Approved: March 2, 2012
(Date)

MINUTES OF THE SENATE WAYS AND MEANS COMMITTEE

The meeting was called to order by Chairperson Carolyn McGinn at 10:30 AM on Wednesday, January 18, 2012 in 548-S of the Capitol.

All members were present.

Committee staff present:
Jan Lunn, Committee Assistant
Melinda Gaul, Chief of Staff, Senator McGinn's Office
Eli Johns, Intern, Senator McGinn's Office
Alan Conroy, Director, Legislative Research Department
J. G. Scott, Chief Fiscal Analyst, Legislative Research Department
Michael Steiner, Senior Fiscal Analyst
Bobbi Mariani, Fiscal Analyst, Legislative Research Department
Jill Wolters, Office of the Revisor of Statutes
David Wiese, Office of the Revisor of Statutes Office
Daniel Yoza, Office of the Revisor of Statutes

Conferees appearing before the Committee:
Secretary Nick Jordan, Department of Revenue

Others in attendance:
See attached list.

There were no bill introductions.

Presentation of the Governor's Tax Proposal

Secretary Nick Jordan, Department of Revenue, provided an overview of the Governor's Tax Plan. (Attachment 1) He described the reasons why the Governor believes tax reform is necessary including: increasing employment in Kansas, increasing Kansans' net income, and increasing the capital flow for small business growth. Secretary Jordan presented various statistics comparing Kansas' job losses, outmigration of Kansas tax filers, tax rankings compared to other states, and capital flow to other states.

Secretary Jordan provided the principles and rationale that guided Governor Brownback's tax reform plan and described the plan as:

- Moving income tax rates from three brackets to two brackets;
- Eliminating individual income tax on non-wage business income;
- Simplifying and streamlining the tax code;

- Bolstering the safety net for low-income Kansans while providing greater accountability;
- Holding the sales tax rate steady;
- Eliminating the two-year severance tax exemption on new pool oil and gas wells (except for oil wells generating fewer than 50 barrels a day);
- Leaving the corporate income tax rate unchanged.

A committee member requested that Secretary Jordan provide a document (without using a dynamic scoring model) reflecting the cost and lost revenue from reducing income tax rates; the cost and lost revenue from eliminating individual taxes on non-wage business income; additional revenue that will result from the elimination of itemized deductions and credits; the cost and lost revenue of the safety net for low-income Kansans; and the additional revenue that will result from the elimination of the two-year severance tax exemption. In addition, reconcile all those items to show new revenue with additional costs under the proposal. Secretary Jordan indicated that information would be furnished to committee members.

Secretary Jordan reported that Regional Economic Models Inc. (REMI) software was purchased in order to measure potential growth. REMI is an economic modeling software tool designed to inform public policy decisions on the economic effects of policy changes. The model focuses on how the impacts of economic changes in one area of the economy influence other areas of the economy in a specified geography. Using the proposed plan and the REMI software, the proposed tax plan could bring \$1.6-\$1.8 billion in increased disposable income in Kansas.

Following discussion and questions, Secretary Jordan's comments and responses appear below:

- Secretary Jordan clarified that the vast majority of Kansans would see a tax reduction under the plan. This includes individuals (even though itemized deductions are lost under the plan) and non-wage business income (as reported by limited liability companies LLCs, S-corps and sole proprietorships).

- A committee member expressed concern for the agriculture industry in Kansas, since many farmers are not LLCs. In addition, many farmers and ranchers want to see what eliminating tax credits and deductions will mean for tax breaks on production equipment and other expenses. Senator Jordan suggested the Farm Bureau might be a better resource to respond to this concern.

- If the proposal is passed, and non-wage business income is exempted, Secretary Jordan clarified he does not anticipate C-corps moving to an S-corps status due to the federal tax liability for S-corps.

- A committee member indicated that concerns about the plan exist; realtors and builders are disturbed about the elimination of home interest deductions and the historic tax credit. Secretary Jordan responded that many potential scenarios exist; tax rates are reduced under the plan (except corporate income taxes), and the mortgage interest deduction is still available under federal income tax deductions. Under the proposed plan, it is projected that with increased growth in the economy additional opportunities for home ownership would be created. He clarified that C-corps can still take advantage of historic tax credits under the proposed tax reform plan.

- Secretary Jordan reported that with the elimination of the Earned Income Tax Credit (EITC), $30 million will be shifted to the Temporary Assistance to Needy Families fund (TANF) and Medicaid, which will be used to draw down matching funding. Secretary Jordan commented that the federal government does allow this type of action.

- A committee member commented that when the state legislature voted on the temporary 1 percent sales tax increase, which is scheduled to be reduced by 0.6 percent in July 2013, then U. S. Senator Brownback could not support that increase. Secretary Jordan responded that the Governor's tax plan holds the sales tax rate steady at 6.3 percent, with 4/10 of each cent going to the highway fund. Studies show that sales tax rates have the least negative impact on economic growth relative to other tax types. Secretary Jordan indicated he would furnish the current percentages of sales, property, and income tax rates at a later time.

- A committee member shared that in meeting with local Chambers of Commerce, it was suggested to eliminate the 1 cent sales tax; Secretary Jordan mentioned the better question would be how much disposable income is in the area. He reiterated that sales tax rates have the least impact on economic growth.

- Secretary Jordan confirmed that if no income tax is paid, a loss cannot be deducted. Steve Anderson, Director of the Division of the Budget, responded that federal government deductions are still allowed; with the proposed state plan, full income will not be taxed; the previously allowed state depreciation reduction is small in comparison. Secretary Jordan commented that, due to the expense of administering the homestead exemption for renters program, it will be eliminated in the new plan; the homestead exemption for homeowners will continue.

- A committee member indicated the EITC is an incentive for low-income individuals to work; Secretary Jordan commented the rationale was to shift EITC monies into services such as TANF and Medicaid. Secretary Jordan confirmed incomes taxes would be reduced and EITC would be eliminated. It was suggested by a committee member that if the administration were to increase the eligibility requirement for poor adults (currently at the rate of 37 percent of Federal Poverty Level), a greater impact would be realized. Secretary Jordan indicated that the Kansas Department of Health and Environment and the Department of Social and Rehabilitation Services are designing the plan; he encouraged the Senator to forward concerns to those agencies.

Updated SGF Profile:
Alan Conroy, Director, Legislative Research Department, provided an updated State General Fund Profile, which includes the Governor's budget and tax proposal plan. (Attachment 2)

Fiscal and Liability Impact of Governor's Tax Plan:
Chris Courtwright, Principal Economist in the Legislative Research Department, discussed the fiscal and liability impact of the Governor's tax proposal (Attachment 3). He indicated that, in general, changes are revenue negative and positive for mineral and sales tax use. The fiscal impact of the plan will be felt in a reduction in the SGF: $89.9 million for FY 2013. The fiscal impact is provided through fiscal year 2018 in the attachment distributed. Mr. Courtwright indicated the analyses presented include much of the information requested earlier in today's meeting.

A committee member commented that if a larger fiscal note (negative number) were seen, it confirms state revenues are growing.

With regard to a question concerning average growth in receipts over a five to ten year period (prior to the recession), Mr. Courtwright indicated growth is difficult to predict coming out of recession. Historically, for the SGF to grow 4 percent in future years, significant growth would be seen in state sales and incomes taxes (greater than 4 percent yearly).

Mr. Courtwright explained that for 564,328 Kansas tax filers with an adjusted gross income of from zero to $25,000, their combined liability under the proposed plan would increase.

A committee member concluded that the 7.5 percent SGF ending balance (released a week ago) has changed to a 6.2 percent ending balance due to the unanticipated loss of $89.9 million for FY 2013 (as a result of the Governor's tax proposal).

Under the Governor's proposed plan for FY 2014, if the 0.6 percent portion of the sales tax were rolled back (according to current statute), the SGF net impact would be a negative $350 million.

Mr. Courtwright indicated the information distributed was provided by the Department of Revenue.

Senator McGinn requested that the information furnished, "Allowing the Credit for Taxes Paid to Other States, No Itemized Deductions, All Taxpayers," be expanded to include Kansas Adjusted Gross Income by age groups. Secretary Jordan will respond at a later date.

The meeting was adjourned at 12:01p.m.