

**Testimony before the House Committee on Taxation in support of HB 2023**

**By Mark Hutton**

**January 19, 2017**

Chairman Johnson, Vice Chair Phillips, and members of the House Committee on Taxation.

My name is Mark Hutton. I am the founder of Hutton Construction Corporation located in Wichita Kansas. We are a general contractor employing approximately 250 men and women that work throughout the Central United States constructing over \$200 million a year in commercial, institutional, healthcare, and industrial projects.

I started this company back in 1992 as the sole employee and understand what it takes to start and grow a business in today's complex environment of government regulations and market challenges.

I'm here today to testify as a proponent of HB 2023. My journey from an ardent supporter to an opponent of this tax policy began two years ago as I sat on this very committee and listened to the Department of Revenue's presentation showing the distribution of the tax savings among the 330,000 business tax filers. It was an eye opening presentation that led me to believe that this portion of the 2012 tax plan was ill conceived and would not have the promised effect of job creation.

Over these last years, as the drumbeat to repeal this policy grew louder and louder, so have the efforts to either justify it as an effective policy or explain away why it hasn't worked.

Since 2012 the citizens of Kansas have waited for results. They have endured income tax increases due to lost deductions and suspended rate decreases. They absorbed the repeal of a promised sales tax rate rollback, and then a year later a sales tax increase along with various other "revenue enhancements". Over the last 4 years they watched as multiple promises were broken so the 330,000 business tax filers could keep their exemption.

The most recent effort comes to us from Arizona State University via the Kansas Policy Institute. Entitled "A Thousand Flowers Blooming: Understanding Job Growth and the Kansas Tax Reforms" it's a report that I think bears discussion.

Early in the report the authors make the following quote:

"In tax policy, patience is a virtue. It can take upwards of five years for tax a policy's effect to be fully seen".

Now I for one was glad to see that statement because now have a timeline to gauge our progress. In 5 years we can expect to see the full results of this policy. We won't have to wait long because 5 years is up at the end of this year.

The authors go on to discuss how the data indicates that the bulk of new job growth in Kansas occurred in pass through entities. That's not a big revelation – it's a well-known fact. According to the Tax Foundation the number of pass through entities grew 175% across the nation over the past 30 years while formations of C-Corporation fell as a result of the tax reform passed in the 80's.

They also address the claim that C-corporations are changing to pass through entities for tax purposes with data that supports their position that this has not been a big problem in Kansas. While this may be true I would point out that it is more likely that companies used a pass through entity when they made an acquisition or created a new business unit. Accountants tell me that this is done all the time and is far less complicated than electing to what the authors label as "corporate switchers".

The authors then take a new tact when they make the case that we've been using the wrong data to measure our job creation progress. Their point is that the Bureau of Economic Analysis data is superior over the more current Bureau of Labor Statistics reports because it does a better job of counting the self-employed. Frankly they make a fair case for their argument but the problem with BEA's reporting is that it lags behind the BLS data by as much as a year, resulting in a less clear picture of our current economic health.

So, why does all of this matter? The authors believe it matters because job growth generally occurs in the small business sector and these are almost always pass through entities. I agree but have a problem with their assumption that a self-employed person, operating as a pass through entity is a job created and that is not necessarily the case. Remember the revelation last year that Bill Self was an LLC? That's just one example of how sometimes employers contract with individuals instead of hiring them but that doesn't mean a job was created – it was just shifted to a different type of employer relationship. Many pass through entities, created for business holdings like real estate transactions will never hire a single employee.

The authors then attempt to correlate the growth in pass through entities to the growth in employment. To establish their case, they selected peer states to compare our private sector employment growth, and then they attempt to correlate job growth in Kansas to the 2012 tax policy. The problem is that the data doesn't do a very good job of supporting their assumption. For instance, in 2012 – 2014 Kansas, at 8.4% growth actually grew slower than peer states Nebraska and Missouri and they have top income tax rates of 6.84% and 6% respectively. The authors attempt to deflect this obvious problem with another analysis based on per capita job growth but the reality is hard to deny that both Nebraska and Missouri created more jobs while taxing those job creators.

Since 2013 the tax payers of this state have paid almost a billion more in taxes with the promise of job growth. So the billion-dollar question is has the 2012 tax policy affected the job growth trend in Kansas? In my opinion the answer is no and here's why.

If you look at the graph of employment data from the BLS you will see that job growth in Kansas has been at virtually the same annual rate since 2010. More importantly there was no perceivable change in the pace of job growth due to the 2012 tax plan. Remember the authors call for "patience"? That report told us that the longer this policy is in place the better the results should be. With less than a year left on their 5-year predication shouldn't we be seeing marked improvement by now? It should be obvious if it's working. Instead it's obvious that it's not.

But what about the wrong data argument? Are we missing jobs in the BLS report that are counted in the BEA report? I thought that is a good question so I graphed the data from the BEA report for Kansas and our peer states, Nebraska and Missouri. Also, for fun, I added the same BLS data from the top graph so we could compare the two data sources side by side. Again there was no perceptible change in employment trends after the tax policy took effect.

This indicates to me that the 2012 tax policy is not working. That's no surprise because the whole premise of the policy is based on the myth that if a company has extra money it will hire people regardless of if they have something for them to do or not.

This belief of the authors is evident when they state: "Critics have attempted to claim that the tax savings for most filers could not possibly have led to job creation but no such determination can be made from taxable income data, as that is what is left after a business may have hired more people or made other investments in the business."

So let's think about that statement for a moment. Based on that logic and the premise that this tax policy is an incentive for business growth, a business owner would make an investment in their business with no expectation of a return on that

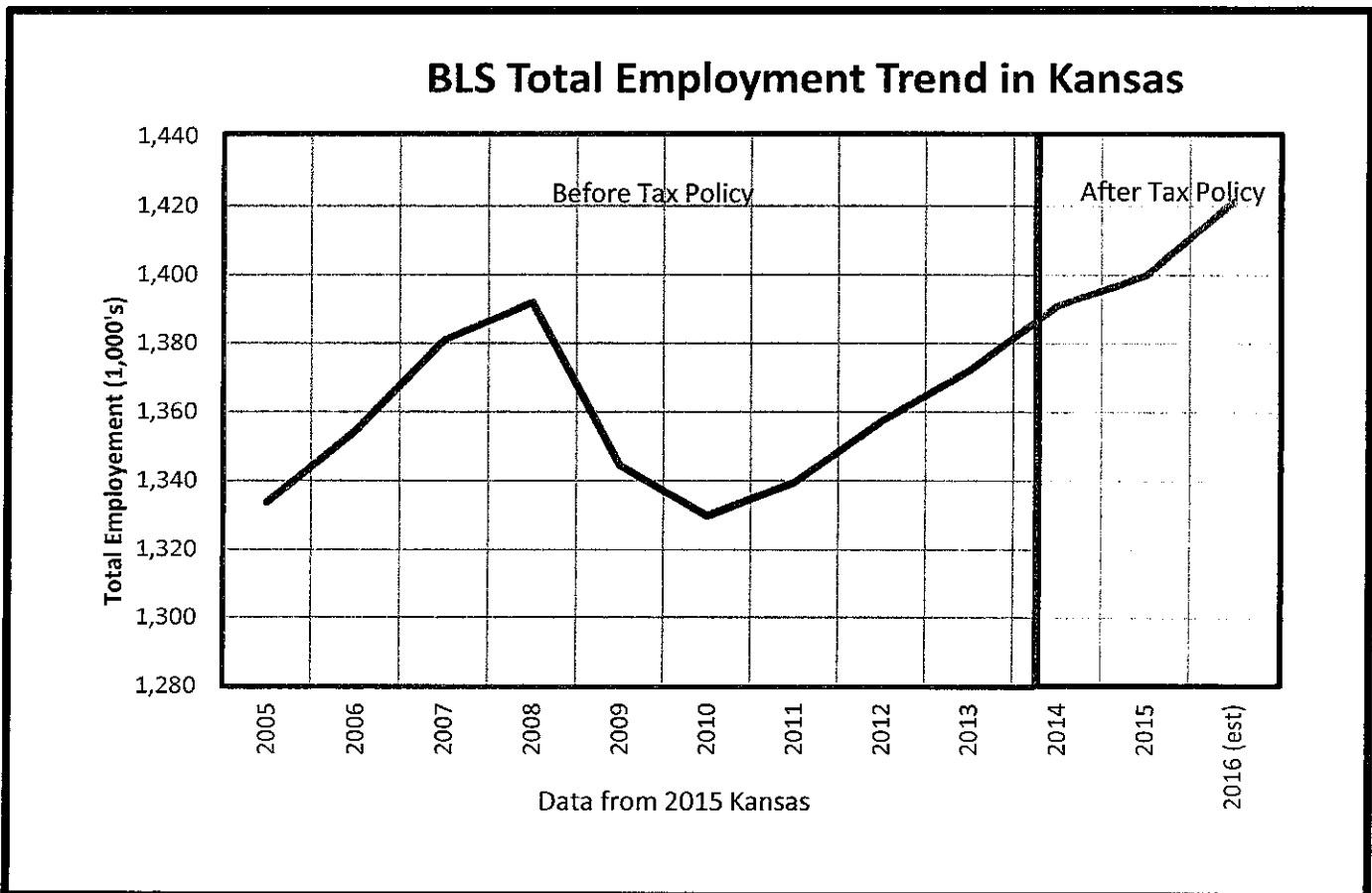
investment so they can lower their tax liability. Now it's been pointed out before that I'm not an economist and I readily concede to that. But I am still a business man and I have to ask - what company does that? What business owner would increase their overhead so they would make less profit and pay lower taxes – in a state that doesn't tax that income?

How many times does it have to be said? Companies don't hire for the sake of hiring – they expect a return on their employees and equipment. If I hire an employee or invest in a piece of equipment it's so I can make more money, not to avoid paying state taxes.

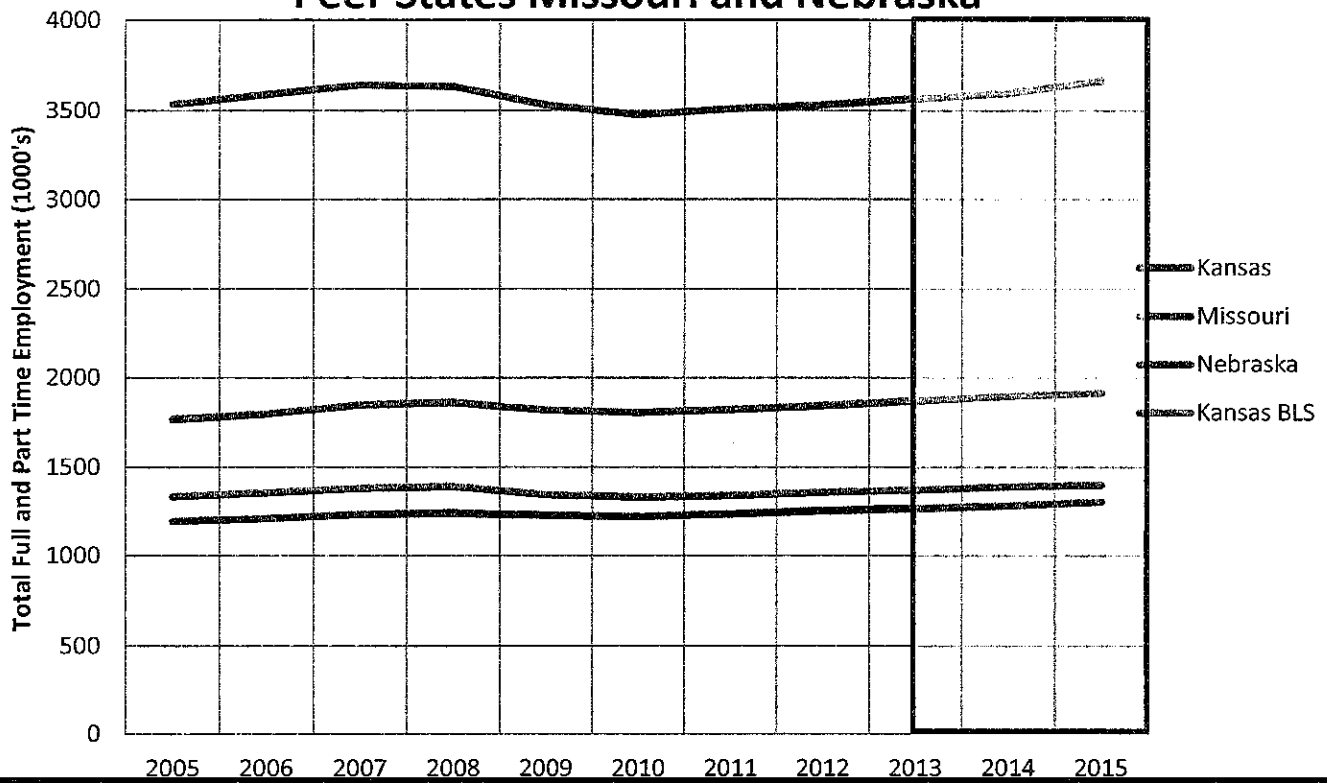
I've asked multiple CPA's about their experience with clients in regards to this policy and I have not found one yet that says they have ever had a client that hired or added equipment to save money on their state taxes. It's demand for a product or service that creates jobs – not extra cash.

I could go on but time precludes it so I'll close with one last thought. My desire to see this policy reversed has little to do with bringing in more tax revenue. For me it's about having a balanced tax policy that respects all of the taxpayers in this state. When we lower or eliminate a tax on one segment of taxpayers with absolutely no requirements to earn that special status and then raise taxes on the rest of the taxpayers to support that policy we are picking winners and loser with our tax code. We are telling hard working individual taxpayers who for various reasons do not enjoy a pass through income that they aren't as important. If you want to incentivize job creation, then do it with a policy that rewards industry when it creates jobs and make it measurable. Let's stop prepaying for something we may never receive.

Thank you for your time and patience today. Mr. Chairman, I will stand for questions at the appropriate time.



## BEA Data Comparison of Kansas Total Employment to Peer States Missouri and Nebraska



## BEA Personal Income for Kansas

