KANSASCHAMBER
UNITED FOR BUSINESS

House Committee on Taxation
Testimony in Support of Senate Bill 22
Presented by Eric Stafford, Vice President of Government Affairs

Wednesday, February 20, 2019

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 support of Senate Bill 22.

SB 22 was introduced in response to the "federal windfall" Kansas is expected to receive as a result of Congress passing the tax cuts and jobs act (TCJA) in December of 2017. SB 22 addresses both individual and corporate income tax provisions.

TCJA nearly doubled the standard deduction for individual tax filers. The standard deduction for married filing jointly increased from $13,000 to $24,000. According to a Tax Foundation article, "The Joint Committee on Taxation estimates that the number of filers who itemize will fall from 46.5 million in 2017 to just over 18 million in 2018, meaning that about 88 percent of the 150 million households that file taxes will take the increased standard deduction."

While this change is a great benefit at the federal level for individual taxpayers, it creates an unintended consequence in Kansas due to the greater discrepancy between the new federal standard deduction and Kansas' $7,500 deduction for married filing jointly. That causes an increase in Kansas taxpayers state income tax liability because current law prohibits taxpayers from itemization if they do not itemize at the federal level. SB 22 addresses this by allowing individuals the chance to itemize on their state return if they use the federal standard deduction.

Regarding corporate income tax reform under TCJA, business tax reform efforts were created to eliminate disincentives to invest and create jobs in the United States and lowered rates through base-broadening provisions. Much like the individual income tax components, lack of action by states will result in an unintended tax increase on businesses at the state level. Some of these provisions would include taxation of foreign income, something Kansas has not historically taxed (Kansas *has* taxed foreign dividend income).

We are asking this committee and the legislature to adopt these key provisions which decouple Kansas tax code from federal changes.

Those corporate income tax provisions included in SB 22 are:

- IRC 965(a) and 965(c) (repatriated income)
- IRC 951A, 250(a)(1)(B)(i) or GILTI as it is known
- IRC section 163(j) on interest limitation deductions
- IRC 118- capital contributions
- IRC 162(r)- FDIC premiums.

Ultimately, TCJA moves business taxes from a worldwide taxation system to a territorial system reflective of the global environment. As previously mentioned, these provisions were created and implemented to help pay for the reduction of the federal corporate income tax rate passed by Congress to improve the tax climate of the United States. Again, this income has never been subject to Kansas corporate income tax before and failure to address these provisions would place Kansas as an outlier and diminish the competitiveness of our state's tax policy.

We urge this committee to support Senate Bill 22 as introduced. Thank you for the opportunity to testify in support of Senate Bill 22 and we are happy to answer questions at the appropriate time.

STATE TAXES AFTER REFORM
PARTNERSHIP

Conformity is a **tax increase** on Kansas businesses.

Blindly Conforming to the Internal Revenue Code is NOT the Right Answer.

- Generally speaking, conformity with the Internal Revenue Code (IRC) eases administrative burdens for both business and States and promotes compliance with State taxes.
- **But the federal Tax Cuts and Job Act (TCJA) is radically different.** The TCJA represents the biggest change in business taxes since the corporate income tax was initially created. It is fundamentally different than any corporate income tax system that has ever been imposed in the United States. Indeed, it is unique from a global perspective: no other country imposes a corporate income tax like the TCJA.

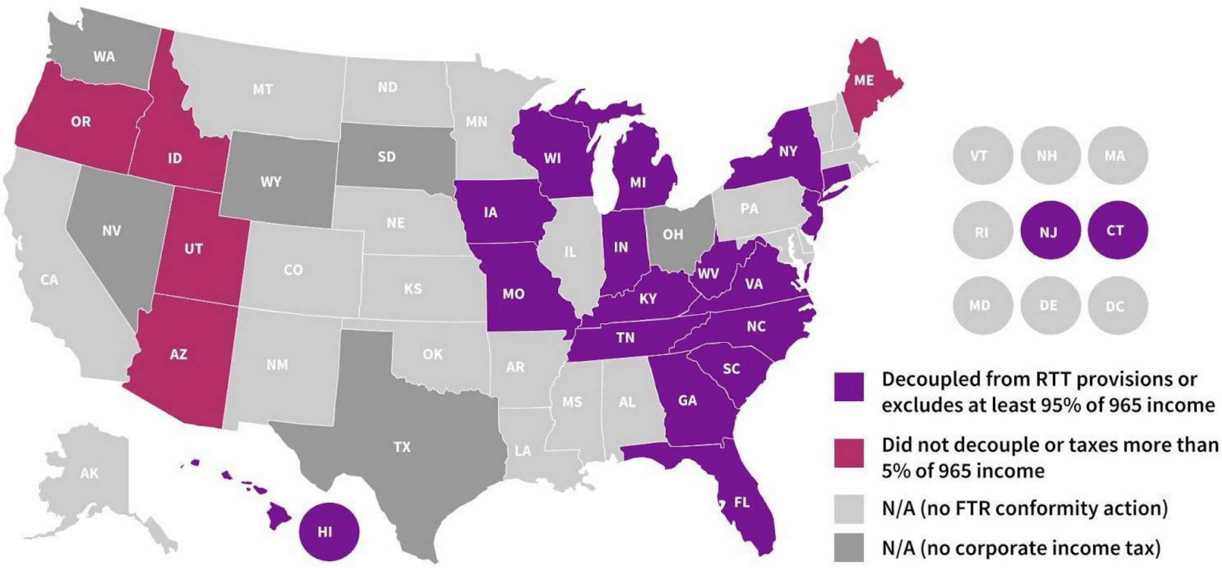
For Businesses, Conformity Without Modification is a SIGNIFICANT TAX INCREASE.

- The single most important fact to understand is that blind conformity to the corporate income tax changes imposed under the TCJA will always result in a state tax increase absent a proactive response. The reason is simple. The federal government significantly reduced the corporate income tax rate, from 35% to 21% (a 40% reduction in the top rate), but at the same time broadened the tax base.
- **States which "conform" to the new, broader federal corporate income tax base, but which do not reduce rates, will automatically and significantly increase business taxes – by 12% on average.**

The RIGHT Answer is to Decouple from Federal Base Broadening Provisions.

- The overarching goal of the business tax reforms was to remove disincentives to invest and create jobs in the United States for all businesses. States which choose to conform to the broader corporate income tax base are instead imposing new barriers to investment and job creation. And although lowering state corporate income tax rates might sound like the right answer, it is not: the federal base broadening provisions mainly relate to *foreign* income, which is generally not subject to state taxation.
- Thus, for policymakers who support improving the economic climate and encourage investment and job creation, **the path forward is simple: decouple from the federal corporate income provisions which broaden the tax base.**

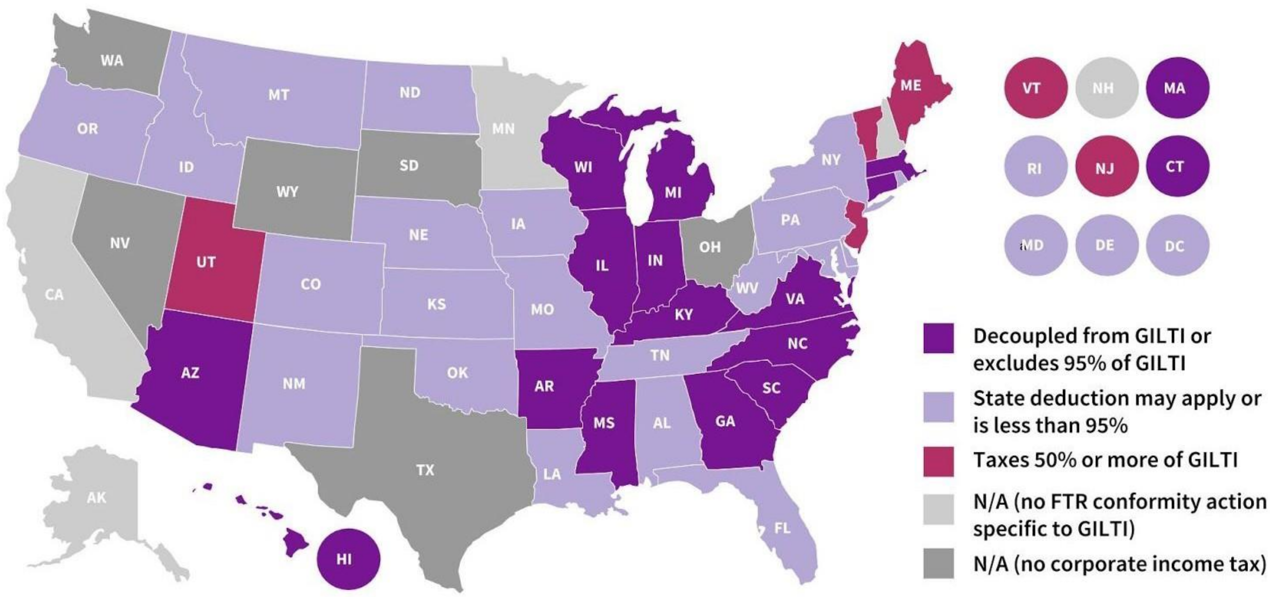
Repatriation Transition Tax (IRC § 965)



- Kansas should follow the example of 17 other states, including Iowa and Missouri, which have already acted this year to exclude deemed repatriated foreign earnings from the state's tax base. (Current Kansas law includes at least 20% of foreign earnings deemed repatriated under IRC § 965 in the state tax base.)
- At the federal level, the repatriation transition tax was designed to effectuate the change from the nation's historical world-wide system of taxation to the territorial system in the Tax Cuts and Jobs Act. Kansas never had a world-wide system of taxation and, thus, the deemed repatriation of foreign earnings has no purpose in Kansas.
- Excluding the deemed repatriated foreign earnings from the tax base is generally consistent with Kansas' historic policy of not taxing a taxpayer's world-wide income.

Responding to Federal Business Tax Reform: Guidelines for Kansas

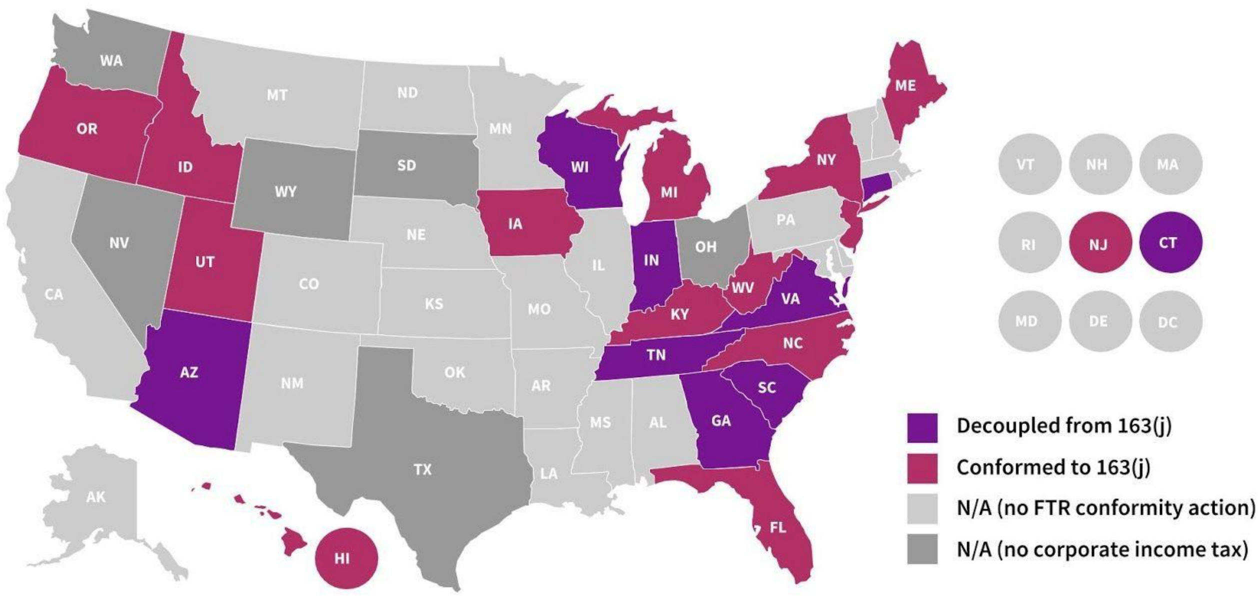
Global Intangible Low-Taxed Income (IRC § 951A)



- Thus far in 2018, 15 states have completely or nearly completely excluded so-called “Global Intangible Low-Taxed Income” (GILTI) from their tax base; based on Missouri’s recent guidance regarding the repatriation transition tax, Missouri is also expected to exclude GILTI.
- Existing Kansas law includes at least 20% of GILTI in the state tax base. Kansas should follow the example set by other states this year and completely exclude GILTI from its tax base. Oppose Kansas’ taxation of any portion of GILTI.
- Excluding GILTI from the state tax base (or providing a 100% deduction for GILTI) is consistent with Kansas’ historic policy of not taxing income earned by a foreign corporation. Furthermore, Kansas does not provide a foreign tax credit, so inclusion of GILTI would tax much more than income earned in “low-tax” jurisdictions.

Responding to Federal Business Tax Reform: Guidelines for Kansas

Interest Expense Limitation (IRC § 163(j))



- Eight states, including Indiana, Tennessee, and Wisconsin, have already decoupled from the new federal interest expense limitation. Kansas should follow their lead.
- Adopting the federal limitation increases the cost of capital and of doing business in Kansas and could encourage businesses to move to states with more favorable tax laws.
- The new federal limitation was coupled with a 40% tax rate reduction; because taxpayers are not benefitting from a tax rate reduction in Kansas, there is no rationale for adopting the new federal limitation.
- Conforming to the new federal limitation would be an administrative nightmare for both taxpayers and the state; the federal computation would not translate to Kansas' tax structure and thus would require significant and inherently controversial rulemaking as we as complicated Kansas-only computations.

Responding to Federal Business Tax Reform: Guidelines for Kansas

Capital Contributions (IRC § 118)

- It is nonsensical for Kansas to adopt this federal provision as it would mean that the state would be imposing tax on state and local incentives designed to grow investment and jobs in Kansas.
- Although this provision has received relatively little attention to date, several states, including Georgia, South Carolina, and Tennessee, have already decoupled from this federal code section.

FDIC Premiums (IRC § 162(r))

- This federal provision disallowing the deduction for FDIC fees was included purely as a means of raising revenue to offset the 40% cut in federal corporate rates. Because taxpayers are not benefitting from such a reduction in Kansas, there is no rationale for limiting the deductibility of FDIC fees.
- Understanding the negative impact of this provision on financial institutions with a significant presence in their states, South Carolina and Wisconsin have already decoupled from tax on FDIC fees.