and K.S.A. 79-3710, found in Section 36, page 48, and Section 37, page 49, respectively, hold the use tax steady at 6.3%, with 4/10 of a cent going to the highway fund as planned in FY14.

Eliminating the two-year severance tax exemption on new pool oil and gas wells:

K.S.A. 79-4217 contains a two-year exemption from severance tax for new pool oil and gas wells. The amendment to the statute found in Section 38, page 54, eliminates this exemption except for oil wells producing less than 50 barrels of oil per day.

OTHER PROVISIONS

Homestead Property Tax Refunds

A homestead property tax refund is available to a Kansas resident who is: (1) a person having a disability; (2) a person who is 55 years of age or older; (3) a disabled veteran; (4) the surviving spouse of active duty military personnel who died in the line of duty; or (5) a person other than one of the aforementioned who has a dependent child under the age of 18 residing with them at the homestead. For 2011, a sliding scale of household income up to \$31,200 applies to gradually phase out the availability of the refund. The maximum refund amount is \$700. Under current law, (K.S.A. 79-4501 *et seq.*) a homestead property tax refund is available to both property owners and to renters.

Overall, the homestead property tax refund program works well for property owners. However, experience has shown claims submitted by renters are frequently incomplete and that many of the claims are suspect. This combination has created a large number of administrative and enforcement problems for the Department of Revenue.

There are approximately 130,000 homestead refund claims submitted per year. About 45,000 of these are from renters. Of the 45,000 renters' claims, approximately two-thirds (66%) "work list," meaning they need manual review by Department staff, and approximately half of the claims (50%) have some type of error requiring corrective or follow-up action by staff. Approximately 7,200 (16%) of the claims are adjusted, and approximately 9,000 (20%) of the claims are denied.

Staff efforts to verify incomplete or suspect homestead refund claims from renters consume substantial Department resources. Errors and mistakes include such things as claiming a refund for property that is not on the tax rolls (such as Section 8 property), not providing a list of what a landlord provides, incorrect addresses, and not completing the claim for all time periods. Determining household income is a difficult issue, as the Department has no way of knowing for certain how many persons live at the reported address. Many claimants report rent payments greater than their income. Examples of fraud include two parties who each list the other as their landlord, and then supply fabricated information to support each other's claims.

Because of these problems, the Bill contains provisions that amend the homestead property tax act to eliminate renters and make homestead property tax refunds available only to property owners. The amendments are found in Section 39 through 44, starting on page 57. As the Department's fiscal note provides, eliminating the food sales tax refund and the homestead refund for renters allows for a reduction of 5 FTE's for annual savings of about \$238,000 beginning in FY 2014.

Food Sales Tax Refunds

K.S.A. 79-3633 through 79-3639 provides for the refund of sales tax paid on food. Under current law a refund is available to a Kansas resident who is: (1) a person having a disability; (2)

a person who is 55 years of age or older; or (3) a person other than one of the aforementioned who has a dependent child under the age of 18 residing with them at the homestead. For 2011, for a household income up to \$17,700 the amount of the refund is \$91; for a house income of more than \$17,700 but not more than \$35,400 the refund is \$46.

In Section 48, page 64, the food sales tax refund is repealed.

Further Income Tax Rate Reductions

New Section 45, page 62, provides for the reduction of income tax rates when actual state general fund receipts exceed the actual state general fund receipts for the immediately preceding fiscal year by more than 2% and the actual ending state general fund balance exceeds the amount of 7.5% of the total amount authorized to be expended or transferred by demand transfer from the state general fund. Marginal rates for both individual and corporate income tax will be reduced to rates estimated by the Secretary of Revenue so that the revenue reductions for individual and corporate tax will be in the same proportion as individual and corporate tax receipts are to total of individual and corporate tax receipts. Reduced rates will be published by October 15 of the year prior to their effect. Lower tax receipts will not trigger an automatic rate increase.

SECTION BY SECTION SUMMARY

Section 1, page 1. K.S.A. 39-7,132 provides an income tax credit for any individual, partnership, trust, estate or other legal entity who enters into an agreement with the Secretary of Social and Rehabilitation Services to provide financial support to a person who receives Temporary Assistance for Families (TAF). The non-refundable credit is equal to 70% of the amount of financial assistance paid by such person. The amendment to this statute restricts to the credit to those who pay corporate income tax.

Section 2, page 2. K.S.A. 40-2246 provides an income tax credit for any small employer establishing a small employer health benefit plan for the purpose of providing a health benefit plan. The amount of the refundable credit varies depending upon when the plan is established and the length of time the plan has been in existence. The amendment to this statute restricts the credit to those who pay corporate income tax.

Section 3, page 3. K.S.A. 65-7107 provides an income tax credit to any person or entity who makes a contribution to an individual development account reserve fund to be used to purchase assistive technology. The non-refundable credit is equal to 25% of the contribution amount. The amendment to this statute restricts the credit to those who pay corporate income tax.

Section 4, page 3. K.S.A. 74-50,173 provides an income tax credit for a portion of the cost of liability insurance paid by a registered agritourism operator that operates an agritourism activity. Though non-refundable the credit, which is equal to 20% of the cost of the insurance,

can be carried over for three years. The amendment to this statute restricts the credit to those who pay corporate income tax.

Section 5, page 5. K.S.A. 50,208 provides an income tax credit to any program contributor that contributes to an individual development account reserve fund. The amount of the refundable credit is up to 75% of the contribution amount. The amendment to this statute restricts the credit to those who pay corporate income tax.

Section 6, page 5. K.S.A. 74-8206 provides an income tax credit for investors investing in stock issued by Kansas Venture Capital, Inc. Though non-refundable the credit, which is equal to 25% of the amount invested, can be carried over until the credit is used. The amendment to this statute restricts the credit to those who pay corporate income tax.

Section 7, page 6. K.S.A. 74-8304 provides an income tax credit and a credit against the tax imposed on insurance companies for investors investing in a certified Kansas venture capital company. Though non-refundable the credit, which is equal to 25% of the amount invested, can be carried over until the credit is used. The amendment to this statute restricts the income tax credit to those who pay corporate income tax.

Section 8, page 7. K.S.A. 74-8316 provides an income tax credit for those making gifts, donations, or grants to a technology-based venture-capital fund. Though non-refundable the credit, which is equal to 25% of the amount invested, can be carried over until the credit is used. The amendment to this statute restricts the credit to those who pay corporate income tax.

Section 9, page 9. K.S.A. 79-8401 provides an income tax credit and a credit against the tax imposed on insurance companies for cash investment in a certified local seed capital pool. Though non-refundable the credit, which is equal to 25% of the amount invested, can be carried over until the credit is used. The amendment to this statute restricts the income tax credit to those who pay corporate income tax.

Section 10, page 11. K.S.A. 79-32,110 imposes the Kansas income tax and establishes the rate of tax. The amendments to this statute provide two brackets for individuals instead of three, and reduce the bottom rate from 3.5% to 3.0% and the top rate from 6.45% to 4.9%. The rates for all other taxpayers are left unchanged.

Section 11, page 12. K.S.A. 79-32,111 provides a credit against the Kansas income tax of a resident individual, resident estate or resident trust for taxes paid to another state on income derived in that state. The amendments to this statute restrict the credit to taxes paid to another state on income derived in another state and included in Kansas adjusted gross income.

Section 12, page 13. K.S.A. 79-32,117 specifies the modifications (additions and subtractions) to federal adjusted gross income which are made in determining Kansas adjusted gross income.

The addition modifications found in subsection (b) are amended to add:

In (xix), an addition modification for (1) loss business reported from Schedule C on line 12 of the federal form 1040; (2) loss from rental real estate, royalties, partnerships, S corporations,

estates, trusts, residual interest in real estate mortgage investment conduits and net farm rental reported from Schedule E on line 17 of the federal form 1040; and (3) farm losses reported on Schedule F and on line 18 of the federal form 1040;

In (xx), an addition modification for any deduction for self-employment taxes;

In (xxi), an addition modification for any deduction for pension, profit sharing, and annuity plans of self-employed individuals;

In (xxii), an addition modification for any deduction for health insurance; and

In (xxiii), an addition modification for any deduction for domestic production activities.

The subtraction modifications found in subsection (c) are amended to:

Include, in (xiv), the exclusion of income or loss reported from Schedule E on line 17 of the federal 1040 from the income of a bank, national banking association, or federal or state savings and loan;

Delete current subtraction modification (xv) which relates to contributions to a 529 family postsecondary education savings account;

Delete current subtraction modification (xvi) which relates to premium costs for qualified long-term care insurance contracts;

Provide, in (xix), a subtraction modification for (1) net profit business reported from Schedule C on line 12 of the federal form 1040; (2) net income from rental real estate, royalties, partnerships, S corporations, estates, trusts, residual interest in real estate mortgage investment conduits and net farm rental reported from Schedule E on line 17 of the federal form 1040; and (3) net farm profit reported on Schedule F and on line 18 of the federal form 1040

Section 13, page 20. K.S.A. 79-32,118 provides for the use of either a standard deduction or an itemized deduction for individual income tax payers. The amendment to this statute, and the repeal of K.S.A. 79-32,120, eliminates the use of itemized deductions.

Section 14, page 20. K.S.A. 79-32,119 establishes the amount of the Kansas standard deduction. The amendments to this statute retain a \$3,000 standard deduction for single individuals and a \$6,000 standard deduction for married persons. The standard deduction for a head of household is increased from \$4,500 to \$9,000.

Section 15, page 20. K.S.A. 79-32,128 relates to part-year residents and the manner in which their income is to be reported. In addition to some simple language corrections, the statute is amended to provide that modified Kansas source income be determined using losses or deductions as set forth in K.S.A. 79-32,117.

Section 16, page 21. K.S.A. 79-32,128 deals with the calculation of the taxable income of a C corporation. Because the statute mandates that the same modifications used for individuals are also used to determine a corporation's taxable income, certain adjustments to the statute are required to ensure the new non-wage business income modifications available to individuals are not available to corporations. The amendment to subsection (b) of the statute addresses addition modifications, while the amendment to subsection (c) of the statute addresses subtraction modifications.

Section 17, page 22. K.S.A. 79-32,143 deals with net operating losses. Under present law either an individual or a business may claim a net operating loss. The amendment to this statute restricts the use of a net operating loss to those who pay corporate income tax.

Section 18, page 24. K.S.A. 79-32,143a deals with the expense deduction. Under present law either an individual or a business may claim an expense deduction. The amendment to this statute restricts the use of a net operating loss to those who pay corporate income tax.

New Section 19, page 27. This Section provides that a partner's or shareholder's basis in a partnership or S-corporation will be the same as that used for federal income tax purposes.

Section 20, page 27. K.S.A. 79-32,177 provides an income tax credit for those making expenditures a facility accessible to individuals with a disability, or to make a facility or equipment usable for the employment of individuals with a disability. Though non-refundable the credit, which is equal to 50% of the amount expended, can be carried over for up to four years. The amendment to this statute restricts the credit to those who pay corporate income tax.

Section 21, page 27. K.S.A. 79-32,182b provides an income tax credit for research and development activities conducted in Kansas. The credit is equal to 6 ½% of the amount expended. The credit may be carried forward, subject to a limit of 25% in any one tax year. The amendment to this statute restricts the credit to those who pay corporate income tax.

Section 22, page 28. K.S.A. 79-32,190 provides an income tax credit for any taxpayer who pays for child day care services for its employees, or that provides facilities and equipment for child day care services. The amount of the refundable credit is either 30% or 50%, subject to certain limitations. The amendment to this statute restricts the credit to those who pay corporate income tax.

Sections 23, 24 and 25, pages 29 and 30. K.S.A. 79-32,196, 79-32,197 and 79-32,197a provide an income tax credit for contributions to a community service organization or governmental entity which engages in the activities of providing community services. The credit, which is at least 50% of the total contribution made, is refundable. The amendment to this statute restricts the credit to those who pay corporate income tax.

Section 26, page 31. K.S.A. 79-32,200 provides an income tax credit for any individual, partnership, trust, estate or other legal entity who enters into an agreement with the Secretary of Social and Rehabilitation Services to provide financial support to a person who receives Temporary Assistance for Families (TAF). The non-refundable credit is equal to 70% of the amount of financial assistance paid by such person. The amendment to this statute restricts to the credit to those who pay corporate income tax.

Section 27, page 32. K.S.A. 79-32,201 provides an income tax credit for any individual, association, partnership, limited liability company, limited partnership, or corporation that makes expenditures for a qualified alternative-fueled motor vehicle licensed in Kansas or that makes expenditures for a qualified alternative-fuel fueling station. The amount of the non-refundable credit varies depending on the size and type of vehicle, and the timing and amount of

expenditure. The amendment to this statute restricts to the credit to those who pay corporate income tax.

Section 28, page 34. K.S.A. 79-32,204 provides an income tax credit for a taxpayer making required improvements to a qualified swine facility. The non-refundable credit is equal to 50% of the cost incurred. The amendment to this statute restricts to the credit to those who pay corporate income tax.

Section 29, page 35. K.S.A. 79-32,207 provides an income tax credit for a taxpayer who makes expenditures to plug an abandoned oil or gas well on their land. The non-refundable credit is equal to 50% of the amount expended. The amendment to this statute restricts to the credit to those who pay corporate income tax.

Section 30, page 36. K.S.A. 79-32,210 provides an income tax credit for property tax paid by a telecommunications company on property initially acquired and first placed in service after January 1, 2001 that has an assessment rate of 33%. The refundable credit is equal to the amount of property taxes timely paid for the difference between the assessment level of 25% and the actual assessment of 33%. The amendment to this statute restricts to the credit to those who pay corporate income tax.

Section 31, page 37. K.S.A. 79-32,211 provides an income tax credit for a taxpayer that contributes to a state-owned historic site or a 501(c)(3) organization which owns and operates a state-owned historic site. The refundable credit is equal to 50% of the amount of the contribution. The amendment to this statute restricts to the credit to those who pay corporate income tax.

Section 32, page 39. K.S.A. 79-32,212 provides an income tax credit for the amount attributable to the retirement of indebtedness authorized by a single city port authority established before January 1, 2002. The non-refundable credit is equal to 100% of the amount attributable, but any credit that exceeds the tax liability is lost. The amendment to this statute restricts to the credit to those who pay corporate income tax.

Section 33, page 39. K.S.A. 79-32,222 provides an income tax credit for a taxpayer that makes qualified expenditures for an existing refinery to comply with environmental standards. The non-refundable credit is equal to the amount of the expenditures. The amendment to this statute restricts to the credit to those who pay corporate income tax.

Sections 34 and 35, pages 41 and 46. K.S.A. 79-3603 imposes the Kansas retailers' sales tax, and K.S.A. 79-3620 deals with depositing and distributing the tax. The amendments hold the sales tax steady at 6.3%, with 4/10 of a cent going to the highway fund as planned in FY14.

Sections 36 and 37, pages 48 and 49. K.S.A. 79-3703 imposes the Kansas consumers' compensating use tax, and K.S.A. 79-3710 deals with depositing and distributing the tax. The amendments hold the use tax steady at 6.3%, with 4/10 of a cent going to the highway fund as planned in FY14.

Section 38, page 51. K.S.A. 79-4217 imposes an excise tax on the severance and production of coal, oil or gas. The statute contains an exemption for new pool oil and gas wells. The amendment eliminates this exemption, except for oil wells producing less than 50 barrels of oil per day.

Sections 39 through 44, pages 57 through 62. K.S.A. 79-4501 et seq. is the homestead property tax refund act. Under current law a homestead property tax refund is available to both property owners and renters. The amendments to K.S.A. 79-4501, 79-4502, 79-4508, 79-4509, 79-4511, and 79-4522 eliminate renters and make homestead property tax refunds available only to property owners.

New Section 45, page 62. Provides for the automatic reduction of income tax rates when actual state general fund receipts exceeds the actual state general fund receipts for the immediately preceding fiscal year by more than 2% and the actual ending state general fund balance exceeds the amount of 7.5% of the total amount authorized to be expended or transferred by demand transfer from the state general fund. Marginal rates for both individual and corporate income tax will be reduced to rates estimated by the Secretary of Revenue so that the revenue reductions for individual and corporate tax will be in the same proportion as individual and corporate tax receipts are to total of individual and corporate tax receipts. Reduced rates will be published by October 15 of the year prior to their effect. Lower tax receipts will not trigger an automatic rate increase.

Section 46, page 63. This section provides that the unused portion of any non-refundable income tax credit earned in a tax year prior to tax year 2013 which is no longer available to individuals for tax years commencing in tax year 2013 may continue to be claimed, subject to any limitations applicable to such credit under the law in effect at the time the credit was earned.

Section 47, page 63. This section repeals statutes included in the 2011 supplement.

Section 48, page 63. This is the general repealer provision.

Balloon Amendment to Section 19

Based on the suggestion received from the Kansas CPA Society to provide for separate Kansas basis calculations for partnership interests and S corporation stock, the Department recommends the attached balloon amendment to Section 19 of the Bill.