

Recommendations from KACIR to accompany the Policy Evaluation Guide

The relative burden of taxes borne by state and local property tax is now high compared to state and local sales taxes and state income taxes. Policy choices as well as the economy and taxpayer behavior have contributed to this shift. Generally, Kansas strives to keep these three sources at about one-third each.

State and Local Tax Receipts	FY 1995	FY 2010	
Sales and Use (state and local)	33.2%	\$2.944B	30%
Income (Individual and Corp) and Privilege	29.0%	\$2.700B	27%
Property, real and personal	37.8%	\$4.335B	43%

Shrinking Tax Bases

A. KACIR continues to be concerned about legislative actions that shrink the tax base for both the state and for local governments. One proposal surfaced at the public forums in response to granting economic development property tax exemptions in recent years.

KACIR recommends the Legislature consider allowing a county to opt out of a property tax exemption (prospective only). For example, if an exemption for wind farms was granted statewide, then a board of county commissioners would be able to pass a resolution to say that exemption wouldn't be in effect in that particular county

B. A Policy Evaluation Guide, published in 2009, continues to provide guidance on policy choices when enacting exemptions and credits. KACIR will distribute the guide to all legislators and staff in the 2011 legislative session.

C. Knowing that the state budget resources are limited and there is no legislative appetite for tax increases, the KACIR continues to recommend the following strategies to address the erosion of the tax base and the imbalance in the state's three major funding sources.

1. Property Tax Recommendations

a. The legislature should not enact any new property tax exemptions for the years 2011 and 2012. After that time, any new exemption that is granted should automatically sunset in 3 years to ensure a review of its effectiveness.

b. Property Valuation Division should examine the cap rate for use value determinations and consider recommending a change, if warranted.

2. Sales Tax Recommendations

a. KACIR notes that 2010 was the first year in many years that no sales tax exemptions were granted. Local governments are very dependent on the sales tax to supplement the property taxes as a source of revenue, but they have little say in exemptions that are granted.

b. KACIR encourages the Legislature to continue the moratorium on any new sales tax exemption granted for the years 2011 and 2012. Any new exemption that is granted should automatically sunset in 3 years.

c. KACIR urges continued study of existing sales tax exemptions and recommends broadening the sales tax base in order to lower the sales tax rate.

Some policy choices to consider include:

(1) Repeal all exemptions granted “by name” to a specific organization. Either replace it with an exemption for all organizations similarly situated, or revoke the exemption.

(2) Tax all admissions to recreation activities or events, whether operated by a non-profit organization, city, county or private organization. Determination of taxability should not be based on who operates the service, but rather whether the service should be taxable or exempt.

(3) Reestablish the policy that was set by the Hodge Commission that all non-profit and religious organizations pay sales tax on their purchases. Alternatively, exempt all non-profits. The current situation is that there is no consistency in the awarding of exemptions. Some pay; some don't.

(4) Clarify the original construction statute to remove “repair” and tax separately the “repair” of personal property. (Currently these services are taxed if they include the alteration or repair of tangible personal property.) The result is that washing a floor is not taxed, but waxing a floor (applying tangible personal property) is taxed. There are also problems with distinguishing labor services in the repair area from original construction. Rewrite those statutes for clarity and ensure that all the household labor services are appropriately taxed, with or without the application of tangible personal property.

(5) Consider imposing a sales tax on household or personal services more broadly. These include items such as tanning beds, beauty and barber, etc. A specific imposition statute would be required. The KACIR recommendation does NOT include business inputs or health services such as medical, dental, legal, advertising, etc. The fiscal note for personal services is approximately \$5.9 million in FY2011.

(6) Develop and adopt a comprehensive policy for exempting fund-raising events of non-profit organizations and require all existing exemptions to come into compliance with this policy by 2012. It is estimated a fund-raising exemption, limited to certain types of activities, would reduce state sales tax revenues by \$10 million in fiscal year 2012.

3. Income Tax Recommendations.

Tax credits have continued to proliferate, as do the requests from business to retain the withholding tax as an incentive to development in addition to other tax

incentives. Major changes were made in the 2010 session to several tax credit/wage withholding incentive programs. Income taxes are still the most elastic tax source (grow as the economy grows) but without some protection, this most important of tax sources will soon erode significantly in the same manner as the property and sales taxes.

The following recommendations protect the income tax base (corporate, individual and privilege):

- a.** The PEAK program should not be expanded for at least two years until the program can be evaluated for its effectiveness.
- b.** New income tax credits should not be granted by the legislature for the years 2011 and 2012. Any new credit that is granted should automatically sunset in 5 years so that it may be evaluated.
- c.** There are numerous credits that are no longer used which should be repealed for two reasons: the space on the tax form is limited, and with the move to electronic filing, the vendors do not want to program for a credit that is not used.
- d.** Those credits that were only minimally used, under \$100,000 should be reviewed by the legislature in 2011.

¹The Joint Committee on the State Tax Structure, otherwise known as the Hodge Commission, was created in 1968 “to make studies, and provide reports with recommendations thereon to the legislature, concerning the various taxes of the state and their relationship to each other and to the economy and public interest.”