

WRITTEN TESTIMONY SUBMITTED TO:

THE KANSAS HOUSE COMMITTEE ON TAXATION

Regarding House Bill 2237

February 7, 2017

Thank you for the opportunity to submit this written testimony. My name is Lisa Christensen Gee and I am a Senior State Tax Policy Analyst for the Institute on Taxation and Economic Policy (ITEP), a nonprofit research group. ITEP's research focuses on federal and state tax policy issues with an emphasis on the goals of sustainability, transparency, and fairness.

My testimony today focuses on the ways in which the changes proposed in House Bill 2237 will help address shortcomings of the state's current tax laws as it relates to issues of revenue adequacy and tax fairness.

Revenue Adequacy

ITEP analysisⁱ of Kansas tax changes enacted between 2012 and 2015 shows the state lost over \$1 billion in revenue annually from changes to its personal income tax, including lowering income tax rates and exempting business pass-through income from taxation (see Figure 1). While the state subsequently made up some of these revenue losses through various measures including increasing regressive sales and cigarette taxes, limiting itemized deductions, and freezing income tax rate cuts in 2015, ITEP estimates that the net impact to the state has been losses of over \$650 million a year.

This dramatic loss of revenue due to deep tax cuts has been the primary driver behind nine rounds of budget cuts, accumulation of record-high debt, and three state credit rating downgrades in the state since 2012. The strong consensus from empirical economic studies over the past 40 years on the relationship between state tax levels and rates of state economic growth and the lived experience of Kansas and other states is that tax cuts do not pay for themselves.ⁱⁱ If the state wants to ensure it has adequate revenue to meet its obligations and fund critical priorities now and in the future, it must enact tax laws that actually bring in the needed revenue. Measures proposed in H.B. 2237 such as reforming the income threshold on the top bracket, closing the LLC exemption, and modernizing the gas tax are effective reforms for beginning to repair the state's ability to raise the adequate revenue necessary to put the state back on secure financial footing.

Figure 1. Impact of Kansas Tax Changes, 2012-2015
Residents, 2015 Income Levels

2015 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%	\$ State Impact (thousands)
Income Range	Less Than \$23,000	\$23,000 – \$42,000	\$42,000 – \$68,000	\$68,000 – \$107,000	\$107,000 – \$205,000	\$205,000 – \$493,000	\$493,000 – Or More	
Average Income in Group	\$13,000	\$32,000	\$54,000	\$86,000	\$139,000	\$289,000	\$1,327,000	
Impact of Personal Income Tax Changes Between 2012 and 2015								
Tax Change as % of Income	+0.7%	-0.4%	-0.5%	-0.8%	-1.0%	-1.4%	-1.9%	\$ -1,082,000
Average Tax Change	96	-129	-291	-671	-1,401	-4,122	-25,817	
Share of Tax Change	-2%	3%	7%	16%	25%	20%	31%	
Impact of Increasing the Cigarette Tax From from \$.79 to \$1.29								
Tax Change as % of Income	+0.2%	+0.1%	+0.1%	+0.0%	+0.0%	+0.0%	+0.0%	\$ +40,000
Average Tax Change	+22	+27	+29	+33	+32	+33	+29	
Impact of Increasing the Sales Tax From from 5.7 to 6.5								
Tax Change as % of Income	+0.6%	+0.5%	+0.4%	+0.4%	+0.3%	+0.2%	+0.1%	\$ +391,000
Average Tax Change	+80	+167	+233	+321	+386	+503	+1,156	
Impact of Cigarette Tax Hikes, Sales Tax Changes, and Personal Income Tax Between 2012 and 2015								
Tax Change as % of Income	+1.5%	+0.2%	-0.1%	-0.4%	-0.7%	-1.2%	-1.9%	\$ -651,000
Average Tax Change	197	66	-29	-316	-983	-3,587	-24,632	

SOURCE: Institute on Taxation and Economic Policy Microsimulation Tax Model, June 2015

Tax Fairness

A second key issue in reforming Kansas tax policy is that of tax fairness. All state and local tax systems are all fundamentally regressive, taking a much greater share of income from low- and middle-income families than from wealthy families. However, tax systems that don't have graduated personal income taxes and that rely more heavily on consumption taxes exacerbate this problem. Not surprisingly, as Kansas stripped its income tax of progressive features between 2012 and 2015 and increased reliance on the sales and cigarette taxes, tax fairness in the state has suffered.

Every two years ITEP produces a report titled *Who Pays: A Distributional Analysis of the Tax Systems in All Fifty States*,ⁱⁱⁱ which assesses the fairness of state and local tax systems by measuring the state and local taxes that will be paid in 2015 by different income groups as a share of their incomes. In the 2015 edition, Kansas joined the ranks of "the Terrible 10"—the 10 states with the most regressive tax structures where the bottom 20 percent pay up to seven times as much of their income in taxes as their wealthy counterparts. Washington State is the most regressive, followed by Florida, Texas, South Dakota, Illinois, Pennsylvania, Tennessee, Arizona, Kansas, and Indiana.

As illustrated in Figure 1 above, the net impact of the tax changes enacted in Kansas between 2012 and 2015 was a substantial tax *shift*, providing net tax cuts to the average taxpayer with over \$42,000 in income while simultaneously raising the taxes of average taxpayers in the bottom 40 percent. On average, millionaire taxpayers received a windfall of around \$25,000 while taxpayers with less than \$23,000 saw their taxes go up

by around \$200. Flattening the graduated income tax rate structure and exempting LLC income from taxation were top heavy cuts, the substantial costs of which were partially offset by tax increases to the bottom, such as eliminating or making certain low-income tax credits nonrefundable and increasing the regressive sales tax. Requiring those with the fewest resources in the state to offset the costs of substantial tax giveaways to the wealthy is poor tax policy.

Key provisions of the bill before you help Kansas begin to correct the upside-down nature of its tax system while also moving towards revenue adequacy and sustainability. These provisions include reducing the sales tax rate on food, re-instating a third income tax bracket where higher rates apply to higher incomes, and removing the exemption for pass-through business income (of which 85 percent of the benefit goes to the top 20 percent of taxpayers).

Conclusion

While there are many ways to raise revenue, Kansas will not be able to fix its long-term structural imbalances by continuing to rely on temporary revenue sources in future fiscal years. Rather, by cleaning up the tax code, broadening the income tax base, and taking steps to restore greater progressivity to its tax system, Kansas will be better situated to meet its current needs and be prepared for the future.

The choice between more cuts to vital public investments or asking wealthy Kansans to pay their fair share should be an easy one.

With that, I thank you again for this opportunity.

ⁱ The ITEP Microsimulation Tax Model is a tool for estimating the impact of federal, state, and local taxes by income group. It uses a very large stratified sample of federal tax returns, as well as supplementary data on the non-filing population, to derive estimates that apply to taxpayer populations at the state level. The U.S. Treasury Department, the Congressional Joint Committee on Taxation, the Congressional Budget Office, and several state departments of revenue use similar models. For a more detailed explanation of the ITEP Tax Model, see http://www.itep.org/about/itep_tax_model_full.php

ⁱⁱ Michael Leachman and Michael Mazerov, "State Income Tax Cuts: Still A Poor Strategy for Economic Growth," Center on Budget and Policy Priorities, May 14, 2015, online at <http://www.cbpp.org/research/state-budget-and-tax/state-personal-income-tax-cuts-still-a-poor-strategy-for-economic>.

ⁱⁱⁱ "Who Pays: A Distributional Analysis of the Tax Systems in All Fifty States" (5th Ed), Institute on Taxation and Economic Policy, January 2015, online at <http://www.itep.org/pdf/whopaysreport.pdf>.