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Testimony of
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Before the
Kansas Senate Committee on Assessment and Taxation
In Opposition to S.B. 22
January 19, 2021

Chair Tyson and Members of the Committee, I'm 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 S.B. 22, which addresses 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 COVID relief bill enacted last month. I will focus on Kansas's conformity to the Global Intangible Low-Taxed Income (GILTI) provision of TCJA, the business loss provisions of the CARES Act, and the Paycheck Protection Program (PPP) provisions of the December COVID relief bill. My overriding point is that given the current difficult and uncertain fiscal and economic situation in which Kansas and most other states find themselves, it would be risky and not fiscally responsible to move forward with this legislation. This bill goes 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, decouple from all of the relaxed limits on claiming business losses in the CARES Act, and decouple from the recently altered federal tax break for forgiven PPP loans.

I'll start with the Paycheck Protection Program tax treatment issue. The PPP program 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 bill 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 didn't exist and the worker therefore wasn't employed. 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, 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, approximately $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. I'm not sure the language was needed, but S.B. 22 makes explicit that Kansas conforms to the new federal tax treatment of forgiven PPP loans. 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. 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.

Second, S.B. 22 now proposes to provide unjustified tax breaks for losses incurred by corporations even before the pandemic hit. The TCJA had eliminated all loss carrybacks and limited loss carryforwards so that they can only offset 80 percent of taxable income rather than 100 percent. The CARES Act retroactively reinstated loss carrybacks for the 2018 and 2019 tax years and extended the carryback period to five years from the previous two. In other words, a business that lost money in 2019, a year of relatively healthy economic growth before the pandemic hit, can now file amended returns for years as far back as 2014 and receive refunds of taxes it had previously paid. In some case these losses will be on-paper only, resulting from overly generous write-offs for depreciation of equipment. Again, this scattershot approach to providing liquidity to corporations is something that the federal government can do because it doesn't have a balanced budget requirement, but the large majority of states don't allow carrybacks because they do have to balance their budgets. For Kansas now to reinstate carrybacks retroactively for three years and to allow carryforwards to zero-out taxable income by conforming to the CARES Act is not fiscally responsible given its budget situation. And this does not even address Kansas's urgent need to decouple from another costly loss-related tax break in the CARES Act that allows very-high-income business owners to use losses from their businesses to offset their salary and investment income, which I discuss in a recent paper. (See Michael Mazerov, "First, Do No Harm: States Can Preserve Revenue by Decoupling From CARES Act Tax Breaks for Business Losses," January 4, 2021.)

Finally, S.B. 22 proposes to substantially 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. (See: Michael Mazerov, "Legislators: Don't Feel Guilty about Taxing GILTI," NCSL Task Force on State and Local Taxation November 17, 2018; https://www.ncsl.org/Portals/1/Documents/Taskforces/GILTI.pdf.) 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.