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Mark A. Burghart, Secretary

Laura Kelly, Governor

MEMORANDUM

TO: Governor's Council on Tax Reform

FROM: Mark A. Burghart, Secretary
Kansas Department of Revenue

RE: Legislative Update

DATE: November 19, 2020

Thank you for the opportunity to review the proposals previously recommended by the Governor's Council on Tax Reform (Council) with you. As you will recall, the Council made seven specific recommendations in its First Interim Report. Only four of those proposals required specific legislation to implement. Those recommendations are set forth below for further discussion and possible introduction in the 2021 Legislative Session, as needed.

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 the other 29 states to 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 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 to 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 (LAVTR)

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. The latest mill levy statistics are set forth in Appendix 5. In light of these rates, the Council recommends the favorable consideration of renewing LAVTR 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 FY19, 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. See Appendix 6.

Relative Shares of Total Kansas State and Local Taxes

	FY 1992	FY 1998	FY 2012	FY 2017	FY 2019
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.