

KANSAS
ASSOCIATION



OF
SCHOOL
BOARDS

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Testimony before the
Special Committee on Assessment and Taxation
On

Kansas Tax Structure

By
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COMMITTEE CHARGE:

Kansas Tax Structure. Review the Kansas tax structure and ways it can be improved and simplified. Study the overall tax structure and policy of the state and local units of government by reviewing the relationship of the various taxes imposed to each other and to the economy. Review ways to identify a fair, simple and effective tax structure that operates in the best interests of all Kansas citizens. Also, study ways to decrease tax rates by broadening tax bases, as well as studying the potential effects of a fair and flat consumption tax and a flat and simplified income tax. Finally, review what current taxes could be eliminated if a new such tax were to be imposed.

Chairman's Charge:

Chairperson Carlson requests all interested parties prepare suggestions for simplifying and improving the state and local tax structure; and for encouraging additional capital investment in the private sector and economic development through significant income and/or property tax reform.

Mr. Chairman, Members of the Committee:

KASB would first like to express our appreciation to legislative leadership for establishing this committee. For several years, our Delegate Assembly has called for a comprehensive study of state and local tax policy, and supported legislation in the 2010 session to create such a study. Our goal is very similar to what is expressed in the charge to the committee: a fair, simple and effective tax structure that operates in the best interest of all Kansas citizens. We have repeatedly suggested Kansas should seek to lower tax rates by broadening tax bases – which is exactly the opposite direction of recent tax policies.

We respectfully offer the following recommendations and observations from the perspective of tax policy regarding public education.

Recommendation 1 – The tax system must support the state’s constitutional responsibility for public education

Education is one of the few specific constitutional duties required by the Kansas Constitution. Article 6 of the constitution is quite explicit:

“The legislature shall provide for intellectual, educational, vocational and scientific improvement by establishing and maintaining public schools, educational institutions and related activities which may be organized and changed in such manner as may be provided by law.”

Article 6 provides that local school boards – the members of our association – are responsible for “maintaining, developing and operating public schools.” The constitution further specifies the *Legislature* has the duty to provide suitable financing for those schools. Because educational funding is a constitutional duty, the judicial system has, from time to time, been called upon to interpret what that duty entails, and there is an emerging definition of what constitutes “suitable finance.” The state tax system must be able to support that duty.

A. Suitable finance for public education supports economic development

The duty to provide suitable educational finance need not be onerous to the taxpayer or economic development. CNBC’s “America’s Top States for Business Report” states it very well:

“Education and business go hand in hand. Not only do companies want to draw from an educated pool of workers, they want to offer their employees a great place to raise a family. Higher education institutions offer companies a source to recruit new talent, as well as a partner in research and development.”

Our public schools have carried out their share of responsibility for “improvement.” Decade by decade, high school completion rates have increased. Kansas students have never been more prepared, even as Kansas schools are faced with far more challenging students. The percent of Kansans successfully completing college has also reached an all-time peak. This has been critical to raising income levels in our state, because the economic benefits of additional education is growing. In a knowledge-based economy, it is absolutely vital educational attainment continues to improve. There will always be cheaper places in the world to send low-skill jobs. Our hope must be to develop people with higher skills than are available elsewhere.

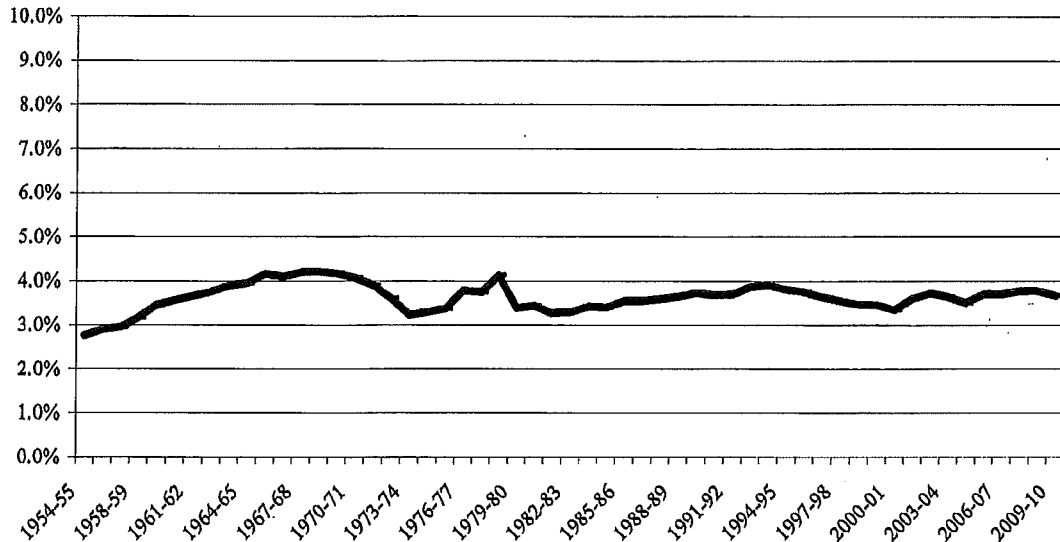
B. Educational costs increase with higher achievement

Kansas has a long tradition of striving to improve educational attainment by investing more resources. Over the past half century, districts added kindergarten, then all-day kindergarten, then preschool programs. We consolidated small schools and districts to offer more comprehensive – and expensive – programs. We mandated equal opportunities first for African-Americans (desegregation), then females (Title IX), then disabled children (special education) and moved the most seriously disabled from institutions to regular classrooms. We keep far more students enrolled through high school and prepare more for college. We raised standards for teachers and reduced class sizes. We added educational and instructional technology. We added special programs and services for at-risk children. Three things are quite clear: these efforts are necessary, they cost more money, and they work. Legislators need look no further than their own Post Audit studies and Kansas State Department of Education reports for evidence.

C. Increasing educational funding has not increased the overall tax burden

Despite all of these changes in education and all the additional funding they require, school district expenditures have not significantly changed *as a percentage of Kansas personal income* in 50 years. KASB has found records of school district general fund expenditures – essentially, the operating budgets – going back to the mid-1950s, which was nearly the last year these costs were less than 3.0 percent of personal income.

District General Fund Expenditures as Percent of Kansas Personal Income



As educational expectations rose in the 1960s, Kansas revised the educational article of its constitution, enacted school unification and passed a sales tax increase to fund a new school finance system. (For those who think consolidation saves money, please note school spending was at its *highest* relative levels during that period.)

Spending compared to income then dropped in the mid-70s, but rose following the passage of the School District Equalization Act, special education laws and mandatory teacher bargaining – only to fall again in the early 1980s. When the 1983 *Nation At Risk Report* warned of declining education performance, Kansas responded by gradually increasing school funding compared to Kansas incomes until it peaked in 1993-94 with another new school finance act. Yet even after the Legislature's response to the *Montoy* lawsuit, school district general funds are less than 4.0 percent of personal income, about at the historical average of the past half-century.

This does not include school district expenditures outside of the general fund and local option budgets: primarily capital outlay and debt service on school construction bonds. These costs aren't included for several reasons. First, we don't have the information going back that far. Second, these expenditures are primarily funded by local revenues, and are either subject to direct voter approval or protest petition. Third, there is nothing to suggest they have made a significant difference in the total Kansas tax burden, which has also changed very little over past decades.

Just as school spending as a percentage of Kansas personal income has changed very little over the past 50 years, total state and local taxes as a percentage of KPI has changed very little over the past *80 years*. Let's be very clear: despite all the talk about the growing size of government and growing tax burden, the real tax burden as measured against total income, has consistently remained between 10.5 and 12.0 percent. The idea that Kansas government spending is taking a bigger share of income just isn't supported by the facts. Spending on K-12 education – a combination of state and local revenue – has increased at just about the same rate as overall state and local tax revenue, which has risen at just about the same rate as Kansas income. In fact, the evidence suggests that spending on education has been one of the most important contributors *to* the rise in income.

D. K-12 Education can likely be funded by maintaining an historic ratio to income

The demands on education will continue to increase, and so will the cost. The State Board of Education announced that more schools and districts failed to make Adequate Yearly Progress this year – not because performance declined, but because AYP standards increased *faster*. History indicates that if Kansas maintains K-12 funding at around 4.0 percent compared to income, performance improves. To simplify the system, a “fair and flat” tax on *all* personal income of approximately 4.0 percent would have funded school district operating budgets without *any* sales or property tax. (Of course, this means all income should be taxed, not just “adjusted” income.) Most important, tax reform should not be used to lower this commitment to education.

Recommendation 2: Address reasons for concerns about tax policy and education funding

If the cost of education and other services isn't really taking a bigger bite of incomes, why are there so many complaints about the level of taxation? Is it really because the tax rates have been so oppressive for 80 years? Are that many people really longing for the good old tax rates of the early 1920s?

Some people will certainly feel taxes are too high no matter how low they are – after all, America was, in large measure, founded over a tax revolt that involved a tea party in Boston. But at least three major factors are also at work.

A. The rise in income has not been shared equally

Recent decades have seen a major shift in wealth to the highest income levels. Since 1970, average income for individuals with less than a bachelor's degree has actually declined compared to the cost of living, while those with higher education levels have increased. Although the percentage of Kansans with college and advanced degrees has increased every decade, it is still a minority of the population. Despite the *overall* rising tide, many Kansans are being left behind. If we allow educational attainment to decline, the situation will grow even worse. It also indicates the need to reduce the regressive nature of some taxes.

B. Tax policy has shifted the tax burden and led to higher rates

The vast expansion of tax abatements, exemptions, credits and now outright payments of tax money for economic development purposes has resulted in significant tax shifting. Because the cost of government has remained constant compared to overall income, every change in the tax code that has lowered someone's relative share of the cost of government has resulted in an increase for someone else. If someone's taxes have gone up relative to their income, someone else is paying less.

State and local tax as a percentage of personal income dropped from 11.1 percent in 2000 to 10.8 percent in 2009. But the percentage of tax revenue from sales taxes actually dropped from 28.6 percent in 2000 to 25.6 percent in 2009 – despite an increase in the state rate and likely increases in local rates as well. Income tax revenues dropped from 27.0 to 25.5 percent. But property tax revenues rose from 28.0 to 33.6 percent – not because *overall* taxes grew more than income, but because sales and income taxes declined *compared* to income.

C. Efforts to reduce property tax reliance have been undercut

The shift to the property tax since 2000 reverses one of the most significant long-term trends in state and local tax policy. In 1930, over 80 percent of Kansas government revenues came from property taxes and authority for sales and income taxes were just beginning. In 1970, property taxes were still over 50 percent of local revenues, but dropped to about 30 percent in 2000 – the last year Kansas had an almost equal balance of sales, income and property tax revenue. A major reason for the drop in property taxes was the state assumption of funding previously provided by local governments. This is certainly true of K-12 education. Prior to the School District Finance and Quality Performance Act of 1992, a majority of school general fund revenues and all capital outlay and debt service came from local property taxes. Now, about two-thirds of school funding comes from the state.

Although overall reliance on the property tax has been reduced, Kansas Department of Revenue studies have shown major shifts within this category. Most notable, there has been a shift toward real estate taxes and in particular, residential real estate. Therefore, home owners have had less benefit from these reductions.

In addition, the Legislature choose to reduce the statewide mill levy for school districts from 35 mills, as approved in the 1992 Act, to the current 20 mills as part of a number of tax reductions in the late 1990s. The reduction of state revenue meant that base aid support of school districts fell far behind district costs, requiring districts to turn to Local Option Budgets. The increase in the LOB has more than offset the reduction in the statewide levy in many districts, and has meant that residents in lower-property-wealth districts now face a higher tax rate than those in wealthier districts. These policies have also led to an increase in special weightings and taxing authorities that have vastly complicated both school finance and state tax policy.

The more the Legislature allows school finance to shift back to local revenue sources to meet state educational requirements, which are vastly unequal across Kansas communities, the harder it will be to provide constitutionally suitable funding to meet the state's education outcomes for all students, regardless of where they live. More unequal local funding will lead to more school finance litigation.

Recommendation 3: Simplify the tax system by improving the school finance system

Providing a stable revenue source for education does not solve the problem of how to distribute funding authority among districts. There is another special legislative committee studying school finance issues, and KASB has appointed its own special committee to develop recommendations in this area. But several issues are obvious. When basic state support for school districts doesn't keep up with education costs and state requirements, school districts must seek local revenues, special weightings or other aid programs from the state, or both. That is why local option budgets have increased, new weightings have been added, and some districts push for additional local taxing authority, which adds to the complexity of the tax system, as well.

There are two steps to simplify the school finance system. First, provide a mechanism for adequate base funding for a "suitable" education. This could decrease reliance on the property tax, which most Kansans probably favor – but only if legislators are willing to increase offsetting state taxes. Essentially, this means funding more of school district budgets through a higher state base, rather than local option budgets and weightings.

Second, maintain an improved local option budget system to allow school districts that wish to spend more to enhance their budgets with local revenues to do so, with a mechanism to assist lower wealth districts in raising comparable revenues with a comparable tax effort. Providing more local funding authority, which some of our members strongly favor, requires a system to equalize revenues raised at the local level. If not, there will be significant disparity in educational opportunity and constitutional challenges based on equity will rise.

Recommendation 4: Consider broadening the tax base and lowering rates

We agree there is a legitimate reason for every exemption the Legislature has passed. But taxpayers need to consider not the increase in taxes they face for losing their particular favorite exemption, but also the *savings* they will realize from lower rates on everything else.

There is also the issue of tax fairness. Everyone benefits from the educational system, which increases the productivity of the economy and allows democracy to function. Everyone benefits from public safety: police, fire and corrections. Everyone benefits from a public infrastructure. Everyone benefits from a social safety net. Therefore, fairness argues everyone should contribute to the cost of government services in the same proportionate manner. Surely that was the reason our state's founders provided for uniform and equal taxation in the Kansas Constitution, so special interests couldn't seek benefits in the tax code for their special advantage.

Recommendation 5: Economic development policies must balance tax rates with services

Our members understand the importance of economic development. They know Kansas is in competition with other locations that may offer tax advantages. But they also know tax policies are only one of many factors used in making business decisions. Kansas is usually in the middle of the states in terms of tax burden, but frequently rates in the top 10 or 15 for business development. Many of the other factors involved require public expenditures that rely on taxes. KASB appreciates those business organizations that supported a tax increase last session in order to protect important public investments in education and infrastructure. Isn't it possible that a system of broad-based taxes, lower, predictable and consistent rates and stable funding for education and government services could be as attractive to business as targeted tax breaks?

Conclusion

Thank you for the opportunity to share these views with the committee. KASB will be sharing with our members the additional information you receive during this hearing and your recommendations. We look forward to working with you to improve our state's tax system for the benefit of all Kansans. As education increases in importance, we believe this generation should invest as much of our income for our children and grandchildren as our parents and grandparents were willing to invest in us.