



February 16, 2021

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Kansas Action for Children
Written testimony in opposition to House Bill 2186
House Taxation Committee

Chairman Smith and Members of the Committee:

Thank you for the opportunity to provide testimony in opposition to HB 2186. Kansas Action for Children (KAC) is a nonprofit, nonpartisan organization. Our vision is to make Kansas the best state to raise -- and be -- a child, and we shape health, education, and economic policies that improve the lives of Kansas children and families. We support budget and tax policy that prioritizes investments in children and families, particularly those with low incomes.

KAC is opposing HB 2186 because implementing an elective single sales factor (SSF) formula for certain industries would be a step back from fair tax policy for Kansas businesses. The current three-factor apportionment formula that balances property, sales, and payroll in the state as the determinants of a multistate corporation's tax obligations to the state is consistent with the fundamental objective of the corporate income tax, which is to ensure that companies support the state services from which they benefit. Corporations with a substantial physical footprint in the state obviously benefit more from those services, yet SSF ignores that footprint in determining their tax liability. An SSF formula would disproportionately favor businesses that have property and employees in Kansas, but little sales.¹

A change to a single sales factor formula does not attract jobs but does repel revenue. Research² has found an SSF formula will not attract manufacturing jobs (one of the industries that would be eligible to use the SSF formula) disproving previous research³ arguing the opposite. The table below prepared by the Center on Budget and Policy Priorities demonstrates that SSF is not strongly correlated with manufacturing job creation or retention. States with and without SSF are intermingled. If SSF was associated with an increase in jobs, we should see SSF states clustered at the top of the table and states with three-factor formulas clustered at the bottom. But that is not

¹ Institute on Taxation and Economic Policy. "Corporate Income Tax Apportionment and the 'Single Sales Factor.'" August 1, 2012. <https://itep.org/corporate-income-tax-apportionment-and-the-single-sales-factor/>

² Merriman, David. "A Replication of 'Coveting Thy Neighbor's Manufacturing: The Dilemma of State Income Apportionment' (Journal of Public Economics 2000)." *Public Finance Review* 43, no. 2 (March 2015): 185–205. <https://doi.org/10.1177/1091142114537892>.

³ Goolsbee, Austan and Maydew, Edward L., *Coveting Thy Neighbor's Manufacturing: The Dilemma of State Income Apportionment* (February 1999). Available at SSRN: <https://ssrn.com/abstract=160535> or <http://dx.doi.org/10.2139/ssrn.160535>

what the table shows.

It should not be surprising that the latest statistical research and the actual experience of single sales factor states does not support the claim that the adoption of this formula boosts in-state investment and job creation. The formula simply provides a windfall tax cut for certain corporations that happen to have a disproportionate share of their property and personnel in a state relative to the share of their sales. The tax cut is in no way contingent on their future job-creation behavior. Corporations can benefit from the tax change in perpetuity even if they never create a single new job in Kansas.

We know an SSF formula usually results in a significant drop in state revenue. As this statement is being prepared the fiscal note on this bill is unfortunately not available. However, New Mexico's elective single sales factor formula reduced its FY18 corporate income tax revenue by \$35 million,⁴ representing 18.3 percent of its total corporate tax receipts in that year. If Kansas had this formula in effect in FY20 and suffered an equivalent revenue loss, corporate income tax revenues would have been \$70.3 million lower. To create jobs, Kansas needs "a more educated workforce, higher quality infrastructure, and other building blocks of a healthy economy."⁵ This bill would lose the needed revenue to sustain and increase those components of a healthy economy.

Even within the Tax Foundation's Report to the legislative tax committees in 2020, they consider the merits of the traditional three-factor apportionment to the single sales factor:

"However, lawmakers should bear in mind the potential revenue consequences of any change in the apportionment formula. (States have undisputed authority to tax businesses with property and payroll in their states, but *under federal law, states lack nexus to tax companies that sell into a state but have no other connections to that state. Therefore, an exclusive focus on sales may generate less revenue, since some companies otherwise captured by that apportionment formula are not, in fact, subject to taxation.*")⁶ (italics and bold mine)

The Tax Foundation report made clear the complications of shifting to a single sales factor method. More consideration of corporate income tax aspects like the base rate, surtax rate, and other corporate provisions seemed more pressing. Of all the choices to improve corporate income tax, is the single sales factor the right choice right now?

⁴ New Mexico Tax Expenditure Report for 2019 and 2020, p. 52.

⁵ Mazerov, Michael. Center on Budget and Policy Priorities. "Case for 'Single Sales Factor' Tax Cut Now Much Weaker." April 1, 2015. <https://www.cbpp.org/blog/case-for-single-sales-factor-tax-cut-now-much-weaker>

⁶ Tax Foundation Report on Kansas Tax Modernization from December 2019: <https://taxfoundation.org/kansas-tax-reform/>

While KAC opposes this bill and the use of the SSF formula to determine taxable business income, if the committee decides to move forward with this bill, KAC urges you to consider two amendments.

- First, this committee should make single sales factor apportionment mandatory for the industries named in the current bill, not elective – as all but four (Arizona, New Mexico, North Dakota, and Virginia) of the other states with this formula do. The elective option is the worst possible choice, which would sharply cut and potentially even eliminate (for manufacturers with only out-of-state customers) tax liability for corporations based here while allowing out-of-state businesses to continue using the current three-factor formula that minimizes their Kansas tax liability. Elective SSF for manufacturers proved so costly to California that voters approved a ballot measure in 2013 to repeal it two years after it took effect.⁷ Out-of-state manufacturing businesses already benefit from a federal law (Public Law 86-272) that exempt them from taxes unless they have a physical presence in the state. If the goal of this bill is to incentivize Kansas job creation, why would we give a tax break to out-of-state businesses that create few (if any) jobs here by allowing them to choose the formula that enable them to pay the lowest tax?
- Second, the committee should enact provisions to ensure businesses that benefit from SSF are investing in the state, like what Kansas had in place previously. As you can read in the bill language, previously businesses were only eligible to make an SSF election if they could demonstrate investment, for example through construction and paying employees above average wages (starting on pg. 6 of the bill). If the goal of this legislation is to create jobs, the bill language should clarify this expectation as a condition of using SSF. The businesses should only be eligible if they create measurable and significant in-state jobs and investment in the state. While KAC generally does not support tax incentives, we believe targeted tax incentives would be more accountable and cost-effective than this proposed legislation.

Again, KAC does not support this legislation or the use of an SSF formula. As the bill stands, it serves as a giveaway to corporations under the belief that corporate tax cuts increase jobs. Kansas learned the hard way in recent years that this belief is not only false but actively harms the state's economic condition.

KAC urges you to oppose HB 2186. We look forward to working with you to identify better ways to retain and attract jobs and businesses to Kansas, but HB 2186 would fail to do that. In addition, this policy change would reduce and make uncertain corporate tax receipts as we balance our budget during the difficult years ahead. Thank you for the opportunity to voice our opposition, and please do not hesitate to contact me at emily@kac.org if you have any questions.

⁷ Alan Prohosky, "Revenue Estimates of California's Apportionment Changes," State Tax Notes, August 13, 2018.

Percent Change in Manufacturing Employment, Dec. 2000–Dec. 2020
 In States with Corporate Income Taxes (data not seasonally-adjusted)

If greater weighting of the sales factor encouraged manufacturing job growth/retention, states shown in bold would be clustered toward the top, and states in italic would be clustered toward the bottom.

| | |
|--------------------|---------------|
| Utah | 11.9% |
| North Dakota | 0.4% |
| Idaho | -0.6% |
| Iowa | -9.5% |
| <i>Montana</i> | <i>-11.2%</i> |
| Nebraska | -13.4% |
| <i>Alaska</i> | <i>-17.7%</i> |
| Arizona | -18.6% |
| Florida | -19.3% |
| Oregon | -19.5% |
| Colorado | -19.6% |
| Wisconsin | -20.3% |
| <i>Kansas</i> | <i>-20.5%</i> |
| Kentucky | -21.1% |
| Minnesota | -22.2% |
| South Carolina | -22.2% |
| Indiana | -22.4% |
| Alabama | -22.7% |
| Missouri | -25.5% |
| Georgia | -26.2% |
| Louisiana | -26.5% |
| Tennessee | -30.9% |
| <i>Oklahoma</i> | <i>-31.7%</i> |
| Mississippi | -31.8% |
| Connecticut | -32.7% |
| <i>Hawaii</i> | <i>-33.9%</i> |
| California | -35.0% |
| Illinois | -35.3% |
| Virginia | -35.5% |

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|----------------------|---------------|
| Maryland | -36.8% |
| Pennsylvania | -37.3% |
| Maine | -37.3% |
| West Virginia | -37.4% |
| New Mexico | -37.6% |
| Arkansas | -37.8% |
| New Hampshire | -38.2% |
| Delaware | -39.1% |
| Vermont | -39.7% |
| North Carolina | -40.1% |
| Massachusetts | -41.9% |
| New Jersey | -42.1% |
| Rhode Island | -45.8% |
| New York | -46.2% |

States with Single Sales Factor Formula in Effect Through Period in **Bold**

States with Equally-Weighted 3-Factor Formula in Effect Throughout Period in *Italic*