HB 2395 Opponent testimony – in person
House Taxation Committee
5 percent income tax and repeal 'ratchet'
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KANSAS POLICY INSTITUTE

Chairman Johnson and Members of the Committee,

We appreciate this opportunity to testify in opposition to HB 2395, which would raise the personal income tax rates for all Kansans and repeal the procedure allowing for future income tax rate declines. A Fiscal Note was not available as this testimony was written, but the negative impact on all Kansans would be significant.

We have many reasons for opposing this tax increase.

First of all, budgets for the current and next two years can be balanced without a tax increase. The adjacent table is a modified version of the Governor's Budget Proposal. It uses the Governor's budget proposals except for the school funding increase this year, the KPERS changes, his tax increases and defers replacing idle funds until FY 2020. We also add our recommended use of school cash reserves, performance-based budget savings, the actual revenue variance above estimates for November through January and assumes a similar positive variance for the last five months. The February variance alone was more than we allowed for the remainder of the year.

Kansas General Fund Budget Plan (millions)			
Description	FY 2017	FY 2018	FY 2019
Beginning balance	$ 37.1	$ 71.5	$ 310.6
Nov. - Jan. revenue above estimate	$ 25.9		
Feb - June revenue above estimate?	$ 25.0		
Revenue Estimate November 2016	$ 5,980.1	$ 5,536.4	$ 5,575.4
Transfer idle funds	$ 317.0	$ -	$ -
Tobacco securitization		$ 265.0	$ 265.0
Gov. transfer & revenue adjustments	$ 18.4	$ 443.3	$ 483.0
Available Revenue	$ 6,403.5	$ 6,316.2	$ 6,634.0
Expenditures - Approved Budget	$ 6,357.5		
Medicaid caseloads	$ 40.7		
Gov. expense adjustment	$ 8.8		
Expenditures - Governor Budget Report		$ 6,261.9	$ 6,154.8
Don't use governor's KPERS changes		$ 140.2	$ 198.6
Excess school cash reserves >15%		$ (196.5)	
Performance-based budget savings		$ (200.0)	$ (200.0)
Lapse school finance reappropriation	$ (75.0)		
Adjusted Expenditures	$ 6,332.0	$ 6,005.6	$ 6,153.4
Ending Balance	$ 71.5	$ 310.6	$ 480.6

Changes to Governor's Budget Plan (millions)			
Description	FY 2017	FY 2018	FY 2019
Governor's Budget Ending Balance	$ 99.6	$ 216.5	$ 538.7
Adjust for prior year variance		$ (28.1)	$ 94.1
Delay repayment of idle funds		$ 45.0	$ 45.0
School finance adjustments	$ 6.9		
Assumed revenue estimate variance	$ 50.9		
Not using KPERS change	$ (85.9)	$ (140.2)	$ (198.6)
School cash reserves		$ 196.5	
Performance based budget savings		$ 200.0	$ 200.0
Not using Governor's tax increase		$ (179.1)	$ (198.6)
Revised ending balance	$ 71.5	$ 310.6	$ 480.6

Source: Kansas Division of Budget

To arrive at the excess school cash reserves, we calculate each district's operating cash reserves (excluding federal, capital and debt) as of July 1 2016 as a percentage of its operating costs (total less capital and debt) for the 2016 school year. The amounts of operating cash reserves in excess of 15% of operating expense across all districts totaled $196.5 million for the 2016 school year. Our calculation of operating cost excludes any Capital Outlay that was allocated to Instruction or other operating costs (since we exclude Capital Outlay carryover funds) but federal spending is still layered through operating costs; removing federal operating costs would produce a higher carryover ratio since the denominator would be reduced and therefore result in more carryover reserves being 'swept' next year. One might consider that a hedge against unknown changes for the 2017 school year. There are other ways to do the calculation of course (e.g., excluding funds in Gifts & Grants) but the process is the same…reflecting the percentage of carryover funds at the beginning of the year as a percentage of the expenditures out of those funds for the year.

The estimated savings from the performance-based budget review is roughly 6% of non-K12 expenditures.

Kansans Oppose Balancing the Budget with Personal Income Tax Hikes

The Fiscal Note on SB 192 shows a $2.4 billion tax increase over five years; subtracting the $974 million from the Fiscal Note on the repeal of the pass-through exemption in HB 2023 , the balance of this proposal – $1.4 billion falls on individuals.

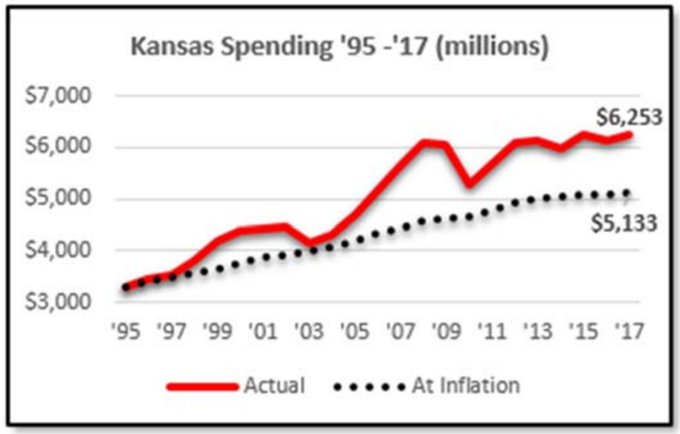
Balancing the budget primarily with a hike on personal income taxes is not what citizens want, however, according to scientific market research. Asked how legislators should close the budget shortfall over the next two years, a plurality of Kansans (38 percent) say to reduce the cost of government, followed by increasing the tax on cigarettes and alcohol (25 percent). Only 4 percent of Kansas say increasing income taxes on individuals should be the primary approach.

Q2: Which is the best way to close budget shortfalls over the next two years?								
501 Registered Voters	All	Region				Ideology		
Credibility Interval: ± 4.5 pct points		Western Kansas	Wichita Area	Kansas City Area	Eastern Kansas	Conserv	Mod.	Liberal
Increase income tax on citizens	4%	1%	4%	3%	6%	3%	6%	4%
Increase income tax on business	17%	28%	19%	13%	15%	15%	19%	19%
Increase the sales tax	5%	2%	9%	4%	2%	6%	3%	7%
Inc. tax on cigarettes & alcohol	25%	12%	22%	32%	26%	28%	26%	19%
Reduce the cost of government	38%	49%	36%	37%	38%	39%	38%	34%
Transfer from highway/other funds	2%	0%	2%	4%	1%	1%	1%	6%
Other	5%	5%	3%	4%	6%	4%	3%	7%
Not Sure	5%	3%	6%	4%	6%	4%	4%	5%

SurveyUSA conducted the study on behalf of Kansas Policy Institute between February 3 and February 8; with participation of 501 registered voters, the survey has a Credibility Interval of ± 4.5 percentage points.

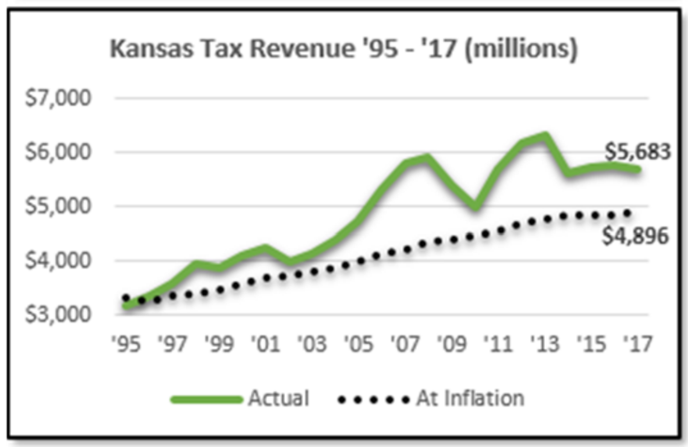
Inefficient Spending

The Kansas budget problems primarily arise from lack of spending control. The budget could have been balanced following passage of the 2012 legislation by having government operate about 8.5 percent more efficiently; spending thereafter could increase as revenue grew and there always would have been healthy ending balances. The need to adjust spending was well-known, but Democrats and many Republicans refused to make government more efficient, so spending and taxes were increased in 2013...and again in 2015.



This fiscal year, General Fund spending is estimated at $6.253 billion, which is $155 million more than was spent in 2012 when tax relief was passed. Approximately $104 million of school transportation funding was also shifted from the General Fund to the All Funds budgets, so the real increase is even greater.

General Fund spending has also increased well above inflation-adjusted levels since 1995. Had 1995 spending been increased for inflation it would be $5.133 billion but actual spending was $1.12 billion more.



And even though Kansans have been allowed to keep more of their hard-earned money, General Fund tax revenue is also well above inflation-adjusted levels since 1995. Tax revenue is estimated to be $5.683 billion this year, which is $787 million more than if 1995 tax revenue had increased for inflation.

Spending data from the National Association of State Budget Officers shows that the states that tax income spent 42 percent more per-resident in 2015 than the states without an income tax; Kansas spent 27 percent more per-resident. It's not access to natural resources or tourism that allows states to keep taxes low; it's simply the spending. The more a state chooses to spend, the more it must tax.

Identifying the savings opportunities takes effort, as explained by former Indiana Governor and now President of Purdue University, Mitch Daniels. He said, "This place was not built to be efficient. [But] you're not going to find many places where you just take a cleaver and hack off a big piece of fat. Just like a cow, it's marbled through the whole enterprise." Governor Daniels was speaking of Purdue but his comment applies universally to government – and also to the private sector.

Fairness Issues

It's also unnecessary to raise taxes given the broad range of income, sales and property tax exemptions in Kansas. The income tax exemption on pass-through income creates a legitimate issue of fairness but the Legislature has long approved (and thus far declined to rescind) many other exemptions, including:

- Retirees of state universities and the Board of Regents participating in their 403(b) plan are exempt from state income tax on withdrawals. Private sector citizens are fully taxed on their pension and 401(k) withdrawals.

- Retirees of other state agencies, school districts and local government participate in the Kansas Public Employees Retirement System (KPERS). They are taxed on their personal contributions to the pension program but are never taxed on the majority of their withdrawals, which come from employer contributions and earnings on all contributions.

- Legislators get an even better deal. In addition to preferential tax treatment, their pensions are based on having worked a full year and earned about $85,000 instead of what they are actually paid – less than $10,000 per year.

- The Legislature allows local government to exempt chosen businesses from state and local sales tax with the use of STAR bonds and Industrial Revenue Bonds, which results in others being taxed more to make up the difference.

- The Legislature provides sales tax exemptions to a wide array business activities, services, retail purchases and many non-profit organizations (for the record, KPI pays sales tax) totaling more than $5 billion dollars annually. Some of the exempt entities even came to the Legislature one at a time asking for special treatment.

- The State of Kansas' HPIP program exempts businesses selected by government from sales tax and provides income tax credits. The PEAK program allows businesses chosen by government to keep 95 percent of their eligible employees' state income tax withholding for up to 10 years.

Conclusion

We oppose HB 2395 and encourage the Legislature to do so as well.