

Testimony for Professor Lori McMillan on Kansas House Bill No. 2549 Before the Kansas House Taxation Committee, February 11, 2010

My name is Lori McMillan and I am an associate Professor of Law at Washburn University School of Law, specializing in the taxation area. When reading through House Bill No. 2549 I am heartened to see the elimination of many of the exemptions from sales taxation enjoyed by many of the specific 501(c)(3) organizations which are found in the current legislation. This is not meant to be an attack on these types of organizations, most of which have laudable goals and provide benefit to society. However, this does reflect a sound policy decision on behalf of the legislature. As such, I wish to address tax expenditure in a general fashion, so that the wisdom of this action might be better understood.

Tax expenditures is the name given to tax breaks granted to various taxpayers in a taxing statute, and can take many forms including special deductions, credits, exclusions, and exemptions. Tax expenditures are the functional equivalent of direct spending by government – in both situations the government foregoes the use of money because it has been directed to a taxpayer. In the case of direct expenditures, the taxpayer is the recipient of the money, and in the case of tax expenditures the taxpayer is the recipient of, for example, a sales tax exemption, which relieves them of the obligation to pay money. The value of the tax expenditure is the amount of tax that they would have had to pay BUT FOR the exemption. As such, tax expenditures should be held to the same budgetary constraints to which direct expenditures are subjected. Because of their very nature, tax expenditures are less scrutinized, partly because they are often buried in legislation, and partly because the people involved don't equate the revenue foregone from an exemption with an actual dollar amount. However, there is a dollar amount, one that is felt both by the taxing authority, as well as the taxpayers who remain in the tax base.

The state has certain revenue needs, and employs the revenue raising device of taxation in order to raise the money needed to meet these needs. Most of the expenditures of government are subject to budgets, and therefore strict oversight, on an annual basis. Since the revenue needs of government are set, if we all contribute our share, we can meet the needs of government with the minimum cost to individual taxpayers. However, if we start exempting taxpayers from having to contribute their fair share, two things happen. The exempted taxpayers enjoy a benefit, while the taxpayers who are not exempted not only have to contribute their fair share, but now they have to cover the amount that should have been paid by the now-exempt taxpayer, which means they have to chip in more than what should be their fair share. The tax base is narrowed, which increases the burden on those of us without exemption. This is why tax expenditures should be subjected to annual review, as budgetary items, and should not be given out lightly. You should ask yourself - for each organization that enjoys exemption – if budgetary constraints would prevent you from making direct expenditures to a particular organization because of reordered spending priorities, the same constraints should operate to prevent them from enjoying a tax expenditure.

There also should be parity between taxpayers – the concepts of equity demand that similarly situated taxpayers should bear similar tax burdens. The average Kansan is feeling the pain of this recession, and the budgetary cuts that have been made across the board to everything from education to hospitals. Although many of the organizations whose exemptions are being eliminated do good works, so does the average Kansan taxpayer who gives a homeless man a cup of coffee, or helps an elderly neighbour shovel their driveway. The fact that good is done should not be the standard for tax exemption from sales tax – otherwise every kind and noble act would need to be evaluated to see what tax benefit it brings.

Special care should be taken when applying this type of tax, to make sure that it is applied as fairly as possible. It is not fair when organizations have an ability to pay, but are exempted for no good, distinctive reason. As I said earlier, many taxpayers do good things, but do not get tax exemption for them. Every taxpayer must pay their fair share, especially in the current economic climate, to make sure the burden doesn't fall even harder on the average Kansan who is the economic bread and butter of the State. If we all contribute our fair share, eventually budgetary deficits can be eliminated, and with a broadened tax base, rates can eventually decrease for everyone.

The choices that must be made when overhauling taxing legislation are difficult ones, and it would be easy and politically expedient to hand out tax expenditures to every group with an admirable goal. However, I believe that you are taking a sound approach from a tax policy perspective, which will be better for the state in the long run. If you have any questions, I would be pleased to answer them. Thank you.