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House of Representatives Taxation Committee
Testimony of Secretary Nick Jordan: Gov. Brownback's Pro-Growth Tax Reform Plan
February 8, 2012

Chairman Carlson, thank you for inviting me to address your committee today on the very important issue of tax reform and how we can create an environment in which Kansas citizens and businesses can flourish in the 21st century.

I'd like to begin by recognizing your important leadership on tax issues over the years. You and many of your House colleagues have been tireless advocates for economic growth, free market principles, and limited government. Your efforts have laid the foundation for many of the discussions taking place this year regarding a serious and substantial reform of our state tax code.

The conversation in Topeka truly has changed, and not just about whether to raise or lower taxes — but how we can work together to grow the Kansas economy and make the tax system fairer, flatter, and simpler for our citizens.

Numbers help tell the story of why this work is so important:

Private Sector Job Losses (Kansas Department of Labor)
- Private sector employment in Kansas fell by 39,700 jobs from 2001 to 2010.

Outmigration of Kansas Tax Filers (Kansas Department of Labor and Rich States, Poor States)
- From 2004 through 2010, within the U.S., there was net outmigration of 15,683 tax filers from Kansas with 17,640 dependents and a total adjusted gross income of $1.09 billion.
- Texas gained the most from Kansas outmigration with 6,395 tax filers from Kansas moving to Texas along with 12,837 dependents and a total adjusted gross income of $305.4 million.
- Only 10 states out of 50 had worse outmigration than Kansas from 2000 to 2009.

Kansas Tax Rankings Compared to Other States (Tax Foundation and Rich States, Poor States)
- State **Business Tax Climate** Index 2011: Kansas ranks 35th
- State **Corporate Tax** Index 2011: Kansas ranks 35th
- State **Sales Tax** Index 2011: Kansas ranks 32nd
- The **top marginal personal income tax rate** is 6.45 percent, which ranks 26th in the nation.
- The **top marginal corporate income** tax rate is 7 percent, which ranks 25th in the nation.
- The **property tax burden** ranks 33rd in the nation.
- The **sales tax burden** ranks 35th in the nation.
- **Debt service** as a share of tax revenue is 8.4 percent, which ranks 30th in the nation.

Capital Flow (Federal Reserve Bank of Kansas City)
In 2010, Nebraska was the regional winner in the ranking of states when comparing state gross domestic product to personal income ratio, which reflects **net capital inflow relative to other states**. Nebraska ranked 10th in the nation; Kansas ranked 32nd.

A piece in yesterday's *Wall Street Journal* titled "The Heartland Tax Rebellion" noted that states without an income tax perform better economically on average than do high-tax states. And on this point, the paper concluded, "It's not a close contest."

It is data such as this that has led Oklahoma Gov. Mary Fallin to propose cutting her state's top income tax rate from 5.25 percent to 3.5 percent, with plans to phase out the income tax completely in the next 10 years. She said, "We're going to have the most pro-growth tax system in the region."

This *Wall Street Journal* article highlighted our work here in Kansas as well, along with income tax reduction plans taking shape in Missouri, South Carolina, Indiana, Idaho, Maine, Nebraska, New Jersey and Ohio.

The *Journal* wrote, "The tax competition in America's heartland is an encouraging sign that at least some U.S. politicians understand that they can't take prosperity for granted. It must be nurtured with good policy, as they compete for jobs and investment with other states and the rest of the world."

With this healthy regional competition as our backdrop, I am happy to now highlight the key components of the Gov. Brownback's pro-growth tax reform plan, which were designed to support the Road Map for Kansas goals of **increasing net personal income** and **private sector employment**, as well as the goal of increasing investment capital flow into the state.

With input from people from every corner of the state, we propose to:

1. **Lower individual income tax rates for all taxpayers by 14 percent to 24 percent and move from three tax brackets to two**. This would result in a top rate of 4.9 percent, down from 6.45, and a low rate of 3 percent, reduced from 3.5 percent.
2. **Eliminate individual income tax on non-wage business income** (as reported by LLCs, S-corps and sole proprietorships on lines 12, 17, and 18 of the federal form 1040 individual income tax return).
3. **Simplify and streamline the tax code** by eliminating itemized deductions and most credits and subtraction modifications.
4. **Bolster the safety net for low-income Kansans** while providing greater accountability by doubling the standard deduction (from $4,500 to $9,000) for head of household filers and investing an additional $60 million in state social services and healthcare programs.
5. **Leave the corporate income tax rate unchanged.**
6. **Hold the sales tax rate steady** at 6.3 percent, with 4/10 of a cent going to the highway fund as planned in FY14.

7. **Eliminate the two-year severance tax exemption on new pool oil and gas wells,** except for oil wells generating fewer than 50 barrels a day.
8. As state tax revenues grow more than 2 percent per fiscal year, **excess revenues will be used to further reduce individual and corporate income tax rates** in future tax years.

By eliminating credits and deductions and lowering income tax rates for all state tax filers, **Kansas' top individual income tax rate will become the second lowest in the region,** and our state will take its first step toward a fairer and flatter tax code.

Top Rate Today	**Change with Brownback Plan**
Colorado 4.63	Colorado........4.63
Oklahoma 5.25	**Kansas 4.9**
Missouri...........6	Oklahoma......5.25
Kansas.........6.45	Missouri 6
Nebraska......6.84	Nebraska 6.84
Iowa 8.98	Iowa..............8.98

Lowering the state income tax rate will give Kansas families and taxpayers an immediate raise in their paychecks as they decrease their state income tax withholding and keep more of the money they earn as they earn it. In fact, the median Kansas tax return uses the standard deduction, has income of $65,430, and is filed married jointly with one child. **This family will see a state income tax reduction of $425.43 per year under Gov. Brownback's plan.**

Further, thanks to the innovative approach of eliminating individual state income tax on non-wage business income earned by many small businesses, approximately 191,000 Kansas tax filers will have the opportunity to invest more in the growth of their small businesses. *This is a unique and highly targeted strategy to make Kansas an incubator for innovation and a national center for entrepreneurship.*

Now I will quickly address several elements of this plan that have been points of discussion.

Why We Should Lower Income Tax Rates

Data show states with zero personal income tax significantly outperform states with the highest personal income tax rates; experience larger than average population growth; and boost state tax revenues at a faster pace than high tax states. (Interestingly, sales tax rates have the least negative impact on economic growth relative to other tax types.) Do we want to be more like states that are growing, or do we want to be more like those losing population and struggling to generate sufficient funds to operate government? Individual income tax rates seem to play a strong role.

Our Tax Code Is Far Too Complicated

Taxes at the federal, state, and local levels are a hodge-podge of dozens upon dozens of taxes, credits, and special interests cobbled together during many decades. To state it bluntly, everyday citizens and small business owners are fed up with this complicated mess. In Kansas, we should be leading the way in modernizing tax policy in a strategic way that funds core government functions while emphasizing economic growth and encouraging greater financial investment in our state.

Taxation Should Be Fair

The Kansas tax code is overly complicated; picks too many winners and losers; and attempts too much social engineering. We should have a fairer, flatter and simpler tax code that broadens the base and lowers rates as much as possible for the benefit of the maximum number of Kansans. As we make changes such as eliminating credits and itemized deductions, some have expressed concerns that this creates "losers." The reality is that **the existing system is full of inequities;** the Governor's proposal seeks to make the playing field more level for more Kansans and lower everyone's individual income tax rates.

Federal Credits and Deductions Are Not Impacted by Kansas Tax Reform

In Kansas, as we make our tax code flatter, fairer, and simpler, we will not impact federal income tax rates, credits, or deductions. Those who claim mortgage interest deductions or receive federal earned income tax credits will continue to do so – and at the significantly higher benefit levels provided by the federal tax code.

In Kansas, our top tax rate today is 6.45 percent; it is 35 percent at the federal level. In that context, deductions are relatively much less meaningful at the state level, particularly when we significantly reduce rates. Further, the one third of Kansas tax filers who currently itemize deductions would take the standard deduction moving forward, providing an additional offset to itemized deductions now claimed. Simply put, as the Kansas Society of CPAs and others have noted, the tax benefit of mortgage interest and other deductions is minimized and then made obsolete as income tax rates move toward zero.

The Safety Net for Low-Income Kansans

There has been a meaningful discussion about the level of social welfare that should be provided to low-income Kansans. Any thoughtful debate on the earned income tax credit should be considered through two lenses: 1) whether welfare benefits belong in the tax code and 2) what is the full range of assistance provided rather than one item in isolation. On the latter, low-income and disabled Kansans receive more than $3.5 billion in assistance annually through SRS and KDHE programs already in place, forming a sizable safety net. In the last fiscal year alone, more than $442 million was provided in food assistance, benefiting an average of 296,000 people per month, and nearly $71 million was provided in child care assistance. This $3.5 billion existing safety net in Kansas (federal and state funding) does not include unemployment benefits or federal programs such as housing assistance that are available on top of other welfare assistance.

Most states do not provide an earned income tax credit on top of the federal income tax credit. Changes to the state EITC will not impact Kansans' federal EITC, which provides up to $5,112 to a family with two qualifying children in the 2011 tax year. Almost two-thirds of taxpayers filing for the state EITC either have no tax liability or their liability is completely eliminated by the credit and they receive money back that was never paid in income tax.

And, importantly, the money now used to provide a state EITC was not used in the Governor's proposal to reduce income tax rates; rather, it was set aside for expansion of social services programs. If the legislature decides the state EITC is an effective tool for lifting Kansans out of poverty, it can keep the credit in place, and there would be no impact on the across-the-board individual income tax rate reductions proposed by the Governor.

Why We Should Take Action Now: The Lost Decade for Jobs
As Gov. Brownback reminds us regularly, "The last decade was a lost decade for jobs in Kansas. Fewer Kansans were working in private sector jobs in January 2011 than were in January of 2001. A growing government and a shrinking private sector are not sustainable. Fixing that is our top priority."

While there are certainly some factors a state cannot control when it comes to its economy, tax policy is one area a state controls completely. And when it comes to Kansas' tax policy, the state does not rank as high as it must compared to other states in order to be as competitive as possible in attracting new businesses and generating economic and private sector job growth.

Tax policy will play a crucial role in positioning Kansas for growth in the years ahead.

According to Kail Padgitt of the Tax Foundation, "Good state tax systems levy low, flat rates on the broadest bases possible, and they treat all taxpayers the same. Variation in the tax treatment of different industries favors one economic activity or decision over another. The more riddled a tax system is with politically motivated preferences the less likely it is that business decisions will be made in response to market forces."

With that understanding, we seek to change the dynamic that has led to average (or worse) economic results — so more Kansas families can achieve a meaningful increase in income and opportunity, and small businesses can enjoy more capital to invest in growth and new jobs.

We have a clear choice: Maintain the cobbled-together status quo that resulted in the lost decade for jobs, or take serious action to reform our state tax system.

This no doubt takes courage and hard work. But by making Kansas tax policy fairer, flatter and simpler, and by creating a pro-growth business environment that encourages financial investment in Kansas, the state can position itself as a top economic performer. This will reduce poverty and create economic opportunities for the maximum number of Kansans.

The Nine States with the Lowest and the Highest Marginal Personal Income Tax (PIT) Rates Ten-Year Economic Performance (performance between 2001 and 2010 unless otherwise noted)						
State	Top PIT Rate*	Gross State Product Growth	Non-Farm Payroll Employment Growth	Population Growth	Net Domestic In-Migration as a % of Population***	State & Local Tax Revenue Growth****
Alaska	0.00%	77.0%	12.2%	12.1%	-2.0%	452.6%
Florida	0.00%	47.7%	0.2%	15.0%	6.5%	82.3%
Nevada	0.00%	58.9%	6.1%	28.9%	14.1%	100.1%
New Hampshire	0.00%	35.2%	-0.7%	4.7%	2.5%	59.6%
South Dakota	0.00%	58.5%	6.4%	7.3%	0.8%	51.2%
Tennessee	0.00%	38.6%	-2.8%	10.3%	4.2%	61.7%
Texas	0.00%	57.7%	8.7%	17.9%	3.4%	75.5%
Washington	0.00%	47.8%	3.0%	12.3%	3.4%	57.8%
Wyoming	0.00%	105.6%	15.2%	14.3%	4.3%	172.2%
9 States with No PIT**	**0.00%**	**58.54%**	**5.36%**	**13.65%**	**4.12%**	**123.66%**
U.S. Average**	**5.47%**	**46.61%**	**0.51%**	**8.63%**	**0.86%**	**70.23%**
Kansas	**6.45%**	**42.35%**	**-1.90%**	**5.61%**	**-2.36%**	**62.87%**
9 States with Highest Marginal PIT Rate**	**9.92%**	**42.06%**	**-1.68%**	**5.49%**	**-1.91%**	**61.79%**
Ohio	8.24%	24.8%	-9.3%	1.2%	-3.1%	44.5%
Maine	8.50%	35.4%	-2.5%	3.4%	2.3%	45.3%
Maryland	9.30%	50.9%	1.7%	7.4%	-1.5%	67.0%
Vermont	9.40%	36.1%	-1.6%	2.2%	-0.1%	64.5%
New York	10.50%	43.1%	-0.4%	1.5%	-8.3%	68.3%
California	10.55%	42.1%	-4.8%	8.0%	-3.9%	77.2%
New Jersey	10.75%	33.7%	-3.6%	3.6%	-4.8%	70.4%
Hawaii	11.00%	57.4%	5.7%	11.7%	-2.2%	72.1%
Oregon	11.00%	55.0%	-0.3%	10.4%	4.5%	46.8%

Data compiled by Laffer Associates

*Highest marginal state and local personal income tax rate imposed as of 1/1/2011 using the tax rate of each state's largest city as a proxy for the local tax. The deductibility of federal taxes from state tax liability is included where applicable. New Hampshire and Tennessee tax dividend interest income only.

**Equal-weighted averages

***2000-2009

****1999-2008

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The Heartland Tax Rebellion

More states want to repeal their income taxes.

Oklahoma Governor Mary Fallin is starting to feel surrounded. On her state's southern border, Texas has no income tax. Now two of its other neighbors, Missouri and Kansas, are considering plans to cut and eventually abolish their income taxes. "Oklahoma doesn't want to end up an income-tax sandwich," she quips.

On Monday she announced her new tax plan, which calls for lowering the state income-tax rate to 3.5% next year from 5.25%, and an ambition to phase out the income tax over 10 years. "We're going to have the most pro-growth tax system in the region," she says.

Associated Press

Oklahoma Gov. Mary Fallin

She's going to have competition. In Kansas, Republican Governor Sam Brownback is also proposing to cut income taxes this year to 4.9% from 6.45%, offset by a slight increase in the sales tax rate and a broadening of the tax base. He also wants a 10-year phase out. In Missouri, a voter initiative that is expected to qualify for the November ballot would abolish the income tax and shift toward greater reliance on sales taxes.

South Carolina Governor Nikki Haley wants to abolish her state's corporate income tax. And in the Midwest, Congressman Mike Pence, who is the front-runner to be the next Republican nominee for Governor, is exploring a plan to reform Indiana's income tax with much lower rates. That policy coupled with the passage last week of a right-to-work law would help Indiana attract more jobs and investment.

That's not all: Idaho, Maine, Nebraska, New Jersey and Ohio are debating income-tax cuts this year.

But it is Oklahoma that may have the best chance in the near term at income-tax abolition. The energy state is rich with oil and gas revenues that have produced a budget surplus and one of the lowest unemployment rates, at 6.1%. Alaska was the last state to abolish its income tax, in 1980, and it used energy production levies to replace the revenue. Ms. Fallin trimmed Oklahoma's income-tax rate last year to 5.25% from 5.5%.

Comparing High- and Low-Tax States

Percentage average growth by category for nine states without personal income taxes and nine states with the highest personal tax rates, 2001-2010

	No income tax	Highest rate
Population	**13.7**	5.5
State product	**58.5**	42.1
Employment	**5.4**	-1.7

Note: States without a personal income tax are Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington and Wyoming. The states with the highest rates are California, Hawaii, Maine, Maryland, New Jersey, New York, Ohio, Oregon and Vermont.
Source: American Legislative Exchange Council, 2011

The other state overflowing with new oil and gas revenues is North Dakota thanks to the vast Bakken Shale. But its politicians want to abolish property taxes rather than the income tax.

They might want to reconsider if their goal is long-term growth rather than short-term politics. The American Legislative Exchange Council tracks growth in the economy and employment of states and finds that those without an income tax do better on average than do high-tax states. The nearby table compares the data for the nine states with no personal income tax with that of the nine states with the highest personal income-tax rates. It's not a close contest.

Skeptics point to the recent economic problems of Florida and Nevada as evidence that taxes are irrelevant to growth. But those states were the epicenter of the housing bust, thanks to overbuilding, and for 20 years before the bust they had experienced a rush of new investment and population growth. They'd be worse off now with high income-tax regimes.

The experience of states like Florida, New Hampshire, Tennessee and Texas also refutes the dire forecasts that eliminating income taxes will cause savage cuts in schools, public safety and programs for the poor. These states still fund more than adequate public services and their schools are generally no worse than in high-income tax states like California, New Jersey and New York.

They have also recorded faster revenue growth to pay for government services over the past two decades than states with income taxes. That's because growth in the economy from attracting jobs and capital has meant greater tax collections.

The tax burden isn't the only factor that determines investment flows and growth. But it is a major signal about how a state treats business, investment and risk-taking. States like New York, California, Illinois and Maryland that have high and rising tax rates also tend to be those that have growing welfare states, heavy regulation, dominant public unions, and budgets that are subject to boom and bust because they rely so heavily on a relatively few rich taxpayers.

The tax competition in America's heartland is an encouraging sign that at least some U.S. politicians understand that they can't take prosperity for granted. It must be nurtured with good policy, as they compete for jobs and investment with other states and the rest of the world.

"Our goal is for our economy to look more like Texas, and a lot less like California," says Mr. Brownback, the Kansas Governor. It's the right goal.