

# Considering Tax Expenditures in State Budget Deliberations

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Text available at

[ssrn.com/paper=1510782](https://ssrn.com/paper=1510782)

# Components of State Public Finance

1. Tax Revenue
2. Government Expenditures
3. Allocation of the Tax Burden

# Tax Revenue

# Tax Revenue Determination

$$\text{Tax Base} \times \text{Tax Rate} = \text{Tax Revenue}$$

# Tax Bases

Income Tax

Taxable Income

Sales Tax

Taxable Sales

Property Tax

Assessed Property Value

# Relationship Between Tax Base and Tax Rate

**Tax Base**



**Who Pays**

**Tax Rate**



**How Much**

# 2008 Sales-Tax Revenue

Taxable Sales x Tax Rate = Tax Revenue

\$57 billion x 5.3% = \$3 billion

# 2008 Sales-Tax Expenditures

*Exempt Sales* x *Tax Rate* = *Tax Expenditure*

*\$75 billion* x *5.3%* = *\$4 billion*

# 2008 Potential Taxable Sales

Taxable Sales	\$57 billion
<u>Plus Exempt Sales</u>	<u>+\$75 billion</u>
Potential Taxable Sales	\$132 billion

# 2008 Sales-Tax Revenue with No Exemptions

$$\textit{Potential Taxable Sales} \times \textit{Tax Rate} = \textit{Potential Revenue}$$

$$\textit{\$132 billion} \times \textit{5.3\%} = \textit{\$7 billion}$$

# 2008 Possible Sales-Tax Rate with No Exemptions

$$\textit{Potential Taxable Sales} \times \textit{Tax Rate} = \textit{Potential Revenue}$$

$$\textit{\$132 billion} \times \textit{2.3\%} = \textit{\$3 billion}$$

# Government Expenditures

# Direct Expenditures

- Writing checks or transferring funds

# Indirect Expenditures

- Providing economic benefit without writing checks or transferring funds
  - Indirect Expenditure = Tax Expenditure
  - Tax Expenditure = Sales-Tax Exemption

# Popularity of Tax Expenditures

- Comparable to Off-Balance-Sheet Financing
- Facilitate Secret Manipulations of State Finances

# Types of Sales-Tax Expenditures

1. Organization-Specific Sales-Tax Expenditures
2. Taxpayer-Specific Sales-Tax Expenditures
3. Sales-Tax Expenditures to Out-of-State Beneficiaries

# Analyzing Organization-Specific Tax Expenditures

**Tax Expenditure  
Beneficiary**

**Direct Expenditure  
Beneficiary**

Nonprofit Hospitals ↔ Kansas Neurological Institute

Religious Organizations ↔ Education

# Analyzing Taxpayer-Specific Tax Expenditures

**Tax Subsidy**

**Full Taxation**

Prescription Drugs



Baby Formula and Diapers

Agricultural Machinery



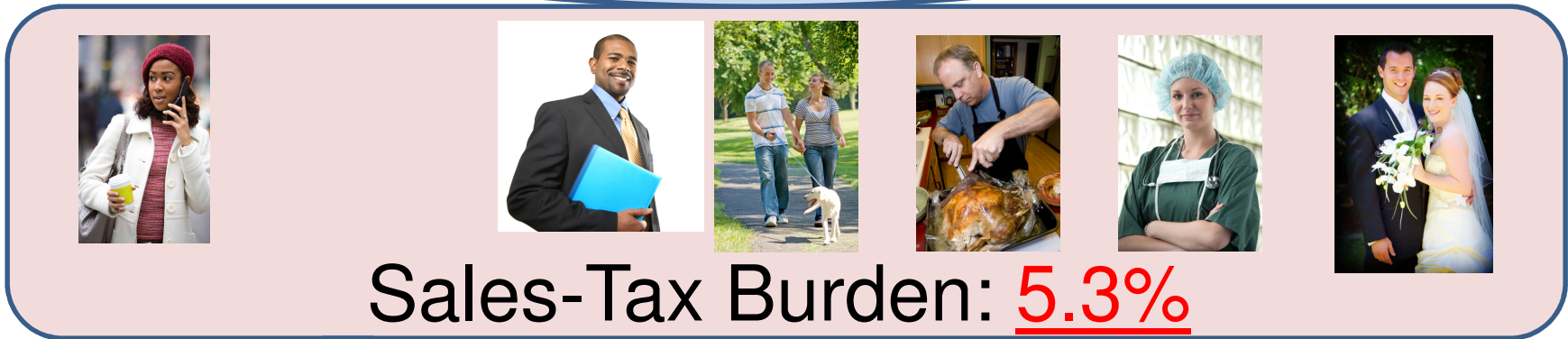
Plumber's Equipment

# Allocating the Tax Burden

# Unfair Allocation of the Tax Burden



State Services



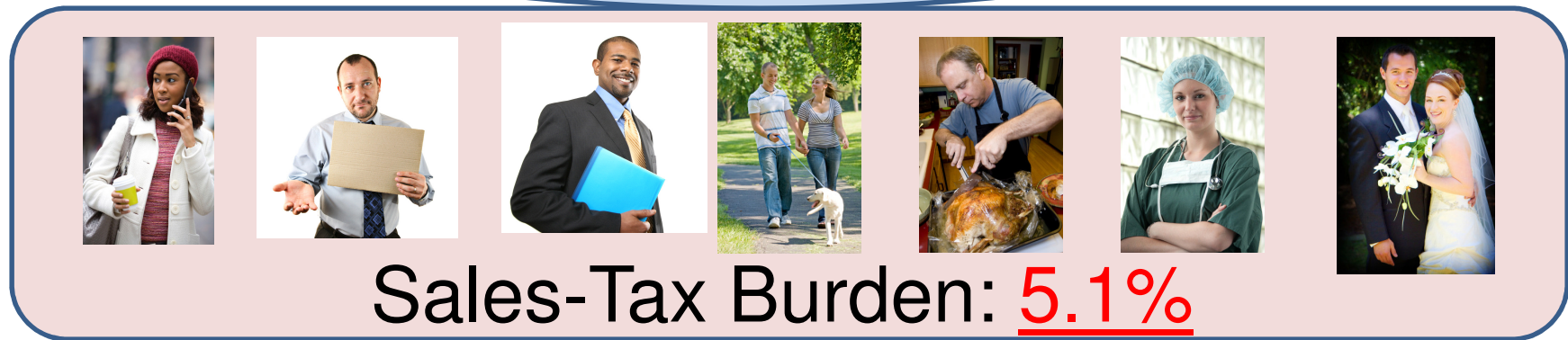
Sales-Tax Burden: 5.3%



# Fairer Allocation of the Tax Burden



## State Services



Sales-Tax Burden: 5.1%

# What Possibilities Await?



## State Services



Sales-Tax Burden: 2% to 3%

# Possibilities

- Low Competitive Tax Rates
- Balanced Budget
- Fair Taxes



**Financing Government**  
or  
***Where has all the Money Gone?***



*Joan Wagon*  
*Kansas Secretary of Revenue*  
*November 18, 2009*

# **Economic Conditions around the Country and in Kansas**



Financing State Government  
just became more difficult with  
the recent estimates...



Allotments will be coming within 2 weeks

## FY 2010

- Reduced income by \$235.2 million
- 4.2 percent below the previous estimate
- The revised estimate is \$5.301 billion;
- 5.1 percent decrease below final FY 2009 receipts.

## FY2011

- Further reduced income by \$122.2 million
- 2.3 percent, below the newly revised FY 2010 figure
- The initial estimate for FY 2011 is \$5.179 billion,
- 2.3% decrease from 2010

# Where did the drop in \$\$ occur?

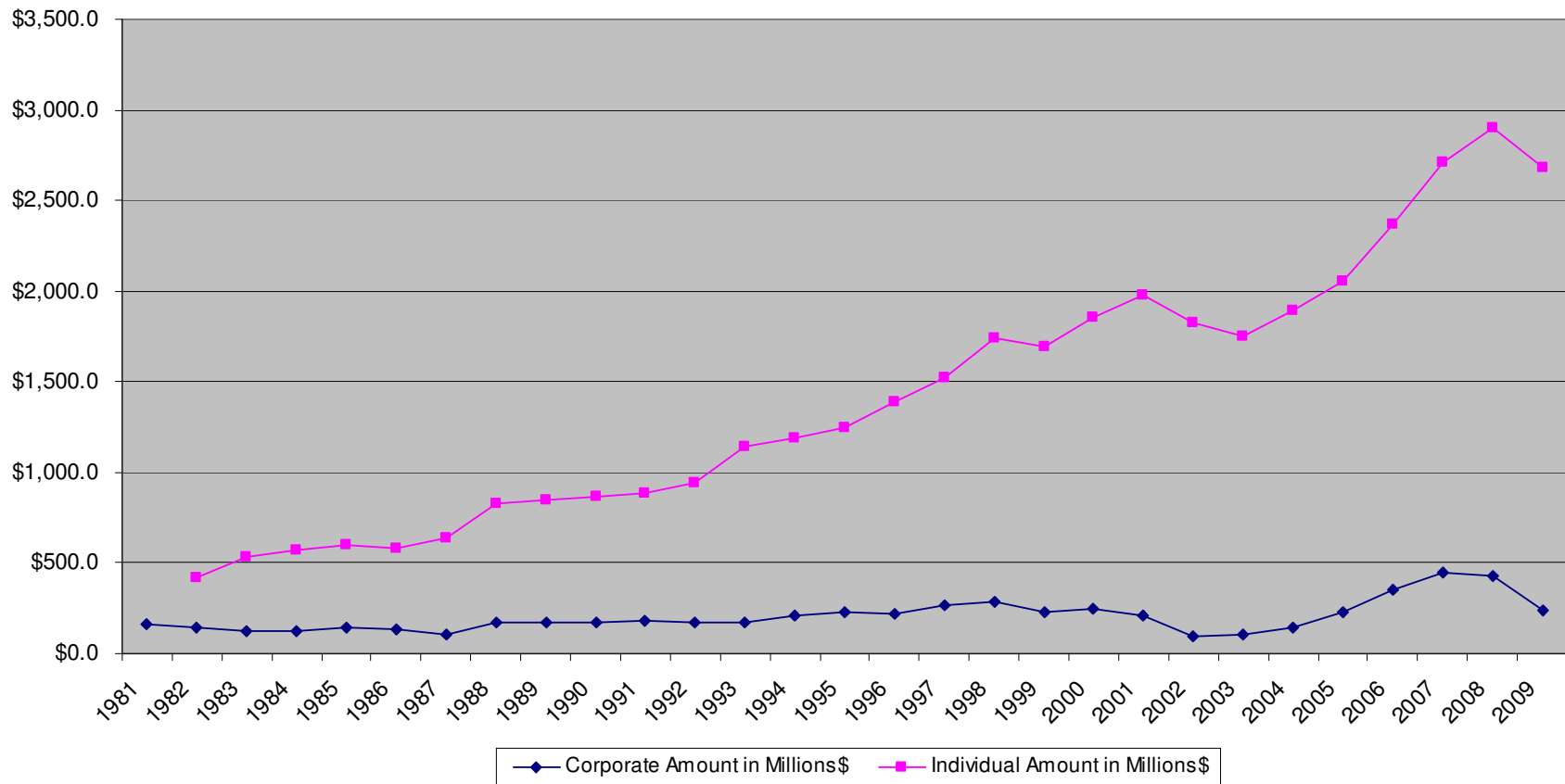
- Kansas Personal Income (KPI) in 2009 is expected to fall by 2.7 percent below the 2008 level.
- Kansas non-farm employment from September 2008 to September 2009 had decreased by about 60,000 jobs, or 4.3 percent
- Kansas jobless rate was 4.4 percent in CY 2008; is expected to jump to 6.95 percent in CY 2009; 7.3 percent in CY 2010; and fall to 6.75 percent for 2011.

# Prior Tax Decisions Impacted Future Budgets

- Legislation in 2006 eliminated the Kansas estate tax as of 2010.
  - Reduce receipts by an estimated \$47 million in 2011 and \$52 million in 2012.
- Franchise tax phased out.
  - Reduce receipts by \$37 million in FY2011 and \$48 million in FY 2012.
- Legislation enacted in 2005 will reduce severance tax receipts to SGF by;
  - \$6.3 million in FY 2011 and \$10.7 million in FY 2012 and \$13.4 million in FY 2013.

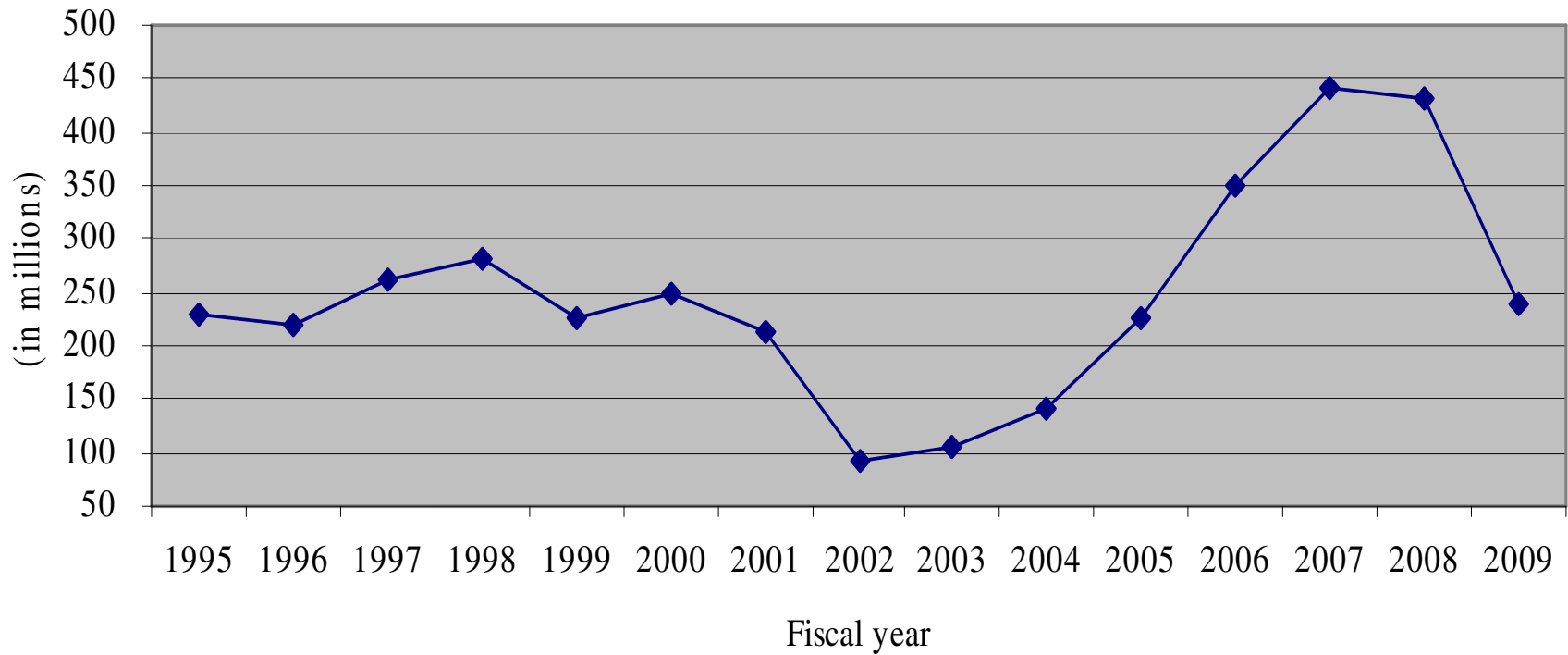
# The Long View of Tax Trends

## Individual and Corporate



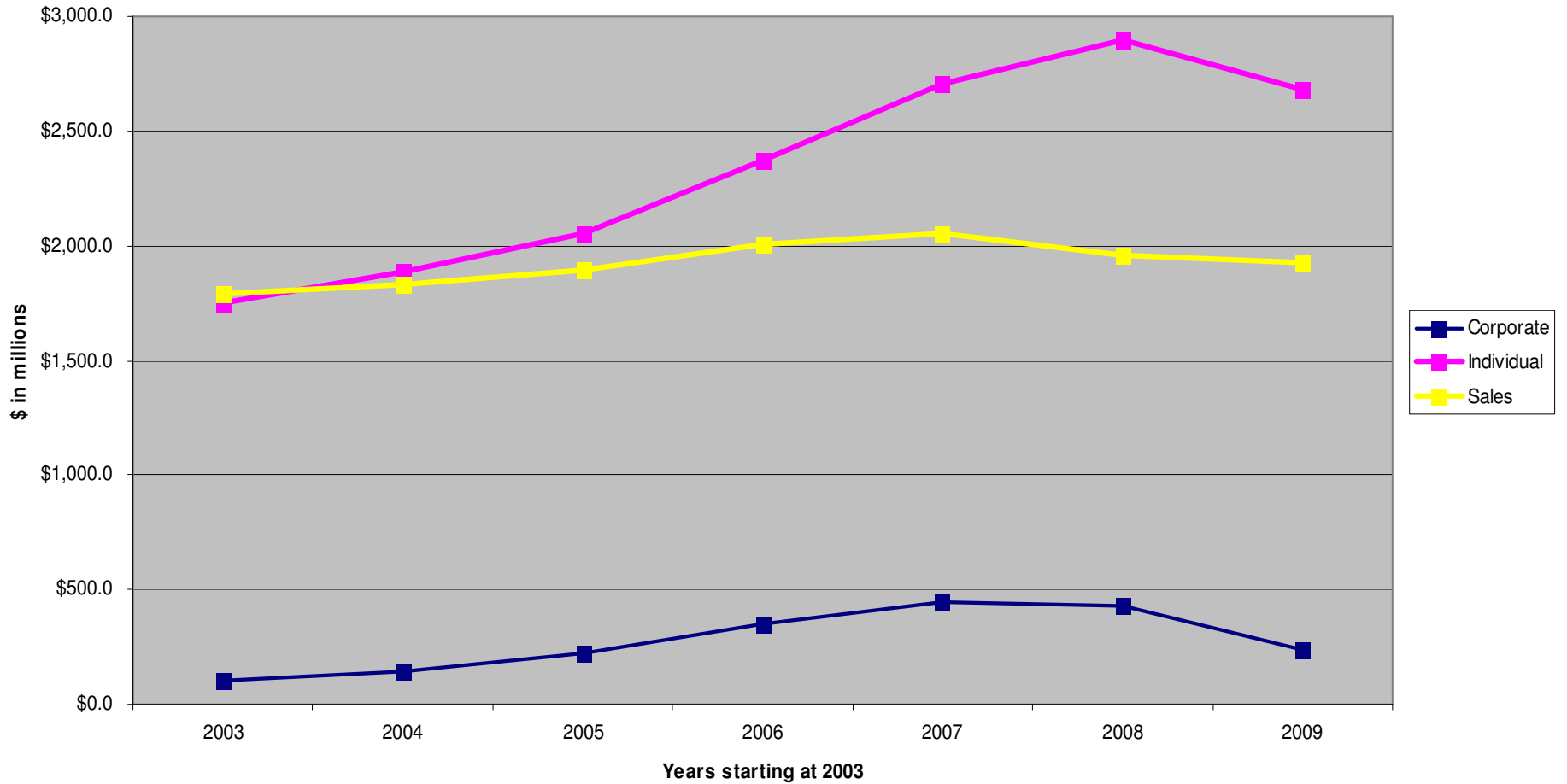
# The Rollercoaster:

Corporate Income Tax - State General Fund  
Fiscal Years 1995-2009



# Major tax sources

Income, Sales and Corporate Taxes



# The Eroding Tax Base, or “Where did the Money Go?”



# How Tax Bases Erode

- Exemptions
- Tax Credits
- Economic Shifts, ie. consumption and business practices; e-commerce, services
- Policy Shifts
  - Tax Credits
  - STAR bonds, TIF's
  - IRB's, EDX's, - other abatements- exemptions

# What we Learned from Studies

- Tax Mix is Unbalanced
- Local Government spending is significant
- Elasticity is declining
- Tax base erosion is a major problem
- Current trends are away from sound tax policy

# Where did the Money Go?

- General property tax and personal property tax reductions -- **\$602 million** in FY2009.
- Changes/reductions Income taxes -- **\$298.7 million**
- Sales tax exemptions -- **\$116 million.**
- Cumulative since FY1995 thru FY 2009, -- **\$10.9 billion**
- **\$1 billion** in FY2009.

# What does the future hold if the present trends continue?

- Continued Erosion of the Tax Base
- Higher Rates
- Less Equity among Taxpayers
- Less Competitiveness with other States
- More Taxpayer Discontent
- More Special Tax Legislation which further erodes the Tax Base, ...and on...and on...

# Tax Policy Recommendations

- Advocates and Legislators should utilize the Policy Evaluation Guide when exemptions or credits are proposed
- Enact a moratorium for 3 years on all credits and tax exemptions.
- Institute a Sunset Review on all sales and property tax exemptions.
- Restructure the financing of local government services

# Serving the people

*Let's concentrate on good management, on prudent economies — and on keeping alive the idea and spirit of public service in Kansas.*

