

Presentation to House Committee on Taxation

Office of the Secretary  
Sam Williams, Acting Secretary  
January 19, 2017

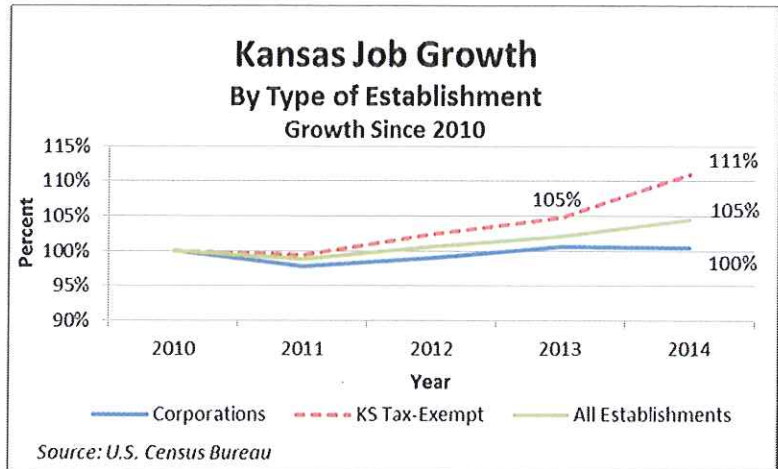


**K**ansas  
Department of Revenue

## Results of Kansas Tax Policy

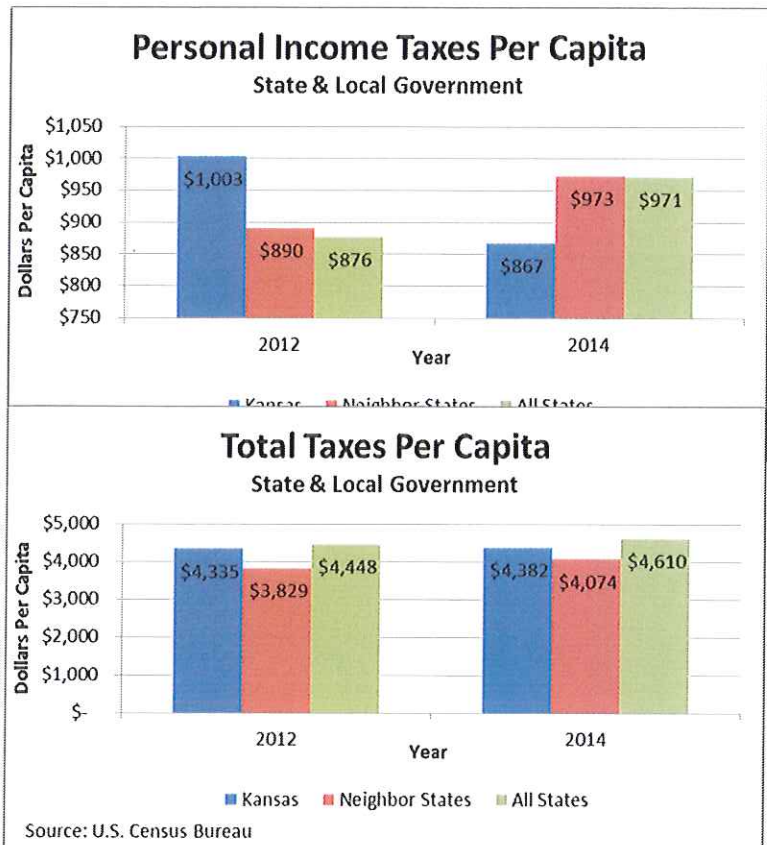
*Kansas's job growth since 2010 is primarily due Kansas tax-exempt businesses, seeing even faster growth after 2013.*

- Kansas job growth is determined by Kansas establishments subject to the income tax exemption. **Without those tax-exempt businesses, Kansas would experience zero job growth, relative to 2010.**
- This same ranking is found when observing Kansas wages. **KS Tax-exempt establishments have seen wages grow 25% above 2010, higher than C-Corps (12%) and the state average (16%).**



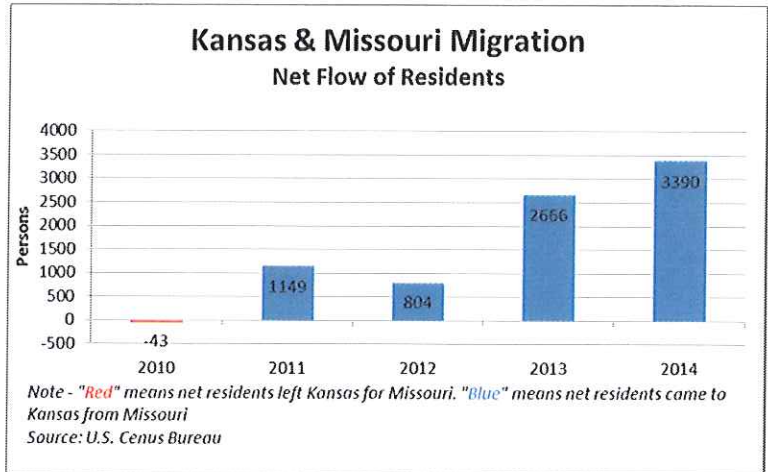
*After tax policy, Kansas takes less from taxpayers than those in the average of neighbor states and all states.*

- In 2012, **Kansas taxed more income out of its citizens than the combined average of neighbor states (13% more) and the average of all states in the nation (14%).**
- In 2014, **Kansas reduced the income tax burden on its citizens and now taxes citizens' income 11% less than neighbors and the average of all states in the nation.**
- **Total taxes per capita have remained steady though the composition of tax burden has changed.**



*Kansas draws in more economic activity from Missouri*

- Since 2011, more people move to Kansas from Missouri than vice-versa. **However 2013 and 2014 saw the largest net influx since 2010.**
- This is very prevalent in the Kansas City area, where **7% income tax rates in KCMO and the lower rates in Kansas, means businesses and people can reduce their tax burden simply by crossing state lines.**



*Kansas runs ahead of the pack in economic activity.*

- Kansas's economic growth into 2016 has put the state ranking higher than the nation and the Plains region.

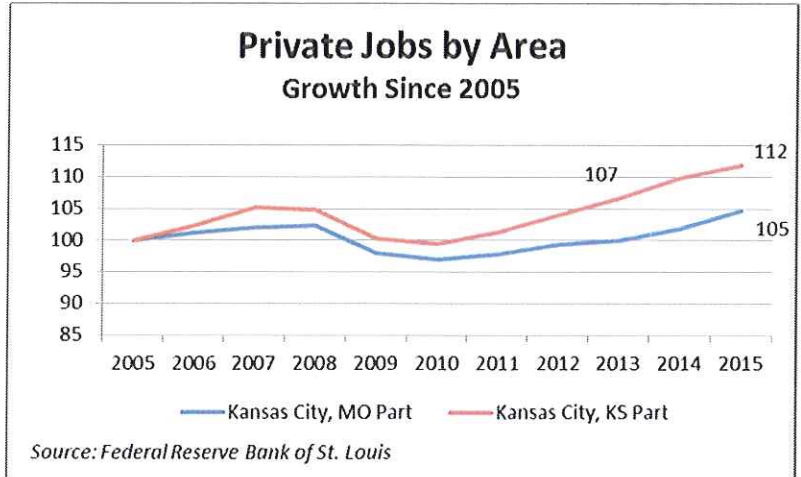
Real Gross Domestic Product		
Annual Growth 2005:Q1 to 2016:Q2		
Area	Growth Rate	State Ranking
United States	1.3%	NA
North Dakota	5.2%	1
Texas	3.4%	2
Oklahoma	2.3%	6
Nebraska	2.2%	7
Colorado	1.8%	9
Kansas	1.6%	13
Missouri	0.7%	37
Nevada	-0.3%	49
Louisiana	-0.4%	50
Plains	1.2%	NA

Note - Data recent as of December 7, 2016  
Source - U.S. Bureau of Economic Analysis

*Kansas City, Kansas Part continues to draw in more new jobs than Kansas City, Missouri Part*

- **Kansas City, KS has added 12% new private jobs than ten years previous, with the tax policy occurring with a faster job growth rate.**

- Over the past ten years, Kansas City, KS part leads the area in new private sector jobs, and the Kansas tax policy has no hindered its performance.



## **KANSAS TAX POLICY AND ECONOMY REVIEW**

- I. Tax Policy Review**
- II. Revenues and Receipts**
- III. The Kansas Economy:  
Latest Economic Conditions, Expected Economic Conditions, and  
Economic Headwinds**
- IV. Small Business Tax Policy**

## **I. Tax Policy Review:**

- Key question – who is best suited to grow the Kansas economy, the government or private sector? The Governor believes it is the private sector, including putting more money back in the pockets of families and assisting business with a good growth environment.
- The Governor proposed and the Legislature passed a new tax policy. Before tax reform Kansas had the 2<sup>nd</sup> highest individual income tax rate in our region. Now Kansas is the second lowest, with Colorado still lower.
- Kansas reduced individual income taxes by an average of 30% for individuals, families and small business. 71% of the tax savings went to individuals and families, putting more money back in their pockets. 29% went to small business.
- Assisting low income families, Kansas has the highest Earned Income Tax Credit in our region.
- Kansas increased the standard deduction for married filing jointly and head of household, the latter helping single parent households. Approximately 80% of Kansans now use the standard deduction.
- 388,000 of lowest income Kansans have been removed from the tax rolls, now with zero tax liability.

## **II. Revenues and Receipts:**

The following three bullet points are centered on State General Fund tax receipts received through the Department of Revenue. This does not include other taxes received by the State, i.e. insurance premium taxes, but reflects a majority of SGF tax receipts. <sup>1</sup>

For notes,

- Total SGF tax receipts comparing actual FY 2015 and FY 2016 receipts = \$58.8 million or 1.1% above last year.
- Total SGF tax receipts for FY 2016 were \$5.6 billion, \$107 million or 1.9% less than estimates.
- State general fund tax receipts comparing fiscal year to date (December) 2017 and 2016 were down \$22.7 million or 0.8%.
- Fiscal Year to Date 2017 state general fund tax receipts were \$2.75 billion, or \$6.9 million (0.25%) above estimates.

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<sup>1</sup> It should be noted that the following equalities hold:

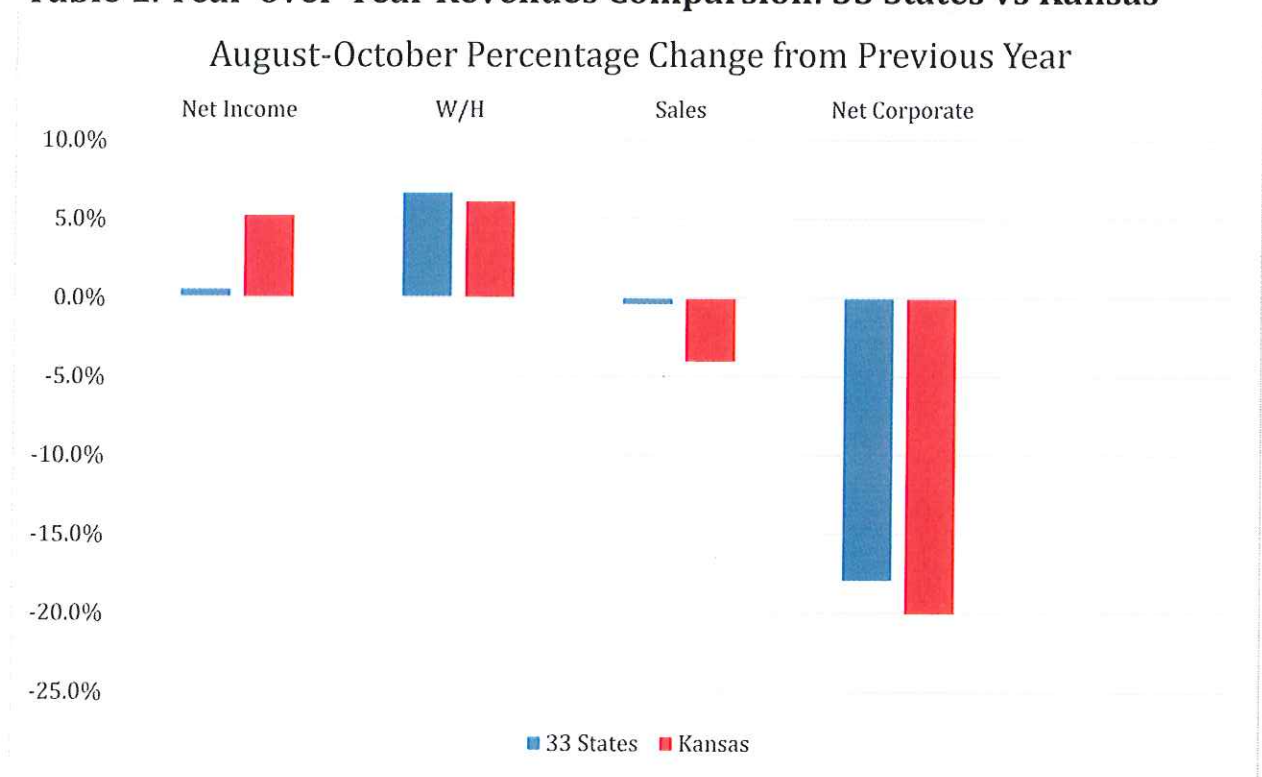
Total taxes = KDOR SGF Tax Collections + Other taxes (Insurance Premiums and Miscellaneous Taxes); and

Total receipts = Total Taxes + Other Revenues (Interest, Net Transfers, and Agency Earnings).

## November 2016 Consensus Revenue Estimating (CRE) Group Meeting

- The Consensus Revenue Estimating Group meets in April and November to make estimates/adjustments. Adjustments were made in July 2016 in response to legislative changes.
- The FY 2016 total taxes were \$5.76 billion, 1.8% below estimates.
- The November 2016 Consensus Revenue Estimating Group revised down the FY2017 estimate for total taxes by \$354.9 million or 5.9%, while the estimate for other revenues was increased by 3.1%. As a result, the estimate of total receipts was decreased by 345.9 million, or 5.5% below the 2016 July estimate. The revised FY2017 forecast represents a 1.5% decrease from the FY2016 total receipts.
- Total taxes for FY2018 and FY2019 are estimated to grow at the pace of 1.4% and 2.2%, respectively.

**Table 1. Year-over-Year Revenues Comparision: 33 States vs Kansas**



August-October Percentage Change from Previous Year

	Net Income	W/H	Sales	Net Corporate
33 States	0.5%	6.6%	-0.4%	-17.9%
Kansas	5.2%	6.1%	-4.0%	-20.0%

## Comparison of Major Tax Receipts across Six States Updated through November 30, 2016

### Description of Report

This report provides a comparison of the growth rates of three major tax revenues across Kansas and other 5 neighboring states. The three tax revenues are Sales & Use tax, Personal Income tax and Corporate Income tax. Table 2 presents a year-over-year comparison of tax receipts, that is, November 2015 to November 2016. Table 3 presents a fiscal-year-to-date comparison between fiscal years 2016 and 2017.

Due to large variations in the sample, we report a median of five neighboring states (excluding Kansas) as well as a mean for our comparison purpose.

### Notes in Tables 2 and 3

1. Missouri and Iowa report gross tax receipts while the other states report net receipts (gross receipts minus refunds). The information on Colorado's monthly receipts is not available.
2. Any statutory changes must be taken into account over the comparison. Effective in July 2015, Kansas increased its statutory statewide sales/use tax rate from 6.15% to 6.5% (a 5.7 % hike) in addition to the statutory change in sales tax disposition to the state highway fund and general fund. The total statutory adjustment used in the report is 6.8%. The adjusted number is given in parentheses.
3. Source: Kansas Department of Revenue, Missouri Department of Administration, Nebraska Department of Revenue, Oklahoma Office of Management and Enterprise Services, Iowa Legislature, Arkansas Department of Finance and Administration, and author's calculation.

**Table 2. November Year-over-year Change in Revenues\*\***

State <sup>1</sup>	Sales & Use <sup>2</sup> Tax	Personal Income Tax	Corporate Income Tax
Kansas	-5.3%	-5.3%	-616.9%
Missouri	12.2%	1.1%	-54.8%
Nebraska	-3.6%	2.4%	-176.9%
Oklahoma	-5.9%	1.1%	0.0%
Iowa	-6.3%	4.3%	-3.3%
Arkansas	-0.2%	-3.4%	NA*
Median - 5 states	-3.6%	1.1%	-29.0%
Mean- 5 states	-0.8%	1.1%	-58.8%

\*For Arkansas's corporate income tax, the percentage growth is not computable because of the negative value in 2015 and positive value in 2016.



**Table 3. Fiscal Year to Date Change in Revenues**

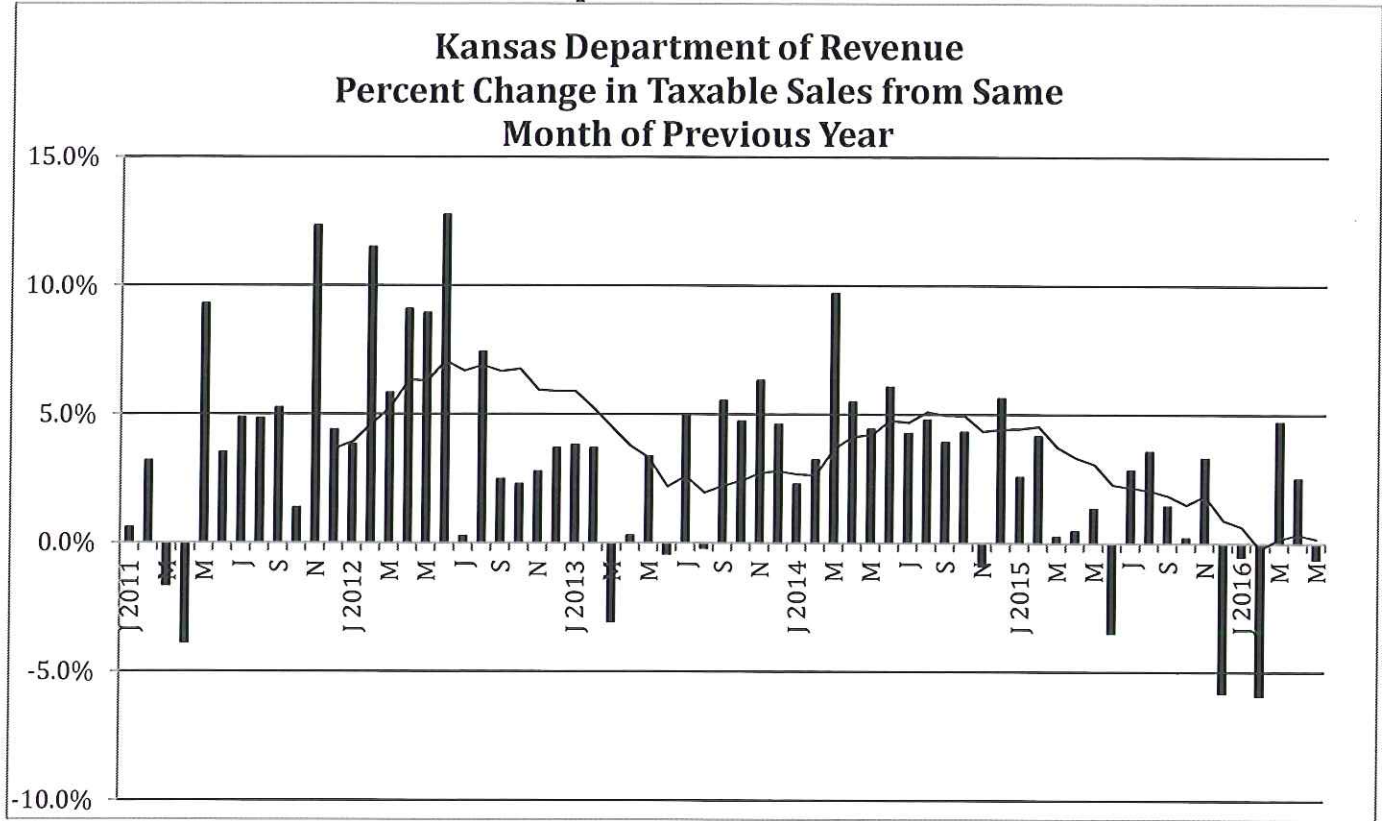
State <sup>1</sup>	Sales & Use <sup>2</sup> Tax	Personal Income Tax	Corporate Income Tax
Kansas	-2.5%	3.6%	-31.5%
Missouri	4.2%	4.2%	-27.6%
Nebraska	-0.1%	4.1%	-48.0%
Oklahoma	-6.3%	-9.3%	-60.4%
Iowa	0.4%	3.2%	-5.7%
Arkansas	-0.2%	3.3%	4.4%
<b>Median - 5 states</b>	<b>-0.1%</b>	<b>3.3%</b>	<b>-27.6%</b>
<b>Mean - 5 states</b>	<b>-0.4%</b>	<b>1.1%</b>	<b>-27.5%</b>

### Analysis

In Kansas, November receipts of sales/use taxes and individual income taxes were down 5.3% compared to the previous year, lower than other states' mean and median. Corporate income tax receipts were down 616.9% compared to a year ago.

A fiscal-year-to-date change in Kansas sales & use tax receipts was -2.5%. Corporate income taxes fell 31.5% compared to the same period in fiscal year 2016. In contrast, FYD Kansas personal income tax receipts increased 3.6%.

**Table 4. Year-over-Year Sales Comparison**

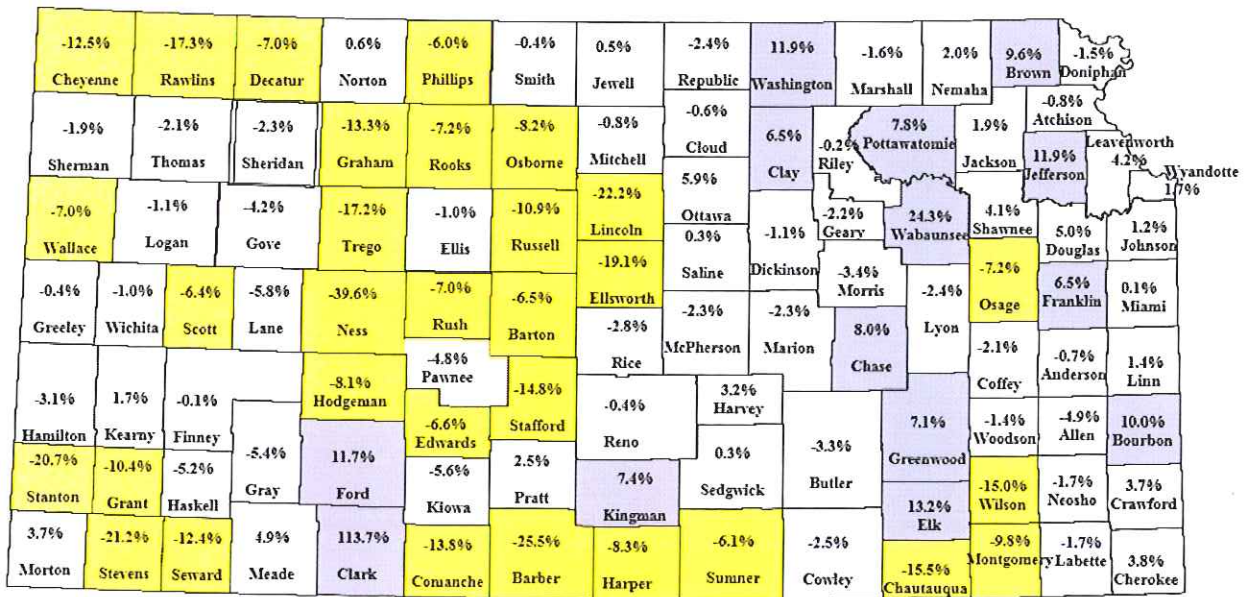


**Table 5. Comparison of Sales Tax Collections by County**

State Sales Tax Collections, Percent Change by County  
Fiscal-Year-to-Date 2017/2016 percentage change  
(July - September 2016)

The sales tax rate increased from 6.15% to 6.50% July 1, 2015.  
A total statewide .5% increase was reported for July-September 2016 vs July-September 2015.

Legend  Counties with an increase of 6.0% or greater  
 Counties with a decrease of 6.0% or greater



### **III. The Kansas Economy**

#### **A. Latest Economic Conditions\***

- The Bureau of Economic Analysis (BEA) has reported that the Kansas real Gross Domestic Product grew at an annualized rate of 2.3% in the second quarter of 2016. This growth was the second highest in the Plains regions and the sixth highest among 50 states. For 2015, Kansas real GDP was 0.8% higher than 2014 levels.
- According to BEA, Kansas Nominal personal income grew at a quarterly rate of 1.0% in the third quarter of 2016, 0.3 percentage points lower than in the second quarter of 2016. This growth was the fifth highest among seven Plains states, 31st highest among all states.
- BEA has reported that the Kansas population increased to a quarterly rate of 0.1% in the third quarter of 2016.
- According to Kansas Department of Labor, the November 2016 unemployment rate (seasonally adjusted) was 4.3%.

#### **B. Expected Economic Conditions for 2016-2018: Moody's Analytics Baseline Scenario\***

- Moody's Analytics Baseline Scenario estimates that the Kansas real Gross Domestic Product grows at the rate of 2.53% for 2017 and 3.28% for 2018.
- Kansas Nominal Personal Income is estimated to grow at a rate of 2.5% for 2016, 4.6% for 2017, and 5.8% for 2018.
- Kansas Nominal disposable income per capita is estimated to increase at a rate of 2.7% for 2016, 4.2% for 2017, and 6.1% for 2018.
- The Estimated percentage growth of the Kansas Population is 0.56% for 2016, 0.65% for 2017, and 0.67% for 2018.
- Kansas total nonfarm and private jobs are expected to increase by 1.15% in 2017 and 1.71% in 2018.

\*Any economic statistics may be subject to subsequent revisions by governmental Agencies or Private research company.

### C. Economic Headwinds

- **Employment:** The November unemployment rate in Kansas was 4.3%. Employment affects withholding tax receipts, which over this fiscal year have been good, with some “blips” in February as an example, when we saw a decline in withholding receipts. KDOR contacted companies with larger reductions in payments and found three primary reasons; 1) a large layoff by a telecommunications company of over 800 employees which was approximately 20% of the reduction in receipts; 2) no overtime this year; and 3) no bonuses this year.
- **Exports:** According to the Kansas City Federal Reserve Bank’s December 2016 Databook, Kansas exports were 9.6% lower in the third quarter of 2016 compared to the same period in 2015. The decline represents an approximate \$268 million hit on the Kansas economy. This has a dynamic effect on our manufacturers and agriculture industries in particular.
- **Oil:** According to the Kansas City Federal Reserve Bank’s December 2016 Databook, September 2016 crude oil production was down 20.5% over last year, and rig counts are zero as of November 2016, compared to 10 rigs of the previous year. The decline in KS Common Oil Price per barrel is evident when comparing per barrel prices each September for the last three years –September 2014 = \$82.85 a barrel; September 2015 = \$35.49 per barrel; and September 2016 = \$35.26 per barrel. In December 2016, the price is at \$42.47 a barrel. (Source: Kansas Department of Revenue, Division of Property Valuation)
- **Agriculture:** Kansas is an important agricultural state, ranking seventh for total agricultural production. According to the July 2016 Federal Reserve’s Beige Book report, farm revenue is rising modestly, providing relief to persistently weak profit margins. Kansas Department of Agriculture economists estimate that for every 1% decrease (increase) in agricultural prices there is a corresponding \$7,794,029 decrease (increase) in state sales tax receipts. The Kansas Farm Management Assn. reports that over the past five years accrual net farm income averaged \$120,000. In 2015 the accrual net income dropped dramatically and was \$4,568.
- **Aerospace:** Moody’s Analytics February 2016 states, Kansas’ large aerospace industry had made little headway in recent quarters, but growth is set to resume later in 2016.
- **Consumption/Sales Tax Receipts:** Certainly the economy and all the aforementioned economic headwinds effect spending by Kansans. Table 5 is a colored coded county-by-county map of Kansas reflecting state sales tax collections from July 2015 to September 2016. Any county with over 6% growth is shaded in blue and those with a decline of greater than 6% are shaded in yellow. Note the significant declines in collections in counties most affected by the oil and agriculture industries.

There is also a national caution in consumption. Most mentioned reasons include increased savings, debt reduction, increased health care costs and increased on-line purchasing.

- **Plains Region:** November 2016 Beige Book reports that the 10<sup>th</sup> District experienced slightly increased economic activity compared with the previous survey, with mixed conditions across sectors.  
“Consumer spending activity increased slightly. Professional and high-tech firms reported considerably higher sales, and bankers reported steady loan demand, stable deposit levels, and

unchanged loan quality. Energy activity rose modestly, and District manufacturing firms reported slight expansion. Transportation and wholesale trade activity declined moderately from the previous survey period, and agricultural credit conditions remained weak, with falling farmland values and continued low commodity prices. Contacts in many industries reported a slight increase in wages, and workers in certain skilled occupations were in short supply.”

- **U.S.:** U.S. real Gross Domestic Product increased at a 3.5% annual rate in the third quarter of 2016, after increasing 1.4% in the second quarter. “The increase in real GDP in the third quarter primarily reflected positive contributions from personal consumption expenditures, exports, private inventory investment, nonresidential fixed investment, and federal government spending that were partly offset by negative contributions from residential fixed investment.”

Moody’s Investors Service reports that in 2016, tax revenues are slowing for most states, growing at an annual rate under 4%.

U.S. gained 156,000 jobs in December 2016 (BLS report). The U.S. unemployment rate is at 4.7%. The labor-force participation rate stayed at 62.7%, changed little in December.

#### IV. Small Business Tax Policy:

Small business is the “back bone” of the economy. According to the Bureau of Labor Statistics BED, 60% of the private sector’s net new jobs have been created by existing small business and about 40% from the “churn” of startups minus closures. Many of these are the businesses we deal with every day in our local communities. Since the recession, in particular, small business has had a hard time finding capital to grow making it hard to add jobs or make capital investments.

Beginning in 2013, Kansas eliminated the individual income tax on business income earned in sole proprietorships and pass-through entities (S corporations, partnerships, and limited liability companies), as well as royalty, rental income and farm income.

Business income from sole proprietorships reported on Schedule C of the business owner’s Federal Form 1040, line 12 is exempt from Kansas income tax. The law also exempts from income tax, all non-wage income received from a pass-through entity (partnership, S corporation, or LLC taxed as a partnership or S corporation) which is reported on Schedule E of the individual owner’s Form 1040, line 17. Net farm income reported on Schedule F of the individual owner’s Form 1040, line 18 is also exempt from Kansas income tax.

- Net first time small business tax filings in combined 2013 and 2014 = 20,412. First time filers means their social security number, name or name of the business have not previously appeared on a Kansas tax return.
- New income to Kansas from first time filers = over \$1.13 billion, of which \$899.47 million was considered as taxable income to Kansas.

For TY 2013, there were 8,666 new filers in the State of Kansas.

For TY 2014, there were 11,746 new filers in the State of Kansas.

- Overall breakdown of small business tax filers (including existing and new):

\$25,000 or less in net income = 81%

\$25,000 to \$75,000 in net income = 12%

\$75,000 or more in net income = 7%

- In 2013 Kansas saw a positive reversal in migration of wealth between Kansas and Missouri. Currently, according to IRS data, Kansas holds a nearly \$85 million advantage in income gains from Missouri, a significant reversal from 1995 to 2009 when more than \$263 million left Kansas for Missouri. Correlation between this reversal and the institution of the small business tax policy?

**Pass-Through Business Entities Outlook** (core entity, excludes sole proprietorships, partners, shareholders).

	Number of Entities*	Number of W-2's **	Gross Wages
TY 2007	74,648	449,047	\$7,093,822,068
TY 2008	77,053 3.2%	465,665 3.7%	\$8,067,357,464 13.7%
TY 2009	78,348 1.7%	420,814 -9.6%	\$7,953,514,696 -1.4%
TY 2010	80,278 2.5%	469,386 11.5%	\$9,191,452,879 15.6%
TY 2011	82,616 2.9%	508,449 8.3%	\$10,231,458,075 11.3%
TY 2012	85,400 3.4%	536,946 5.6%	\$11,090,310,462 8.4%
TY 2013	87,943 3.0%	579,002 7.8%	\$11,937,866,014 7.6%
TY 2014	90,084 2.4%	605,943 4.7%	\$12,587,097,859 5.4%

\*Number of entities represents core business and this number does not include sole proprietorships, partners, shareholders, etc. We have reported 331,173 entities taking advantage of the small business tax policy. As reported above in 2014, 253,084 are small businesses and the balance are farmers.

\*\*Number of W-2s does not represent the number of jobs, i.e. there could be multiple W-2s for the same individual or duplicate W-2s.

## C-Corporations Outlook

	Number of Entities*	Number of W-2's	Gross Wages
TY 2007	30,075	429,587	\$11,184,942,564
TY 2008	29,431 -2.1%	426,525 -0.7%	\$11,706,742,107 4.7%
TY 2009	28,810 -2.1%	377,757 -11.4%	\$11,219,432,122 -4.2%
TY 2010	28,532 -1.0%	392,617 3.9%	\$11,946,362,252 6.5%
TY 2011	28,240 -1.0%	412,951 5.2%	\$12,863,710,506 7.7%
TY 2012	28,187 -0.2%	425,591 3.1%	\$13,788,502,128 7.2%
TY 2013	27,532 -2.3%	418,406 -1.7%	\$13,365,344,975 -3.1%
TY 2014	26,949 -2.1%	415,195 -0.8%	\$13,220,435,012 -1.1%

\*Number of W-2s does not represent the number of jobs, i.e. there could be multiple W-2s for the same individual or duplicate W-2s.



## C-Corporations Outlook – W-2's Associated with "Switchers"

	Number of Entites that switched to Pass-Through Entity**	Share of Switchers	Number of W-2s	Gross Wages
TY 2010	346			
TY 2011	353	1.2%	4,709	\$152,820,909
TY 2012	343	1.2%	5,683	\$149,895,897
TY 2013	575	2.0%	9,020	\$285,736,307
TY 2014	369	1.3%	4,649	\$151,303,312

\*\*These C-Corp entities filed under the same FEIN and switched to a pass through entity filing a K-120S which per federal law claim and pay taxes on wages, dividends, capital gains etc. A small number of those entities switched back to a C-corporation in the later years.