

Report of the Special Committee on Assessment and Taxation to the 2018 Kansas Legislature

CHAIRPERSON: Representative Steven Johnson

VICE-CHAIRPERSON: Senator Caryn Tyson

OTHER MEMBERS: Senators Tom Holland and Dan Kerschen; and Representatives Ken Corbet, Tom Sawyer, and Kristey Williams

STUDY TOPIC

Review and Monitor State Revenue Sources and Analyze Implementation of the Tax Lid

- The Committee will review major state revenue sources and changes in state tax policy enacted in recent years; monitor implementation of the new individual income tax law by the Department of Revenue; conduct an overview of the State General Fund finances as it relates to FY 2018 and FY 2019; analyze additional issues involving taxation by local units of government, including implementation of the tax lid; and make any recommendations deemed appropriate to the 2018 Legislature.

Special Committee on Assessment and Taxation

REPORT

Conclusions and Recommendations

The Committee notes the final impact on receipts, taxpayers, and the economy of the 2017 *individual income tax law changes* cannot be fully ascertained until returns have been filed in the spring. The Committee recommends the standing taxation committees continue to look at *property tax limitation mechanisms* used in other states; oversight, evaluation, and enforcement of the *current tax lid* be assigned to a single state agency; and additional *exemptions to the tax lid* be considered for certain costs borne by cities and counties that are outside of their control. The Committee notes three elections on property tax increases have been conducted, with voters approving two and one failing. The Committee recommends further study of the current *agricultural land use valuation system* to allow changes in valuation to more closely be associated with current market realities. The Committee finds that a more complete *disclosure of state and local tax incentives* would provide additional accountability and transparency and enable more rigorous cost-benefit analyses and consideration of possible “clawback” legislation. On the issue of *collecting tax on sales from remote vendors*, the Committee is encouraged by efforts being undertaken by a number of other states and recommends that Kansas continue to participate in all organizations and discussions designed to enhance the collection of taxes on goods shipped to consumers.

Proposed Legislation: None

BACKGROUND

Given the number of changes in state tax policy in recent years (including multiple changes in the individual income tax, two increases in the state sales tax rate, and reimposition of a property tax lid on certain local units of government), the Legislative Coordinating Council (LCC) received several requests for interim tax policy studies. As a result, the LCC subsequently approved a broad-based topic generally charging the Committee with reviewing major revenue sources and some of the policy changes made in recent years.

COMMITTEE ACTIVITIES

The Committee met on December 7-8, 2017, and reviewed the charge from the LCC.

Staff outlined the latest Consensus Revenue Estimates made in November and the implications

those changes had for projected ending balances in FY 2018 and subsequent years.

Department of Revenue officials presented information on the implementation and timing of certain features associated with the new individual income tax law, including the promulgation of withholding tables that were released over the summer.

Staff distributed information about the history of property tax limitations in other states and on the history of school district property taxes in Kansas.

Another presentation covered the history of the sales tax in Kansas dating back to its enactment in 1937.

Department of Revenue officials provided the latest data on fiscal notes associated with the potential repeal of sales tax exemptions and with

extending the tax to a number of currently untaxed services.

Staff explained the new property tax lid that was effective for budgets set by local units of government over Summer 2017. The Committee then held a public hearing on potential changes to the tax lid. Representatives of the Kansas Association of Counties and the League of Kansas Municipalities said enacting 2017 HB 2424 and providing additional exemptions would be helpful for cities and counties if the tax lid were going to be made more workable in the future.

Auditor staff from Legislative Division of Post Audit presented the Committee with two recently completed audits: one involving how other states evaluate and inventory tax incentives and a second covering how Kansas treats agricultural land for property tax purposes.

A representative of the Tax Simple Center told the Committee Kansas would be better served by adopting a more streamlined individual income tax and suggested he would be willing to work with policymakers to draft a proposal.

Staff covered the 1992 *Quill* decision by the U.S. Supreme Court involving the ability of states to attempt to tax sales by remote vendors. A representative of the Department of Revenue presented the latest information on legislative efforts by the states and discussed the status of current litigation that could overturn some of the precedents set in the 1992 case.

At the conclusion of the two-day meeting, the Committee directed staff to prepare the final report outlining its conclusions and recommendations to the 2018 Kansas Legislature.

CONCLUSIONS AND RECOMMENDATIONS

Individual Income Tax Law Changes

The Committee notes the final fiscal impact of the 2017 individual income tax law changes cannot be fully ascertained until returns are filed and processed in the spring, nor can the impact on taxpayers and subsequent impact on the state's economy. The Committee states the 2018 Legislature should keep this in mind when

evaluating another round of major changes to the state and local tax structure. In particular, the Committee wishes to express concern over the relatively high combined state and local sales tax rate (the eighth highest nationally, according to one study) and what that means for competitiveness and the overall health of the state's economy.

The Committee is intrigued by the income tax simplification proposal advanced by the Tax Simple Center and encourages proponents of that idea to continue to work with the Department of Revenue, tax professionals, and the standing committees.

Property Tax Limitation Mechanisms

Relative to ongoing concerns over property tax burdens, the Committee recommends the standing committees review other statutory and constitutional property tax limitation methodologies employed by other states to determine whether any of those mechanisms would be more effective than the current Kansas property tax lid.

Current Tax Lid

The Committee asks the Kansas Association of Counties to provide information about 2017 tax lid election results to the 2018 Legislature. Such information should include the costs of the elections, the amount of additional tax dollars in excess of the lid that were subject to the elections, and what specific projects those additional property taxes were proposed to fund.

The Committee notes exceptions to the property tax lid were approved by voters in two elections and failed in one election in 2017 and recommends such property tax lid election results and information be tracked each year on an ongoing basis and that those results be reported annually to the standing taxation committees alongside local sales tax election results. But the Committee also recognizes that, under current law, no single state agency is charged with oversight, enforcement, or data collection relative to the tax lid and recommends the 2018 Legislature consider assigning these responsibilities to a specific state entity.

Exemptions to the Tax Lid

A number of costs borne by cities and counties under current law are outside the control of governing bodies, and the Committee recommends review of additional exemptions from the provisions of the tax lid, including for additional costs associated with employee benefits and for payments made for leases to public building commissions. Another issue that could be addressed legislatively involves the September 15 requirement for a mail ballot tax lid election that does not appear to be statutorily flexible, and that date falls on a Saturday in 2018. (*Note: KSA 2016 Supp. 25-433a provides, if September 15 is a Sunday, the election shall be the next business day.*) The Committee notes HB 2424 will begin the 2018 Session on General Orders in the House and would be an appropriate vehicle to use in continuing discussion of many of these tax lid issues.

Agricultural Land Use Valuation System

The Committee acknowledges the current averaging system for use valuation of agricultural land for property tax purposes was designed to provide stability and certainty, but that system can produce changes in valuation that do not reflect current market realities. The Committee recommends the 2018 Legislature further examine possibilities for the formula that might more closely synchronize changes in valuation with changes in prices, including considering the number of years being averaged, and using a simple average as opposed to a rolling average approach.

Disclosure of State and Local Tax Incentives

The Committee recommends the standing taxation committees be briefed on the final series of “best practices” recommendations being developed by the Legislative Division of Post Audit as of December 15 in the wake of the audit on how other states inventory and evaluate certain tax credits and exemptions. The Committee is especially interested in a rigorous review process similar to one used in Indiana, as well as certain full disclosure requirements similar to those used in New Mexico. If that review can be supported by legislative action, the Committee recommends that action to the Legislature.

In the name of accountability and transparency, the Committee believes a more complete disclosure of tax incentives is a necessary first step in weighing whether those foregone state and local tax dollars might instead be put to other uses (including potentially other better targeted and more efficient tax incentives). More disclosure also would allow policymakers to consider more rigorous enactment or enforcement of “clawback” provisions that would enable the public sector to recover resources if incentive recipients do not adhere to certain requirements or stipulations.

The Committee finds that all major state and local tax incentive programs should be subject to an annual independent cost-benefit analysis presented to the standing taxation committees.

Finally, the Committee finds the logic of the U.S. Supreme Court compelling in the 1983 decision *Regan v. Taxation With Representation of Washington*, 461 US 540:

“Both tax exemptions and tax-deductibility are a form of subsidy that is administered through the tax system. A tax exemption has much the same effect as a cash grant to the organization of the amount of tax it would have to pay on its income.”

This language from the Court equating tax exemptions and government subsidies, in essence, suggests there is no practical difference between an exemption and an appropriation. As such, the Committee stated Kansas needs to do a better job monitoring the utilization of its state tax dollars.

Collecting Tax on Sales from Remote Vendors

On the issue of collection of sales tax from remote vendors, the Committee is encouraged by the efforts being undertaken in recent years by many states, including South Dakota, Colorado, and Massachusetts. The Committee is satisfied with the action taken to date similar to efforts of Colorado and South Dakota, but recommends consideration of the Massachusetts approach and possible necessary legislation. Kansas should continue to participate in all multi-state

organizations and discussions designed to enhance the ability of states to collect sales and use taxes on taxable goods shipped to consumers. Should the 1992 U.S Supreme Court precedent from *Quill* not be overturned with a new decision to reflect marketplace realities of the 21st century, the Committee recommends the Kansas Legislature continue to encourage members of the Kansas

Congressional delegation to enact authorizing federal legislation referenced in that original decision. Creating a level playing field and providing equity for main street business in Kansas is of increasing concern for the state's economic development. Moreover, collection of tax on currently unreported sales would improve the revenue elasticity of the sales tax and reduce the pressure on other tax sources.