



Testimony to House Taxation Committee on HB 2427

Motor Fuel Taxes

May 5, 2014

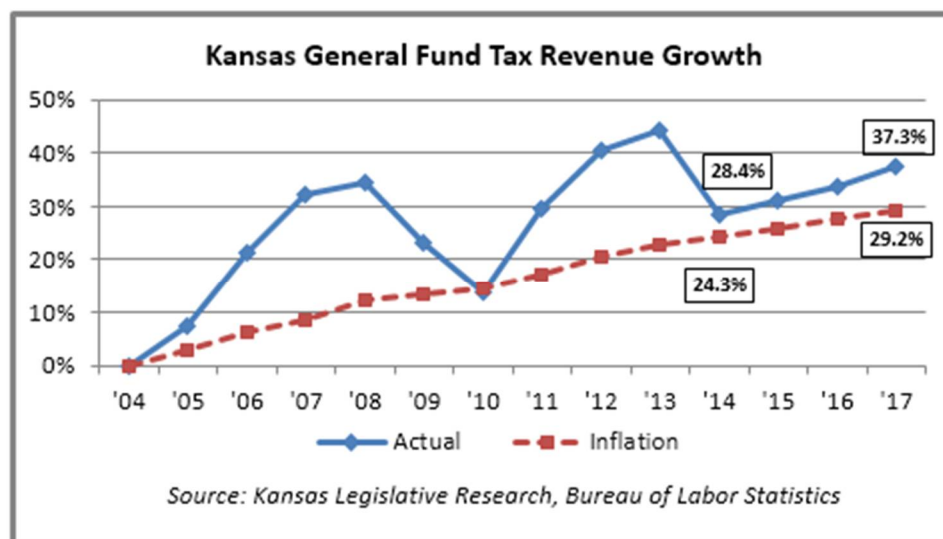
Dave Trabert, President

Chairman Klee and members of the Committee:

We appreciate this opportunity to provide testimony on the merits of HB 2427. We oppose HB 2427 because we do not believe that any tax increase is necessary, as Kansas has a spending problem instead of a revenue problem.

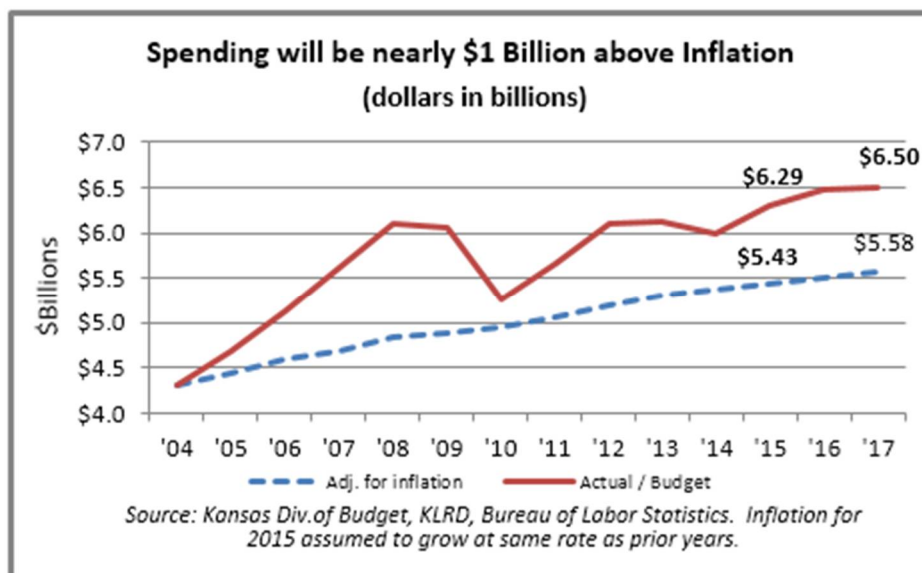
Contrary to 'sky is falling' claims, the new Kansas revenue estimates show that tax revenue will continue to be well ahead of the inflation-adjusted historic trend. Tax revenue increased by 28.4 percent over the last ten years, or 4 points more than the increase in inflation (Midwest Urban Cities calculated on a fiscal year basis). The April 2015 Consensus Revenue Estimates put total General Fund tax revenue at \$5.743 billion this year and growing to \$6.025 billion over the next two years.

Inflation would be 29.2 percent higher in FY 2017 than in FY 2004 if it continues at last year's pace, but tax revenue would be 37.3 percent higher.



The problem with the Kansas budget is that the cost of government was not reduced when tax reform was enacted.

While tax revenue has remained ahead of inflation since 2004, proposed spending in FY 2017 will be nearly \$1 billion higher than 2004 spending adjusted for inflation. But that's not the only evidence of a spending problem.



Every state provides the same basket of basic services (education, social service, etc.) but some states do so at a much lower cost and pass the savings on in the form of lower taxes. In 2012, the states that tax income spent 49 percent more per-resident providing services than the states without an income tax, and they don't do it by pushing spending to local government; the ten states with the highest combined state and local tax burden spent 43 percent more per resident than the ten states with the lowest burdens. Kansas, by the way, spent 37 percent more per resident than the states without an income tax.

Let's put that in perspective. Kansas' 2012 spending of \$6.098 billion was 37 percent higher than

2012 Actual Spending Per-Resident		
State Grouping	Amount	Variance
No Income Tax	\$2,491	
Income Tax	\$3,702	49%
Lowest State/Local Tax Burden	\$2,726	
Highest State/Local Tax Burden	\$3,901	43%
Kansas	\$3,409	

Source: National Association of State Budget Officers, Census. State spending totals exclude federal funds and bond issue proceeds.

the per-resident spending of states without an income tax. This year Kansas is expected to spend \$191.5 million more than in 2012 and the budgets under consideration in the Legislature will add another \$210.1 million in the next two years.

There may not be sufficient interest in the Legislature and the Governor's office to reduce the cost of government, but the opportunities are ample.

That said, if raising taxes is the preferred method of balancing the budget, the lesson of the last recession is that the State is better able to fund necessary services with a steady revenue stream from consumption taxes rather than income taxes.

Tax revenue declined in FY 2009 and FY 2010 but the magnitude of the decline was much greater for income taxes, which dropped 21% over two years or about \$702 million. Retail sales tax was fairly steady, dropping just \$59 million or 3% over the same period. Imagine how differently the budget processes of those two

years would have been if Kansas

had had more reliance on

consumption taxes and less on

income taxes. The income leg of

the so-called 3-legged stool may satisfy the political / social desire of those who want to tax income but it is not is government's best interest of having a steady tax stream to fund necessary services.

Decline in Income and Retail Sales Tax During Last Recession				
Tax Type	2008	2009	2010	2-Year Chg.
Income	3,361,891	2,948,450	2,659,663	-21%
Retail Sales	1,711,398	1,689,516	1,652,037	-3%

Source: Kansas Legislative Research

Some of the justification for raising income taxes is being couched in terms of fairness, as in, 'why should one group be exempt from income tax but others must pay tax.' The focus of those discussions are the businesses organized as Limited Liability Corporations (LLCs), partnerships and other business entities that are taxed as Individuals instead of Corporations.

There is another group, however, that has been exempt from state income tax for decades – state and local government retirees' pensions. As explained in our 2011 publication of A Comprehensive Reform of the Kansas Public Employees' Retirement System ...

"KPERs benefits are not taxable for state income tax purposes. Employee contributions to the plan are after tax, so it's appropriate that distributions from employee contributions would be not be taxable to avoid double taxation. However, KPERs members never have to pay state income tax on the majority of their pension benefits, which come from employer contributions and earnings on employer contributions.

The cost to taxpayers of providing government retirees with these tax-free benefits is substantial. The exact amount of pension distributions from employer contributions and the applicable tax rate for each recipient would have to be identified to accurately calculate the benefit, but we can make a reasonable estimate. As noted in Table 4, in order to fully fund the state/school plan based on the market value of plan assets, the employer contribution rate would be 15.26% and the total employer and employee contribution rate would be 19.33%; the employer rate is therefore 78.9% of the total. For the KP&F plan, the employer rate would be 75% of the total (19.8% for the employer, 26.32% in total). The following estimate of a \$52 million income tax benefit to KPERs retirees is based on the lower employer rate of 75%."¹

Table 12 - Retirement Benefit Estimate for 2010 (millions of dollars)	
Total KPERS distributions - Calendar 2010	\$ 1,108.6
Estimated portion from Employers	75%
Estimated employer funds distributed	\$ 831.5
Assumed state income tax rate (middle bracket)	6.25%
Estimated state income tax benefit to KPERS retirees	\$ 52.0
<i>Source: KPERS, 2010 distributions as listed at KansasOpenGov.org; Kansas Dept. of Revenue</i>	

Then-KPERS executive director Glenn Deck said our estimation of the tax benefit was reasonable. The current tax benefit should be similar; marginal tax rates have declined but pension distributions were \$1.329 billion in 2013. But regardless of the actual amount, state and local government retirees are exempt from paying income tax on the portion of their pensions funded by taxpayers.

There is certainly a discussion to be had about fairness in taxation, but anyone proposing to increase or charge a tax based on fairness should be supportive of taxing government retirees the same as private sector retirees. Otherwise, proposals to raise income taxes may be a matter of political expediency but not about 'fairness.'

While we believe the cost of providing services should be reduced rather than increase any tax, the motor fuels tax proposal is preferable to an income tax increase. We do recommend, however, that the motor fuels tax be permanent; the proposed sunset effective July 1, 2018 will merely create a large hole in the General Fund budget when general sales tax is shifted back to KDOT to replace the loss of motor fuels tax revenue.

¹ <http://www.kansaspolicy.org/ResearchCenters/BudgetandSpending/BudgetandSpendingStudies/71799.aspx>