KANSAS CHAMBER
UNITED FOR BUSINESS

Governor's Council on Tax Reform
Public Comments on Tax Policy in Kansas
Presented by Eric Stafford, Vice President of Government Affairs
Kansas Chamber of Commerce

Thursday, November 14, 2019

Chairman Morris, Madam Chair Lee, and members of the Governor's Tax Council, my name is Eric Stafford and I serve as Vice President of Government Affairs for the Kansas Chamber. The Kansas Chamber represents small, medium and large businesses from across the state of Kansas under our mission "to continually strive to improve the economic climate for the benefit of every business and citizen and to safeguard our system of free, competitive enterprise."

In the fall of 2017, the Kansas Chamber launched our Vision 2025 strategic plan for the state. Kansas is in a global combat for jobs and talent. But for too long, Kansas has been a slow-growth state. This plan includes four key pillars which we believe are essential to turn Kansas into a leading state which is attractive for investment and retention. Those pillars are:

- GROW the state's talent supply
- ADVANCE competitiveness
- EXPAND innovation & entrepreneurship
- IMPROVE business infrastructure.

We started our plan by traveling across the state, to gather input from Kansans on what is important to their communities and what they believe are keys to unlocking strong economic growth for the state.
We heard about the need for workers (talent supply), eliminating redundancy in workforce development efforts and the importance of providing essential skills for careers, infrastructure needs (some of which were local needs vs. state), a competitive tax climate (consistent policies so businesses can plan), and others.

For our first major undertaking of the Vision 2025 plan, we have partnered with the Tax Foundation to conduct a comprehensive review of the Kansas tax code. According to the Tax Foundation website, "The Tax Foundation is the nation's leading independent tax policy nonprofit. Since 1937, our principled research, insightful analysis, and engaged experts have informed smarter tax policy at the federal, state, and global levels. For over 80 years, our goal has remained the same: to improve lives through tax policies that lead to greater economic growth and opportunity."

The Tax Foundation has conducted state-specific studies for several states including Nebraska, Iowa, South Carolina, Utah, and Pennsylvania, to name a few. Our Kansas study will be released in early December and takes an in-depth look at personal and corporate income taxes, property taxes, and sales tax in our state. The study will offer policy recommendations for Kansas to adopt with the goal of making our state more competitive and attractive for investment and economic growth. We will share those recommendations with the legislature leading up to and during the 2020 session.

While we wait for the results of the Tax Foundation Report, we know there are specific items Kansas must address immediately. Kansas already lags in the competitiveness of our tax climate. By failing to address decoupling the Tax Cuts and Jobs Act (TCJA), Kansas is at an even greater disadvantage. Many last year were referring to the two bills vetoed by Governor Kelly as "tax cuts" for the rich and multi-national corporations. Calling that legislation a cut to taxes is factually untrue.

This committee has heard testimony from the department of revenue about "rolling conformity" states, like Kansas. That means we adopt federal changes without the need for legislation each year. While that simplifies our tax code, it also means if there are big changes at the federal level, Kansas will adopt those changes unless the legislature takes specific action to not adopt them (decouple). I share this background to make our case that the federal tax changes in 2017 have resulted in an unintended tax increase on individual taxpayers and businesses in our state by no action of the legislature. As we outline the specifics of those items below, we will argue why some provisions are now subjecting income to Kansas corporate income tax that had not previously been taxed in our state prior to 2018.

<u>Individual Taxpayers</u>

TCJA nearly doubled the standard deduction for individual tax filers. The standard deduction for married filing jointly increased from $13,000 to $24,000. According to a Tax Foundation article, "The Joint Committee on Taxation estimates that the number of filers who itemize will fall from 46.5 million in 2017 to just over 18 million in 2018, meaning that about 88 percent of the 150 million households that file taxes will take the increased standard deduction."

While this change is a great benefit at the federal level for individual taxpayers, it creates an unintended consequence in Kansas due to the greater discrepancy between the new federal standard deduction and Kansas' $7,500 deduction for married filing jointly. That causes an increase in Kansas taxpayers state income tax liability because current law prohibits Kansas taxpayers from itemization if they do not itemize at the federal level. Many small businesses have lost this tax benefit as well since they file their returns under the personal income tax versus corporate income tax.

<u>Corporate Income Tax</u>

TCJA made significant changes in how the federal government treats foreign investment and income for companies with foreign operations. Business tax reform efforts were created to eliminate disincentives to invest and create jobs in the United States and lowered rates through base-broadening provisions. Much like the individual income tax components, lack of action by states has resulted in an unintended tax increase on businesses at the state level.

Prior to TCJA, the U.S. operated on a worldwide tax base which resulted in an estimated $3 trillion or more in profits U.S. companies left overseas due to the disadvantageous nature of America's tax code. It is important to note that <u>not all</u> of that $3 trillion comes in the form of cash. When TCJA passed, a one-year tax window for 2017 was created to tax repatriated earnings, with a large portion of those earnings coming in the form of assets (capital building investments and operations in foreign countries). So the federal government elected to tax reinvestment of foreign profits into facilities. The repatriation provisions (IRC 965) were included as a pay-for to lower the corporate income tax rate at the federal level.

Post-TCJA, America will now operate in a quasi-territorial tax structure. While repatriation dealt with foreign earnings over the previous 30 years, a new tax provision known as GILTI (Global Intangible Low Tax Income) (IRC

951A) was created. GILTI was designed to ensure a minimum tax is paid on worldwide income and to deter/reduce incentives by businesses to shift profits outside of the United States.

Kansas has an 80% dividend received deduction. In the eyes of the IRS, GILTI is a dividend, even though it's actually income. Therefore, Kansas which has historically taxed foreign dividends, will now be (and has been with lack of legislative action) taxing foreign income- something our state has not done before. Below is a paragraph from David Rankin's SB 22 testimony last year before the Senate Select Committee on Federal Tax Code Legislation. David is the Senior Vice President of Taxation and Business Development for Seaboard Foods:

"The federal provision imposes tax at the statutory rate of 21% but allows a 50% tax deduction which reduces the effective tax rate to 10.5%. Foreign taxes paid are added to taxable income but reduced by a deduction equal to 50% of the income inclusion. The deductions are contingent on a taxpayer having positive taxable income so taxpayers with losses will not receive the 50% deductions. Finally, a foreign tax credit is allowed for 80% of the foreign taxes paid. If the foreign tax rate exceeds 13.125%, no incremental U.S. tax is due. Because Kansas does not allow a foreign tax credit, U.S. parent companies with foreign subsidiaries will be forced to pay incremental Kansas income tax even if no incremental U.S. income tax is imposed."

It is important to note that according to our tax experts, foreign-owned businesses are not subject to GILTI. As Kansas continues to tax GILTI income, Kansas-based companies would be operating at a competitive disadvantage to foreign-owned businesses that are not subject to this tax. Repatriated income (IRC 965) is also foreign income which Kansas has chosen to subject to tax, is again a change from our state's historical position of <u>not</u> taxing foreign income. Ultimately, we believe business income earned in another country should not be subject to state taxes.

Several other base-broadening provisions included in TCJA should be considered as well for decoupling. These items were also created as "pay-fors" to lower the corporate income tax rate, while no rate reduction has been experienced in Kansas. Those are:

- IRC section 163(j) on interest limitation deductions
- IRC 118- capital contributions
- IRC 162(r)- FDIC premiums

At the end of this testimony, I have included a series of maps outlining how states have addressed decoupling from these items. These show that Kansas, especially on the foreign income provisions, continues to be a growing outlier by not decoupling from these base-broadening provisions, and by including foreign income in its tax base.

<u>Wayfair Response</u>

We briefly would like to mention that we will again introduce legislation in 2020 in response to the U.S. Supreme Court opinion in the *Wayfair* case in summer of 2018. We have supported policies which level the playing field between brick and mortar and online only retailers in the past and will continue to support a state-level legislative response to this issue.

Below is the Tax Foundation's Wayfair checklist of factors from the South Dakota law that the Court strongly suggested should be included to pass their constitutional test.

1. Safe harbor: Exclude "those who transact only limited business" in the state. (South Dakota's is $100,000 in sales or 200 transactions.)
2. No retroactive collection.

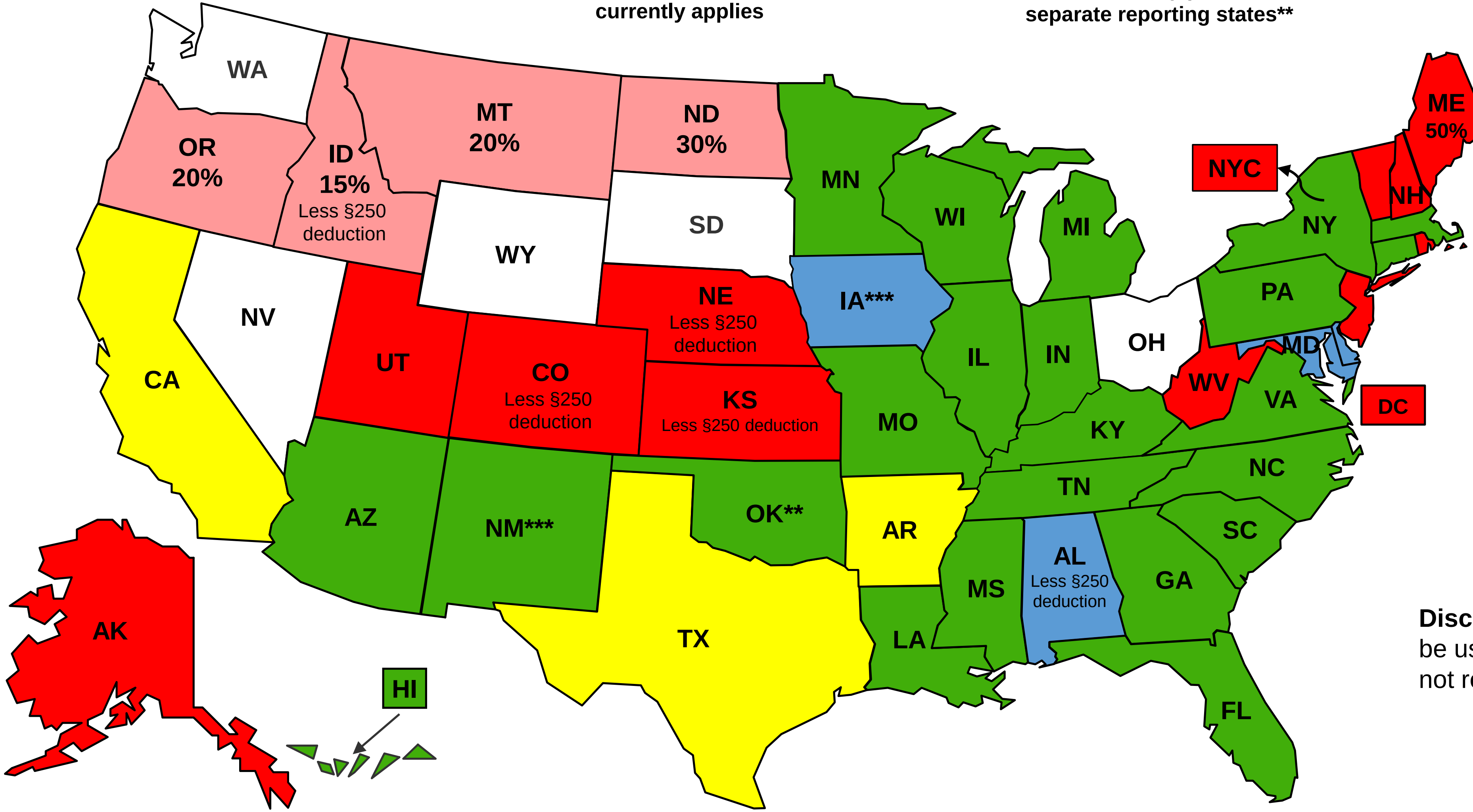
3. Single state-level administration of all sales taxes in the state.
4. Uniform definitions of products and services.
5. Simplified tax rate structure. (South Dakota requires the same tax base between state and local sales tax, has only three sales tax rates, and limited exemptions from the tax.)
6. Software: access to sales tax administration software provided by the state.
7. Immunity: sellers who use the software are not liable for errors derived from relying on it.

A map summarizing response by states to the Wayfair decision is also included at the end of our testimony.

We appreciate the opportunity to offer public comment before this Council today. I am happy to answer any questions you might have at the appropriate time.

State Corporate Income Tax Conformity to GILTI*

- State does not impose a corporate income tax
- Decoupled from GILTI (or excludes 95%)
- Have not addressed IRC conformity and/or GILTI coupling specifically. Neither GILTI nor § 250 deduction currently applies
- Potentially coupled to GILTI, but inclusion may be constitutionally prohibited in separate reporting states**
- Coupled or potentially coupled to 10% to 30% of GILTI**
- Coupled or potentially coupled to GILTI**



NY: 5% of GILTI taxed starting in 2019

NH: Less §250 deduction

VT: Less §250 deduction

MA: 5% of GILTI taxed

CT: 5% of GILTI taxed

RI: Less §250 deduction

NJ: Less §250 deduction

DE: Less §250 deduction

WV: Less §250 deduction

MD: Less §250 deduction

Disclaimer: This information should be used for general guidance and not relied upon for compliance.

Note: Those states with "less §250 deduction" only tax 50% of GILTI (or 62.5% after 2025).

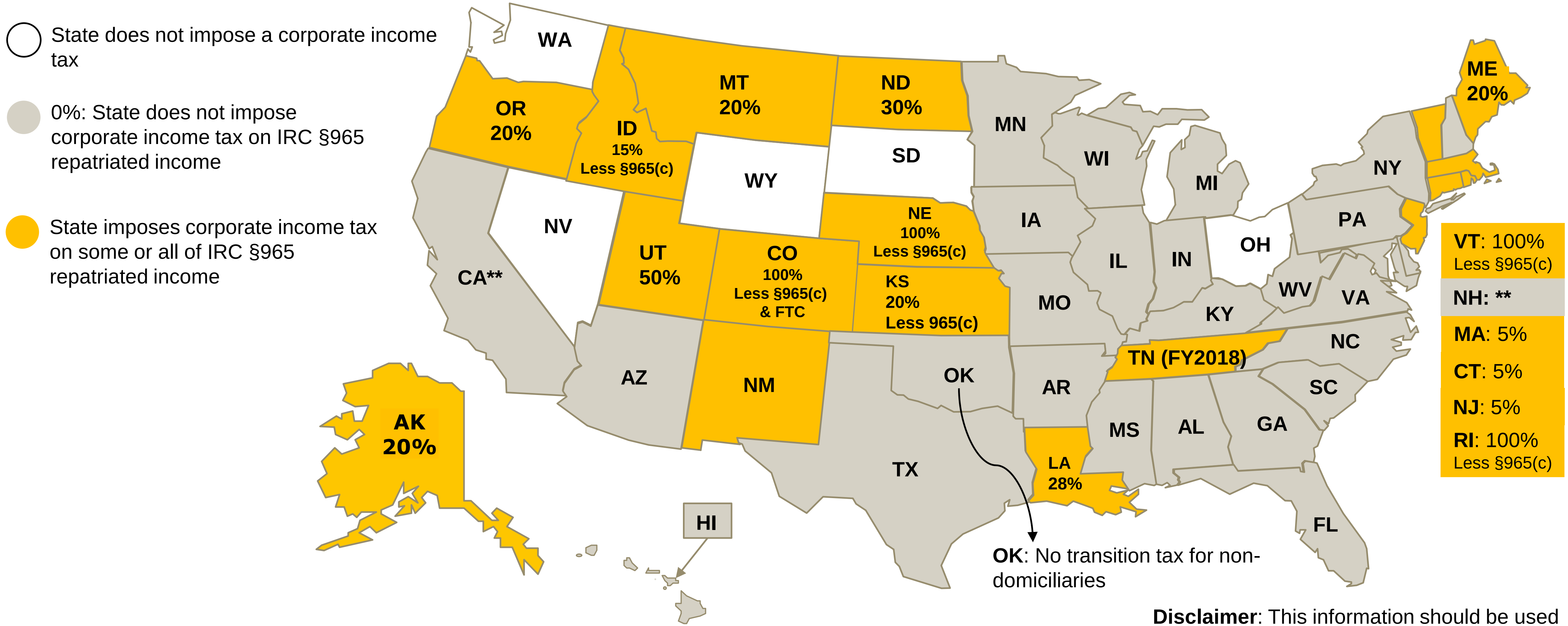
* Based generally on 80% or more direct corporate ownership of foreign corporations. Other rules may apply for smaller % ownership or state personal income tax (PIT) purposes.

** GILTI is not specifically referenced in many state conformity statutes so some states may still decouple from some or all of GILTI by administrative/legislative action.

*** Iowa conformity begins in 2019. New Mexico decouples starting in 2020.

Source: Council On State Taxation

One Time Issue: State Corporate Income Tax Conformity to IRC §965 Repatriated Income*



Disclaimer: This information should be used for general guidance and not relied upon for compliance.

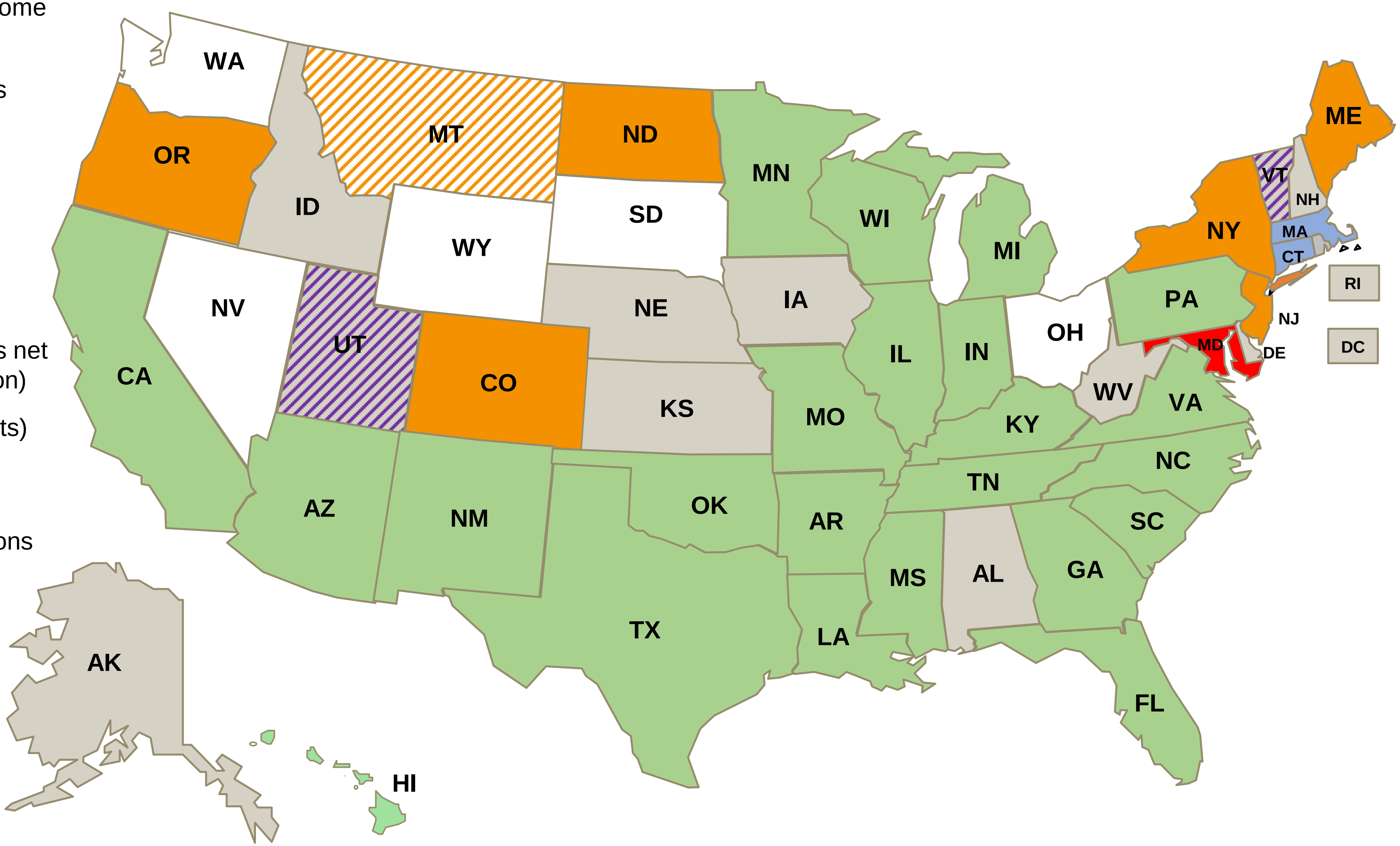
* Based generally on 80% or more direct corporate ownership of foreign corporations. Other rules may apply for smaller % ownership or PIT purposes.

**No conformity update but taxes a portion of foreign dividends (when distributed) for water's edge filers.

Source: Council On State Taxation

GILTI State Factor Representation*

- State does not impose a corporate income tax
- The state currently does not impose its corporate income tax on GILTI
- No factor representation allowed
- No new guidance
- Other methodology
- Sales factor denominator only includes net GILTI (after Sec. 250 or other deduction)
- Foreign factors (including gross receipts) relating to taxable income allowed in denominator(s)
- Pattern indicates unofficial state positions (in appropriate colors)



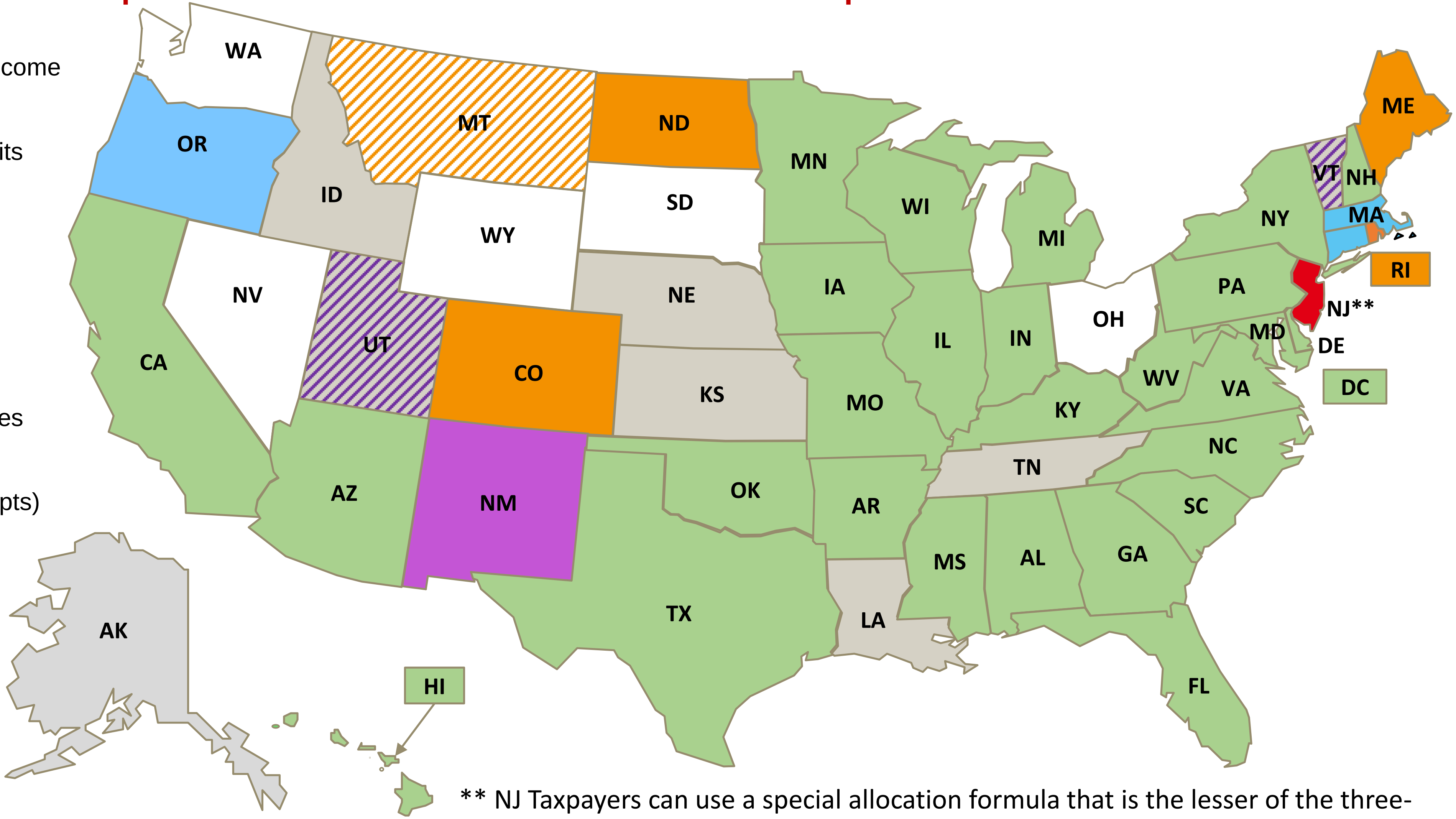
* Based generally on 80% or more direct corporate ownership of foreign corporations. Other rules may apply for smaller % ownership or PIT purposes.

Source: Council On State Taxation

Disclaimer: This information should be used for general guidance and not relied upon for compliance.

IRC §965 Repatriated Income State Factor Representation*

- State does not impose a corporate income tax
- The state currently does not impose its corporate income tax on IRC §965 repatriated income
- No factor representation allowed
- No new guidance
- Other methodology
- Sales factor denominator only includes net IRC §965 repatriated income.
- Foreign factors (including gross receipts) relating to taxable income allowed in denominator(s)
- Pattern indicates unofficial state positions (in appropriate colors)



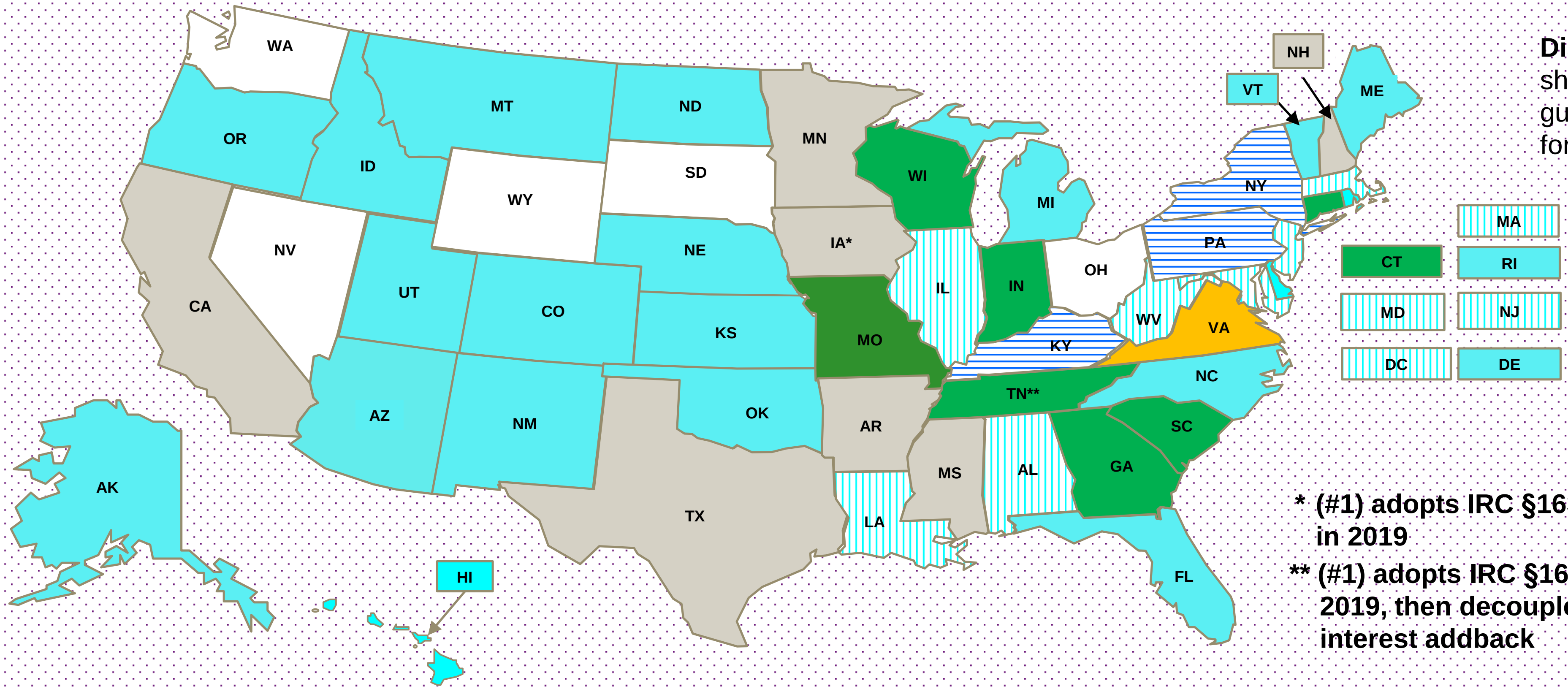
* Based generally on 80% or more direct corporate ownership of foreign corporations.
Other rules may apply for smaller % ownership or PIT purposes.

** NJ Taxpayers can use a special allocation formula that is the lesser of the three-year average 2014 through 2016 allocation factor or 3.5% for calculating the tax on dividends and deemed dividends received by a taxpayer from a subsidiary for tax years beginning on and after January 1, 2017 and beginning before January 1, 2019.

Source: Council On State Taxation

Disclaimer: This information should be used for general guidance and not relied upon for compliance.

State Conformity to 30% Interest Expense Limitation



Disclaimer: This information should be used for general guidance and not relied upon for compliance.

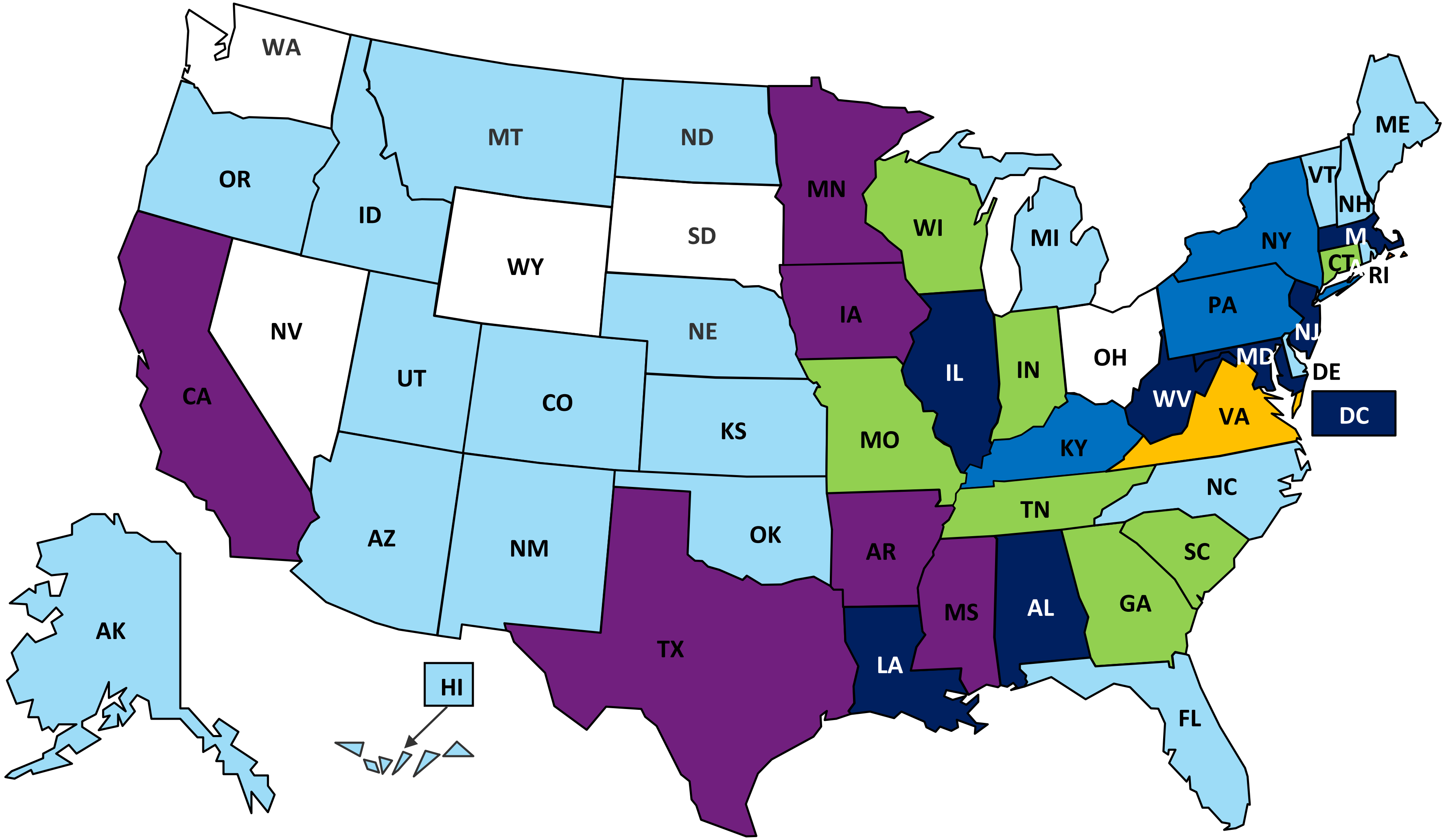
*** (#1) adopts IRC §163(j) in 2019**

**** (#1) adopts IRC §163(j) in 2018 and 2019, then decouples. State has interest addback**

5	**No General Corporate Income Tax**
20	**Adopts IRC §163(j) as of 1/1/18**
3	**Adopts IRC §163(j) with interest addback related to intangible income**
8	**Adopts IRC §163(j) and has general interest addback provisions**
7	**Enacted Legislation Decoupling from IRC §163(j) [Note – some of these states did not decouple as of 1/1/2018 but decoupled at a later date and some states may still have an intercompany interest expense adjustment]**
1	**Provides a corporate and individual subtraction equal to 20 percent of business interest disallowed pursuant to § 163(j) of the IRC**
7	**Does not adopt IRC § 163(j) as of 1/1/18**

Source: Council On State Taxation

State Conformity to 30% Interest Expense Limitation



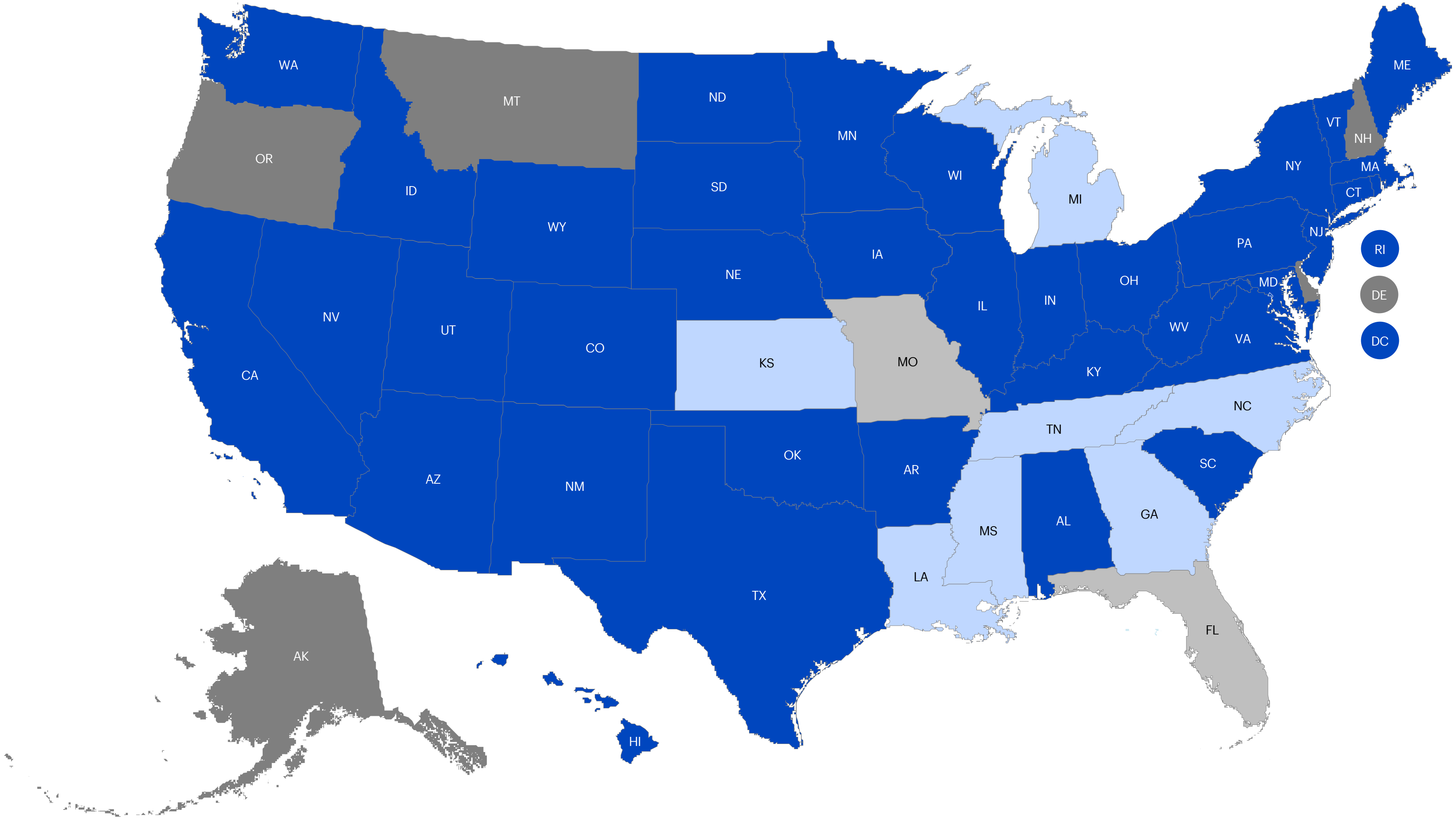
- Does not adopt IRC §163(j)
- Adopts IRC §163(j)
- Adopts IRC §163(j) with interest addback related to intangible income
- Adopts IRC §163(j) and has general interest addback provisions
- Enacted legislation decoupling from IRC §163(j) [Note: Some of these states did not decouple as of 1/1/18 but decoupled later and some states may still have an intercompany interest expense adjustment]
- Provides a corporate and individual subtraction equal to 20 percent of business interest disallowed pursuant to IRC §163(j)
- No general corporate income tax

Source: Council On State Taxation

Disclaimer: This information should be used for general guidance and not relied upon for compliance.

Wayfair and Marketplace Implementation

as of 10/1/19



- **Wayfair + Marketplace (37)**
- **Wayfair Only, Action Needed on Marketplace (7)**
- **Action Needed on Wayfair + Marketplace (2)**
- **No Sales Tax (5)**

Marketplace Collection by State

as of 10/1/19

	amazon	ebay	Etsy	Google
AL	✓	✓	✓	✓
AR	✓	✓	✓	✓
AZ	✓	✓	✓	✓
CA	✓	✓	✓	✓
CO	✓	✓	✓	✓
CT	✓	✓	✓	✓
DC	✓	✓	✓	✓
HI	*Effective 1/1/20*			
IA	✓	✓	✓	✓
ID	✓	✓	✓	✓
IL	*Effective 1/1/20*			
IN	✓	✓	✓	✓
KY	✓	✓	✓	✓

	amazon	ebay	Etsy	Google
MA	✓	✓	✓	✓
MD	✓	✓	✓	✓
ME	✓	✓	✓	✓
MN	✓	✓	✓	✓
ND	✓	✓	✓	✓
NE	✓	✓	✓	✓
NJ	✓	✓	✓	✓
NM	✓	✓	✓	✓
NV	✓	✓	✓	✓
NY	✓	✓	✓	✓
OH	✓	✓	✓	✓
OK	✓	✓	✓	✓

	amazon	ebay	Etsy	Google
PA	✓	✓	✓	✓
RI	✓	✓	✓	✓
SC	✓	✓	✓	✓
SD	✓	✓	✓	✓
TX	✓	✓	✓	✓
UT	✓	✓	✓	✓
VA	✓	✓	✓	✓
VT	✓	✓	✓	✓
WA	✓	✓	✓	✓
WI	*Effective 1/1/20*			
WV	✓	✓	✓	✓
WY	✓	✓	✓	✓

✓ = Law in effect, currently collecting
✕ = Law in effect, collection TBA
Date = Law in effect, announced collection start

Source: Amazon, eBay, Etsy, Google

Wayfair **and Marketplace by State**

as of 10/1/19

Economic Nexus (*Wayfair*)			Marketplace		
Implemented (44)			**Pending (2)**	**Implemented (37)**	
Alabama	**Minnesota***	**Washington***	Michigan	Alabama	New Jersey
Arizona	Mississippi	West Virginia	North Carolina	**Arizona**	**New York**
Arkansas	Nebraska	Wisconsin		**Arkansas**	**North Dakota**
California*	Nevada	Wyoming		**California**	**Ohio**
Colorado*	**New Mexico**			**Colorado**	**Oklahoma***
Connecticut	New Jersey			Connecticut	**Pennsylvania***
District of Columbia	New York			District of Columbia	**Rhode Island***
Georgia*	**North Carolina***			**Hawaii**	**South Carolina***
Hawaii	**North Dakota***			**Idaho**	South Dakota
Illinois*	**Ohio**			**Illinois**	**Texas**
Idaho	**Oklahoma***			**Indiana**	**Utah**
Indiana	**Pennsylvania**			**Iowa***	**Vermont**
Iowa	**Rhode Island***			**Kentucky**	**Virginia**
Kansas^	South Carolina			**Maine**	**Washington***
Kentucky	South Dakota			**Maryland**	**West Virginia**
Louisiana*	Texas			**Massachusetts**	**Wisconsin**
Maine	**Tennessee***			**Minnesota***	**Wyoming**
Maryland	Utah			**Nebraska**	
Massachusetts	Vermont			**Nevada**	
Michigan	**Virginia**			**New Mexico**	

Passed at least one chamber; On Governor's desk; **Enacted in 2019**; **Updates existing law or regulation*; *^New regulation*