

# Tax Loopholes

*Making decisions based on evidence*

## FISCAL FOCUS

Budget and Tax Policy in Perspective

For decades, Kansas has been successful and able to provide its citizens with a better quality of life because of the strong foundation we've built together. That foundation includes stable roads and bridges that allow us to get where we need to go, peace of mind that our elderly and disabled neighbors are being cared for, and the pride that comes from having a strong local school system. Without that foundation, it would be impossible for our communities and our economy to thrive.

When we talk about budgets and taxes, we're really talking about our ability to maintain and strengthen the foundation of our state. Protecting the foundation of our state will not only protect our quality of life; it will ensure that future generations won't be left to repair damages and rebuild public structures that we've already built. But in order to do so, we need to make critical budget and tax decisions — in both the long-term and the short-term — that will allow us to meet the funding priorities of our state.

For the long-term, we will eventually need to update our tax structure in a way that reflects the modern economy. In the meantime, we need to hold the line on creating tax loopholes that jeopardize our ability to maintain the Kansas foundation that we all rely upon.

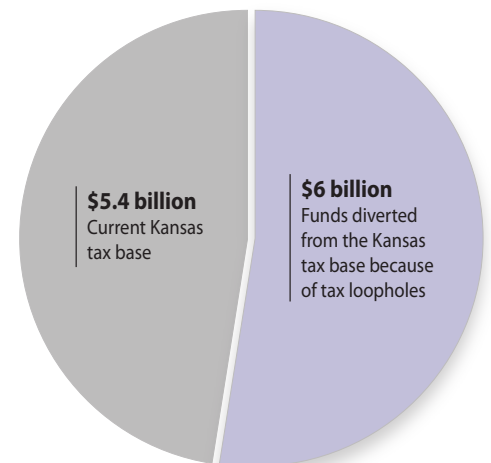
### The Kansas tax base is no longer sustainable.

Over the years, decisions about state taxes have often been made without full consideration for how those decisions will impact the future of our state. During the 2009 Legislative Session — with a budget gap of more than \$1 billion looming for Fiscal Year 2010 — state lawmakers approved several additional tax loopholes, which contribute to the erosion of our tax base and our ability to protect Kansas infrastructure. These loopholes

included four new sales tax exemptions and a sweeping new tax incentive that allows some employers to keep the state income tax withholding money they collect from their employees.

While the dollar value of each tax credit or tax exemption may not be significant on the surface, they accumulate into hundreds of millions of dollars being diverted from our tax base. Moreover, this narrowing of the state tax base puts pressure on lawmakers to raise tax rates in order to meet funding priorities, which results in fewer taxpayers paying an unbalanced share of the cost of maintaining our state infrastructure.

According to the most recent Tax Expenditure Report issued by the Kansas Department of Revenue, tax loopholes have cut our state's tax base in half, resulting in more than \$6 billion in lost revenues each year.



### We need to base tax policy decisions on evidence.

Kansas has always relied on its state tax code for the revenues needed to support our state infrastructure. Each year, the Legislature reviews state expenditures through the appropriations process, which serves as a system of checks and balances to scrutinize the effectiveness of specific expenditures. However, with tax loopholes, there are no

checks and balances. Once a tax credit or tax exemption is enacted, it is seldom reevaluated by the Legislature. With no set criteria for creating tax loopholes, our tax system has become haphazard and inefficient.

The Kansas Advisory Council on Intergovernmental Relations (KACIR) recently recommended a set of criteria for evaluating new tax policy that would make future changes to the Kansas tax system more deliberate and effective. The KACIR, a council enacted by the Legislature, studies services provided by the various levels of government in Kansas and promotes cooperation and efficiency within government. One product of the KACIR is the “Tax Base Policy Evaluation Guide,” which is designed to help lawmakers assess potential tax credits and exemptions. The guide contains a number of important questions for lawmakers to ask when determining whether to support a new tax credit or tax exemption. However, at the heart of the guide is the basic question, “Are you prepared to reduce something else in the budget to pay for the exemption or provide the recipients of the exemption a specific appropriation in the budget?”

Kansas taxpayers expect decisions about tax policy to be made responsibly and deliberately. By requiring evidence to establish the need for a tax credit or exemption and evidence of the estimated benefit to the state, lawmakers can take a more evidence-based approach to tax policy and ensure the long-term creation of responsible tax policy for our state.

### **The evidence shows that we need to hold the line on new tax loopholes.**

The Kansas tax system will ultimately need to be modernized in order to maintain and strengthen the foundation of our state. Our state tax system was created

in the late 1800s and early 1900s when Kansas was largely an agricultural and manufacturing state. In addition to the erosion of our tax base through tax loopholes — like tax credits and exemptions — significant problems exist within the state tax system because of the shift, over time, in our economy from agricultural and manufacturing industries to more service-based industries.

However, until the state is able to fully modernize our tax system, the KACIR guidelines are an important tool that can slow further erosion of our tax base by providing a tool for lawmakers to prioritize indirect spending from tax loopholes. If we allow our tax system to be further eroded through the adoption of new tax loopholes each year, state revenues will continue to fall short of the costs of maintaining our state infrastructure. Many of the investments we forgo now will have an impact on the state’s future prosperity because it will short-circuit investments in Kansas children, our future workforce. Adopting an evidence-based approach to tax policy will strengthen our tax system and ensure that Kansas maintains the strong foundation it needs to provide for future prosperity.



720 SW Jackson, Suite 201  
Topeka, Kansas 66603  
[www.kac.org](http://www.kac.org)

*This report was written and published by Kansas Action for Children as part of its Fiscal Focus Initiative. The Fiscal Focus Initiative is funded, in part, by The Annie E. Casey Foundation and the United Methodist Health Ministry Fund. The findings and conclusions presented are those of Kansas Action for Children and do not necessarily reflect the opinions of the funders.*

### **Sources and Notes**

- 1 “Initial State General Fund Revenue Estimate for FY 2009 and FY 2010 Memo”, Kansas Division of the Budget and Kansas Legislative Research Department, November 4, 2008.
- 2 Tax Expenditure Report, Calendar Year 2007, Kansas Department of Revenue, p.1.
- 3 Tax-Base Policy Evaluation Guide, Kansas Advisory Council on Intergovernmental Relations, September 2009.
- 4 Ibid., p. 2.

# A FISCAL FOCUS REPORT | TAX LOOPHOLES

Question	Sales Tax		Income Tax		Property Tax	
	Yes	No	Yes	No	Yes	No
<i>If the answer to any of these questions is no, the exemption should not be granted.</i>						
1. Are you, as an elected policymaker, willing to reduce something else in the state budget to pay for this tax exemption/credit, or appropriate funds in the budget to the recipients of the tax exemption/credit?						
2. Does the tax exemption/credit include a sunset provision to allow for review and approval?						
3. Does the tax exemption/credit make enforcement and administration less difficult?						
4. Does this tax exemption/credit make the tax system more progressive?						
5. Is this tax exemption/credit prospective only? Retroactive exemptions should be avoided because they impact governmental revenues that have already been allocated or spent, both state and local.						
6. Is there a positive cost benefit to the state or local government that comes from this tax exemption/credit that justifies reducing the state's tax base?						
7. Can the entity requesting the tax exemption/credit provide documented estimates on its value?						
8. Do the entity estimates agree with state-provided fiscal estimates?						
9. If this is an exemption for a specific organization or subset of a larger group, and the tax exemption/credit was granted to all of the members of the group, would the fiscal note still be minimal?						
10. Is the valuation that will be removed from the property tax rolls an insubstantial dollar amount?						
11. Is the property tax that will be shifted to other property owners insubstantial?						
12. Does the exemption avoid creating an improper or preferential classification of property such that one group will have a competitive advantage?						
13. Does the exemption provide a substantial benefit to the public?						
14. Do the proponents of the tax credit agree to the public disclosure of the amounts claimed?						
15. Does the tax exemption/credit achieve a policy goal that can be justified to the public?						
16. Does this exemption treat taxpayers in this class or group the same? Singling out an exception or exemption for a specific taxpayer is poor tax policy and should be avoided.						
17. If this exemption gives an economic or competitive advantage to one group over another, is the justification for preferential treatment an accepted policy such as: improving economically disadvantaged areas, removing barriers to interstate competition in border communities, helping a depressed area or industry, assisting local communities to develop attractions of statewide or multistate importance?						
18. Does granting this exemption increase the tax burden on the public?						
19. Is the nonprofit organization receiving this tax benefit providing a service that the government would otherwise provide, such as foster care or health services?						
20. Is the nonprofit organization unable to continue operating without the exemption?						
21. If this exemption is passed, will organizations/businesses that provide similar or identical services as this nonprofit organization have the same competitive playing field?						

*Evaluation tool reprinted with permission from the KACIR's "Tax Base Policy Evaluation Guide"*