



GOVERNOR'S COUNCIL ON TAX REFORM

Laura Kelly
Governor of the State of Kansas

GOVERNOR'S COUNCIL ON TAX REFORM

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Co-Chair
Former Kansas State Senator

Steve Morris
Co-Chair
Former Kansas State Senator

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COUNCIL'S ACADEMIC ADVISOR

Dr. Donna K. Ginther
Institute for Policy and Research Director, University of Kansas
Chief Academic Advisor

IN MEMORIAM

Carl Brewer

Former Mayor of Wichita

March 8, 1957 - June 12, 2020

Sadly, Carl Brewer, one of the Council's original members, passed away on June 12, 2020. Carl's history of public service is well known. After working more than 30 years in the aircraft industry, Carl served the City of Wichita as a City Council Member and as Mayor. He served Wichitans in either of those roles from 2001 to 2015. Carl is credited with overseeing the revitalization of downtown Wichita and being a key figure in the development of the Eisenhower Airport. With that experience, he ran in 2018 for governor. Upon Governor Laura Kelly's election, he served as a member of Governor Kelly's transition team and later named a member of the Governor's Council on Tax Reform.

“Carl was an outstanding Mayor, served for more than two decades in the Kansas National Guard, and was a strong supporter of the Kansas Labor community,” **Governor Laura Kelly said**. “I have no doubt the impact of his contributions to our state will be felt for generations to come. I'm also grateful for his service in my administration, both during our transition, and later when he played an integral role on the Governor's Council on Tax Reform. Carl truly embodied all of the best qualities of what it means to be a Kansan, and he will be dearly missed.” Carl's insight will be sorely missed as the Council continues its important work in 2021.

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SECOND INTERIM REPORT OF THE GOVERNOR'S COUNCIL ON TAX REFORM

BACKGROUND

On September 9, 2019, Governor Laura Kelly signed Executive Order 19-11 ([Appendix 1](#)) which established the Kansas Council on Tax Reform to bring together a diverse group of experts and stakeholders committed to a shared vision of increased prosperity and well-being for all Kansans. The Order noted that fair and efficient tax policy is necessary to grow the economy, allow citizens to thrive, and predictably fund state and local units of government. The Council's work to evaluate the overall adequacy and equity of the state and local tax systems was deemed especially important given the implications of dramatic changes in state tax policy since 2012.

The Council was to submit an initial report to the Governor late in 2019 or early in 2020 regarding potential legislative recommendations for consideration during the 2020 session; and continue to monitor a number of public finance issues throughout 2020 before submitting a final report by December 1, 2020.

The global COVID-19 pandemic significantly truncated the 2020 legislative session and its policy deliberations - while at the same time creating an entirely new set of demands on the public sector and reducing available resources to address such demands because of the collapsing economy and its impact on receipts.

Governor Kelly, on November 19, 2020, subsequently announced that the Council's important work would be extended into 2021 to help policymakers digest the very latest economic and revenue forecasts and continue robust discussion of any and all tax reform proposals given the new realities involving the ongoing nature of the COVID-19 crisis.

COUNCIL ACTIVITIES

Prior Recommendations

The Council's first interim report ([Appendix 2](#)) from January of 2020 included a number of recommendations:

A. Digital Goods

1. Council Recommendation

Changes in technology have allowed what once were taxable sales of tangible personal property to avoid tax merely because the property is delivered in digital format. The technological advances in the delivery of products were never contemplated 83 years ago when the state sales and use tax was enacted in 1937. The state and local sales tax base continues to shrink in light of these unintended exclusions. The Council believed that the current treatment of digital asset sales is not fair and equitable. The inclusion of digital products in the sales and use tax base would be another step toward leveling the playing field between brick-and-mortar stores and retailers selling digital products. The Council recommended that the 2020 Kansas Legislature join 29 other states who include the sale of digital products in the state and local sales tax base.

2. Fiscal Note

FY 2021 -- \$45.6 Million (all funds)

FY 2022 -- \$50.4 Million (all funds)

B. Marketplace Facilitator

1. Council Recommendation

K.S.A. 79-3705c allows Kansas to require out-of-state retailers to register and collect and remit compensating use tax on sales of tangible personal property into the State of Kansas. The Department of Revenue issued Notice No. 19-04 on August 1, 2019 notifying out-of-state retailers to register with the State of Kansas. The existing statutory scheme does not allow Kansas to require marketplace facilitators to do the same. A marketplace facilitator is a person who facilitates sales by an internet retailer through a physical or electronic marketplace. Kansas is one of only three states that has not enacted a marketplace facilitator provision. The Council recommended that the Legislature consider and pass legislation that would require marketplace facilitators to register and begin collecting compensating use tax on sales to Kansas customers. This legislation would further level the tax playing field that has for 53 years been skewed in favor of out-of-state retailers and against in-state main street Kansas retailers.

2. Fiscal Note

FY 2021 -- \$30.4 Million (all funds)

FY 2022 -- \$33.6 Million (all funds)

C. Food Sales Tax Refundable Income Tax Credit

1. Council Recommendation

In order to reduce the regressivity of the sales tax on food, the Council recommended consideration of a new refundable food sales income tax credit that would benefit as many as 400,000 Kansas households to help offset state and local sales tax paid on groceries. Elimination of the prior food sales tax rebate program in 2012 coupled with sales tax rate increases exacerbated the overall regressivity of the Kansas tax structure. The Council noted that targeting this relief to low and moderate-income taxpayers would be a more effective way of providing relief to those who need it the most than would lowering the sales tax rate by one cent on all food purchases.

2. Fiscal Note

FY 2021 – (\$53.2) Million (all funds)

FY 2022 – (\$54.8) Million (all funds)

D. Property Tax Lid Exemption

1. Council Recommendation

An issue of critical importance to the continued cost-share approach for transportation projects concerned the local property tax lid. The Council recommended consideration of legislation that would provide an exemption from the tax lid for cities and counties for transportation costs that would allow the local units to participate in the funding of infrastructure projects as partners with the state.

2. Fiscal Note

FY 2021 – No fiscal effect on state property tax revenues

E. Local *Ad Valorem* Property Tax Reduction Fund (LAVTRF)

Levy rates are staggering, especially in many rural counties, and are a significant burden for homeowners and constitute a major impediment to local economic development efforts. In light of these rates, the Council recommended the favorable consideration of renewing LAVTRF distributions, which have been suspended since 2002, with the proviso that an extra share of available funds be distributed to those rural counties with the highest average mill levy.

F. Reaffirmation of the “Three-Legged Stool”

History will reflect that policymakers in 1992 made a conscious decision to reduce the property tax leg of the stool by increasing income and sales taxes and providing funds to schools to provide property tax relief through the then new K-12 funding law. This balanced approach was embraced by members of both parties for 20 years. Indeed, the Governor’s Tax Equity Task Force formed by Governor Bill Graves in 1995 embraced the balanced “three-legged” approach and concluded that a balanced and diversified approach would reduce problems caused by over-reliance on a single revenue source. There are equity considerations implicit in this broad-based approach to state and local taxes. In relying on all three major sources, there is one that is considered regressive (sales), one progressive (income) and one somewhere in between (property).

The Council believes the stool has again moved out of balance and is too property tax heavy due in large part to the massive income tax reductions between 2012-2016 that effectively shortened that leg of the stool. The latest figures show that for FY 2019, the property/vehicle leg was over 34 percent of total state and local taxes, sales/use taxes 28 percent, and income/privilege taxes only 26 percent.

Relative Shares of Total Kansas State and Local Taxes

	<u>FY 1992</u>	<u>FY 1998</u>	<u>FY 2012</u>	<u>FY 2017</u>	<u>FY 2019</u>
Property/Vehicle	38.73%	30.89%	34.04%	37.08%	34.29%
Sales/Use	22.80%	28.07%	28.35%	31.17%	28.00%
Income/Privilege	21.13%	27.97%	24.64%	19.43%	26.45%
All Other	17.34%	13.07%	12.97%	12.32%	11.26%

The Council recommends that a return to the old notion of a more balanced “three-legged stool” again be a guiding principle for all future tax policy discussions and decisions.

G. Caution by the Governor and the Legislature

Given the devastation to the public sector brought about by the ill-conceived tax policy in 2012, the Council recommends that the Governor and the Legislature exercise extreme caution when considering proposals that would diminish revenue until Kansas has fully restored its fiscal health, including creation of a “rainy-day fund” and an end to the transfer of highway dollars to the State General Fund. The damage to the state has been great and the return to financial normalcy will take time.

Council Meetings During 2020

February 28, 2020 Meeting

The Council met in February, before the severity of the unfolding pandemic was clear, to review the Council's initial report, monitor the status of recommendations to that point of the 2020 session, and receive reports on projected State General Fund profiles. At that meeting, Lead Academician, Dr. Donna Ginther, provided a great deal of data and analysis about the history of state and local tax policy. The Tax Foundation also presented recommendations for tax modernization, and the Urban Institute outlined a broader history of how state tax reform efforts had succeeded or failed in other states.

August 26, 2020 Meeting

The Council subsequently met remotely on August 26 to receive reports on what had happened to the economy and tax receipt forecasts since its last meeting, hear a special presentation from Dr. Ginther ("The Kansas Economy and Taxation in the Age of COVID"), and be updated by the Urban Institute about what budgetary implications the COVID-19 crisis was having in other states.

November 19, 2020 Meeting

At the outset of the November 19, 2020 meeting, which also was conducted remotely, the Governor announced the extension of the Council ([Appendix 3](#)). In that announcement, the Governor added that she continued to embrace the balanced three-legged stool approach for state and local finance, while highlighting the importance of offsetting the regressive nature of the sales tax on groceries for many Kansas families, providing targeted property tax relief, and determining how much room may be available for tax relief given the most recent budget projections.

Also at that November meeting, the Council received an extensive briefing from Dr. Ginther, its lead academician, on the severity of the COVID-19 crisis, its implications for the Kansas economy in both the short run and long run, and concerns about the shape and speed of the recovery in the absence of any additional federal stimulus legislation. She also presented an additional study comparing and contrasting Kansas sales and excise tax policy with that of other states. The Urban Institute updated its study on state responses to the pandemic, noting that many states had cut budgets and accessed rainy day funds over the summer and fall. In terms of November tax-related election results, Arizona approved an income tax hike on high earners (for education), Arkansas adopted a sales tax hike (for transportation), tobacco tax increases were approved in both Oregon and Colorado, and gambling was expanded in several states (including Nebraska). Illinois voters rejected a measure that would have moved to a more progressive income tax system, while California rejected a tax increase aimed specifically at commercial property.

The Urban Institute also explained that COVID-19 appeared to have accelerated state and voter actions regarding the legalization of marijuana, as ballot measures were approved in four more states – Montana, South Dakota, Arizona, and New Jersey.

Budget Director Larry Campbell said that notwithstanding some modest increases in the November revenue forecast relative to the previous April estimate, projections were indicating an extremely challenging budget situation for the incoming 2021 Kansas Legislature.

The Council subsequently adopted the following conclusions and recommendations and agreed to continue meeting in 2021 prior to issuance of a final report.

CONCLUSIONS AND RECOMMENDATIONS

Even as so many perceptions about the challenges faced by the public sector have changed since the Council was first established in 2019, the underlying mission of the Council to evaluate the adequacy and equity of the state and local tax systems in place in Kansas remains.

Our collective notion of adequacy now may have changed significantly given the impact the pandemic has had not just on tax receipts, but also on demand for additional public-sector aid and support for individuals and businesses. Moreover, even as attention throughout 2020 has necessarily been focused on COVID-19 caseloads and business closures and other more immediate metrics, a great many medium- and long-run social costs that have yet to be realized that are going to continue to provide additional stress on governments at all levels. Some research has shown that significant mental health costs from the 1919 flu pandemic lasted for well over a decade.

Even as the Council continues to evaluate measures of equity with an emphasis on concepts like progressivity versus regressivity, we recognize the need to be realistic about the ongoing demands that are going to be placed on the public sector even as the state moves into 2021 and hopefully begins to emerge from the worst of the crisis. The Council further notes that past actions in Kansas during challenging budget times, including cutting funding for critical infrastructure and the K-12 public school system, has proven to be penny wise and pound foolish with disastrous long-term consequences. Tax reform proposals under consideration in 2021 need to be relatively modest, have any tax reductions targeted to the people most in need of relief, and ideally be close to revenue-neutral in their overall impact on receipts.

The Council also finds that the magnitude of Kansas' state and local budget challenges would be greatly reduced if the federal government could break the ongoing stalemate over the Health and Economic Recovery Omnibus Emergency Solutions (HEROES) Act stimulus and recovery legislation that was originally approved by the U.S. House of Representatives in May.

The Council therefore adopted a motion to memorialize congressional leadership and the Kansas delegation to continue negotiations. The Council’s letter to Congress ([Appendix 4](#)) expressed concern over the growing likelihood that the nation may slide into another recession in 2021 if the federal stalemate could not be broken; and added that without any additional federal support, cuts to state and local budgets would increase unemployment and lengthen the duration of any such recession. The letter further explained that because Kansas cannot constitutionally operate with a negative budget balance, the state would be facing a series of unattractive policy options making it far less likely to give serious consideration to certain tax relief measures championed by individuals, business interests and others absent enactment of the state-and-local revenue sharing component in the federal legislation.

A number of proposals under consideration during both the 2019 and 2020 legislative sessions sought to decouple the state from certain federal income tax provisions for both businesses and individuals. The Council notes that Kansas has chosen to be a conformity state for many administrative, enforcement and compliance reasons that help streamline its income tax system. Moreover, the November Consensus Revenue Estimate update explains that federal CARES Act provisions enacted earlier in 2020 are expected to reduce SGF receipts – as a direct result of such conformity – by \$70.0 million in FY 2021 (\$40.0 million for individual income taxes and \$30.0 million for corporation income taxes) and by \$36.0 million in FY 2022 (\$23.0 million in individual income taxes and \$13.0 million in corporation income taxes). Choosing to allow these most recent changes to flow through and impact Kansas income taxes while at the same time pursuing additional legislative efforts to selectively decouple from certain other federal provisions enacted in 2017 would not be a consistent public policy approach.

The Council further renews all 2019 recommendations (made in the initial January 2020 report) for consideration by the Governor and the 2021 Kansas Legislature. The Council finds that extension of the use tax mandate to marketplace facilitators and digital goods taxation are even more important in 2021 given that they would address equity issues facing many Kansas businesses struggling in the wake of the pandemic; and would provide revenue enhancements that could subsequently be used to fund other recommendations, including restoration of a refundable food sales tax credit and LAVTRF funds for local units that would help reduce local property tax levies.

On the issue of property taxes, it is important to remember that even as much of the Council’s work and discussion since September of 2019 has focused on state tax issues, its mission contemplates a broader charge of addressing the entire state and local tax system. With local units of government relying primarily on the property tax, and a great many legislative proposals relating to property taxes under consideration in recent years, the Council hopes to monitor and potentially provide input into some of those ongoing discussions during 2021. The Property Valuation Division and local officials have a great deal of

administrative and legal expertise that can be brought to the table to help navigate property tax nuances and complexities and provide additional guidance about the impact of potential changes in law.

The Council very much appreciates the extensive analyses and insights that Dr. Donna Ginther has been providing about the Kansas economy, tax structure and the impact of COVID-19 – as well as the broader national updates from the Urban Institute – and will continue to use those resources to monitor multiple state tax proposals throughout the 2021 session.

Respectfully submitted on behalf of the
Governor's Council on Tax Reform

Steve Morris, Co-Chair

Janis Lee, Co-Chair

APPENDICES

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