Kansas Action for Children

March 17, 2021

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Kansas Action for Children
Verbal testimony in opposition to HB 2421
House Taxation Committee

Chairperson Smith and Members of the Committee:

Thank you for the opportunity to provide testimony in opposition to HB 2421. Kansas Action for Children is a nonprofit, nonpartisan organization. Our vision is to make Kansas the best state to raise -- and be -- a child, and our organization shapes health, education, and economic policies that improve the lives of Kansas children and families. We support budget and tax policy that prioritizes investing in children and families, particularly among those with low incomes.

Individual itemization won't help most Kansans facing economic insecurity.

Kansas Action for Children encourages the committee to examine the bill to determine which taxpayers would benefit most. Modeling on HB 2421 from the Institute on Taxation and Economic Policy (ITEP) shows that roughly one in 10 taxpayers (12 percent) in the bottom 80 percent of the income distribution would benefit from the bill. In contrast, more than four in 10 taxpayers (43 percent) in the top 20 percent of the income distribution would benefit.[1] This proposal would not drastically reduce the tax liability of low- and moderate-income taxpayers (those who have been most affected by COVID-19). Instead, it would overwhelmingly favor higher-income Kansans (those who have been the least affected by the economic downturn).

This part of the bill will also affect the state's revenue stream. The fiscal note for SB 22 (as introduced), which is a similar piece of legislation, showed the individual itemization component would cost the state approximately $61 million in the first year. Modeling from ITEP estimates this component of the bill would cost $81 million in the first year.[2] With the current economic downturn, Kansas could face a revenue shortfall in FY2022. Your committee should be considering additional revenue raisers, not reductions.

[1] Revenue estimates from ITEP are in 2019 dollars because, due to the economic effects of COVID-19, 2020 income estimates are no longer reliable.
[2] See above.

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The legislation is risky because we do not know the full effect on the Kansas Department of Revenue, as it will have to assume responsibilities in areas previously covered by the federal government, such as fraud monitoring. The fiscal note for the comparable SB 22 bill indicates that roughly $385,000 a year would be needed to help the department implement the bill, monitor for fraud and abuse by developing forms, hiring staff, and changing computer systems. We will be spending money while losing revenue. This will undercut our state budget's fiscal stability while undermining our ability to invest in proven programs that help children and their families.

Business deductions aren't itemized deductions.

Confusion has been introduced into legislative hearings this year by mixing up itemized deductions with business expense deductions. Business revenue and expenses that pass through to an individual's tax return are usually first calculated in Schedule C (Profit or Loss from Business), where the net profit (or loss) then carries over to income on the tax return.

Itemized deductions are very different. These deductions were significantly changed in the federal Tax Cuts and Jobs Act of 2017 (TCJA), eliminating options that many used to itemize (such as individual non-reimbursed business expenses, with mileage expenses being a common deduction when it was available). Currently, the most common itemized deductions include personal expenses related to medical care, charitable contributions, mortgage interest, and property taxes.

We believe this understanding is critical to evaluate who still uses itemized deductions. Businesses are not affected by changes to personal itemized deductions.

While the federal government increased the standard deduction in the TCJA, it also eliminated personal and dependent exemptions (which further reduce taxable income). Kansas has retained its standard deduction **and** exemptions that help Kansans who also use the federal standard deduction.

Corporate tax breaks reward those who have avoided tax obligations.

This year will mark the fourth year the Legislature has considered a bill proposing to decouple from federal changes made in the TCJA. These changes were made in recognition that many large U.S. multinational corporations attempted to dodge their tax obligations, by shifting their income to lower-tax jurisdictions, for example.

Again, this component of the bill is not revenue neutral. Based on the SB 22 fiscal and supplemental notes, KAC estimates this portion of the bill could decrease state revenue significantly, with most of the benefit going to multinational corporations.

It is essential committee members have a full understanding of the cost of the Paycheck Protection Program (PPP) loan provision before working the bill.

Federal tax policy regarding PPP loans could significantly reduce revenue in Kansas. Unfortunately, there has not been an estimate of this cost publicly available. We urge lawmakers to ensure they have an estimated cost of this provision before acting.

Kansas businesses received approximately $5 billion in PPP loans for businesses (up to 500 employees) to use for payroll and other allowed expenses. However, the CARES Act legislation made the unusual decision to treat these loans differently than their normal tax treatment, and not count the loans as income. While that seems reasonable given the pandemic and businesses' hardships, a subsequent federal relief bill rejected IRS guidance that businesses would not be able to use this non-taxable income for business expense deductions. This interpretation would allow PPP loan recipients to benefit from 1) receiving the loan, 2) having the loan be non-taxable, and 3) use the loan for business expense deductions.

KAC understands that businesses have been hit hard by COVID-19, but allowing businesses to use these funds for deductions (which would assume these businesses did well enough to make a profit this year) does not make good fiscal sense. Since not all small businesses were able to secure a PPP loan, the additional beneficial tax treatments of these loans disadvantage eligible businesses who were unable to receive a loan.

KAC does not believe this treatment of PPP loans should be included in the bill. We also believe the Kansas legislature should actively decouple from federal law and not conform to this provision. We are deeply concerned there is not an estimate of the cost of this provision to inform lawmakers about whether the state can afford it, on top of the already high cost of the bill.

Tax cuts could impact state's ability to receive federal funds from newest relief bill.

The American Rescue Plan, the newest federal relief bill, makes clear the federal fiscal aid is not to be used for net tax cuts. In fact, "for every dollar that a state government spends on net tax cuts, it will lose a dollar of the federal fiscal aid it receives from the Act's Coronavirus State Fiscal Recovery Fund."[3] This is good policy, because it discourages states from using one-time federal aid for permanent tax cuts, which could cause problems down the road for state revenue. To be clear, the Kansas legislature is not barred from making net tax cuts,

[3] Johnson, Nick. Center on Budget and Policy Priorities. "Rescue Plan Protects Against Using Federal Dollars to Cut State Taxes." March 11, 2021. https://www.cbpp.org/blog/rescue-plan-protects-against-using-federal-dollars-to-cut-state-taxes

but any net tax cuts would affect how much money the state receives from the federal government.

While federal Treasury guidance has yet to be released, we believe the federal legislation is clear that if a state changes their law in a way that reduces net tax revenue any time after March 3, until they spend all the funds, they must repay an equivalent amount of the federal aid.

Lessons from the Great Recession show us that tax cuts are not the way to economic recovery. Increased investment and a healthy state general fund balance bolster economic growth. Tax cuts hurt families and deepen existing economic and racial inequity.

KAC urges you to not divert needed state revenue to high-income Kansans and multi-national corporations. We ask you to reject proposals that foster corporate tax avoidance. We also believe more information is needed around the true cost of the bill before any further action takes place.

KAC wants to prioritize the needs of small Kansas businesses who have been struggling to stay open during the COVID-19 pandemic and low- and middle-income Kansans who have borne the brunt of the economic downturn. We encourage you to concentrate on our state's lengthy list of needs for reinvestment, debt reduction, and securing a fiscal foundation to recover from this economic downturn.

Lawmakers should reject calls for legislation like HB 2421 and concentrate on the state's needs as Kansas works toward recovery. Thank you for the opportunity to voice our opposition to this bill, and please do not hesitate to contact me at emily@kac.org if you have any questions.