

**Testimony of  
Michael Mazerov, Senior Fellow, Center on Budget and Policy Priorities  
Before the  
Kansas House Committee on Taxation  
In Opposition to H.B. 2421 and S.B. 22  
March 17, 2021**

Chair Smith, Vice Chair Mason, and Members of the Committee, I am Michael Mazerov, a Senior Fellow with the State Fiscal Policy division of the Center on Budget and Policy Priorities in Washington, D.C. The Center is a non-partisan research and policy institute that pursues federal and state policies designed to reduce poverty and inequality and to restore fiscal responsibility in equitable and effective ways.

I appreciate the opportunity to testify today in opposition to H.B. 2421 and S.B. 22, which address Kansas's conformity to several provisions of the federal "Tax Cuts and Jobs Act" (TCJA) enacted in December 2017, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) enacted in March 2020, and H.R. 133, the Consolidated Appropriations Act, 2021 (CAA) enacted at the end of December. I will focus on Kansas's conformity to the Global Intangible Low-Taxed Income (GILTI) provision of TCJA and the Paycheck Protection Program (PPP) provisions of the CAA. My overriding point is that given the current difficult and uncertain fiscal and economic situation in which Kansas finds itself, it would be risky and not fiscally responsible to move forward with these bills. They go in the opposite direction of what the state should be doing; it should remain fully coupled to the GILTI minimum tax, as it has been for the last three years, and it should decouple from the recently expanded federal tax break for forgiven PPP loans – at least for larger borrowers. I also want to bring to the committee's attention the very real possibility that the potential revenue loss from enacting these bills has just effectively doubled due to the enactment of the federal American Rescue Plan last week.

Let me begin with this last point. In order to ensure that the aid distributed to states will provide the maximum benefit to people suffering hardship as a result of the pandemic and the recession and as much macroeconomic stimulus as possible, the American Recovery Plan includes a provision stating that the funds may not be used "to either directly or indirectly offset a reduction in the net tax revenue of such State . . . resulting from a change in law, regulation, or administrative interpretation during the covered period that reduces any tax (by providing for a reduction in a rate, a rebate, a deduction, a credit, or otherwise). . . ." The Act further stipulates that if a state chooses to enact a net tax cut after March 3, 2021, it will lose the equivalent amount of federal aid. This limit on net tax cuts extends until the state expends all the funds, which it must do by the end of 2024. Now, we do not yet have guidance from the Department of Treasury as to how it will interpret, implement, and enforce this prohibition. Nonetheless, there is a very real risk that should Kansas enact either S.B. 22 or H.B. 2421, it will lose an additional dollar in federal aid for every dollar of tax reduction in

either bill. For this reason alone, these bills should not be enacted until Treasury issues guidance and policymakers can weigh this potential additional loss of revenue against the perceived merits of these bills.

Turning to the policy merits of the bills, I'll start with the tax treatment of Paycheck Protection Program loans. As you know, the PPP effectively reimburses wage and certain other expenses incurred by businesses receiving PPP loans via loan forgiveness if the businesses meet certain conditions regarding how the loan is spent. This subsidy in and of itself is valuable to businesses. Presumably, those workers are generating more income for the business than their wages are costing, and even if that is not true in the short term it is valuable for the business to be able to keep them employed and maintaining their skills rather than possibly losing them to another employer. But the December 2020 CAA layered a tax break on top of that direct reimbursement of their wages. Previously, if wages were paid out of forgiven PPP loans, the forgiven portion of the loan wasn't treated as gross income, but neither could the wages paid out of the forgiven portion be deducted as expenses. That was tax neutral treatment; it had the same result as if the program hadn't been created, the worker therefore hadn't been employed, and there was therefore no wage paid that could be deducted. However, the federal tax treatment was changed in December retroactively to the beginning of 2020 so that now those wages can be deducted even though they are effectively reimbursed by the federal government through loan forgiveness. You and I can't deduct a charitable contribution if it's reimbursed by somebody else, a medical expense reimbursed by our insurance company, or a business travel expense reimbursed by our employer, but PPP participants can now deduct wage expenses reimbursed by the federal treasury.

Congress can of course choose to provide a tax break on top of a direct subsidy, but it could be extremely costly for Kansas to provide an additional tax break of its own. So far, more than \$5 billion of PPP loans have been provided to businesses in Kansas, and more are on the way from the new batch of PPP loans authorized in the December relief bill. If expenses on those loans can now be deducted, with a top tax rate of 5.7 percent for the personal income tax and 4.0 percent for the corporate tax, Kansas could be facing hundreds of millions of dollars of personal and corporate income tax revenue losses. Kansas should go in the opposite direction and decouple from the federal tax breaks, retaining tax-neutral treatment. Given its balanced budget requirement, it simply can't afford to provide an additional tax break, let alone potentially lose twice as much revenue due to the "no net tax cuts" provision of the American Rescue Plan. (Just this week, California postponed action on a bill to allow up to \$150,000 of PPP-reimbursed expenses to be deducted rather than the full amount due to concerns that enacting it would result in a reduction in ARP aid.) At the very least, this bill should not be moved forward until the Committee has received an estimate from the revenue department regarding how much revenue would be lost from conformity to the federal tax break.

H.B. 2421 and S.B. 22 also would completely decouple from TCJA's minimum tax on "Global Intangible Low-Taxed Income." Kansas should retain its current level of conformity to this provision, which has been in place now for three years with no evidence offered to suggest it has harmed the state's economic competitiveness in any way. Kansas has long required "water's edge" combined reporting for its corporate income tax because it has understood that, without it, corporations can easily shift profits to subsidiaries in low- or no-tax states. But Kansas remains vulnerable to the same kinds of income-shifting strategies when corporations use them to shift profits internationally. Such shifting remains an enormous problem:

- CBO (2018): “Profit shifting also lowers taxable corporate income in the United States—by roughly \$300 billion each year, recent estimates from the economic literature suggest.”
- Zucman, et al. (2020): 36% of MNC corporate profits earned outside their home countries are reported in tax haven nations; 14% of U.S. federal corporate tax revenue lost due to income-shifting
- Clausing (2020): “[P]rofit shifting is likely to be costing the US government over \$100 billion a year in 2017 (at 2017 tax rates). While much can be done to refine these estimates and learn more about the scale of the problem, the problem remains unambiguously very large.”
- International Monetary Fund (2015) “estimates annual total [worldwide] corporate tax losses associated with profit shifting at more than \$500 billion, with \$400 billion for OECD member states” (which includes the U.S.)
- De Simone (2019): “A lot of the research out there ignores one major tax strategy . . . that companies can take, and that is taking advantage of their subsidiaries with losses. . . . When we include this important strategy we find that . . . all of the research out there could underestimate the amount that corporations are engaging in this income-shifting activity by as much as 50 percent. . . .”

Two recent studies estimate that the anti-income-shifting provisions of the 2017 federal tax overhaul legislation will prevent only about one-fifth of the U.S. corporate tax base erosion arising from international income shifting:

- CBO: “On net, the . . . changes in tax law will reduce profit shifting by roughly \$65 billion per year, on average, over the next 11 years. . . . Profit shifting . . . lowers taxable corporate income in the United States. . . . by roughly \$300 billion each year. . . .”
- Clausing: Lower federal corporate tax rates and GILTI taken together provide disincentives for income shifting by U.S.-based MNCs sufficient to recoup just \$19B of estimated \$114B annual federal loss from income shifting.

A very “business-friendly” Congress realized the seriousness of the international profit-shifting problem by including GILTI in TCJA. In so doing, it provided Kansas and all states with an opportunity to recoup a small portion of the revenue loss by conforming to the GILTI provision. It would be imprudent for Kansas to now forgo that opportunity by decoupling.

Thank you for the opportunity to testify today.