

Approved: 1-25-93  
Date

MINUTES OF THE HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT.

The meeting was called to order by Chairperson Wanda Fuller at 3:30 p.m. on January 19, 1993 in Room 423-S of the Capitol.

All members were present except:

Committee staff present: Lynne Holt, Legislative Research Department  
Bob Nugent, Revisor of Statutes  
Ellie Luthye, Committee Secretary

Conferees appearing before the committee:  
Pat Oslund, Research Economist, University of Kansas  
Dr. Charles R. Warren, President, Kansas, Inc.

Others attending: See attached list

The Chair introduced Pat Oslund, Research Economist from the University of Kansas. She presented testimony by Dr. Anthony L. Redwood, Professor of Business and Executive Director of the Institute for Public Policy and Business Research at the University of Kansas. Dr. Redmond addressed the relationship between taxation and economic development in a broad sense, and, specifically, as it relates to Kansas. (Attachment 1)

Ms. Oslund gave testimony on the general overview of the Kansas tax structure and how it compares with other states in the region and with the U.S. (Attachment 2)

The Chair next called upon Dr. Charles R. Warren, President, Kansas Inc., who gave testimony on "Kansas Tax Competitiveness and Economic Development". (Attachment 3)

Following these presentations the conferees stood for questions.

The meeting was adjourned at 4:50 p.m. The next meeting of the House Economic Development Committee will be Wednesday, January 20, 1993 in Room 423-S.

HOUSE - Economic Development - E

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# **TAXATION ISSUES AND ECONOMIC DEVELOPMENT**

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Executive Director, Institute for Public Policy  
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The University of Kansas

Presented to the  
House and Senate Economic Development Committees  
Kansas Legislature

January 19, 1993

January 19, 1993  
Economic Development  
Attachment 1

## **Introduction**

The purpose of this testimony is to:

1. address the relationship between taxation and economic development in a broad sense (philosophy, strategy, principles) and, specifically, as it relates to Kansas, and;
2. introduce my colleague, Pat Oslund, who will inform the Committee on specific research relating to the relative impact of the Kansas tax code on key sectors of Kansas industry.

## **TAXATION in the 1986 Kansas Economic Development Strategy**

Please refer to my paper (previously distributed), "Review of the Kansas Strategy for Economic Development..." (Kansas Business Review, 1992).

The key points that need to be made concerning the role and significance of taxation with respect to the state's economic development strategy are the following:

1. The strategy adopted in 1986 was a radical change, indeed a reversal of the previous Kansas strategy, which I would characterize as "smokestack chasing" through tax incentives and subsidies (p.21).
2. The "new" economic environment facing Kansas firms, characterized by fierce global competition, rapid technology change, short product and process cycles, sophisticated consumers, and totally new industries (p.21), is (and will be more so) radically different from the past.
3. Key choices made in 1986 included:
  - a) Should Kansas continue to target ATTRACTION of new industry as the primary focus of its strategy, or should we have a more balanced approach with a primary emphasis on the RETENTION AND EXPANSION of our EXISTING industry and on the START UP of NEW FIRMS?

The pros and cons in relation to this are listed on page 23. The choice was made to have a balanced approach on all three forms of business development. Recent research (Dr. Jarvin Emerson, KSU) shows that around 90 percent of new job creation in Kansas is from existing industry and start-ups, confirming the wisdom of that decision.

- b) Second, which of the alternatives, INCENTIVES or INVESTMENT in the FUNDAMENTALS (the resource base) is the more effective approach in fostering long-term business development and competitiveness? After reviewing the pros and cons (p.23), the decision was made to adopt a

long-term investment approach. The objective was to neutralize tax and incentives as factors affecting business location and business competitiveness, so that Kansas firms would compete and grow on the basis of non-tax factors, such as a highly productive work force, timely access to technological innovation, accessible finance, and so on.

c) Consequently, state resources were to be strategically invested in the seven foundations underpinning business development and firm competitiveness, namely **Human Capital, Infrastructure Capital, Financial Capital, Innovation/Technology Capital, Commitment/Capacity Capital, Business Environment, and Quality of Life**. (See the listing of economic development initiatives on pages 26 and 27 for each foundation).

d) Let me stress what is perhaps a truism, namely that Kansas firms will only be competitive in the future if:

one they have the best possible resources available to them (skilled workers, technology, finance, etc.), and;

two they operate in a supportive business environment, which we have defined as

- a neutral (not advantaged and not disadvantaged) tax code, and;
- supportive state services and business assistance.

### **WHERE ARE WE vis-a-vis the STRATEGY?**

Let me characterize our situation as follows, particularly relative to our region:

1. **Overall**, our business sector carries a significantly higher tax burden than regional average.
2. **Structure**. Our tax structure
  - i) penalizes CAPITAL INVESTMENT, which is nonsensical in the emerging CAPITAL intensive, technology-oriented economic environment of the 1990s.
  - ii) penalizes the ONLY two sectors of our economic base that have the potential to create jobs and wealth for Kansas, namely MANUFACTURING and BUSINESS/EXPORT SERVICES.
3. **UNCERTAINTY**. Seemingly endless changes in the TAX CODE create a level of uncertainty and distrust that can negatively influence firm decisions to locate or stay in Kansas. There is a pressing need for STABILITY.

What we need is:

1. a TAX LEVEL competitive with the regional average, and;
2. limited tax incentives for only two purposes,
  - i) to offset/neutralize their existence in other states, and;
  - ii) to encourage firms to strive towards high performance and maximum competitiveness (e.g. undertake R&D, retraining).

What we have is: the complete opposite of what we set out to have in our 1986 economic development strategy, and is, in my opinion, harmful to state business development, namely,

1. a TAX BURDEN on Kansas business that is too high, and;
2. an increasing tendency to use tax incentives and subsidies TO OFFSET this disadvantage, largely targeted to the ATTRACTION of firms, the lowest priority of business development for the state.

**DO TAXES MATTER IN BUSINESS LOCATION?**

Older academic studies answered this question in the negative. Recent studies, however, have been finding a significant link. Let me summarize here:

- For firms seeking to relocate, an initial decision concerning regional location will be based largely on business competitiveness factors such as work force productivity, access to markets, and suppliers, etc. However, intra-region site location decisions could be influenced by tax factors, particularly significant, as distinct from modest, tax differentials.
- The tax factor will vary significantly in impact by type of firm.
- Statistical studies suggest that if all state/local business taxes were reduced 10 percent from their usual level (e.g. state corporate income tax from 5% to 4.5%, and effective property tax from 2% to 1.8%), we could expect a long run increase in employment of around 2.5 percent, above and beyond the growth that would have occurred without the business tax reduction.

**TAX BURDEN ON KANSAS INDUSTRIES**

It is my pleasure now to introduce my colleague, Pat Oslund, Research Economist in the Institute. She is the architect of our TAX IMPACT model and has prepared estimates of the relative tax burden of our key Kansas industries. (Funding for this model's development and related research was provided by Kansas Inc.).

**BUSINESS TAXES IN KANSAS AND NEARBY STATES**  
**Where Does Kansas Stand?**

Testimony Presented to the  
Senate Commerce Committee and  
House Economic Development Committee

by

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January 19, 1993

Good afternoon. I'm Pat Oslund from the Institute for Public Policy and Business Research at the University of Kansas. I'm happy to have the opportunity to address you today concerning business taxes in Kansas. Some of you may be familiar with some of the material that I will present today from my presentations last year.

The main purpose of my talk is to give you a general overview of the Kansas tax structure and of how it compares with other states in the region and with the U.S. I will then present some more specific results from a tax simulation model developed at IPPBR with the support and guidance of Kansas Inc. The model that we have developed lets us translate the general characteristics of a state's tax structure-- its rates, tax base, exemptions, etc.--into an estimate of the taxes that would be paid by typical firms in Kansas industries.

Before we get started, I'd like to let you know that your handouts contain copies of tables and graphs illustrating the concepts I will be discussing this morning. The tables and graphs start on page 11.

#### **Figure 1. State and Local Tax Revenue 1990**

Let's begin with a look at the general level of taxation in Kansas and five other nearby states. State and local taxes in this region, measured on a per-capita basis, are consistently lower than the U.S. average. Within the region, the states clearly break themselves into two groups. Colorado, Iowa, Kansas, and Nebraska collected combined state and local revenues between \$1800 and \$2000 in 1990. Kansas, with revenues of \$1846 per capita, ranked 27th in the nation. The lower taxed states in the region, Missouri and Oklahoma, each collected less than \$1600 per capita; they ranked 45th and 39th in the nation respectively.

#### **Figure 2. Transfers from State to Local Governments**

As you can see in Figure 1, Iowa, Missouri, and especially Oklahoma depend more heavily on state level taxes than on local taxes. However, there is no clear relationship between the amount of funds collected at the local level and the amount of funding for locally provided services. As you can see in Figure 2, all of the state governments redistribute funds to local governments. The Kansas school finance program that was passed in 1992 will make some big changes, moving much more of the responsibility for funding schools to the state level.



Just a quick comment on the data before I continue. I would like to point out that the U.S. Bureau of the Census is the major provider of state level data on tax revenues and expenditures throughout the U.S.. The Census Bureau makes a considerable effort to make sure that the data are categorized in an consistent manor. But the price for this is some delay in the publication of data. 1990 is the latest year available for these state comparisons.

### **Figure 3. State Tax Revenue Sources 1990**

State level revenues come from a variety of sources. You can see in Figure 3 that the states in the region is that they vary considerably in the breakdown of tax revenues. The sales and individual income taxes are the two largest revenue providers in most of the states. Oklahoma stands out with a fairly high percentage of "other" revenue. This is mainly oil and gas severance taxes. Iowa and Kansas stand out in the region with a fairly high amount of revenue derived from the corporate income tax, as measured on a per capita basis.

### **Figure 4. Local Tax Revenue Sources 1990**

The breakdown of local tax revenue is also interesting. Three of the states in our region are heavily dependent on local sales taxes. In two of those states, Missouri and Oklahoma, the local sales tax seems to be a substitute for property taxes. In two these states, property taxes on a per capita basis are only about half the national average.

### **Figure 5. Sales Tax as a Percent of State and Local Taxes**

The sales tax, both state and local, has become an increasingly important revenue source when measured as a share of total tax revenue. The trend in Kansas, the Region, and the U.S. is clearly upward. The region as a whole is more dependent on the sales tax than is the nation on average. For the last three years for which data are available, Kansas seems to be hovering at a little less than the national average.

The rising importance of the sales tax raises the question of the regressivity of a state's tax system. A tax is considered regressive if it takes a larger portion of the income of poor families than of well-off families. Whether sales taxes are more regressive than alternatives (for example property taxes) probably depends in large part upon the exemptions which a state builds into its

sales tax system. Exemptions for groceries, medicines, and other basics reduce the regressivity of the tax.

### **Figure 6. Local Property Tax Per Capita**

Property taxes per capita have exhibited a steady upward trend. In Kansas taxes grew about 72% during the 1981-1990 period. The region and the nation followed a similar pattern. During that same time period, prices grew only about 44%. So the rise cannot be attributed to inflation alone.

Reviewing the general characteristics of the tax structure, Kansas appears to be a rather average state. However, we need to look in more detail at those taxes that specifically affect businesses in order to say much about whether the Kansas tax structure is so to speak "competitive." We need to concentrate on the corporate income taxes, sales taxes on inputs, and commercial and equipment property tax rates to get a better picture of the Kansas business tax situation.

Although I have been asked to talk about the competitiveness of the Kansas tax structure, this is not meant to imply that Kansas should seek to be the lowest taxed state in the area. Some economists even dispute whether lowering taxes increases a state's rate of growth. Even if it does, there are questions about the costs versus the benefits.

### **Table 1. Corporate Income Tax Rates**

I'd like to turn now to three specific taxes. specifics that most affect businesses: corporate income taxes , sales taxes, and property taxes.

The Kansas corporate income tax falls in the middle range of the region, with smaller incomes taxed at 4.0% and incomes above \$50,000 taxed at 7.35%. There are, however, some pitfalls involved in comparing corporate income tax rates across states. It is important that the tax base is defined differently from state to state. The most important single difference is the deductibility of federal income taxes from state taxable income. For states that allow federal deductibility (Iowa and Missouri), the effective rate is actually less than the rate shown in Table 1.

Income tax credits and deductions used for economic development purposes also affect the actual tax a firm will pay. I will have more to say on this later this morning.

## **Table 2. Income Allocation Methods**

The method by which income is apportioned to a state also has an important impact on the income taxes of multi-state firms. The question here is--what share of the firm's overall income can be taxed by a particular state? Apportionment generally depends on three percentages: the percentage of payroll, property, and sales that the firm has in-state. Most states in the nation give equal 1/3 weights to each factor. The most common alternative is a sales-only formula.

The question of apportionment is especially important when we talk about export-based firms. Let me digress for a moment to explain what I mean by an export-oriented firm. This firm is assumed compete to sell its output in a regional, national, or international market. These firms in particular bring new money into the state, money which recirculates and stimulates further growth through a multiplier or ripple effect.

For the export-based, multi-state firm, there is a distinct advantage to be had by locating in a state that bases the state corporate income tax on "sales only." The firm may locate a major production facility in the state, but still have relatively small in-state sales and hence relatively small in-state income taxes.

## **Table 3. Sales Tax Rates**

The sales tax affects firms in several different ways.

1. As an add-on to the price of the product. A firm may not be able to pass all of an increase in sales taxes on to consumers. If not, sales taxes will most likely affect firm profits.
2. Through taxes on intermediate products which affect costs. Intermediate products are used in the firm's business activities. Depending on a state's sales tax exemptions, only some, not all, of these purchases are tax exempt.
3. Through taxes on capital goods such as machinery and equipment, and construction of new facilities.

The combined state and local rates in Kansas are toward the high end for the region. In terms of the sales tax base, Kansas recently added taxes of 2.5% on electricity, gas, and water used for industrial purposes, and on the labor portion of new construction.

#### **Table 4. Effective Property Tax Rates**

Next we turn to the property tax. Comparing property taxes across states presents a whole set of obstacles. Each state has its own assessment procedures, reappraisal schedules, and classification schemes. The most reasonable measure of comparison is the tax as a percentage of the true market value of various types of properties. I will refer to this as the "effective tax rate." While data on tax levies are readily available, true market values are only estimates--so the accuracy of the effective tax rate is less than perfect. Nevertheless we have tried to make these comparisons for several states in our region.

Iowa and Nebraska stand out as having high residential real estate taxes. In contrast, residential taxes in Kansas are in the average range, although not as low as in Oklahoma or Missouri. Note that the effect of the school finance reforms in 1992 lowered residential real estate rates on average in the state. My preliminary estimates for 1993 show an additional lowering due to the recently passed Kansas constitutional amendment.

Tax rates for commercial and industrial real estate remain high, but have been lowered significantly by the recent amendment. The trade off is that rates for machinery and equipment have increased, making them the highest in the region. Clearly the amendment will benefit those firms for which real estate comprises a significant portion of total property, while it will disadvantage very machinery and equipment intensive firms.

No other state in our region has such a large differential between residential real estate and personal property. If there is any single business tax where Kansas stands out as uncompetitive, it is the tax on machinery and equipment.

#### **Table 5. Major Tax Changes, Corporate Income Tax**

Every year, taxation is one of the thorniest issues facing policy makers. In many states, sales and income taxes have been increased to supply state revenue.

Oklahoma enacted a major tax increase package in 1990, including a 20% corporate rate increase. Nebraska has increased corporate rates twice since 1989. As a feature of the 1992 Kansas school finance plan, the corporate income tax on the upper bracket of income was increased to compensate for the loss of property tax revenues. At the same time, the rate for firms with small incomes was decreased.

#### **Table 6. Major Tax Changes, Sales Tax.**

As you can see, most states in the region have increased their rates in the last few years. Kansas is by no means unusual in this category. Even states that have not raised this tax have attempted to do so. For example, a 1 % sales tax increase was recently vetoed in Iowa.

#### **Table 7. Major Tax Changes, Property Tax**

Of the states in the region, Nebraska and Kansas have experienced the largest changes in their property tax systems.

In Kansas, the 1992 school finance legislation lowered rates in most, but certainly not all, areas of the state. Even more recently, the passage of the constitutional amendment has shifted taxes between personal property and real estate.

Nebraska also passed a constitutional amendment in 1992. The amendment responded to some serious constitutional challenges that taxation in Nebraska was not uniform and equal as had been required by law. Under the new amendment, the Nebraska legislature has the authority to set different tax rates for different types of property.

#### **Table 8. Locations included in Simulations**

So far, you have been presented with a factual overview of tax structures in the region. I'd like to turn now to the second part of my talk, the results from the Institute's tax model. The model is really just a way of summarizing all the information we have talked about so far today. That is, the model estimates what the combination of tax rates, exemptions, credits, abatements, etc. do to a firm's bottom line.

Our model was first developed in 1987--it was revised in 1990 and again in 1992. The simulation model is designed to translate information about a state's tax structure -- its rates, tax base, and incentives-- into an estimate of the overall business taxes that would be paid by a typical firm. The model is set up so that we can compare taxes of Kansas firms with the taxes that similar firms would pay in other states. We can also analyze the impact of tax changes. For example, the model was used during the 1992 legislative session to analyze the impact of the school finance package.

The model analyses taxes for major cities and an average non-metro area in each of the comparison states. Note that one neighboring state, Colorado, is not included in the model--this is because we were unable to obtain some critical data.

#### **Table 9. Industries included in simulations**

Our simulations include ten manufacturing and three nonmanufacturing industries. As you can see, the industries include a mixture of high tech industries and heavier manufacturing. They also include a mixture of high growth and low or negative growth industries.

Most results of the model will be presented as averages for the manufacturing and nonmanufacturing sectors. In some cases, we will look at the by industry detail.

#### **Tables 10 and 11. Major Assumptions of the Tax Model**

Any model starts with a set of assumptions. The assumptions of our tax model are presented in Tables 10 and 11. Our model looks at medium sized establishments with 100 employees. We look at two scenarios, which, for lack of better terminology, I refer to as "new firms" and "mature firms." These firms are alike except that new firms qualify for tax incentives, assumed to be at the maximum level allowed in the state, while mature firms fail to qualify.

The new and mature firms share several assumptions. Most importantly, the establishments are assumed to be export-oriented. As I mentioned earlier, this means that they sell most of their output in national or even international markets. This assumption is critical to our model. The export-oriented firms are not tied to local markets, so it makes sense to think of them locating in an alternative state to Kansas. Additionally the export-oriented firms find it difficult to pass a tax increase on to consumers (since they face national competition). Increases in tax are likely to have a direct impact on profits for these firms.

In the results that I present today, I assume that costs for labor and raw materials are constant throughout the region so that we can single out the impact of tax differentials. Our larger research project allowed costs to vary by location.

The estimates for mature firms are intended to illustrate differences in the basic tax structures across states. The estimates of new firms are intended to illustrate differences in both basic rates and state tax incentive structures. In order to discuss the situation of the new firms, it is necessary to discuss tax incentives in more detail.

### **Table 12. Major Tax Incentives**

On the surface, the incentives available in the states in the region look very similar. But an examination of the details of the programs shows some substantial differences. One of the major differences is the length of time for which an incentive is allowed. It makes a big difference whether a property tax abatement is allowed for 10 years or three years. In order for us to be able to compare incentive structure with different durations, we decided to run all simulations for 20 years. The numbers that I will report are annual averages over a 20 year period.

Kansas has some of the most generous tax credits and tax abatements in the region. The new firm simulations for Kansas assume a full property tax abatement for the first 10 years of operation, and no abatement for the second 10 years. This is the single largest incentive offered to firms. Next in importance to property tax abatements are job and investment credits, recently revised as part of the revamping of the Kansas enterprise zone act.

### **Table 13. Taxes for New Firms Receiving Credits and Abatements**

If a firm coming to Kansas receives the full abatement and credit "package", Kansas taxes range from about 3% lower than the regional average to 3% higher, depending on industry and on location. The comparison assumes that the firm could get a full credit/abatement package in any of the other states.

### **Table 14. Taxes for Mature Firms Receiving NO Credits or Abatements**

For mature firms receiving no incentive, taxes in Kansas--combined state, federal, and local, are about 7% to 14% higher than the regional average, again depending on the location in the state. The severe tax disadvantage for mature firms was a major finding of our tax study.

### **Table 15. By Industry Tax Disadvantage**

To back up a little, the numbers cited above lump all manufacturing industries together. A richer picture emerges if we look at some detailed industry results. Table 15 shows these results for an average urban area in Kansas. The tax disadvantage depends, among other things, on how much property a firm uses, its level of profits, and on how much it uses taxed inputs such as gas and electricity.

## Table 16. Taxes by Type

The results for mature firms reflect the high level of taxation for commercial property and equipment, and also a relatively high corporate income tax. Earlier I talked about the effective property tax rate on industrial and commercial real estate. This clearly explains the property tax contribution to the overall high level of taxation in Kansas. The role of the income allocation formula helps to explain the high level of income taxes reported by our model. Sales only formulas, offered by Missouri, Iowa, and Nebraska, offer advantages to export-oriented firms.

### Impact of 1992 Tax Changes (no table)

As I mentioned earlier, we used our model to analyze the tax provisions of the 1992 Kansas school finance plan. Unfortunately, these major tax changes did little overall to improve the situation of Kansas firms *vis a vis* the rest of the region. Our model shows that the impact of the tax changes varies by type of industry and by community. In many areas of the state, increases in corporate income and sales taxes just about balance out decreases in property taxes. Our model predicted that for some industries like grain mill products, which make heavy use of gas and electricity, taxes would generally rise under the 1992 legislation. Service type industries, using less of these inputs are were predicted to benefit under the new legislation.

Without going into the details, I'd like to briefly summarize the average impacts that our model found for mature firms in other areas of the state:

Location	Property	Total State and Local
Olathe	-24.0%	-11.2%
Overland Park	+ 9.6%	+ 7.1%
Wichita	-29.0%	-14.5%
Kansas City	- 8.9%	- 1.7%
Non-metro av.	-13.7%	+0.4%

### Conclusions

I'd like to conclude by making some speculations about the consequences of the business tax structure for economic development in Kansas. In particular, how do business taxes affect our ability to attract new firms and to provide a healthy environment for established industries?

There is still no absolute consensus among academic researchers as to whether "tax climate" variables affect firm location decisions, the number of new firms attracted to a region,



or the rate of employment growth. Results seem to vary with research methods, source data, and on whether the researcher attempts to measure the dollar value (rather than just the number) of incentives available. Those manufacturers (and also export oriented service firms) that face a lot of competition in national markets are probably sensitive to taxes, since they have little latitude to pass the taxes on to their customers.

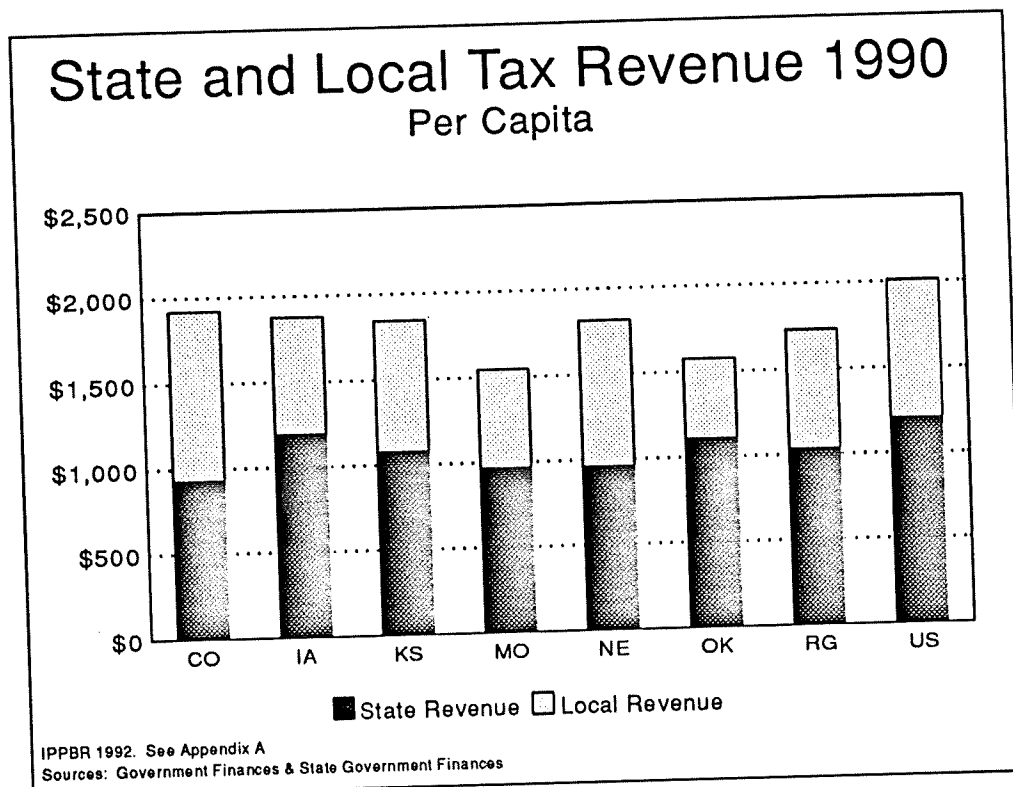
An emerging view that seems to be developing is that state and local taxes do have a significant negative impact on growth. But even if this is true, the size of a tax reduction needed to stimulate new business activity is questionable. Estimates range from \$2,000 to \$11,000 per job per year.

The high level of business property taxes in Kansas may make it difficult for "mature" firms of this type to compete profitably, and hence acquire the financial capital necessary for expansion or retooling. More and more, we see that established firms are asking for tax abatements whenever they consider any kind of expansion. Ironically, property tax abatements help to make Kansas an attractive location for those new and expanding firms which can secure abatements for a 10 year period.

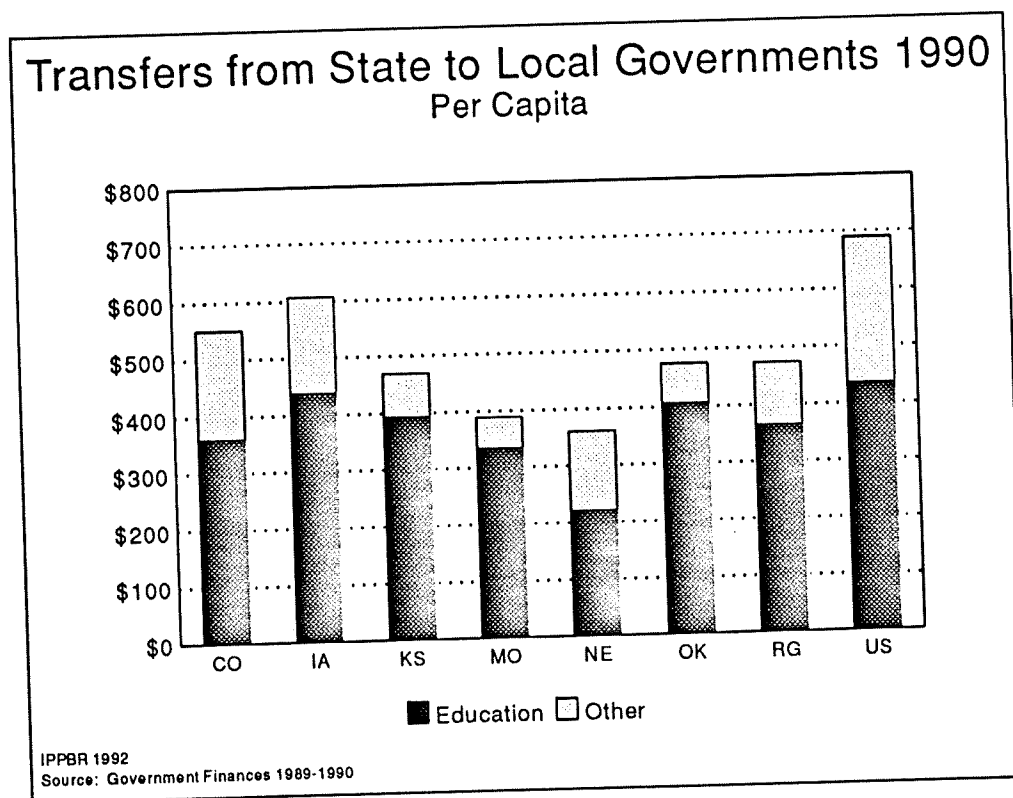
In contrast with the early to mid 1980's state governments in the region seem to be moving away from offering increasingly higher tax incentives attract new firms. Most of the recent state legislation has affected basic rates rather than credits and exemptions. Kansas is the only state to significantly revise its incentive programs in the last few years (enterprise zones). The new Kansas program is not a larger program--it just tries to be a more targeted one.

A final observation concerns the uncertainty about state and local taxes which affects virtually every state in the region. A firm deciding on whether to choose or to continue to choose Kansas as a location will look not just at this year's rates, but on trends and on projections of what the future holds. If a firm looks at a state in serious fiscal crisis it will figure out that taxes have to go up or services have to be seriously diminished. Uncertainty about future taxes may also help to explain the popularity of incentives-- an incentive is a guarantee of a specific job credit or investment credit or property tax break which in part insulates the firm from some of the uncertainties of constantly changing rates.

I think that those states in the region that show the most stability in tax rates and in the level of services provided (rather than simply the lowest rates) will be the winners in stimulating growth and investment.

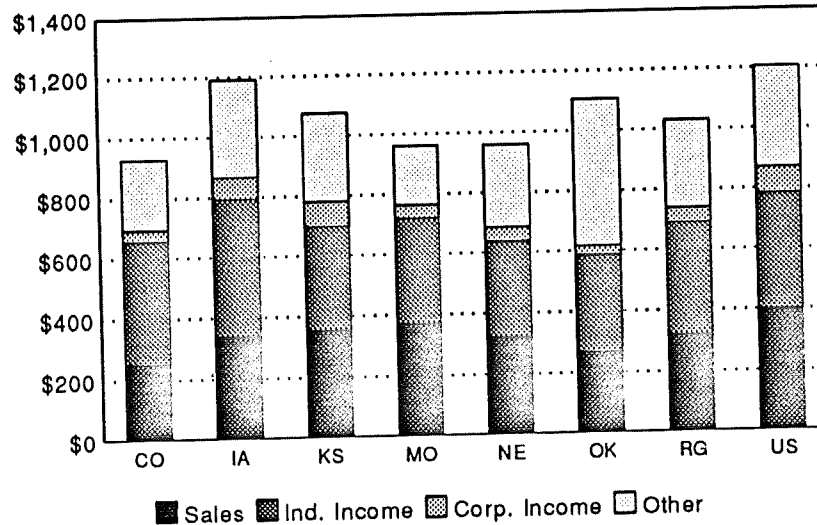


**Figure 1**



**Figure 2**

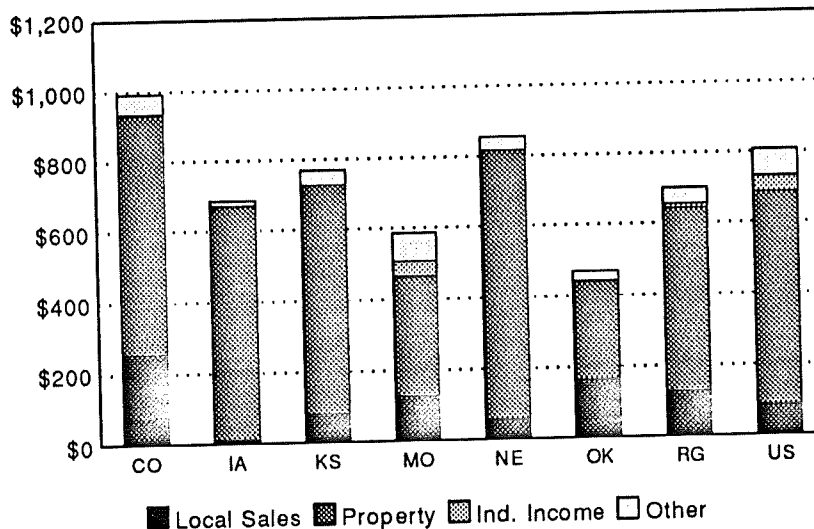
## State Tax Revenue Sources 1990 Per Capita



IPPBR 1992. See Appendix A  
Source: State Government Finances

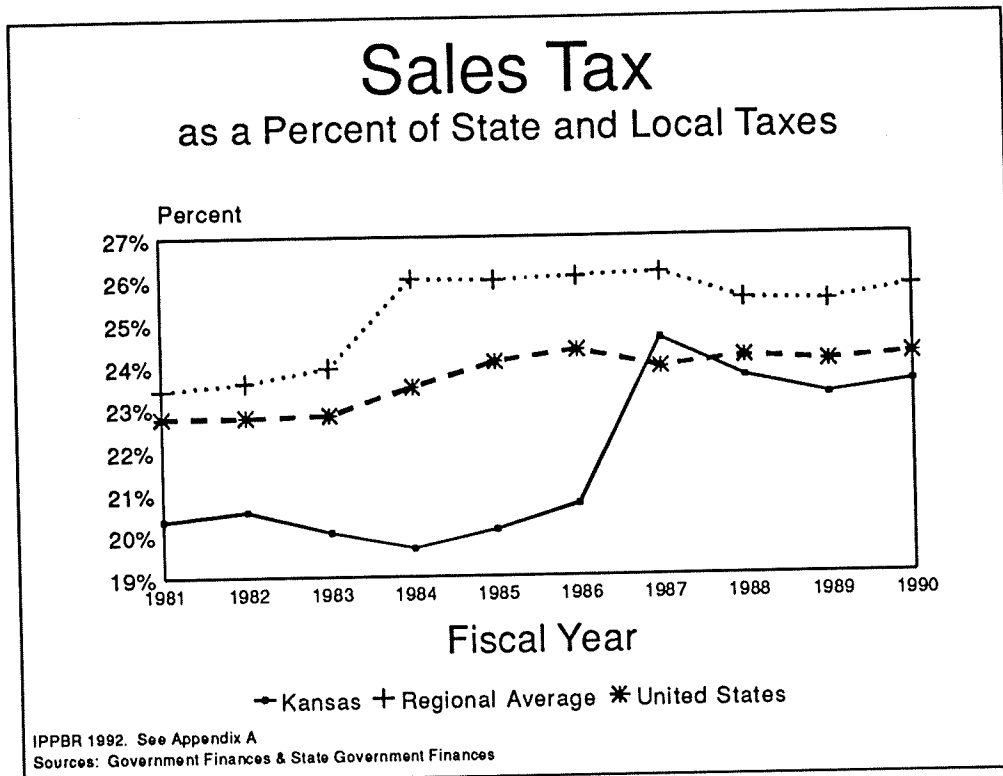
Figure 3

## Local Tax Revenue Sources 1990 Per Capita

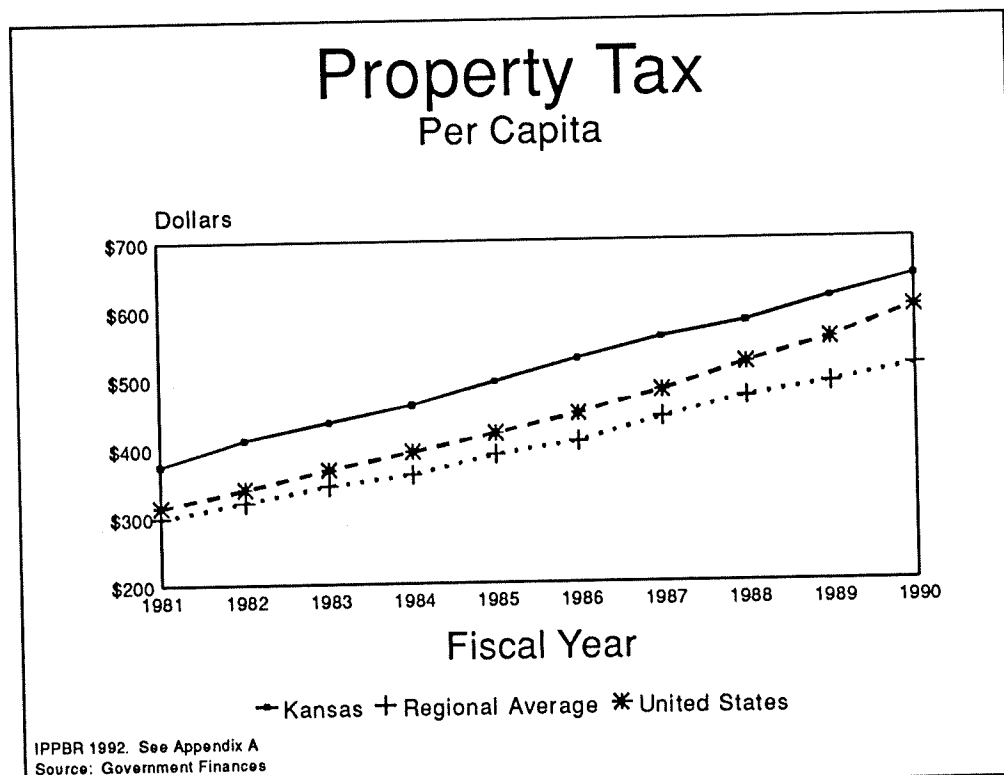


IPPBR 1992. See Appendix A  
Source: Government Finances

Figure 4



**Figure 5**



**Figure 6**

Table 1  
Corporate Income Tax Rates: 1992

State	Rates	Fed. Deduct.?
CO	flat 5% by 1994	No
IA	4 brackets 6% to 12%	Yes (50% deductible)
KS	2 brackets 4.0% and 7.35%	No
MO	flat 5%	Yes (100% deductible)
NE	2 brackets 5.58% and 7.81%	No
OK	flat 6%	No

**Table 2**  
**Allocation Methods for Income of Multi-State Firms**

Colorado	Choice of two factor formula (1/2 sales, 1/2 property), or three factor formula (1/3 each sales, property, payroll).
Iowa	Single factor formula based on sales only.
Kansas	Three factor formula (1/3 each sales, property, payroll). For firms with a payroll factor exceeding 200% of the average of the property factor and the sales factor, a two factor formula based 50% on sales and 50% on property is an option.
Missouri	Choice of single factor formula based on sales only or a three factor formula (1/3 each sales, property, payroll).
Nebraska	A single factor formula based on sales only was phased in between 1988 and 1992.
Oklahoma	Three factor formula (1/3 each sales, property, payroll).

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**Table 3**  
**Sales Tax Rates: 1991**

State	State Tax	Local Tax
CO	3%, and .2% on tourism related goods and services	up to 5%
IA	4%	up to 1%, also hotel/motel tax, up to 7%
KS	4.9%	up to 1% county, up to 1% city, and additional 1% city or county for health care
MO	4.225%	up to 2% each, city and county
NE	5%	1% - 1.5%
OK	4.5%	up to 2%

Table 4  
Effective Property Tax Rates  
Tax as % of Market Value

State	Real Estate	Other
CO (1991)	Residential: 1.19% Comm., indust.: 2.40%	Mach., equip.: 2.40% Inventory: exempt
IA (1991)	Residential: 2.10% Comm., indust.: 2.88%	Mach., equip.: .86% Inventory: exempt
KS (1991)	Residential: 1.49% Comm., indust.: 3.73%	Mach., equip.: 2.50% Inventory: exempt
KS (1992) estimated	Residential: 1.26% Comm., indust.: 3.14%	Mach., equip.: 2.10% Inventory: exempt
KS (1993) estimated	Residential: 1.24% Comm., indust.: 2.68%	Mach., equip.: 2.68% Inventory: exempt
MO (1991)	Residential: .93% Comm., indust.: 1.95%	Mach., equip.: 1.67% Inventory: exempt
NE (1990)	Residential: 2.10% Comm., indust.: 2.11%	Mach., equip.: 2.31% Inventory: exempt
OK (1990)	Residential: .94% Comm., indust.: .93%	Mach., equip.: .93% Inventory: .93%

Table 5  
Major Tax Changes Since 1989  
Corporate Income Tax

State	Tax Change
CO	gradual reduction of rates from 6% to 5% for high income firms (1987-1993) established income tax credit for R & D (1989)
IA	repealed credits for venture capital fund investments (1989) 10% credit for investment in qualified seed capital fund initiated (1990)
KS	repealed alternative minimum tax established in 1988 (1989) alternative allocation method based on property and sales allowed (1989) rate increased from 6.75% to 7.35% for incomes over \$50,000. Rates decreased to 4.0% for lower income firms.incomes below \$50,000. Brackets changed (1992)
MO	instituted a temporary tax increase form 5 to 6.5% for high income firms (1989) measure to make tax increase permanent defeated (1991)
NE	rates increased, total of 17.5% (1990, 1991) one year surcharge of 15% for incomes over \$200,000 (1991) one year surcharge of 2% on depreciable property (1991)
OK	corporate rate increased from 5% to 6% (1990)



**Table 6**  
**Major Tax Changes Since 1989**  
**Sales Tax**

State	Tax Change
CO	none
IA	12 services added to sales tax base, tax on consulting later repealed, measure to increase sales tax rate vetoed (1992)
KS	rate increased from 4.0% to 4.25% (1989) sales tax on manufacturing machinery removed (1989) rate increased to 4.9% (1992) some exemptions eliminated, and electricity, gas, water, construction services taxed at 2.5% (1992)
MO	temporary state sales tax increase from 4.125% to 4.425% (1989) rate is 4.225% (1992)
NE	rate increase from 4% to 5% (1990)
OK	rate increased from 4% to 4.5% (1990)

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**Table 7**  
**Major Tax Changes Since 1989**  
**Property Tax**

State	Tax Change
CO	new appraisals (1989) cities, counties, and school districts may negotiate property tax incentive payments for new of expanded businesses (1990)
IA	none
KS	valuations based on first statewide appraisal in 20 years are established, different property classes assessed at different percentages (1989) inventories removed from property tax base (1989) school finance plan imposed 32 mill school tax and reduced rates in most areas (1992) Constitutional amendment. Machinery and equipment assessment ration increased from 20% to 25% . Commercial and industrial real estate reduced from 30% to 25%. Utility property increased from 30% to 33%.
MO	none
NE	statewide equalization (1990) court cases successfully challenged property tax system (1988-1990) one year suspension of taxes on personal property, revenue made up by state (1991) constitutional amendment giving legislature authority to decide what types of property should be taxed (1992) property tax legislation taxing personal property on the basis of net book value (1992)
OK	enabling legislation to allow cities, counties, and towns more ability to grant incentives for reinvestment and historic preservation (1990)

Table 8  
Locations Included in Simulations

Iowa:	Des Moines
Kansas:	Kansas City Olathe Overland Park Wichita
Missouri:	Kansas City
Nebraska:	Omaha
Oklahoma:	Oklahoma City
All	Nonmetro Average

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Table 9  
Industries Selected for the Study

Industries	SIC Code	Employment 1989	Growth 80-89
Manufacturing			
Meat Products	201	13,309	48.9%
Grain Mill Products	204	3,514	-2.3%
Misc. Converted Paper Products	267	2,626	17.1%
Commercial Printing	275	6,285	48.9%
Pharmaceutical and Biological Products	283	1,865	9.4%
Misc. Plastic Products	307	6,718	26.5%
Fabricated Structural Metal Products	344	4,448	-32.9%
Construction and Related Machinery Mfg.	353	4,207	-32.1%
Electronic Components and Accessories	367	1,443	8.1%
Motor Vehicles and Equipment Mfg.	371	6,492	-22.1%
Non-Manufacturing			
Wholesale Trade: Durable Goods	508	10,020	-36.8%
Computer and Data Processing Services	737	4,224	50.6%
Research, Development, and Testing	873	755	68.9%

## Table 10

### New Firm Assumptions

1. Firms in each industry are assumed to hire 100 full-time employees.
  2. Firms are export-oriented, selling 90 percent of their product outside the state.
  3. Firms receive a full property tax abatement for 10 years. This applies only to firms in industries that qualify for abatements, basically manufacturing and distribution.
  4. Firms purchase a new structure and new machinery and equipment.
  5. Firms qualify for job and investment tax credits at the level of \$1000 per \$100,000 investment and \$1500 per job. Firms in non-metro areas qualify for \$2500 per new job.
  6. All simulations are annual averages over a **20 year** period. This means that the simulations include part of the time period during which tax abatements have expired.
  7. The model incorporates what is known as the *federal offset*. Reductions in state and local taxes generally increase federal taxable income, and hence the federal income tax.
- 

## Table 11

### Mature Firm Assumptions

1. Firms in each industry are assumed to hire 100 full-time employees.
2. Firms are export-oriented, selling 90 percent of their product outside the state.
3. Firms receive no property tax abatement.
4. Firms operate from buildings that were purchased previous to the period under analysis. They replace some of their machinery and equipment each year.
5. Firms do not qualify for job and investment tax credits.
6. All simulations are annual averages over a **20 year** period.
7. The model incorporates the *federal offset*. Reductions in state and local taxes generally increase federal taxable income, and hence the federal income tax.

Table 12  
Major Tax Incentives  
Kansas and Six State Region

Type of Incentive	KS	# States
Basic job credits	yes	5
Basic investment credits	yes	5
Enterprise zone job credits (revised in 92)	yes	4
Enterprise zone investment (revised in 92)	yes	3
Property tax abatement, new/expanded firm	yes	5
Sales tax exemption, manufacturing equipment	yes	6
Inventory exemption	yes	5
Research and development tax credit	yes	4

Table 13  
New Firms Receiving Tax Credits & Abatements  
Partial Model: Variation in Taxes Only

Location	Manufact.: Tax as % of Reg. Av.	Other: Tax as % of Reg. Av.	Manufact.: Ranks	Other: Ranks
<b>Metro Areas</b>				
Des Moines, IA	98.2%	98.1%	3	2
Olathe, KS	98.3%	100.3%	4	5
Overland Park, KS	97.1%	98.7%	1	3
Wichita, KS	97.8%	100.1%	2	4
Kansas City, KS	100.1%	103.3%	7	7
Kansas City, MO	99.7%	96.5%	6	1
Omaha, NE	103.0%	101.9%	8	6
Oklahoma City, OK	99.2%	103.4%	5	8
<b>Nonmetro Areas</b>				
Non-Metro, IA	97.3%	96.6%	1	1
Non-Metro, KS	102.6%	103.5%	5	4
Non-Metro, MO	98.5%	96.8%	2	2
Non-Metro, NE	102.4%	101.3%	4	3
Non-Metro, OK	101.8%	105.3%	3	5

Source: Calculated by IPPBR. Metro ranks range from 1 (lowest) to 8 (highest). Nonmetro ranks range from 1 (lowest) to 5 (highest).

**Table 14**  
**Mature Firms Receiving NO Tax Credits or Abatements**  
**Partial Model: Variation in Taxes Only**

Location	Manufact.: Tax as % of Reg. Av.	Other: Tax as % of Reg. Av.	Manufact.: Ranks	Other: Ranks
<b>Metro Areas</b>				
Des Moines, IA	96.9%	97.6%	1	1
Olathe, KS	108.6%	108.0%	7	7
Overland Park, KS	104.9%	104.9%	5	5
Wichita, KS	107.6%	107.5%	6	6
Kansas City, KS	113.9%	113.4%	8	8
Kansas City, MO	101.1%	98.9%	4	2
Omaha, NE	101.1%	101.7%	3	3
Oklahoma City, OK	100.8%	101.8%	2	4
<b>Nonmetro Areas</b>				
Non-Metro, IA	96.0%	96.1%	1	1
Non-Metro, KS	110.2%	109.7%	5	5
Non-Metro, MO	98.7%	97.4%	2	2
Non-Metro, NE	101.6%	101.7%	3	3
Non-Metro, OK	103.6%	104.8%	4	4

Source: Calculated by IPPBR. Metro ranks range from 1 (lowest) to 8 (highest). Nonmetro ranks range from 1 (lowest) to 5 (highest).

**Table 15**  
**By Industry Tax Disadvantage for Mature Firms**  
**Kansas Nonmetro Area**

Industry	SIC Code	Tax Disadvantage
Manufacturing		
Meat Products	201	6.5%
Grain Mill Products	204	8.5%
Misc. Converted Paper Products	267	11.9%
Commercial Printing	275	12.4%
Pharmaceutical and Biological Products	283	9.5%
Misc. Plastic Products	307	12.6%
Fabricated Structural Metal Products	344	10.9%
Construction and Related Machinery Mfg.	353	9.8%
Electronic Components and Accessories	367	8.2%
Motor Vehicles and Equipment Mfg.	371	11.6%
Non-Manufacturing		
Wholesale Trade: Durable Goods	508	7.7%
Computer and Data Processing Services	737	8.6%
Research, Development, and Testing	873	12.7%

**Table 16**  
**Taxes for Printing and Publishing Firm**  
**Results for Average Nonmetro Area**

	Kansas	Region	Kansas as % Region
Federal Taxable Income	\$2,209,632	\$2,391,277	92.4%
Federal Income Tax	\$751,275	\$813,034	92.4%
State Income Tax	\$119,960	\$42,129	284.7%
Unemploy. and Workers' Comp.	\$71,083	\$44,413	160.0%
Property	\$237,765	\$140,450	169.3%
Franchise	\$2,500	\$4,357	57.4%
Sales Tax	\$30,928	\$35,206	87.8%
On Mach. and Structures	\$7,836	\$22,383	35.0%
<b>TOTAL</b>	<b>\$1,213,510</b>	<b>\$1,079,589</b>	<b>112.4%</b>

**House Committee On Economic Development  
The Kansas Legislature**

**January 19, 1993**

**"Kansas Tax Competitiveness and Economic Development"**

**Testimony of**

**Charles R. Warren, Ph.D.  
President, Kansas Inc.**

January 19, 1993  
Economic Development  
Attachment 3



## Introduction

Tax policy is an issue of major importance in economic development, and has been a major focus of the work of Kansas Inc. since its inception in 1986. Kansas Inc. has undertaken the following studies of the Kansas tax system with the Institute for Public Policy and Business Research, University of Kansas, and Wichita State University:

- 1987 - Analysis of Kansas Tax System and Tax Simulation Model;
- 1989 - Study of the Impact of Reappraisal and Classification;
- 1990 - Overview of State and Local Taxation in the Region;
- 1991 - Analysis of Impact of Reform of State Sales Tax Exemptions;
- 1992 - Analysis of Impact of School Finance Tax Reform Proposals;
- 1992 - Costs and Taxes in Selected Kansas Industries, 1992 Update.

The 1986 Economic Strategy resulted in two constitutional amendments that enabled local governments to provide property tax abatements for manufacturers, interstate commerce companies, and research and development firms, and exempted inventories from the property tax.

In 1988, Kansas Inc. recommended a package of legislative changes that resulted in:

- 1) the sales tax exemption for manufacturing machinery and equipment;
- 2) the two factor formula option for unitary corporate taxation; and
- 3) elimination of the state Alternative Minimum Tax.

Since 1989, Kansas Inc. studies have made significant contributions to state tax policy, including:

- 1) Defeat of proposals to remove the sales tax exemptions for professional services and businesses.
- 2) Reduction of ad valorem taxes on marginal oil wells.
- 3) The 1991 study was used to fashion the school finance tax proposals. It was a Kansas Inc. recommendation that state and local revenues from income, sales and property taxes be balanced on a one-third, equal basis.

- 4) Kansas Inc. recommended reduction in the severance tax on natural gas and that has been endorsed by the 1992 Interim Committee on Taxation.
- 5) During the 1992 session, Kansas Inc. advised on reform of property tax abatements and revision of the Kansas Enterprise Zone Act.

### **The 1993 Strategy and Kansas Tax Policy**

A primary goal of the 1993 strategy is to ensure that Kansas has a supportive, positive business climate. If business is to prosper in Kansas, it must be able to operate within a climate that is supportive and sensitive to its needs. More important for business than all of the programs or forms of assistance provided under traditional economic development labels are the resources and business environment that state and local government create in the exercise of their basic authority and responsibility. It is vitally important for the political leadership to demonstrate that Kansas is receptive to the requirements of business and supportive of the needs of firms of all sizes.

The most important, single component of a state's business climate is its system of taxation. The distribution of the tax burden between individuals and corporations or employers is the most readily judged criterion of whether a state is receptive to business. The existing Kansas tax structure is not favorable to business.

### **The Goal of Tax Neutrality**

The 1986 economic development strategy explicitly rejected the goal of striving to be a low tax state; it wisely chose a goal of tax competitiveness that would attempt to neutralize the issue of taxation as a locational factor. The 1993 strategy continues to strive for that position of tax neutrality, so that Kansas is neither a low-tax nor a high tax environment. That goal still has not been achieved, and can only be reached if the taxation on businesses is lowered and made more equitable vis-a-vis the taxation on individuals and other taxpayers.

### **Business Taxes are High**

Kansas collects more of its total state revenues from corporate income taxes. than over states in this region. Corporate income taxes have comprised over 8 percent of revenue while it has averaged over 5 percent in neighboring states. According to the Division of Budget, it will comprise 6.7% percent of state general fund revenue in FY94. The corporate income tax rate at 7.35 percent above \$50,000 is near the highest in this region. Kansas imposes a unitary tax on a corporation's world-wide income and gives less favorable treatment to the calculation of the state's share than

other states in this region.

Property taxes in Kansas fall disproportionately on businesses with the classification rate of 25 percent twice that of residences. Yet, the constitutional amendment has lowered property taxes for commercial and industrial property. The effective tax rate on commercial and industrial property is estimated for 1992 to be 2.63 percent (using an average state mill levy of 105.2). Kansas no longer has the highest business rate in the region; that distinction now belongs to Iowa. Effective tax rates on business property in this six state region are now estimated at:

Iowa	2.88
Kansas	2.63
Colorado	2.40
Nebraska	2.11
Missouri	1.95
Oklahoma	.93

### **The Need for Tax Stability**

Equally important as the rate of taxation is the stability of the tax system. In recent years, Kansas has witnessed a series of massive changes in tax policy with an endless round of proposed and enacted reforms in taxation.

Some of these have resulted in a reduced tax burden for most taxpayers, for example, the School Finance Act of 1992. Others, such as the recently passed constitutional amendment on classification, have benefitted some taxpayers while raising rates for others. The classification rate on business machinery and equipment was increased from 20 to 25 percent by the amendment at a time when new investments in advanced technology and equipment are needed. New forms of taxation or the reinstatement of old practices have been suggested each legislative session. Current business exemptions have been proposed for elimination. The taxation of business and professional services has been proposed seriously and has undermined the confidence of that industry, especially in border areas, such as Johnson County where service sector growth is the strongest. In the 1992 session, a 2.5 percent sales tax was imposed on utilities consumed in production, discriminating against energy-intensive manufacturing industries. We are pleased with the Interim Tax Committee's recommendation to restore this exemption.

### **Taxation of Existing Business**

The 1990 and 1992 business tax studies conducted for Kansas Inc. by the Institute of Public Policy and Business Research,

University of Kansas, have found consistently that state and local taxes are regionally competitive for new firms, but taxes on mature firms are the highest in the region. The current package of incentives for new firms attracted to the state and expanding firms results in a total tax amount over a 20 year period slightly less than the regional average. Yet, the vast majority of jobs are found within mature firms which are responsible for 80 percent of new job creation in Kansas. While recent reductions in property taxes have helped some mature firms, the tax relief provided has been offset by new sales and income taxes in most cases. Property and income tax burdens on existing firms must be reduced if mature firms are to enjoy a competitive tax situation.

### **Business Incentives**

Incentives for new investments in machinery and equipment that increase the technological capability of firms must be provided and expanded. Global competitiveness and the manufacture of quality products requires a continuous upgrading of equipment to enable more sophisticated and advanced production processes. This is as true of service sector firms, whose work depends greatly on advanced computing and communications equipment, as it is of manufacturing firms. Tax policy should not only encourage the upgrading and investment in equipment, but also investment in human capital and increases in existing employment. The job tax credits and training and education incentives need to be expanded for Kansas firms.

### **Property Tax Abatements**

Cities and counties in Kansas must continue to have the ability to abate or exempt property taxes on new and expanding businesses if they are to remain competitive with neighboring states. However, tax abatements or exemptions, provided either under the constitutional provisions or as the result of the issuance of industrial revenue bonds (IRB), should be reexamined for their use in the achievement of the strategic goals of promoting higher wage, higher value added businesses.

Attached to my testimony is Table 10 of the 1992 KU/Kansas Inc. study. As the table indicates, Kansas tax abatement policies are more liberal than comparison states, with the notable exception of Missouri. Missouri can abate up to 100 percent of property taxes for up to 25 years.

The recommendations made by the 1992 Interim Committee on Taxation are sound and, if enacted, will help increase the credibility of tax abatement policy. These recommendations are:

- 1) "that any property currently on the tax rolls not be removed pursuant to an exemption or abatement;

2) "that businesses be required to reimburse local governmental units when conditions have not been met which were agreed to prior to the granting of the exemptions or abatements (a "claw-back" provision); and

3) "that mandatory cost-benefit analyses for both IRBs and abatements be filed with the Department of Revenue prior to the granting of the exemptions."

Incentives and abatements should be provided only to those firms where the benefits of location or expansion can be shown to be demonstrably above the costs incurred not only by the granting jurisdiction but also by neighboring governments and the state government. These results must be demonstrated through a rigorous, complete cost-benefit analysis.

The Board of Kansas Inc. has not adopted a policy on tax abatements. However, I would suggest these additional options for tax abatement reform.

1) That tax exemptions issued in connection with IRBs be restricted to the type of firms eligible under the constitutional provisions, plus export-oriented service sector firms. Tax abatements should not be authorized for retail establishments.

2) Local government abatement policies should clearly encourage higher wage firms by providing a greater level or period of abatements to such firms, and a correspondingly lower level to firms that pay lower wages, do not generate wealth from outside the state boundaries, or produce only products of marginal value.

The 1992 School Finance Reforms have reduced the dependency of school districts on the local property taxes and has severed the relationship between per pupil student aid and local assessed valuation. State equalization aid now occurs through redistribution of state sales and income taxes. Only 5 or 6 school districts are now subject to property tax recapture provisions. It should be recognized that local tax abatements produce growing sales and income tax revenues for state government, and that two-thirds of the state budget is spent on education. If used judiciously, tax abatements can contribute to our goal of a strong Kansas economy as well as a growing tax base.

Thank you very much. I would be pleased to answer any questions.

**Table 10**  
**Property Tax Abatements**

State	Extent of Tax Abatement	Eligibility Requirements
Colorado	Local option for property tax "incentive" payment in enterprise zones. Limited to increase in value of property due to new or expanding business. Abatements rarely used. Limited to 50% of taxes on personal property only for up to 4 years.	Must be a qualified new or expanding business facility located in enterprise zone.
Iowa	Local option to abate local property taxes on value added to industrial real estate. Max. abatement: YR 1: 75% YR 2: 60% YR 3: 45% YR 4: 30% YR 5: 15%.	Limited to new construction of industrial real estate, research service facilities, warehouses, distribution centers. Also applies to new industrial equipment and machinery (which is considered part of real estate in Iowa).
Kansas	Local option to exempt all or any portion of buildings, land, added improvements, and machinery and equipment for new or expanding firms. Exemptions last for no more than 10 years after opening of new business or completion of expansion. Property financed with industrial revenue bonds may be exempt for up to 10 years.	Limited to property of new or expanding businesses used for 1) manufacturing; 2) research and development; or 3) storing goods or commodities which are stored or traded in interstate commerce. No restrictions on types of firms qualifying for exemption with industrial revenue bonds.
Missouri	Under Urban Redevelopment programs: up to 100% of improvements to real property may be tax exempt for up to 25 years.  Under Enterprise Zone programs: 50%-100% of value of improvements to real property will be abated up to 25 years.	Improvements to real property must occur in blighted areas of cities with populations over 4,000 in Jackson and St. Louis counties, 2,500 elsewhere in state. For enterprise zone exemption, any industrial or commercial firm, or firm renting/leasing residential property to low or moderate income persons qualifies. Applied to real estate improvements only.
Nebraska	15 year tax abatement for agricultural processors investing at least \$10 million and hiring at least 100 new workers.	Agricultural processing only.
Oklahoma	New and expanding facilities are 100% exempt from property tax for 5 years. Included in exemption are land, buildings, improvements, structures, machinery, equipment, and other personal property used directly in the manufacturing process.  Also: machinery and equipment used in oil and gas production are exempt.	Limited to manufacturing, research and development, and those computer service and data processing facilities that obtain at least 80% of their revenue from out of state. Applies to new and expanding firms. Exemption for equipment applies only if such equipment results in a net increase in employment.

**SOURCES:** Information provided by individual state departments of revenue and commerce and state statutes.