The Brownback Pro-Growth Plan:
Making the State Income Tax Flatter, Fairer and Simpler

"The last decade was a lost decade for jobs in Kansas.
Fewer Kansans were working in private sector jobs in January 2011 than were in January of 2001.
A growing government and a shrinking private sector are not sustainable.
Fixing that is our top priority." – Gov. Sam Brownback

The Kansas Economy

We want to turn Kansas into an incubator for innovation and entrepreneurial success. Kansas should be the model for the nation in growing private sector jobs.

Since taking office in January of 2011, Gov. Sam Brownback's top priority has been to create an environment in which Kansas businesses can thrive and add jobs — so Kansas families can achieve a meaningful increase in income and opportunity as outlined in his Road Map for Kansas.

To support this goal, the Governor convened economic summits around the state, bringing together small business owners, major corporations, university leaders, economists, and taxpayers to chart a strategic plan for the state's growth. He asked members of his cabinet to travel the state for input on growing the Kansas economy. Secretary of Revenue Nick Jordan led discussions on tax policy and its impact on the economy.

One theme of the summits and citizen meetings has been clear. In the 21st century, Kansas is no longer content to be in the middle of the pack or to lag in key economic growth factors. Not only do we face increasingly intense competition from other states, we face global competition.

Tax policy will play a crucial role in positioning Kansas for growth in the years ahead. Will our tax policy continue to be a complicated hodge-podge of dozens upon dozens of taxes, credits, and special interests cobbled together during many decades? Or will we begin the process of streamlining and modernizing Kansas' tax policy in a way that funds core government functions while emphasizing business growth and encouraging financial investment in Kansas?

As economist Dr. Arthur Laffer has said, "Economics is all about incentives. People like doing things they find attractive and are repelled by things they find unattractive. Government policies change the attractiveness of activities."

The Kansas Economy: An Unsustainable Status Quo

In light of the national and international competition that is so prevalent in the 21st century marketplace, the Kansas economy has been average or below average for too long. This is reflected by private sector job losses, people moving out of the state, and a relative lack of capital flow into Kansas.

While there are certainly some factors a state cannot control when it comes to its economy, **tax policy is one area a state controls completely.** And when it comes to Kansas' tax policy, the state does not rank as high as it must compared to other states in order to be as competitive as possible in attracting new businesses and generating economic and private sector job growth.

Sn. Assmnt & Tax
1-12-12

Attachment # 1

Numbers help tell the story:

Private Sector Job Losses (Kansas Department of Labor)

- Private sector employment in Kansas fell by 39,700 jobs from 2001 to 2010.

Outmigration of Kansas Tax Filers (Kansas Department of Labor and Rich States, Poor States)

- From 2004 through 2010, within the U.S., there was net outmigration of 15,683 tax filers from Kansas with 17,640 dependents and a total adjusted gross income of $1.09 billion.
- Texas gained the most from Kansas outmigration with 6,395 tax filers from Kansas moving to Texas along with 12,837 dependents and a total adjusted gross income of $305.4 million.
- Only 10 states out of 50 had worse outmigration than Kansas from 2000 to 2009.

Kansas Tax Rankings Compared to Other States (Tax Foundation and Rich States, Poor States)

- State **Business Tax Climate** Index 2011: Kansas ranks 35th
- State **Corporate Tax** Index 2011: Kansas ranks 35th
- State **Sales Tax** Index 2011: Kansas ranks 32nd
- The **top marginal personal income tax rate** is 6.45 percent, which ranks 26th in the nation.
- The **top marginal corporate income** tax rate is 7 percent, which ranks 25th in the nation.
- The **property tax burden** ranks 33rd in the nation.
- The **sales tax burden** ranks 35th in the nation.
- **Debt service** as a share of tax revenue is 8.4 percent, which ranks 30th in the nation.

Capital Flow (Federal Reserve Bank of Kansas City)

- In 2010, Nebraska was the regional winner in the ranking of states when comparing state gross domestic product to personal income ratio, which reflects **net capital inflow relative to other states.** Nebraska ranked 10th in the nation; Kansas ranked 32nd.

Brownback Road Map for Kansas Metrics

- In 2010, the average net personal income in Kansas was $39,005.[1]
- In January 2011, private sector employment was 1,035,200.[2]
- In 2010, the percentage of Kansas' children living in poverty was 18.4 percent.[3]
- In January 2011, the unemployment rate in Kansas was 7.4 percent.[4]

According to Kail Padgitt of the Tax Foundation, "Good state tax systems levy low, flat rates on the broadest bases possible, and they treat all taxpayers the same. Variation in the tax treatment of different industries favors one economic activity or decision over another. The more riddled a tax system is with politically motivated preferences the less likely it is that business decisions will be made in response to market forces."

With that understanding, we seek to change the dynamic that has led to average (or worse) economic results — so more Kansas families can achieve a meaningful increase in income and opportunity.

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[1] U.S. Bureau of Economic Analysis and Census Bureau

[2] Kansas Department of Labor

[3] U.S. Census Bureau 2010 American Community Survey

[4] Kansas Department of Labor

By making Kansas tax policy fairer, flatter and simpler, and by creating a pro-growth business environment that encourages financial investment in Kansas, the state can position itself as a top economic performer. This will reduce poverty and create economic opportunities for the maximum number of Kansans.

Conversely, the status quo could perpetuate the troubling trends that challenged the Kansas economy over the "lost decade." Inaction is not a responsible or compassionate option.

Guiding Principles of Reform

Some principles guiding Gov. Brownback's pro-growth plan for tax reform are:

1) Taxes at the federal, state, and local levels are a complicated hodge-podge of dozens upon dozens of taxes, credits, and special interests cobbled together during many decades. In Kansas, it's imperative to begin streamlining and modernizing our tax policy in a strategic way that funds core government functions while emphasizing business growth and encouraging greater financial investment in our state.
2) The Kansas tax code is overly complicated; picks too many winners and losers; and attempts too much social engineering. We should have a fairer, flatter and simpler tax code that broadens the base and lowers rates as much as possible for the benefit of the maximum number of Kansans.
3) Small businesses and business start-ups are essential to the long-term health and growth of the Kansas economy. These businesses are the engine of job creation and capital investment.
4) Lower income tax rates allow Kansas families and businesses to keep more of their own hard-earned money. They know how to spend it more effectively than government does.
5) Data show states with zero personal income tax significantly outperform states with the highest personal income tax rates (in terms of gross state product); experience larger than average population growth; and boost state tax revenues at a faster pace than high tax states.

The Nine States with the Lowest and the Highest Marginal Personal Income Tax (PIT) Rates Ten-Year Economic Performance (performance between 2001 and 2010 unless otherwise noted)						
State	Top PIT Rate*	Gross State Product Growth	Non-Farm Payroll Employment Growth	Population Growth	Net Domestic In-Migration as a % of Population***	State & Local Tax Revenue Growth****
Alaska	0.00%	77.0%	12.2%	12.1%	-2.0%	452.6%
Florida	0.00%	47.7%	0.2%	15.0%	6.5%	82.3%
Nevada	0.00%	58.9%	6.1%	28.9%	14.1%	100.1%
New Hampshire	0.00%	35.2%	-0.7%	4.7%	2.5%	59.6%
South Dakota	0.00%	58.5%	6.4%	7.3%	0.8%	51.2%
Tennessee	0.00%	38.6%	-2.8%	10.3%	4.2%	61.7%
Texas	0.00%	57.7%	8.7%	17.9%	3.4%	75.5%
Washington	0.00%	47.8%	3.0%	12.3%	3.4%	57.8%
Wyoming	0.00%	105.6%	15.2%	14.3%	4.3%	172.2%
9 States with No PIT**	**0.00%**	**58.54%**	**5.36%**	**13.65%**	**4.12%**	**123.66%**
U.S. Average**	**5.47%**	**46.61%**	**0.51%**	**8.63%**	**0.86%**	**70.23%**
Kansas	**6.45%**	**42.35%**	**-1.90%**	**5.61%**	**-2.36%**	**62.87%**
9 States with Highest Marginal PIT Rate**	**9.92%**	**42.06%**	**-1.68%**	**5.49%**	**-1.91%**	**61.79%**
Ohio	8.24%	24.8%	-9.3%	1.2%	-3.1%	44.5%
Maine	8.50%	35.4%	-2.5%	3.4%	2.3%	45.3%
Maryland	9.30%	50.9%	1.7%	7.4%	-1.5%	67.0%
Vermont	9.40%	36.1%	-1.6%	2.2%	-0.1%	64.5%
New York	10.50%	43.1%	-0.4%	1.5%	-8.3%	68.3%
California	10.55%	42.1%	-4.8%	8.0%	-3.9%	77.2%
New Jersey	10.75%	33.7%	-3.6%	3.6%	-4.8%	70.4%
Hawaii	11.00%	57.4%	5.7%	11.7%	-2.2%	72.1%
Oregon	11.00%	55.0%	-0.3%	10.4%	4.5%	46.8%

Data compiled by Laffer Associates

*Highest marginal state and local personal income tax rate imposed as of 1/1/2011 using the tax rate of each state's largest city as a proxy for the local tax. The deductibility of federal taxes from state tax liability is included where applicable. New Hampshire and Tennessee tax dividend interest income only.

**Equal-weighted averages

***2000-2009

****1999-2008

Gov. Brownback's Fairer, Flatter and Simpler Pro-Growth Plan

- **Lower individual income tax rates and move from three brackets to two brackets:**
  - **3 percent** rate for income under $15,000 ($30,000 married filing jointly), a 14 percent rate cut.
  - **4.9 percent** rate for income $15,000 and over ($30,000 married filing jointly), a 24 percent cut.
  - *Note: Current rates are 3.5 percent, 6.25 percent, and 6.45 percent*
- **Eliminate individual income tax on non-wage business income** (as reported by LLCs, S-corps and sole proprietorships on lines 12, 17, and 18 of the federal form 1040 individual income tax return)
- **Simplify and streamline the tax code:**
  - Eliminate itemized deductions and some credits (see Appendix A)
  - Eliminate subtraction modifications for 529 education savings program and long-term care contract premiums
  - *Note: No impact on deductions or credits claimed at the federal level*
- **Bolster the safety net for low-income Kansans while providing greater accountability** by doubling the standard deduction (from $4,500 to $9,000) for head of household filers and investing an additional $60 million in state social services and healthcare programs
- **Leave the corporate income tax rate** unchanged
- **Hold the sales tax rate steady** at 6.3 percent, with 4/10 of a cent going to the highway fund as planned in FY14, as data show that sales tax rates have the least negative impact on economic growth relative to other tax types
- **Eliminate the two-year severance tax exemption on new pool oil and gas wells**, except for oil wells generating fewer than 50 barrels a day

Expected Results and Next Steps

- By eliminating credits and deductions and lowering income tax rates for all state tax filers, **Kansas' top individual income tax rate will become the second lowest in the region** (only slightly higher than Colorado), and the state will take its first step toward a fairer and flatter tax code.

Top Rate Today	**Change with Brownback Plan**
Colorado........ 4.63	Colorado 4.63
Oklahoma...... 5.25	**Kansas.............. 4.9**
Missouri...............6	Oklahoma........ 5.25
Kansas 6.45	Missouri 6
Nebraska 6.84	Nebraska......... 6.84
Iowa.............. 8.98	Iowa 8.98

- **Lowering the state income tax rate will give Kansas families and taxpayers an immediate raise** in their paychecks as they decrease their state income tax withholding and keep more of the money they earn as they earn it. This directly relates to the Governor's Road Map goal of increasing personal disposable income.

- **Thanks to the innovative approach of eliminating individual state income tax on non-wage business income** (e.g., from LLCs and S-corps), approximately 191,000 Kansas tax filers will have the opportunity to invest more in the growth of their small businesses. *This is a unique and highly targeted strategy to make Kansas an incubator for innovation and a national center for entrepreneurship.*
- As revenues grow more than 2 percent per fiscal year, **future excess revenues will be applied to reductions in individual and corporate income tax rates** in the subsequent tax years.
- **The median Kansas tax return** uses the standard deduction, has income of $65,430, and is filed married jointly with one child. This family will see a state income tax reduction of $425.43 per year.
- **A single parent filing as head of household** will see his or her standard deduction double from $4,500 to $9,000.
- **A small business owner** with an LLC, S-corp or sole proprietorship filing on the K-40 individual income tax form will not pay state income taxes on income from lines 12, 17 and 18 of the federal 1040 form.
- **This reform is designed to be close to revenue neutral** and fully fund the Governor's proposed FY13 budget and the statutorily required 7.5 percent ending balance.

The ultimate goal is to unleash the Kansas economy by making state tax policy more competitive nationally and globally. This will increase net personal income and private sector employment while reducing unemployment and the number of children living in poverty.

Why This Approach

From 2004 through 2010, there was net outmigration of 15,683 tax filers from Kansas with 17,640 dependents and a total adjusted gross income of $1.09 billion.

The top six states people moved to from Kansas were either regional competitors with lower income tax rates (Missouri, Oklahoma and Colorado) or states with no income tax (Texas, Washington and Florida). Texas gained the most from Kansas outmigration with 6,395 tax filers along with 12,837 dependents and a total adjusted gross income of $305.4 million.

Data show that states with zero personal income tax significantly outperform states with the highest personal income tax rates (in terms of gross state product); experience larger than average population growth; and boost state tax revenues at a faster pace than high tax states.

Why is there an emphasis on small business in this plan?
The plan provides lower rates for all taxpayers while targeting small businesses for additional relief since those businesses are so vital to job creation in our state. Of the approximately 220,000 business filers in Kansas, about 191,000 file business income on the K-40 individual income tax form. Under a fairer, flatter and simpler plan, these taxpayers will not pay taxes on their business income reported on lines 12, 17 and 18 of the federal 1040 individual income tax return.

Why are small businesses so important?
Startups and small businesses are the main driver of the Kansas economy. A study by the Kauffman Foundation found, "Both on average and for all but seven years between 1977 and 2005, existing firms are net job destroyers, losing 1 million jobs net combined per year. By contrast, in their first year, new firms add an average of 3 million jobs."

Why do you want to broaden the tax base?
Today, 25 percent of Kansas tax filers pay zero individual income tax. A broader tax base will be more fair and stable, even as everyone's rates are lowered.

Further, as economist Dr. Arthur Laffer has said, "Economics is all about incentives ... Don't be surprised when government raises taxes on work, output, and employment and increases subsidies to non-work, leisure, and unemployment that the economy will produce less work, less output, and less employment and will produce more non-work, leisure, and unemployment. It's the nature of people."

Why move money into social service programs instead of leaving it as a tax credit or refund?
By moving money into social service programs, we are helping to ensure that the people who most need assistance will receive it. Welfare programs have more oversight and can target the neediest citizens (see Appendix B). For example, by moving money from an earned income tax credit that pays an average lump sum payment of $357 one time per year, we can expand social welfare programs that offer sustained aid throughout the year.

Why eliminate itemized deductions?
The tax system needs to be more fair and less complicated. By eliminating deductions at the state level (no impact on federal deductions), we accomplish both objectives while also lowering tax rates by 14 percent to 24 percent for everyone. *Importantly, as individual income tax rates are reduced now and in the future, itemized deductions become less and less meaningful because the overall income tax burden is lower for everyone.*

Appendix A

Credits Proposed for Elimination for Individual Income Tax Filers to Create a Fairer, Flatter and Simpler Kansas Tax Code

- Abandoned Well Plugging Credit
- Adoption Credit
- Agritourism Liability Insurance Credit
- Alternative Fuel Tax Credit
- Angel Investor Credit
- Assistive Technology Contribution Credit
- Child and Dependent Care Credit
- Child Day Care Assistance Credit
- Community Service Contribution Credit
- Disabled Access Credit
- Earned Income Credit
- Environmental Compliance Credit
- Historic Preservation Credit
- Individual Development Account Credit
- Law Enforcement Training Center Credit
- National Guard Employer Health Insurance Credit
- Research and Development Credit
- Single City Port Authority Credit
- Small Employer Health Benefit Plan Credit
- Swine Facility Improvement Credit
- Telecommunications Credit
- Temporary Assistance to Families Contribution Credit
- Venture Capital and Local Seed Capital Credits

Appendix B

Federal Court Cases Involving Earned Income Tax Credit Abuse or Fraud

- Detroit: In September 2011, the Justice Department sued Crystal Ireland and her business, Master Mind Preparation, to bar them from preparing tax returns for others. According to the suit, Ireland allegedly fails to comply with due-diligence requirements imposed by federal law on tax return preparers who claim the earned income tax credit (EITC) on their customers' returns. The suit also alleges that Ireland falsified her customers' income in order to claim the maximum EITC for them. Of the returns prepared by Ireland claiming the EITC for tax years 2007 through 2009, the IRS reduced or disallowed the EITC claim on 93 percent of those returns.
- Houston: In February 2011, the government asked a Texas federal court to bar two Houston-area tax preparers, Christopher Helton and Marcia Johnson, from preparing any more federal tax returns. The pair allegedly claims false earned income and fuel tax credits on their customers' tax returns. The complaint alleges that the defendants routinely prepare tax returns that either claimed the earned income credit for taxpayers who do not qualify for it or overstate the amount of the credit for eligible taxpayers. Helton and Johnson allegedly prepared tax returns claiming more than $1.5 million in earned income tax credits during tax years 2007 through 2009, and the complaint describes fraudulent tax refunds based on false earned income credits as a "rampant problem."
- Allentown, Pa.: The Justice Department sued Carmen Gonzalez in 2011 to stop her from preparing tax returns for others. According to the complaint, Gonzalez fails to comply with due diligence requirements imposed by federal law on tax return preparers who claim the earned income tax credit, and she falsifies her customers' information in order to maximize their credits. She has allegedly prepared at least 2,500 returns since 2007.
- Hialeah, Fla.: A complaint filed in federal court in 2011 seeks to bar Milagros Espinal from preparing tax returns for others. The government alleges that Espinal claims improper or false tax credits, including earned income credits, as well as fabricated or overstated tax deductions. She allegedly prepared at least 2,000 returns for the 2004 through 2007 tax years.
- Over the past decade, the Justice Department's Tax Division has obtained hundreds of injunctions against tax-scheme promoters and preparers of fraudulent tax returns, including those with false claims for earned income tax credits. For example, over the past year, the Justice Department announced injunctions or injunction complaints against the following individuals in cases involving the earned income credit: Sony Ducasse of Greenacres, Fla.; Maritza Villanueva of Irving, Texas; Michael Brier of R.I.; Saloum Njie of Atlanta; Shirley Clark of Jacksonville, Fla.; James King of Dublin, Ga.; George Thomas Gaines of Aurora, Colo.; Aurelia Sanderson Johnson of Montgomery; Jody Ball of Bryson City, N.C.; Christopher Musyoki and Samuel Nganga of Cobb County, Ga.; and John Lewis, Artels James and Perry Wright of Birmingham, Ala.
- *Berkowitz* case: In 2004 and 2005, the Berkowitz tax scam involved Kansas, with multiple refunds going to the same addresses with different SSNs and names. The group tried to obtain at least $54 million in fraudulent federal and state income tax refunds using the identities of at least 2,900 prisoners and deceased persons. The defendant, Marvin Berkowitz, admitted directing a fraud ring that obtained at least $4.5 million in actual tax refunds from the Internal Revenue Service and the tax agencies of at least 28 states. On August 3, 2011, Marvin Berkowitz was sentenced to 18 years in federal prison.