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Three Strategies for Making Enacted Kansas Tax Plan Less Unfair and Less Costly

Yesterday, the Kansas House of Representatives passed, and sent to Governor Sam Brownback, a tax plan, Senate Substitute for House Bill 2117, that had been previously ratified by the state Senate. A number of lawmakers in both houses have expressed dismay at the projected long-term cost of the bill, and the governor has indicated that he would be open to further revisions to the tax package. The plan sent to the Governor could be improved in several important ways:

First: **take a more targeted approach to cutting taxes on "pass through" businesses**. The tax bill would completely exempt the non-wage income of "pass-through" business entities, mirroring an earlier proposal by Governor Brownback. Under an earlier version of this legislation, this exemption would phase in gradually over time. For example, in 2013 and 2014 the first $100,000 of qualifying business income would be exempt. If the goal of this provision is to "take the tax off small businesses," as Governor Brownback said earlier this week, exempting a certain flat amount of such income would be a far more direct—and far less costly—way of achieving that goal. Kansas could also choose to increase the amount of small business investments in equipment that can be immediately expensed. This amount, based on federal law, is set to fall to $25,000 in 2013: Kansas lawmakers could choose to increase the amount of expendable small business expenses to the current $125,000 instead.

Second: **preserve the food sales tax credit and renter's credit**. Kansas is one of a small number of states that still tax groceries under the state sales tax; the state has chosen to offset the impact of this tax on low-income families by providing a small, but vital, tax credit to seniors and families with children earning under $31,000 a year. Many of the taxpayers affected by the bill's repeal of the food sales tax credit already live under the poverty line. The tax bill would also repeal a tax credit for low-income renters that is designed to help offset the property taxes that renters pay indirectly in the form of higher rents.

As lawmakers, including President Ronald Reagan, have long realized, taxing low-income families further into poverty is counterproductive because it pushes families into the social safety net. In this sense, much of the tax savings from repealing these two tax credits may be lost due to increased safety-net spending—hardly the outcome most Kansas policymakers had in mind.

Third: **get serious about itemized deductions**. Kansas is one of thirty states that allow most of the same itemized deductions that are allowed on federal tax forms. These deductions typically offer the biggest benefits to the very best-off taxpayers, and a number of states have recently moved to reform itemized deductions by imposing income limits on eligibility. The bill on the governor's desk takes a different approach, by entirely repealing certain itemized deductions while leaving others unchanged. This makes filing income tax forms more complicated for Kansans, without making these deductions better targeted at all. Instead of eliminating entirely the itemized deduction for extraordinary medical expenses, for example, lawmakers could instead phase out all itemized deductions for taxpayers above a certain income level.

Of course, one of the biggest cost drivers in the bill is the reduction in the top personal income tax rate from 6.45 to 4.9 percent. While advocates of cutting the top tax rate have described it as a strategy for economic development, there is little empirical evidence that cutting state income tax rates can, taken on its own, lead to greater economic growth. This shouldn't be surprising, since tax cuts must inevitably be paid for either through cuts in public investment or increases in other taxes. When these changes are viewed as a package, it's easy to see why cutting income taxes isn't an economic panacea.