KANSAS ASSOCIATION OF COUNTIES

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To: Chairman Mike Burgess and the House Govt. Efficiency Committee

From: Commissioner John Miller, Norton County, on behalf of the KAC

Date: February 15, 2012

Re: HB 2725

Mr. Chairman and members of the committee, my name is John Miller. I am a Norton County Commissioner but I am here today to speak as the Legislative Policy Committee Chair of the Kansas Association of Counties.

The Kansas Association of Counties opposes **HB 2725**, which would abolish the Kansas Advisory Council on Intergovernmental Relations, or KACIR. While I have never been a member of the KACIR, I have personally attended many KACIR meetings, and have appreciated the council's work to thoughtfully discuss the many ways that various levels of government (i.e. state, counties, cities, townships, unified school districts) intersect.

Rarely is it the case that any level of government has exclusive responsibility for anything. For example, counties serve dual purposes as both an arm of state government and as a local service provider. With the state, we have joint responsibility for a variety of services such as transportation, mental health, detention and corrections, and elections. But, we also share revenue sources such as the property tax and sales tax authority. When we work together closely, all levels of government benefit and most importantly, our citizens benefit.

In the past several years, the KACIR has developed a ***Tax Base Policy Evaluation Guide*** which provides a way to evaluate whether a tax exemption or a tax credit makes sense. After several hours of discussion, the KACIR released the Guide which hopefully provides guidance to legislators and locally elected officials. The KACIR, working with the Kansas Department of Revenue, also commissioned some studies on tax policy issues such as progressivity & regressivity, tax incidence, and related subjects which still provide useful information. The KACIR has even tackled the often-controversial issue of consolidation, and suggested ways to eliminate obstacles to consolidation while respecting the ability of jurisdictions to make their own best decisions about whether or how to consolidate.

The KACIR was first established in 1969, then abolished in 1995, and re-created in 2002. Our Association wants government to work efficiently and effectively for Kansans. For this to happen, we need to be on the same page as much as possible. The KACIR is one way, and a relatively simple and low-cost way, to ensure that important intergovernmental discussions occur. For these reasons, we urge the committee to table this bill, and allow the KACIR to continue its work.

Thank you for the opportunity to visit with you today about HB 2725.

Tax-Base Policy Evaluation Guide

Kansas Advisory Council on Intergovernmental Relations
September 2009

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How the Guide Works

The Policy Evaluation Guide (PEG) provides policy makers a means for assessing tax exemptions and credits. The Guide focuses on the three primary taxes (Sales, Income, and Property) and provides the basic tenets and principles of the tax as well as a structure for evaluating specific requests for exemptions or exclusions. Simply put, the PEG is a tool to help policy makers with tax policy decisions.

- √ Legislators can ask conferees the questions in the guide during a legislative hearing.
- √ The answers to the questions should be part of a legislative deliberation or discussion.
- √ Fiscal staff should respond to these questions in fiscal notes.
- √ The PEG will be updated at least bi-annually by the KACIR to reflect changes in legislative policy.

The Tax Mix
The sales, income and property taxes are often referred to as the 3-legged stool of taxation. Conventional wisdom suggests that good tax policy would result in each tax representing about 1/3rd of the tax revenues for state and local government.

In Kansas, the balance on the three-legged stool has shifted since the enactment of the school finance law in 1992. Some imbalance is occurring each year as exemptions are passed by the Legislature and tax rates change. Currently, the deficiency is in the share provided from the sales and use tax. The following table lists the dollars and percent of total each tax generated in fiscal year 2008 from both state and local sources and the percentages in FY 1995 for comparison:

State and Local Tax Receipts	FY 1995	FY 2008	
Sales and Use (state and local)	32%	$3.126B	29%
Income (Ind and Corp) and Privilege	28%	$3.410B	32%
Property, real and personal	40%	$4.102B	39%

Source: Kansas Tax Facts

Basic Principles of Taxation
In preparing this guide, common themes exist for each of the taxes discussed. All tax legislation should be evaluated with the following objectives in mind. While there are always policy tradeoffs based upon the various tax criteria applied to each tax and the overall tax structure, a good tax is **simple** – for the taxpayer and the administrator, **transparent** and easily understood, **stable,** and **neutral** in its impact on various groups of taxpayers.

- The tax should be equitable across all classes or groups of taxpayers. Singling out an exception or exemption for a specific taxpayer is poor tax policy and should be avoided. Additionally, the KACIR notes that non-profit organizations already receive a significant benefit by being exempt from federal and state income tax and in most cases, they are also property tax exempt.
- Retroactive exemptions or credits should be avoided because they impact governmental revenues which have already been allocated or spent.
- The tax system or mix of taxes should produce revenues that are adequate to finance an agreed-upon level of public services over time; have sufficient elasticity to grow with the economy, and produce adequate revenue in economic downturns.
- A broad tax base allows the lowest possible rate, while also enhancing compliance, public acceptability and the stability of the revenue source. It is poor public policy to erode the underlying tax base by granting unwarranted, gratuitous exemptions, exclusions, or tax credits. It is important not to remove items from taxability unless they meet rational, economically meritorious criteria, especially economic development incentives since they may not treat all taxpayers in the class equitably.
- All exemptions, tax credits, and exclusions should be subject to systematic, continuing review.

The Most Basic Question of All

"Are you prepared to reduce something else in the budget to pay for the exemption?"

or

"Are you prepared to provide the recipients of the exemption a specific appropriation in the budget?"

An exemption, exclusion, or credit is no different than an appropriation, except that it is administered through the tax system. Exemptions allow purchases to be made without tax; credits usually are refunded or carried forward on a tax return after the fact.

Both have the advantage to the recipient of avoiding the appropriations process, and avoiding the public scrutiny that comes from a budget appropriation since tax transactions are usually confidential and only reported in the aggregate without identifying a specific taxpayer.

NOTES

Retailers Sales tax is a uniform tax on consumer expenditures, paid by both businesses and individuals, for tangible personal property and services, except where there is specific justification for exception. The tax should not create competitive disturbances among various types of sellers or forms of business organization; otherwise, economic efficiency is lost.

Compensating Use Tax is the tax on consumer out-of-state expenditures from out of state purchases delivered into Kansas, such as internet/catalog sales from out-state sellers purchased by a Kansan. It is accrued by a business or a consumer and paid directly to the state; individuals can self-report their use tax liability on their income tax form. Some retailers (such as Internet companies) voluntarily remit use tax on behalf of their Kansas customers through the Streamlined Sales Tax Project.

Tax Rates

The state sales and use tax rate in Kansas is 5.3%. Local governments may levy an additional amount which is administered by the state and collected by merchants at the same time the state tax is collected. Cities may have up to an additional 3%; counties are limited to 1% without specific legislative authority. Other taxing districts have been created in recent years, such as transportation districts and the newly authorized community improvement districts. Total state and local sales taxes in any given jurisdiction range from 5.3% to over 9%.

Local tax rates may change only on the first day of a calendar year quarter, 60 days after notification has been given to retailers by the state. A rates and boundaries data base is maintained by the state to notify retailers the correct amount to collect. Kansas is a member of the Streamlined Sales Tax Governing board and conforms to the uniform definitions adopted by that group as well as other administrative provisions.

Basic Principles of the Sales and Use Tax:

1. It is a tax on the final purchase of tangible personal property.
2. The sale of all tangible personal property is taxable unless specifically exempted by statute.
3. Services are generally not taxed, except the tax is specifically imposed on labor or personal services that involve the alteration or repair of tangible personal property, such as dry cleaning, auto repair, etc.
4. Production (business) inputs should not be subject to sales tax. This includes raw materials and machinery used in the manufacturing process as well as livestock or plant materials for human consumption in agriculture.
5. Governmental purchases should not be subject to tax as it would increase the cost of providing government services. In some cases, taxation of purchases or funds provided by the federal government is not allowed.

Kinds of Sales Tax Exemptions

1. Conceptual exclusions – items in which there is not a final sale to a consumer. Wholesale sales, items for resale and production inputs fall in this category.
2. Administrative exclusions – those items which simplify and expedite the administration of the tax. Examples are exempting isolated and occasional sales, such as garage sales.
3. Legal exemptions – generally constitutional constraints on a state's taxing authority. This would include purchases by the federal government or prohibitions against state interference of interstate and foreign commerce.
4. Policy exemptions– items exempted by the legislature. Usually these are made to further some social or economic goal or to give merchants in one state a competitive advantage to merchants in other states.

Kansas Income Taxes

Individual income taxes in Kansas are levied on the Federal Adjusted Gross Income of the individual with some deductions and credits allowed. Kansas has a progressive individual income tax where taxpayers with larger incomes pay a greater percent of their income in taxes. Tax rates are graduated and range from 3.5% to 6.45%.

Fiduciary income taxes must be filed by the fiduciary of a resident estate or trust if the estate or trust had taxable income or gain from a Kansas source. This tax begins its calculation with federal taxable income. The rates are the same as a single individual taxpayer.

Corporate income taxes in Kansas are levied on Federal Taxable income with some credits allowed. Federal Taxable income is gross income less expenses. The corporate income tax is progressive with a 4% tax rate on all taxable income and a surtax of 3.1% on taxable income over $50,000.

Privileges taxes, enacted in 1963, are levied on the net income for banks, trust companies, federally chartered savings banks and savings and loan associations. The calculation begins with federal taxable income. The tax amount is 2.25% of Kansas taxable income and a 2.125% or 2.25% surtax is also levied on amounts over $25,000 but the rate varies with the type of institution.

All of these taxes are affected by changes in the federal income taxes that change the federally adjusted gross income (Individual or Corporate) or federal taxable income (Privilege). From time to time, the legislature considers whether to "**decouple**" from the federal changes in order to prevent revenue loss, such as from changes in accelerated depreciation which were enacted in 2008 and 2009. Decoupling would cause changes to appear as a subtraction or addition modification on the Kansas tax return.

Question	Sales Tax		Income Tax		Property Tax	
	Yes	No	Yes	No	Yes	No
19. Is the nonprofit organization receiving this tax benefit providing a service that the government would otherwise provide, such as foster care, health services?						
20. Is the nonprofit organization unable to continue operating without the exemption?						
21. If this exemption is passed, will organizations/businesses that provide similar or identical services as this non-profit organization have the same competitive playing field?						

In 2002, the Legislature created a 15-member Kansas Advisory Council on Intergovernmental Relations (KACIR). The KACIR engages in a continuous study of the services provided by the various levels of government within the state. By monitoring a wide range of governmental relations, the Council helps to promote cooperation and efficiency within government; thereby helping the leaders in Kansas work together more efficiently.

K.S.A. 12-4001 sets out the required staffing for KACIR. According to statute, the Council is composed of 15 members of whom 11 are appointed by the governor. There are city and county officials, a township official, a school board member, executive branch members and private citizens that staff this Council.

The Policy Evaluation Guide is a publication of the
Kansas Advisory Council on Intergovernmental Relations

	Yes	No	Yes	No	Yes	No
10. Is the valuation that will be removed from the property tax rolls an insubstantial dollar amount?						
11. Is the property tax that will be shifted to other property owners insubstantial?						
12. Does the exemption avoid creating an improper or preferential classification of property such that one group will have a competitive advantage?						
13. Does the exemption provide a substantial benefit to the public?						
14. Do the proponents of the tax credit agree to public disclosure of the amounts claimed?						
15. Does the exemption/credit achieve a policy goal that can be justified to the public?						
16. Does this exemption treat all taxpayers in this class or group the same? *Singling out an exception or exemption for a specific taxpayer is poor tax policy and should be avoided.*						
17. If this exemption gives an economic or competitive advantage to just one group over another, is the justification for preferential treatment an accepted policy such as these: improving economically disadvantaged areas, removing barriers to interstate competition in border communities, helping a depressed area or industry, assisting local communities to develop attractions of statewide or multistate importance.						
18. Does granting this exemption increase the tax burden on the public?						

are stated as a percentage of a similar federal credit, such as the Earned Income Tax Credit (EITC). Others are Kansas credits and exhibit a wide variety of form and size. Complete information about Kansas tax credits can be found in the Department of Revenue's most current Tax Expenditure Report on its website, www.ksrevenue.org. Thirty-eight different credits are available to individual and fiduciary income tax filers. Thirty-three are available to corporate filers.

Basic Principles of an Income Tax

1. **Equity and Fairness** – Taxes should be based on the ability to pay. The tax system should treat people of similar economic circumstances equally.
2. **Competitiveness** – Taxes should contribute to a level playing field for all in the economy. The tax system should not influence the investment and spending decisions of individuals and businesses, unless planned as an inducement to economic growth and investment.
3. **Stability and Predictability** – Tax base should be stable and predictable over the economic cycle.
4. **Simplicity and Accountability** – A tax system should be easy for citizens to understand and to comply with, and easy to enforce and audit.
5. **Revenue Adequacy** – Taxes should produce sufficient revenues to finance state services.

Kansas Ad Valorem Property Tax

Property tax began as a simple tax on all wealth when it was adopted in Kansas in the mid-1800s. Through a variety of constitutional and statutory exemptions, it has been transformed into a tax that is largely a real estate tax, supplemented by a tax on utility property and motor vehicles. These taxes fund local services provided by cities, counties and other taxing subdivisions. Services include roads, streets, parks, ambulance, solid waste, fire and police protection. Property taxes are also used to fund schools through the statewide school levy and the state has a small property tax levy used for the upkeep of certain buildings and grounds.

When property is exempted, total property taxes do not correspondingly decrease. Instead, the tax burden shifts to other taxable property. The cost of providing local services does not decrease simply because property is exempted. For example, an exempt building will still need fire and police protection, and upkeep for surrounding public roads and bridges, *etc.* What is a tax break for some is actually a tax increase for others.

Basic Principles of the Property Tax

Property taxes have historically been the major income source for maintaining state and local governments. The taxing philosophy has been that the burden of providing the services the state and local governments afford should be borne equally by all, in proportion to the amount of the property they owned. However, as the tax base has narrowed, cities and counties have turned to the sales tax to supplement their declining property tax base. Because not everyone owns property, adding the sales tax as a financing source for cities and counties helps ensure that all residents pay a share of the cost of local government.

The Kansas Constitution requires property to be valued uniformly and equally, although the assessment percentages may vary by class of property. **Appraisal** is determining the fair market value of the property. **Assessment** is determining what portion of its appraised value may be taxed. For example, residential property is assessed at 11.5% of its appraised value while commercial property is assessed at 25% of its fair market value. Agricultural land is not appraised by fair market value, but instead on its use value as determined by the type of crops grown, soil types and a host of other factors.

Property tax exemptions

The Kansas Supreme Court[1] ruled that in order to be considered constitutional, a property tax exemption must:

1. Have a public purpose and be designed to promote the public welfare. The court leaves the determination as to whether an exemption is in the public interest to the legislature.
2. Provide a substantial public benefit, e.g., is the loss of revenue from the removal of the property from tax rolls offset to some extent by a corresponding benefit to the public?
3. Not allow for large accumulations of tax-exempt property that would disturb the general principle of equality and uniformity; and
4. Be based on the use of the property not on a characteristic or the status of the taxpayer and not create an improper classification of property.

From a policy perspective, the Kansas Legislature holds considerable authority over property tax exemptions. The Kansas Legislature can provide an exemption for property beyond those granted in the Kansas Constitution if the statutory exemption promotes meets the four requirements set forth above.

There are basically two types of property tax exemptions: constitutional and statutory. Some of the constitutional exemptions include household goods and personal effects, merchants and manufacturers inventories, agricultural equipment and property of religious, charitable, educational organizations. Many of these are repeated in the statutes, as well as others for policy reasons.

[1] State ex rel. Tomasic v. of Kansas City, 237 Kan 572, 701 P.2d 1314 (1985)

Use this Guide to Evaluate Tax Exemptions or Credits

If the answer to any of these is **no**, the exemption should not be granted.

Question	Sales Tax		Income Tax		Property Tax	
	Yes	No	Yes	No	Yes	No
1. Are you as an elected policy maker willing to reduce something else in the state budget to pay for this exemption/credit or appropriate funds in the budget to the recipients of the exemption/credit?						
2. Does the exemption/credit include a sunset provision to allow for review and approval?						
3. Does the exemption/credit make enforcement and administration less difficult?						
4. Does this exemption/credit make the tax system more progressive?						
5. Is this exemption/credit prospective only? *Retroactive exemptions should be avoided because they impact governmental revenues that have already been allocated or spent, both state and local.*						
6. Is there a positive cost benefit to the state or local government that comes from this exemption/credit that justifies reducing the tax base?						
7. Can the entity requesting the exemption/credit provide documented estimates on its value?						
8. Do the entity estimates agree with state-provided fiscal estimates?						
9. If this is an exemption for a specific organization or subset of a larger group, and the exemption/credit was granted to all of the members of the group, would the fiscal note still be minimal?						