Testimony to Senate Assessment & Taxation Committee
SB 508 Taxing Pass-Through Income
April 28, 2016
Dave Trabert, President

Chairman Donovan and members of the Committee,

We appreciate this opportunity to present testimony in opposition to SB 508, which we believe to be an unnecessary tax increase that would also have a negative impact on economic growth and job creation.

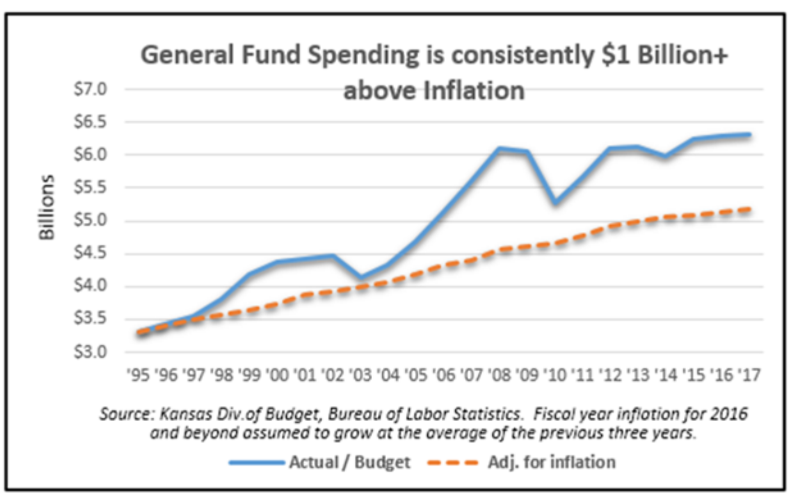
No tax increase is necessary as long as government is not operating efficiently, and there is ample evidence that state government is far from efficient. Here are but a few examples:

- ✓ The Alvarez & Marsal efficiency study, which wasn't even a complete review of state operations, found more than $2 billion worth of savings opportunities over five years.

- ✓ Kansas has 170.4 state government employees per 10,000 residents, which is 25 percent higher than the national average of 136.4.[1] At the national average, Kansas would have 9,879 fewer full time and part time state employees.

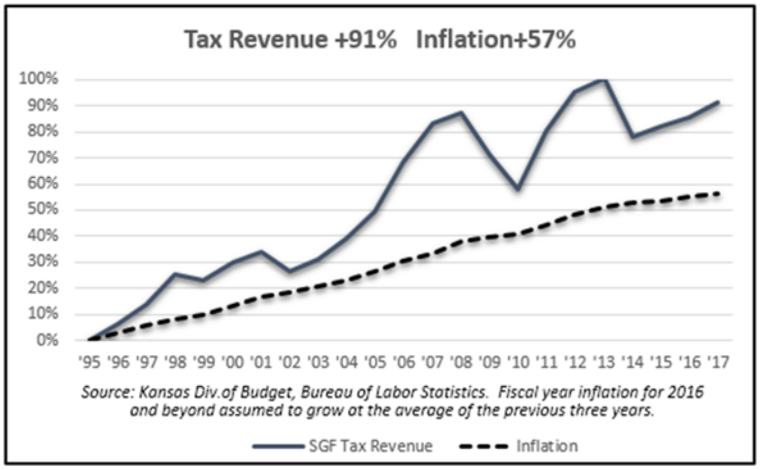
- ✓ Every state offers the same basic basket of services but some states provide services at a much better price. In 2014, the states that tax income spent 48 percent more per-resident than the states without an income tax; Kansas spent 34 percent more.[2]

Not all of the savings would directly benefit the General Fund, but savings elsewhere could reduce the need for General Fund spending. Universities, for example, could reduce extraneous employment and thereby have less need for General Fund aid.

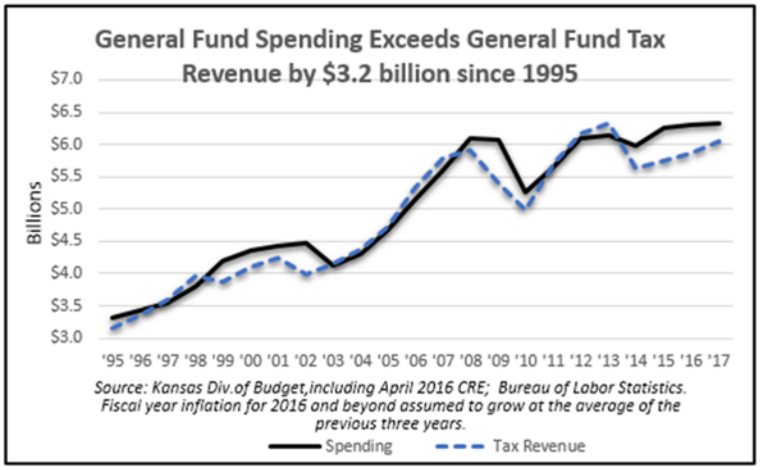


The adjacent graph shows that General Fund spending has grown much faster than inflation over the last 20 years and is now $1.2 billion above inflation-adjusted levels.

General Fund tax revenue has also far outpaced inflation. If inflation continues at the same pace, Consensus Revenue Estimates would put FY 2017 tax revenue 91 percent higher than in FY 1995, with inflation only 57 percent higher. Accordingly, Kansas doesn't have a revenue problem, it has a large spending problem.



In fact, General Fund spending (budgeted through 2017) will have exceeded General Fund tax receipts (April 2016 CRE) by $3.2 billion since 1995.



The gaps between tax revenue and spending have been filled with transfers, interest income and agency earnings to avoid negative ending balances, except in FY 2010 under Gov. Mark Parkinson and State Budget Director Duane Goossen, when the State had an unconstitutional negative ending balance. But filling budget gaps in this manner is not a sustainable model and spending needs to be brought in line.

Proponents of raising taxes will likely skip over the implications for the Kansas economy and say that SB 508 is about tax fairness, but we must respectfully disagree with that positioning. There certainly is a legitimate issue of fairness in not taxing pass-through income and that's one of the primary reasons that Kansas Policy Institute expressed a preference for simply reducing marginal income taxes on all taxpayers when the matter first arose in 2012.

If the purpose of SB 508 was fairness, then all of the fairness issues would be under consideration, including but not limited to:

- KPERS retirees have been exempt from paying income tax on the majority of the pensions for decades. Indeed, an exemption was added in 2013 for retirees of Overland Park police and fire (see exemption xxiii on page 9 of the bill). Private sector employees are fully taxed on their retirement income.
- Commercial and Industrial real estate is taxed at 117% of the effective tax rate on residential real estate, and some real estate is exempt from paying property tax.

- Reversing course on those who moved their families and businesses here as a result of tax reform is certainly not fair to them.

- SB 508 itself contains other tax exemptions.

- Local and state government routinely waive property and sales taxes for select businesses in the name of economic development, which puts their competitors at a disadvantage and causes everyone else to pay more for the ever-growing cost of government.

Much rationale for the existence of these and other examples have been expressed but 'fairness' is not among them.

In our opinion, SB 508 is not about fairness but we would welcome a thorough examination of all of the exemptions and exceptions to paying taxes for the purpose of broadening the base and reducing rates on everyone. To do so with just one issue, however, is neither fair nor beneficial to the Kansas economy.

We oppose SB 508 as it is an unnecessary tax increase and urge you to do so as well.

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[1] U.S. Census, Survey of Public Employment and Payroll (2014); Census 2014 population estimates.

[2] National Association of State Budget Officers; spending from federal dollars and the issuance of bonds are excluded.