

Senate Committee on Assessment and Taxation
Opposition to Senate Bill 508- Small Business Taxes
Presented by Eric Stafford, Vice President of Government Affairs



Thursday, April 28, 2016

Mister Chairman and members of the committee, my name is Eric Stafford, Vice President of Government Affairs for the Kansas Chamber. The Kansas Chamber appreciates the opportunity to testify in opposition to Senate Bill 508 which proposes to roll back the small business tax cuts of 2012.

Last year our organization asked for the legislature to find further efficiencies which results in savings instead of making Kansas a more expensive place in which to own and operate a business. Unfortunately a tax increase ultimately passed focused on consumption, itemized deductions and product-specific tax increases.

We were asked last year where the state should cut spending. The answer of possible savings through efficiencies has been presented in the A&M study, suggesting 105 recommendations that could save the state over \$440 million per year over the next five years. The legislature might not believe that every recommendation is a good one. But if some of the biggest cost-saving recommendations are adopted, Kansas could achieve significant savings through a variety of more efficient delivery methods for essential state services. We would suggest the legislature take action on those recommendations from the efficiency study before coming back, again, to increase taxes on taxpayers in our state.

But here we are one year later and this committee is having the same debate- should we tax small businesses? Some legislators state that businesses need to pay income taxes in order to fix the budget. Senate Bill 508 is being messaged as a "fix" for an unintended "loophole" to the small business side of the tax cuts. However, you'll notice attached to my testimony a summary of what was in conference committee in 2012 under HB 2117 for consideration.

Under the header of "Business Accelerator" HB 2117 phased in the small business tax cuts starting with an exemption of \$100,000 in tax years 2013 and 2014; a \$250,000 exemption in years 2015 and 2016, followed by all income exempt in tax year 2017. What ultimately passed essentially made the changes immediate instead of a phased-in approach as was being considered in conference committee.



The Kansas Chamber, with headquarters in Topeka, is the leading statewide pro-business advocacy group moving Kansas towards becoming the best state in America to do business. The Chamber represents small, medium and large employers all across Kansas.

835 SW Topeka Blvd Topeka, KS 66612 785.357.6321 kansaschamber.org

If the tax cuts have caused the budget problem, why is no one introducing legislation targeting the other 71% of the 2012 and 2013 tax cuts which reduced personal income tax rates? We suspect it's politically more expedient to raise taxes on businesses instead of individuals. Legislation continues to attack the business tax cuts which accounted for only 29% of the total reduction in state income taxes but passed with the goal of improving our tax climate for private sector businesses.

How do we best position Kansas to grow in the future? What is the best policy decision to generate economic growth for the state? We would argue the best approach is to protect the income tax cuts from 2012 and focus on efficiencies.

After the tax cuts went into effect, many legislators who supported reductions in income taxes talked about the economic benefit of lower taxes. Editorials were written about correcting the decades of over taxation in Kansas. It was said that more money in the pockets of Kansas taxpayers was a good thing. We agreed then and we agree now, that lower taxes position our state over the long-run to be more competitive in our ability to attract and retain investment in our state. Kansas has been and remains very competitive in a number of areas. These changes to tax policy were made because our tax climate was not very competitive. In some cases, that still remains the case (property tax burden, C-Corp tax policy, etc) even after the income tax cuts.

Are the tax cuts working? It's a great question that has been debated heavily since 2012. We know the tax cuts have attracted businesses to Kansas, and now we're looking to change the rules on them just a few short years later. According to data from the department of revenue, there were over 18,000 first time small business filers in the state, bringing over \$1 billion of new income to the state in 2013 and 2014. Year-over-year revenues continue to grow, even with a stagnant economy being pulled down by low oil and ag commodity prices which have adversely impacted forecasted revenues.

I would also add that 20% of respondents to our Business Leader's Poll in December 2015 said the tax cuts helped them stay in business. Even results from the Docking Institute at Fort Hays State fall 2015 survey showed 88 % of respondents felt taxes on small businesses should decrease or stay the same. Only 11% felt they should be increased.

Technical Concerns with SB 508

The professionals we work closely with on tax policy have raised several concerns with SB 508.

- If 70% of small business income is subject to state income tax, would the state allow for 70% of losses as part of a quid pro quo theory?
 - SB 508 subjects business 70% of income to taxation without allowing for a proportionate amount of deductions to state adjusted gross income (state AGI will be higher than federal AGI).

- If 70% of small business income is subject to state income tax, would the state allow some of the related federal deductions attributable to the income such as self-employment tax deduction, self-employed health insurance deduction and the DPAD (domestic production activities deduction)? Using 70% of these deductions would be simple but inconsistent with their base on the federal side.
- Tying the modification language to “material participation” of IRC 469 and “self-employment income” under IRC 1402 creates much complexity at the state level. Considering the federal level material participation test is applied yearly, and subject to different federal elections (such as grouping and the real estate profession) the amounts subject to Kansas adjustment could change often for Schedule E income.
- SB 508 rewards investment income, rental income, etc. (passive income) by protecting 100% of income from state taxes while subjecting nonpassive income to taxes. Differentiates between passive and nonpassive income.

If the intent of SB 508 is to close the perceived “loophole” of the small business tax cuts, SB 508 makes several questionable changes to the bill which are highlighted above and will result in significant confusion because of the “material participation” and “nonpassive” language. Our tax professionals ensure us this will result in a much more burdensome filing process for small businesses.

If the intent of SB 508 is to make our tax policy “fair,” let’s remind this committee about the commercial property assessed rate on property taxes compared to residential property; or how commercial property pays sales tax on utilities while ag and residential remains exempt; or how employers pay hundreds of millions of dollars annually in unemployment insurance taxes to provide protections to their employees during times of economic downturn; or KPERS retirees paying no income taxes on pension contributions long before businesses were exempt from income taxes. There are many instances where an argument could be made that tax policy isn’t fair.

We will close by saying we are extremely disappointed that we are having this debate again after the legislature passed a tax increase in 2015. We encourage you to review, debate the merit, and adopt recommendations from the efficiency study before looking to pass the largest tax increase on small businesses in this state’s history.

Thank you for the opportunity to testify in opposition to Senate Bill 508 and I am happy to answer any questions at the appropriate time.

HB 2117 Conference Committee Tax Plan

Income taxes:

- Collapses the three tax brackets into two
 - The bottom rate will be 3 percent starting tax year 2013
 - The top rate will be 5.5 percent in tax years 2013 and 2014 (4.9 percent with a 6/10 surcharge)
 - Tax year 2015 the top rate decreases to 5.3 percent (4.9 percent with a 4/10 surcharge)
 - Tax year 2016 the top rate decreases to 5.1 percent (4.9 percent with a 2/10 surcharge)
 - In tax year 2017, the top tax rate will be 4.9 percent

Tax Credits/Deductions/Modifications Included:

- Beginning 2013, People will be able to claim either EITC or food sales tax credit, but not both
- Beginning 2013, Home Mortgage interest, if claimed on federal return
- Beginning 2013, Charitable Deductions, if claimed on federal return
- Angel Investor
- Historic Preservation tax credit
- Individual Development Accounts
- Community Service Tax credit
- Child dependent care tax credit
- Beginning 2013, Increases the maximum Homestead Tax Credit to \$800, a \$100 increase from the current \$700 cap
- Learning Quest
- Long Term health Care
- Historic Site preservation, sunset extended
- Regional foundations, sunset extended
- Deferred Maintenance, sunset extended
- Electric Cogeneration, sunset extended

Homestead Program

- Beginning in 2013, renters could no longer participate in the program. The maximum refund for property owners would be increased to \$800 from the current \$700.

Business accelerator

- Phases in over four years the elimination of tax on non-wage business income (\$100,000 exempt in tax years 2013 and 2014; \$250,000 exempt 2015 and 2016; all exempt 2017)

Other tax credits and changes

- **Increases LAVTRF** transfers from SGF to \$45 million
- **Expands ROZ** add 24 counties bringing the total to 74 counties: Allen, Anderson, Bourbon, Brown, Chase, Cherokee, Clay, Coffey, Doniphan, Ellsworth, Grant, Haskell, Labette, Linn, Marshall, Meade, Morris, Nemaha, Neosho, Osage, Ottawa, Rice, Sumner and Wabaunsee.
- **Sales and Use "Click-Thru" Nexus:** expands the definition of a retailer doing business in the state for the purposes of sales and use tax collection to include "click-thru nexus" provisions in which a retailer would be responsible for collecting and remitting use tax who enters into agreement with one or more Kansas residents for a commission or other consideration, directly or indirectly, refers potential customers by a link on an internet website, by telemarketing, by an in-person or oral presentation, when the gross receipts from sales in Kansas exceeds of \$10,000 during the prior 12 months.
- **OGVDTF** – creates county-specific trust funds where money from certain severance tax receipts are held in trust until they are released.
- **Corporation Income Tax Apportionment** – would allow businesses moving into the state, which employ 10 or more people to use a single-factor (sales) income tax apportionment formula starting in tax year 2013. Companies using the single-sales-factor could not participate in PEAK or HPIP.
- **HPIP** unitary use if the company invests \$10 million and creates 50 jobs in Kansas.
- **Bars the Incarcerated** from claiming Homestead or food sales tax rebates.
- **Clarifies** that helium is subject to severance tax
- **Cleans up** statute language from the business and job development changes in 2011.

Beginning 2013, the following tax credits are only available to C Corporations:

- Small Employer Health Benefit Plan
- Assistive Technology
- Venture Capital
- Agritourism
- Research and development
- Child day care assistance
- Temporary assistance to families
- Alternative fuel
- Swine facility improvement
- Abandoned well plugging
- Telecommunications property tax

- Single city port authority
- Environmental compliance.
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Beginning 2013, the following credits are repealed:

- National Guard health insurance
- Law enforcement training center contributions
- Adoption
- Disabled access

Severance Tax

Effective July 1, 2012, wells in “new pools” producing more than 100 barrels-a-day will no longer be exempt and will be subject to severance tax.