

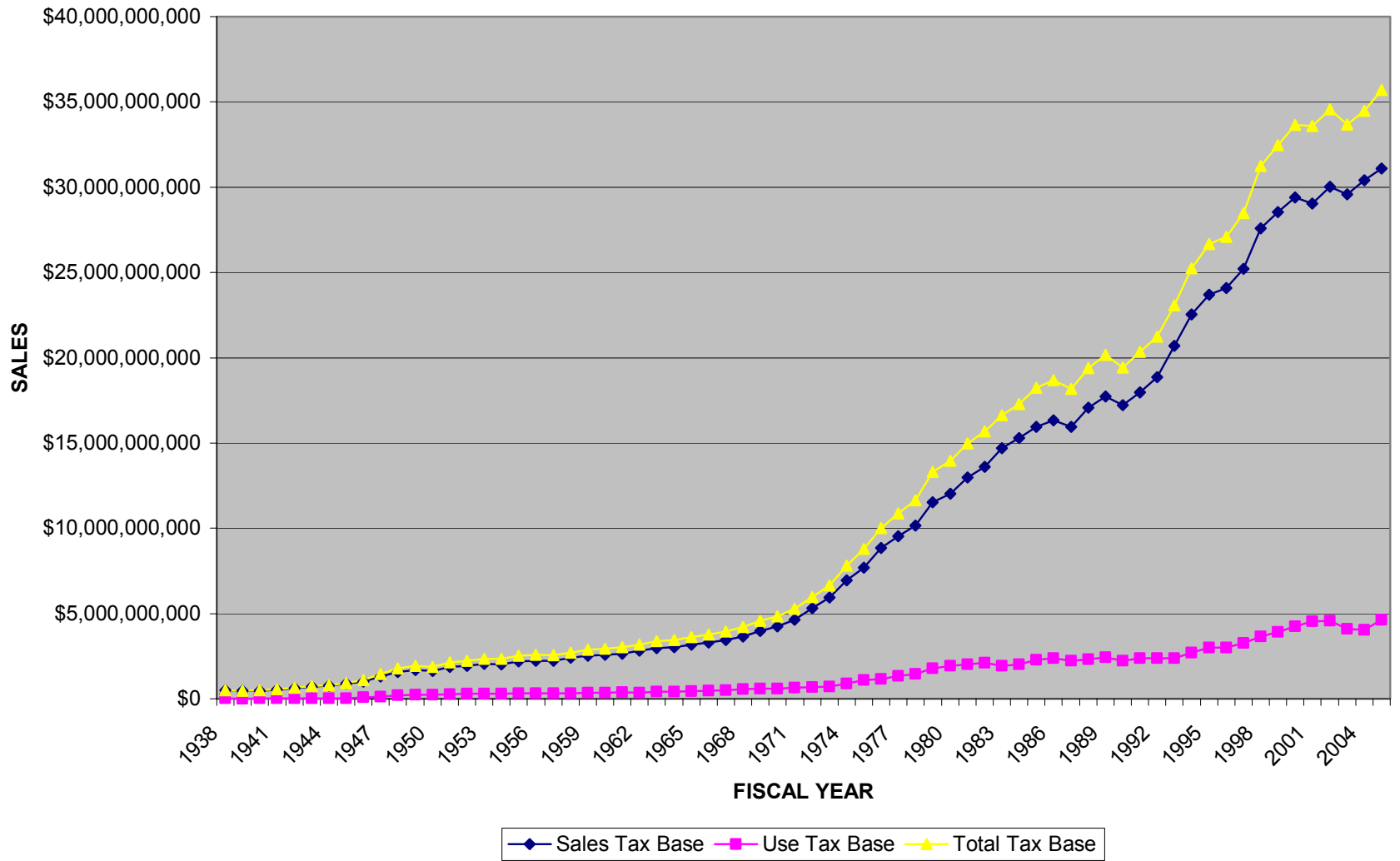


# Sales Tax Base Erosion in Kansas

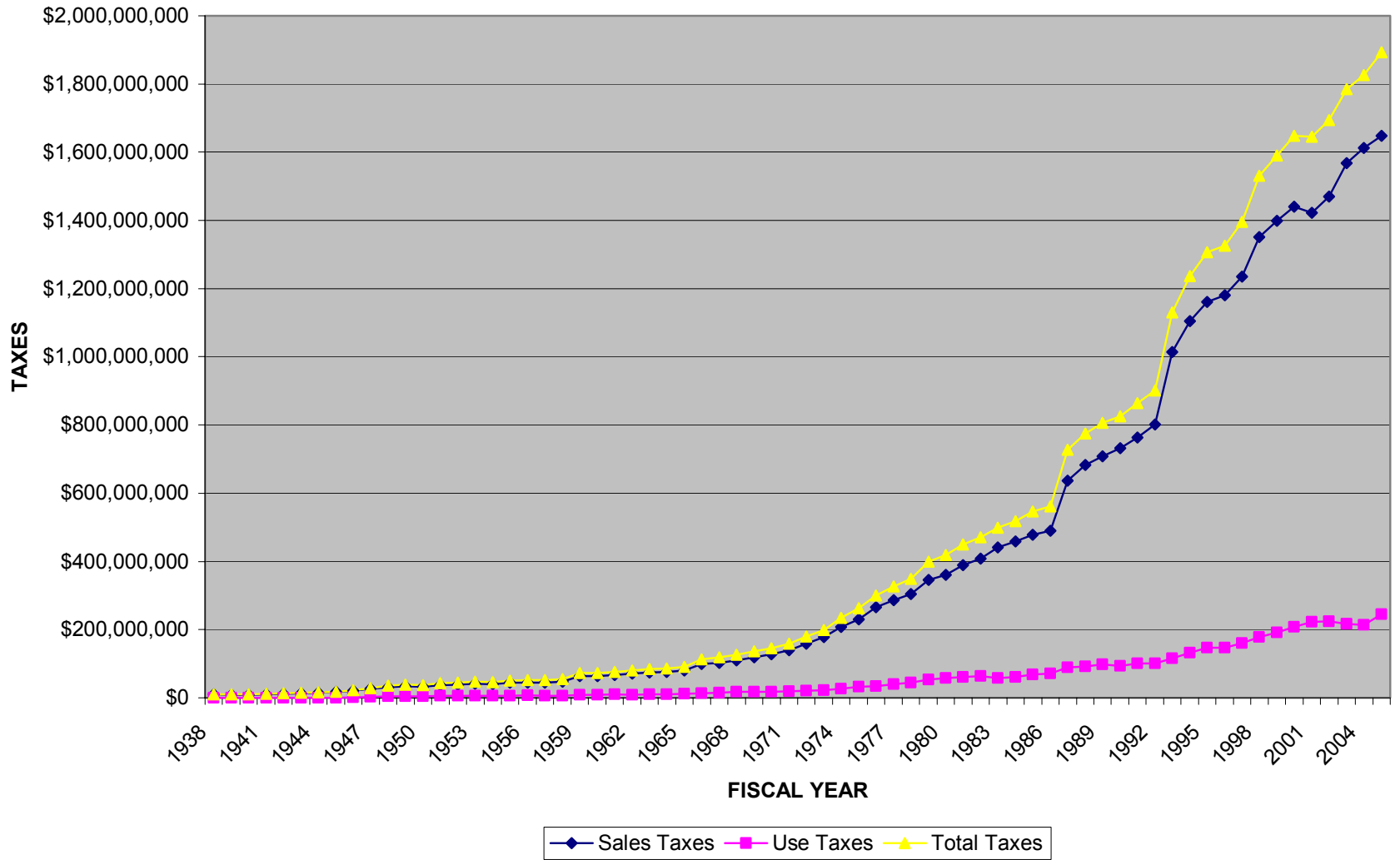
By John D. Wong and Nickolaus J. Hernandez

For the Kansas Legislature  
Special Committee on Assessment and Taxation  
September 13, 2006

# TAX BASE



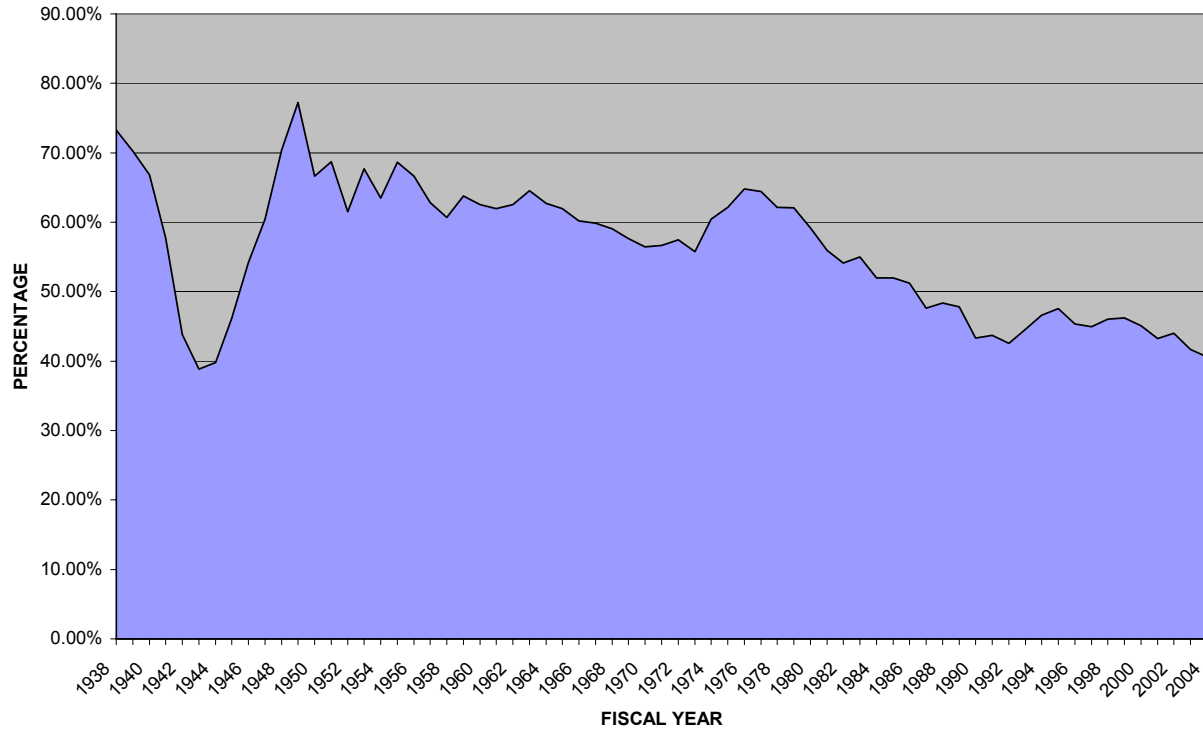
# TAX RECEIPTS



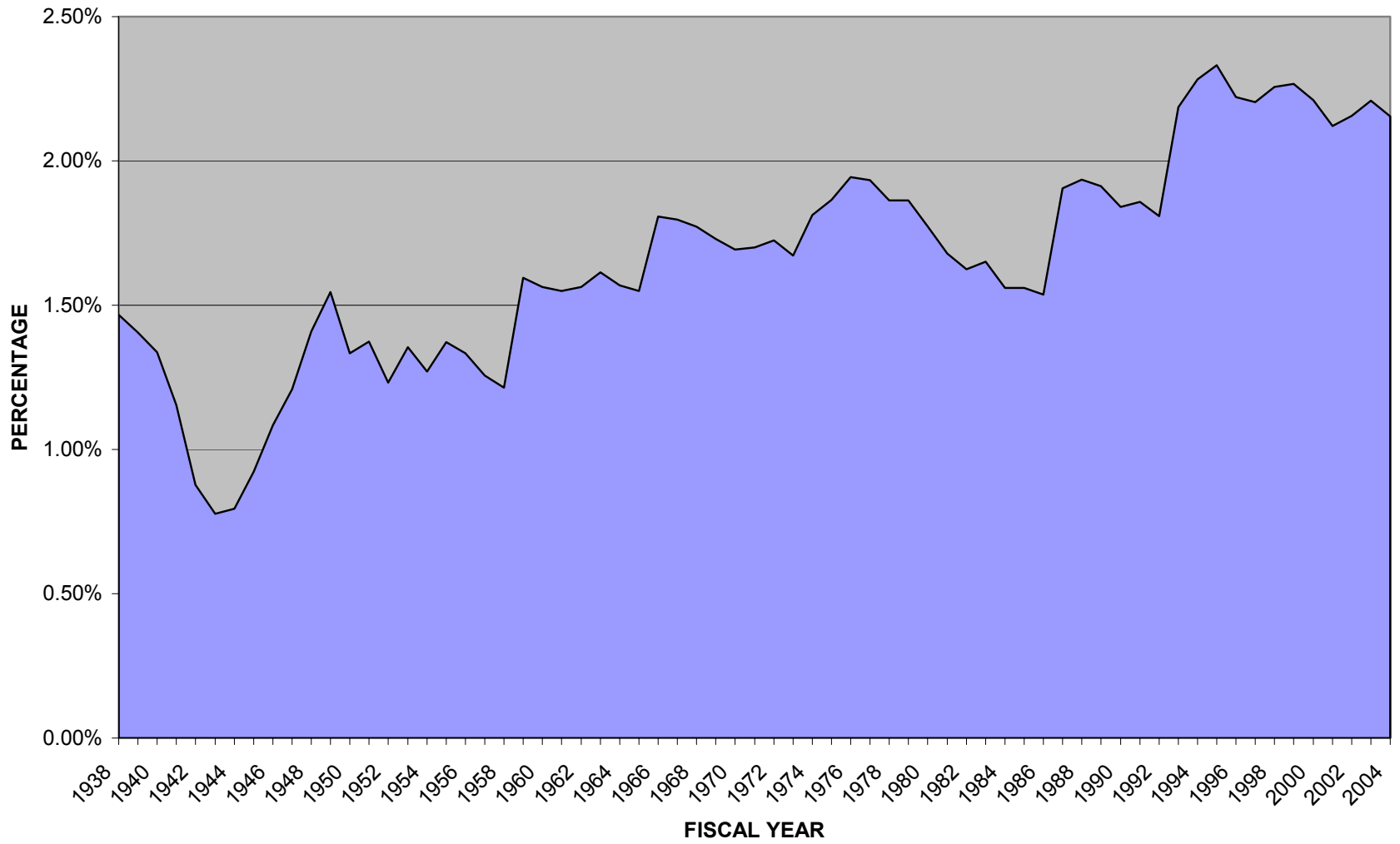
# Causes of Sales Tax Base Erosion

- Legislated statutory exemptions
- Attempts to tax services
- Cross-border shopping
- Technological change

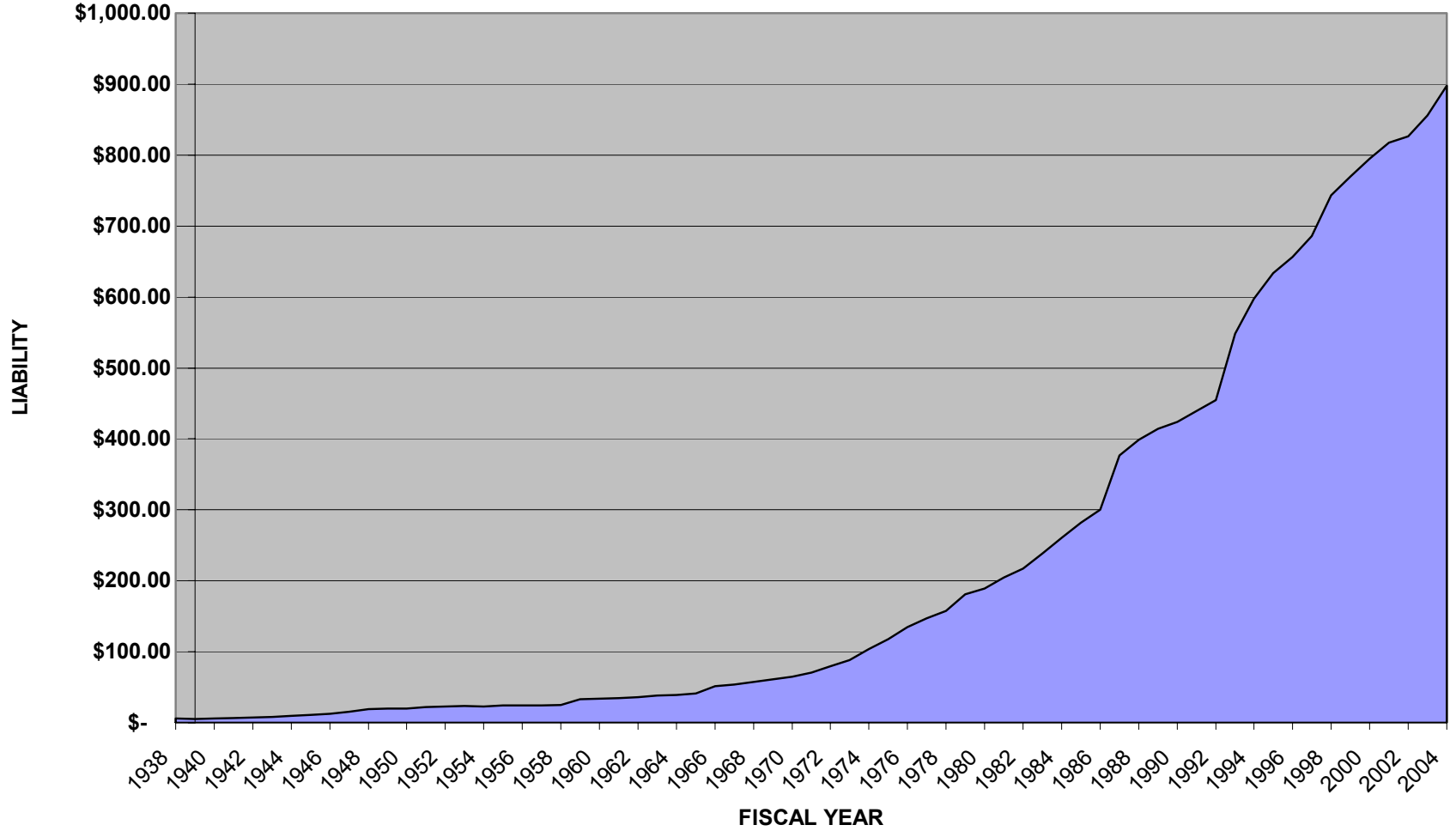
### SALES AND USE TAX BASE AS A PERCENTAGE OF PERSONAL INCOME



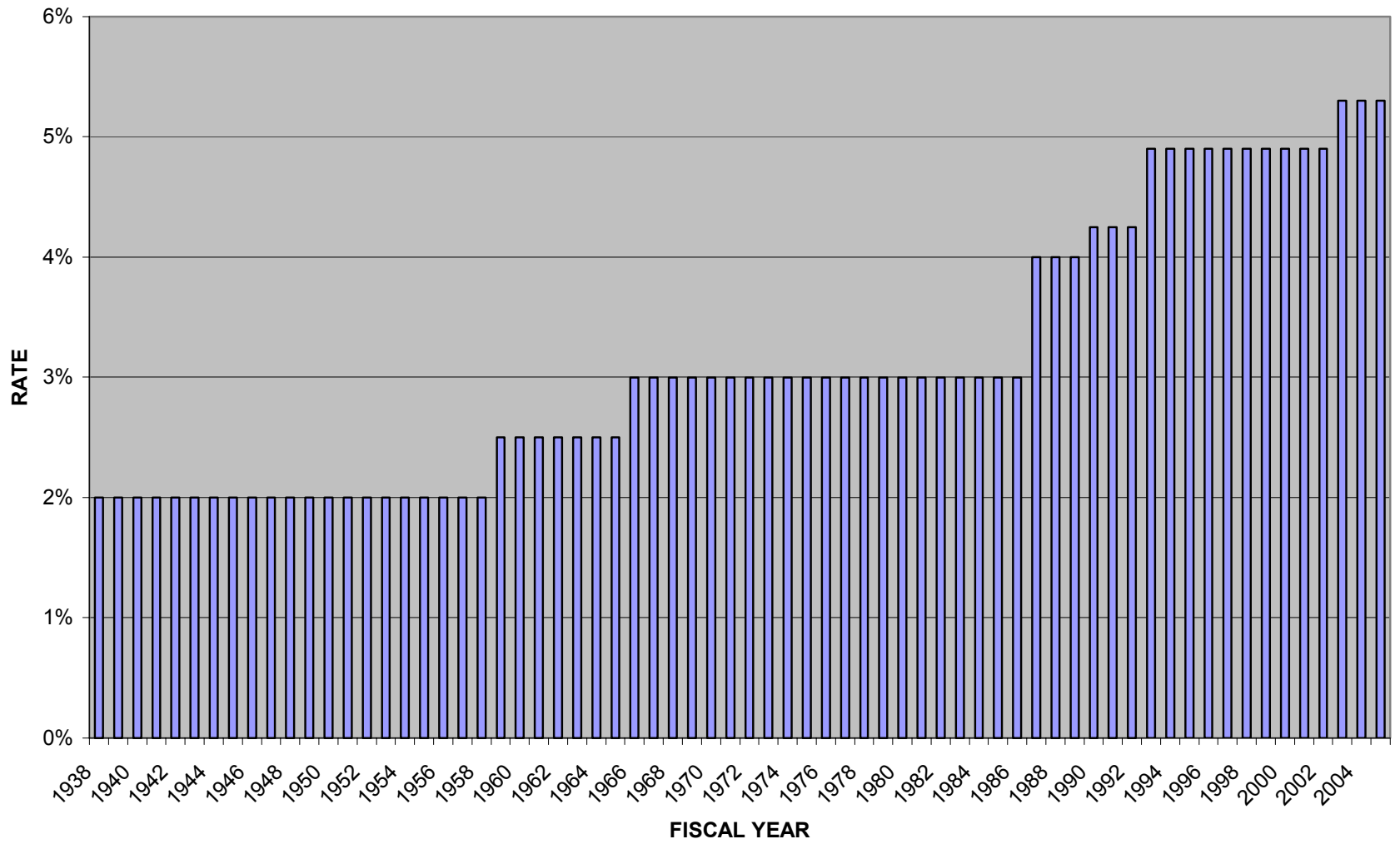
# SALES AND USE TAXES AS A PERCENTAGE OF PERSONAL INCOME



# PER CAPITA STATE SALES AND USE TAX LIABILITY

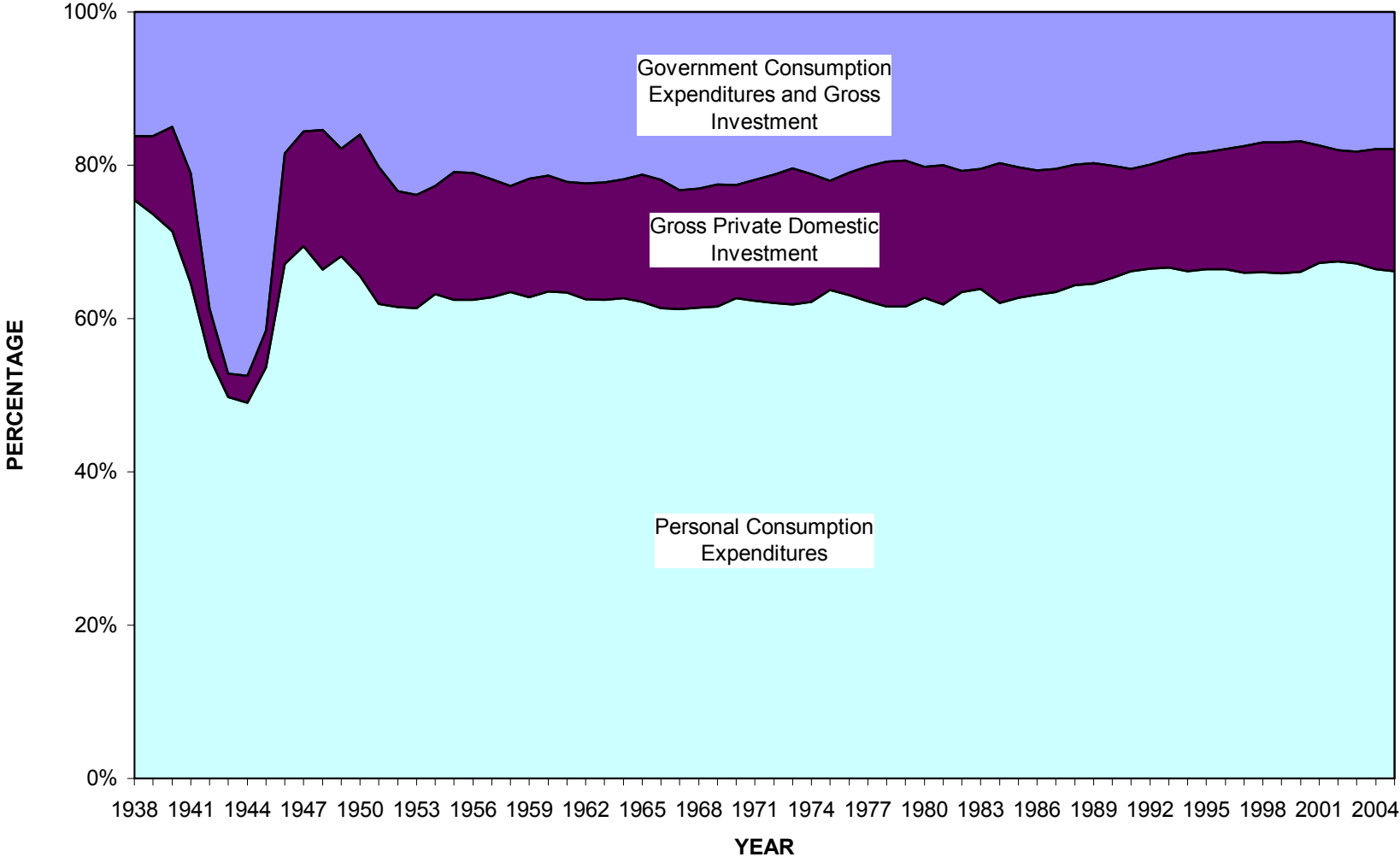


# TAX RATE

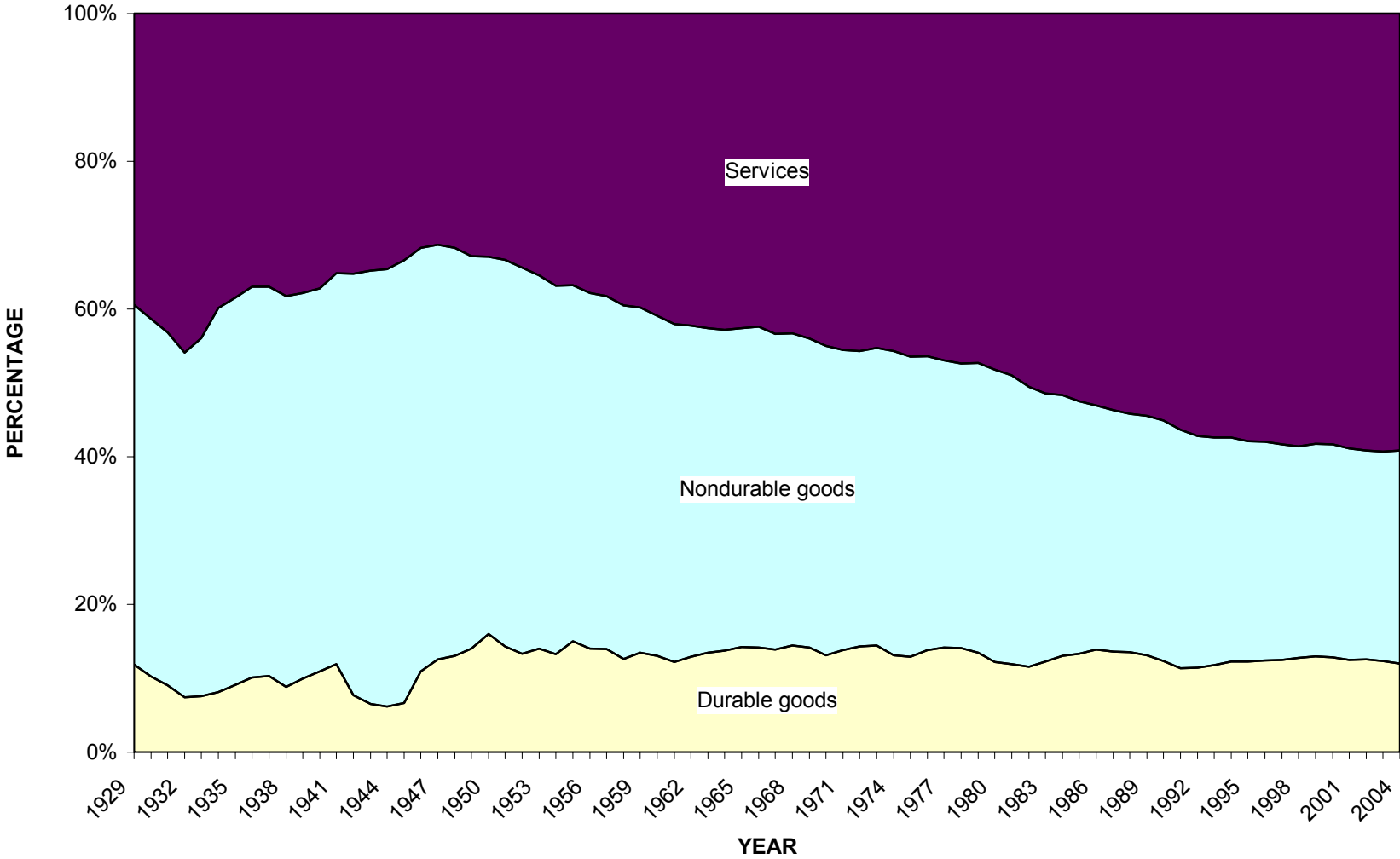




# COMPOSITION OF DOMESTIC CONSUMPTION AND INVESTMENT

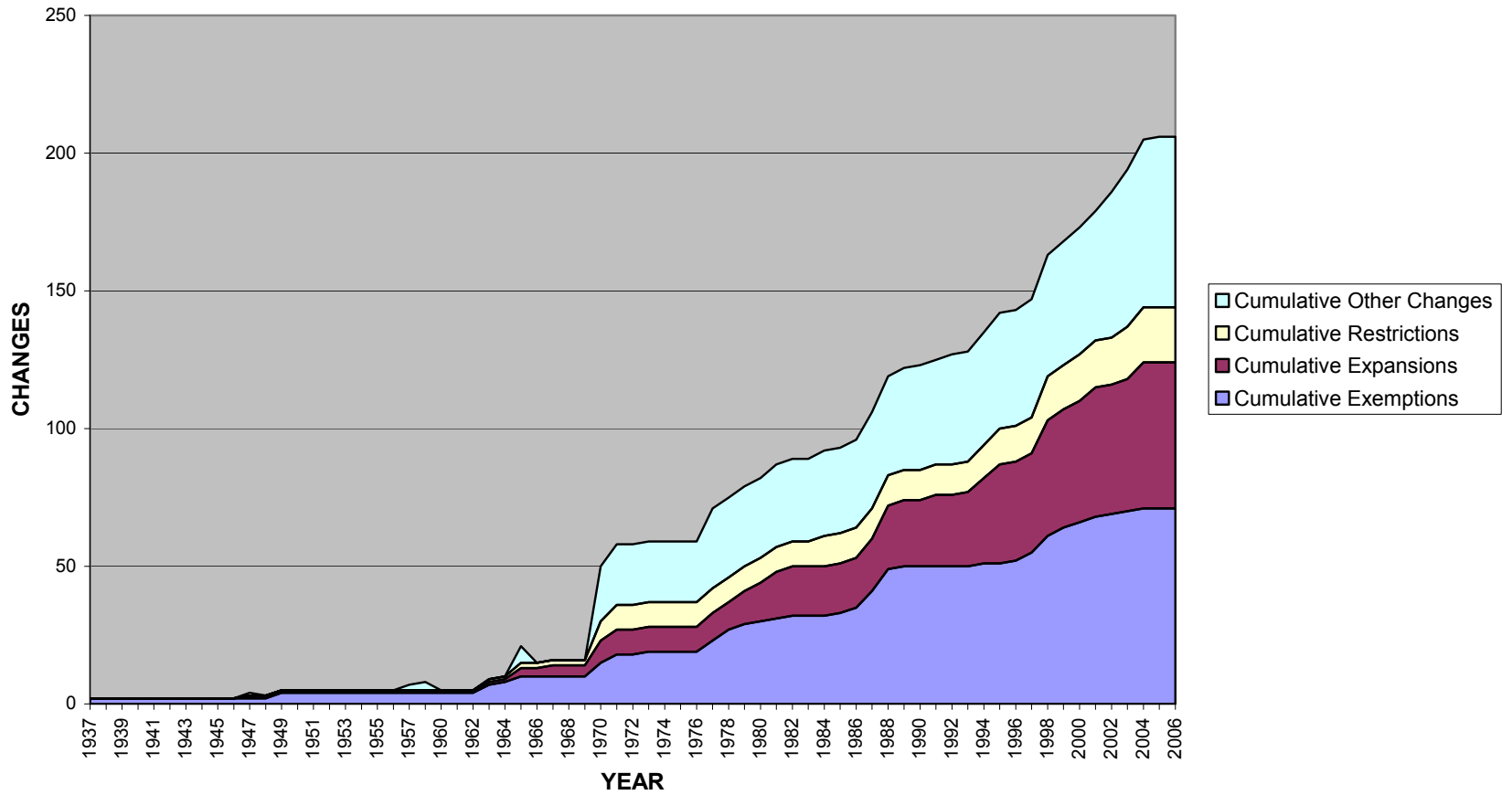


# COMPOSITION OF PERSONAL CONSUMPTION EXPENDITURES BY PRODUCT TYPE

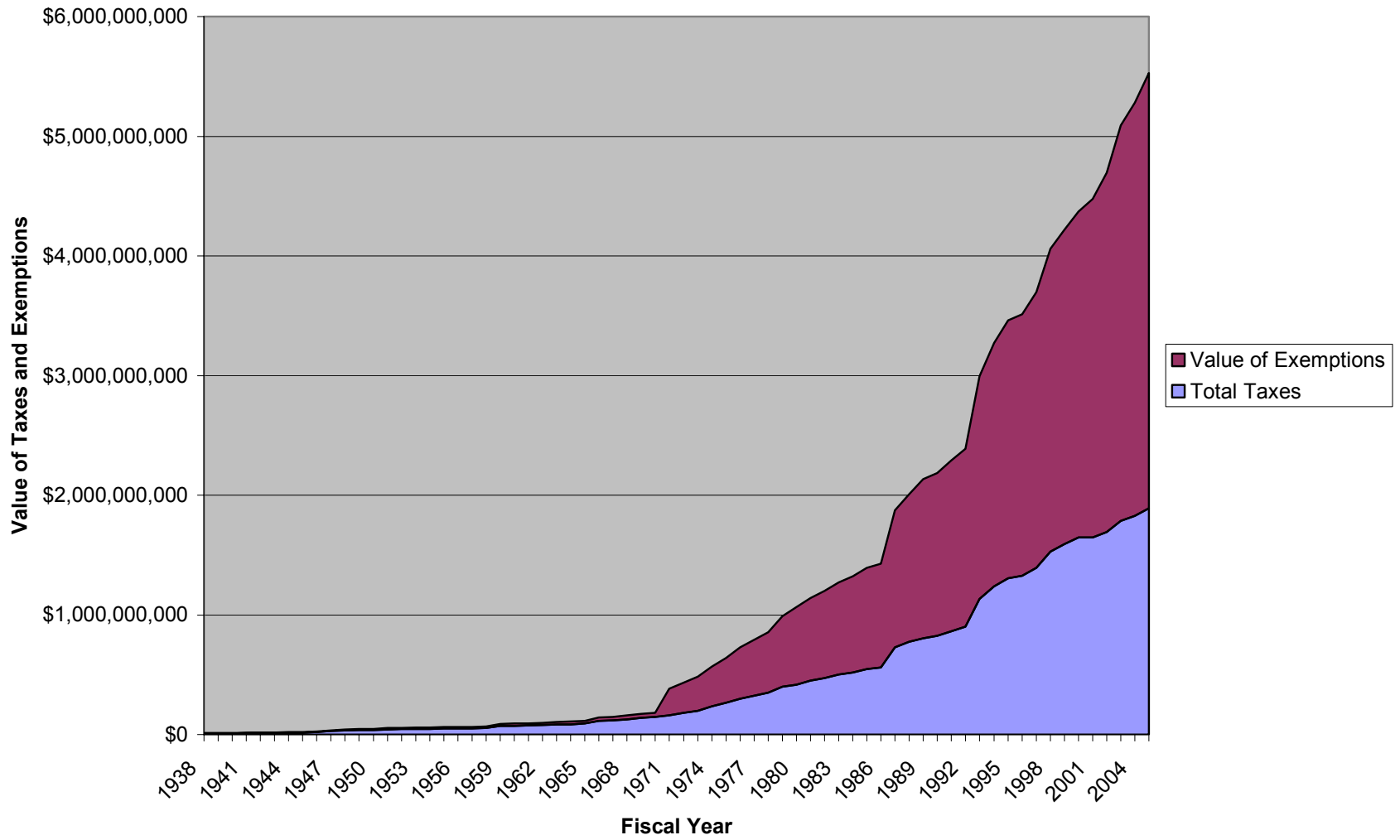




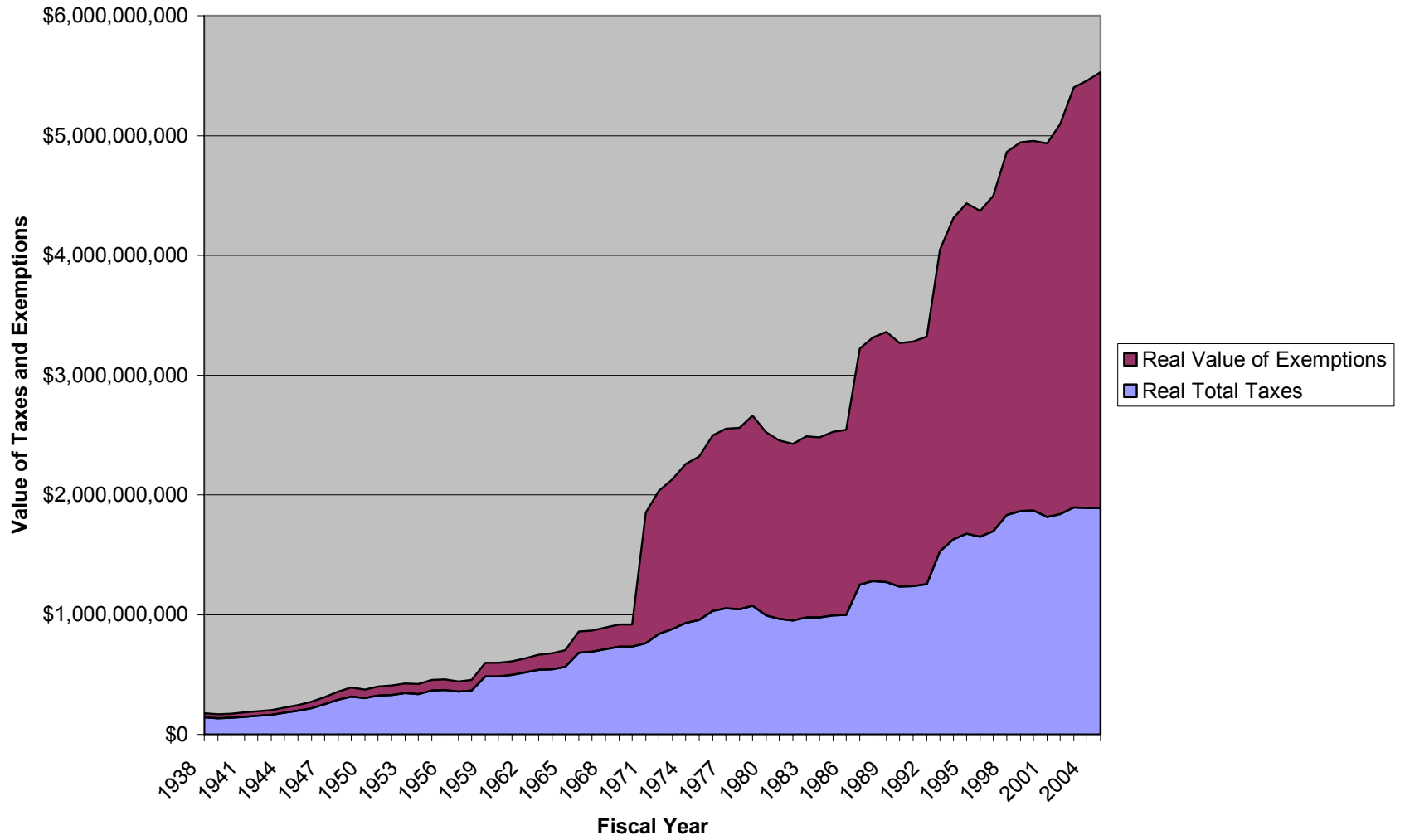
# CUMULATIVE NUMBER OF STATUTORY SALES AND USE TAX CHANGES



# TOTAL VALUE OF SALES AND USE TAXES AND EXEMPTIONS

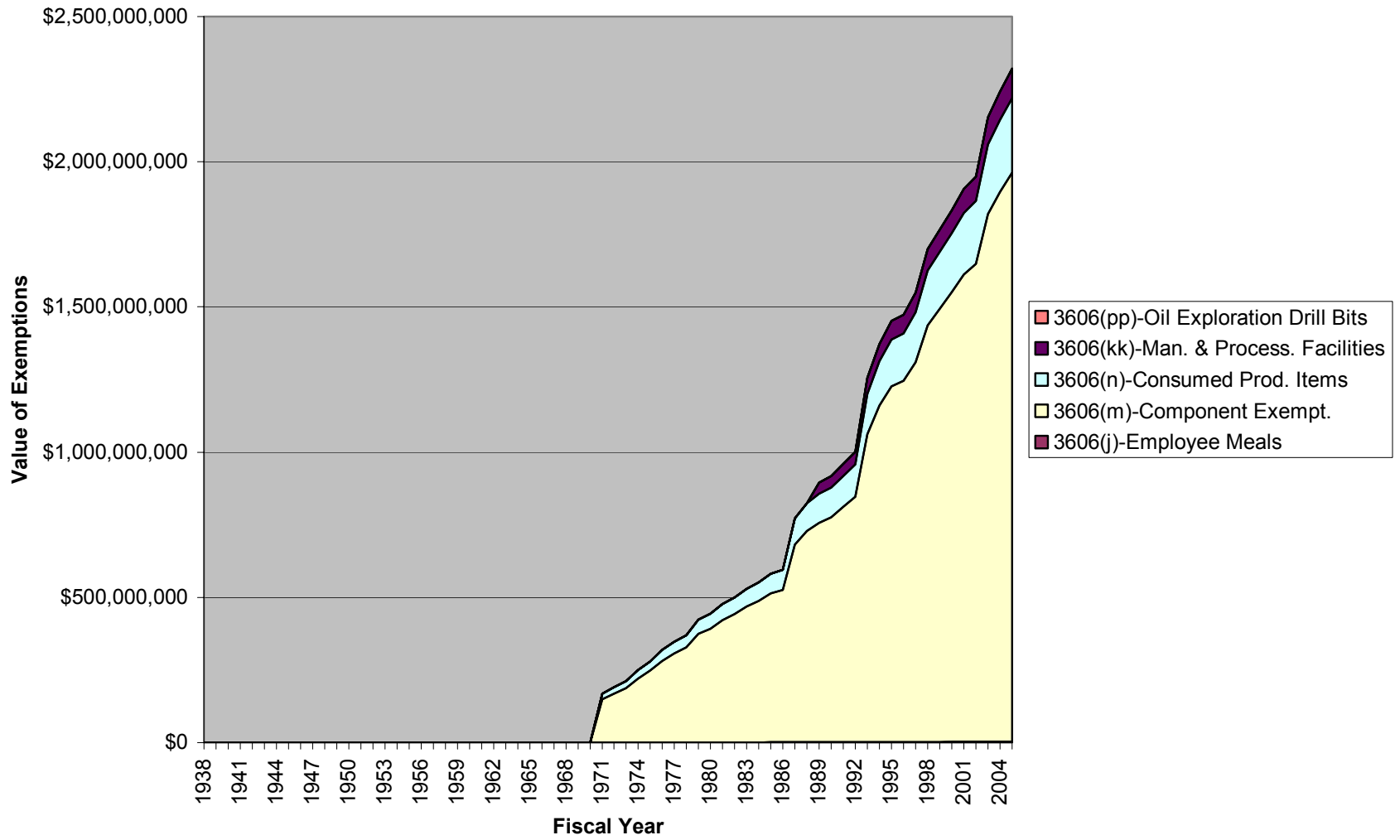


# REAL VALUE OF SALES AND USE TAXES AND EXEMPTIONS



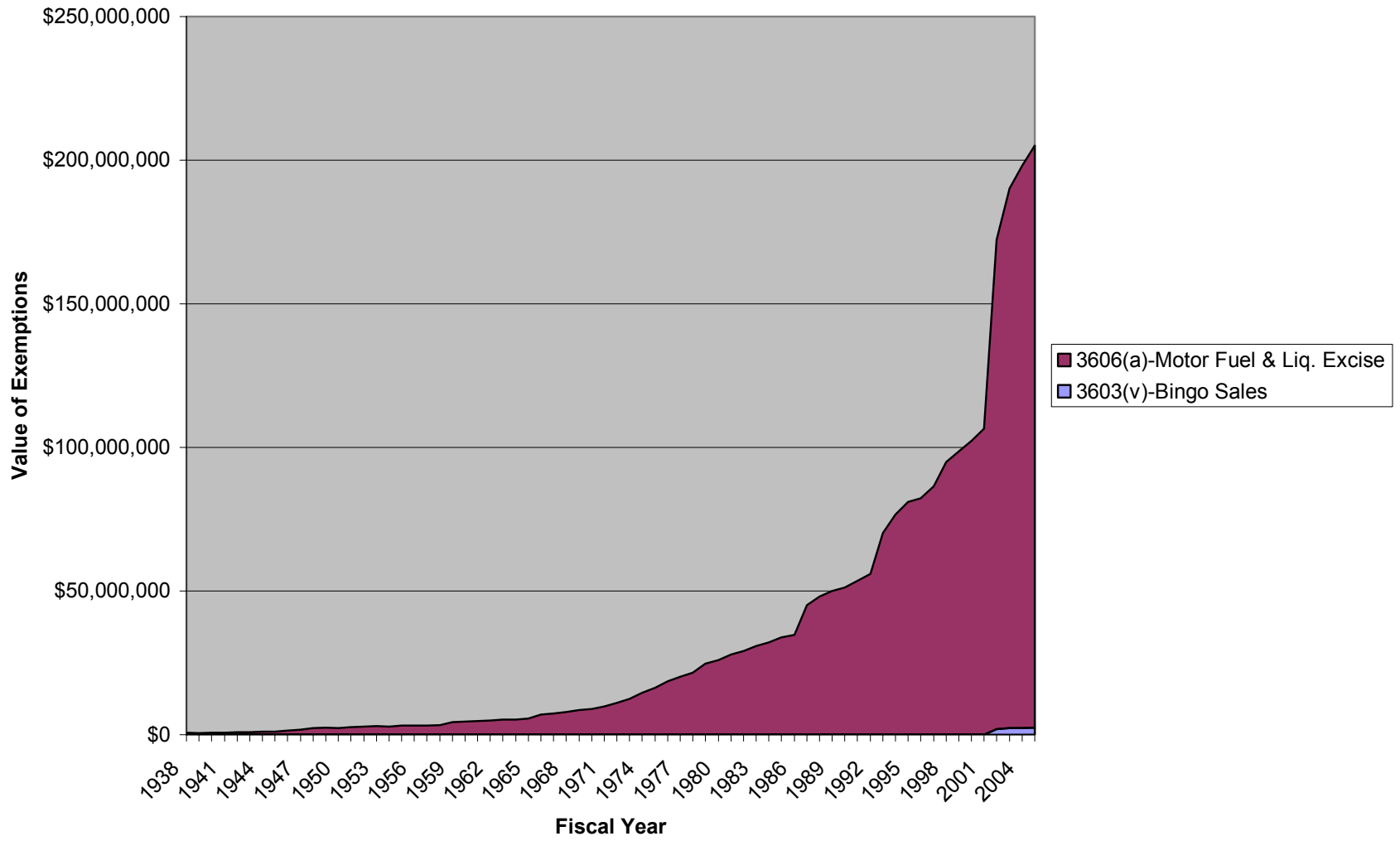


# TOTAL VALUE OF COMPONENT EXEMPTIONS





# TOTAL VALUE OF EXCISE TAXED EXEMPTIONS



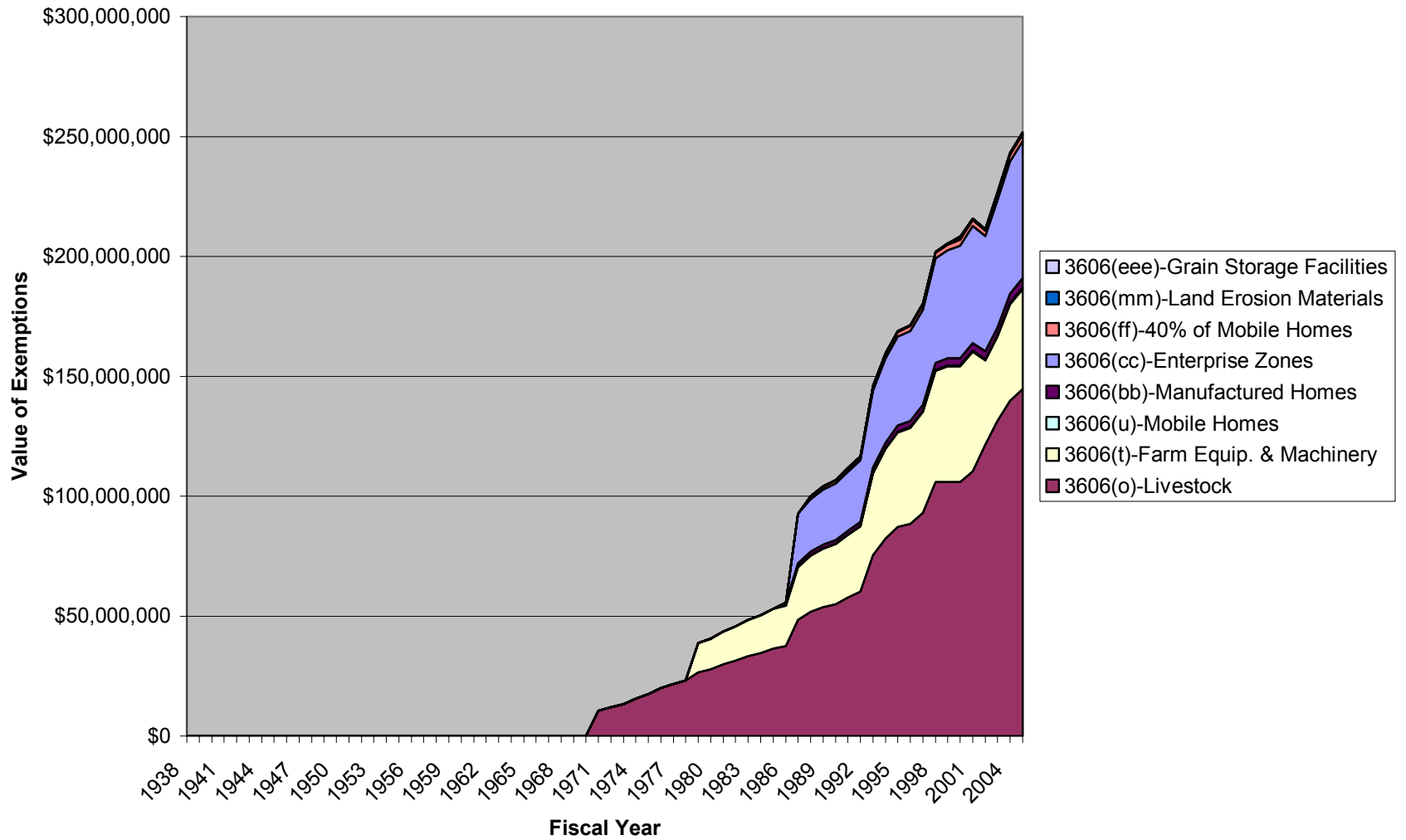


# Traditional Arguments for Inclusion of Services in the Sales Tax Base

- The sales tax should be as broadly applicable to consumer expenditures as possible.
- Taxation of services makes the sales tax less regressive.
- Revenue from the sales tax is more responsive to rising levels of personal income and economic activity if services are taxable.
- Administration of the sales tax is simplified if the tax is applicable to services rendered in conjunction with sales of tangible personal property.

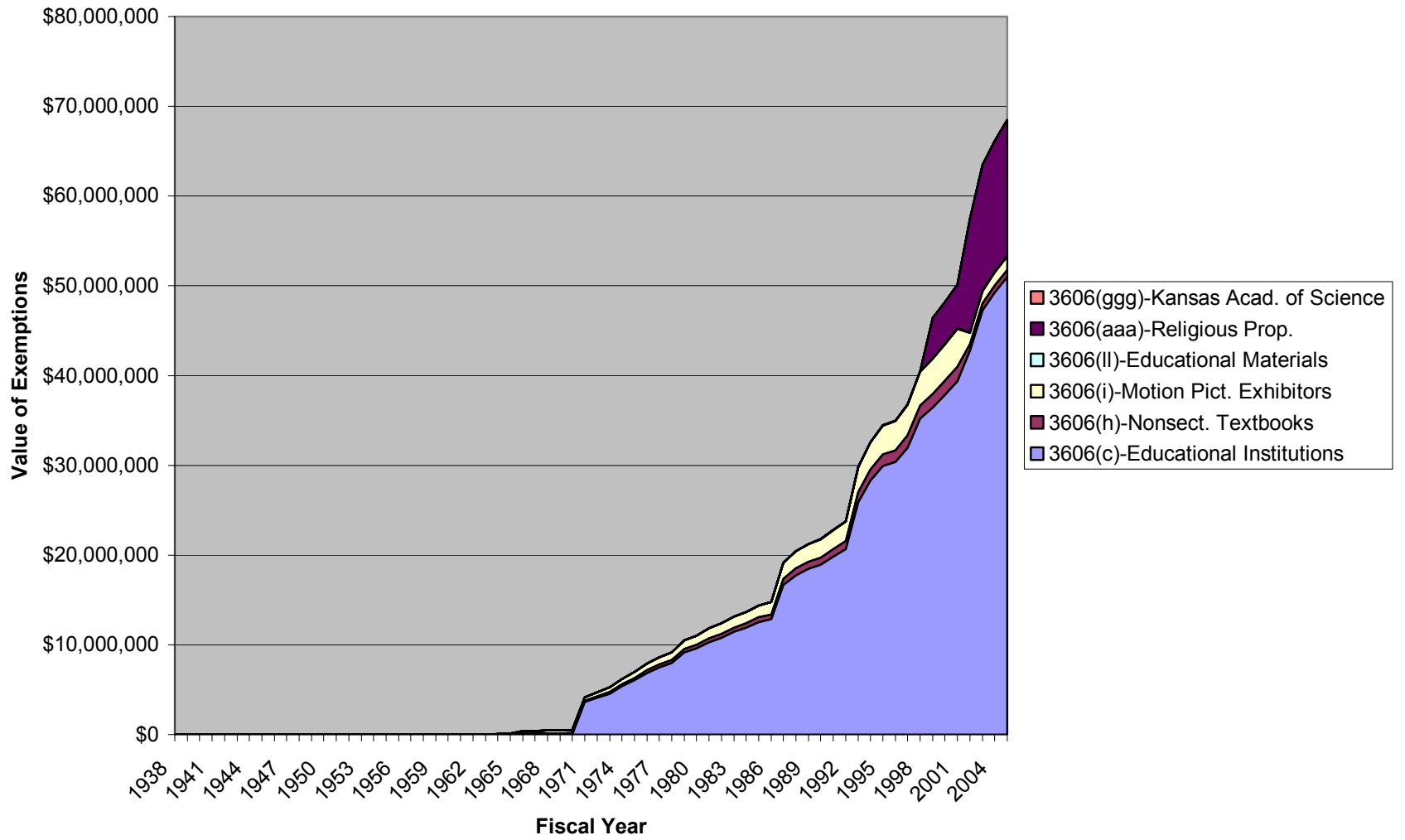


## TOTAL VALUE OF AGRICULTURAL AND LAND USE EXEMPTIONS





# TOTAL VALUE OF RELIGIOUS, EDUCATIONAL, LITERARY, AND SCIENTIFIC EXEMPTIONS



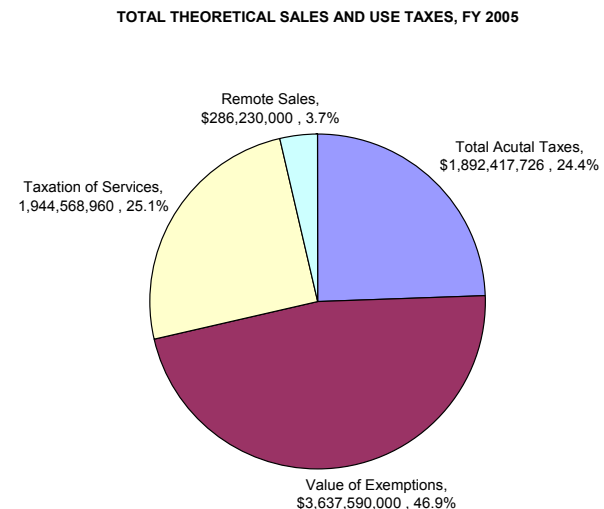




# Policy Choices

# Theoretical Retail Sales and Use Tax Receipts

- In addition to actual sales and use tax receipts of \$1,892.4 million in FY 2005, the State of Kansas could anticipate as much as:
  - \$3,637.6 million in additional revenue from the elimination of the identified exclusions and exemptions,
  - \$1,994.6 million in additional revenue from the comprehensive taxation of services, broadly defined, and
  - \$286.2 million in additional revenue from the taxation of remote sales.
- All total, theoretical sales and use taxes for fiscal year 2005 could be as high as \$7,760.8 million, approximately 4.1 times present sales and use tax collections.



# The Future of the Sales Tax Is Tied to Addressing Four Problems (Fox, 1998)

- Avoiding proliferation of sales taxes on business inputs,
- Keeping household purchases of tangible personal property inside the tax base,
- Bringing household purchases of services into the tax base, and
- Getting Congress to help states enforce use taxes.

# Problems with Legislative Statutory Exemptions

- The cumulative fiscal impact of the exemptions is huge.
- Tax exemptions that may benefit only a few shift the burden.
- Exemptions are adopted piecemeal, often in response to specific industry requests.
- Once adopted, exemptions are rarely evaluated or repealed.
- Public revenues are growing more slowly than the demand for public services.

# Taxing Consumption Versus Production

- The Hodge Committee (1970: 10) recommended that the retail sales tax should remain focused on consumption rather than on production.
- The committee recommended that component part rule be retained and refined.
- The committee suggested that it would be more desirable to exempt “consumables” as a class than to continue the policy of selective exemption through listing specific items.
- However, the committee concluded that a general exemption for machinery and equipment used in production was not warranted.

# Taxing Personal and Professional Services

- The Hodge Committee (1970: 16) recommended that the sales tax should not be extended to include personal and professional services.
- The committee concluded that if additional services were to be taxed, the most practical approach would be to start with services associated with the sale of tangible property and performed generally by firms already registered under the sales tax act.
- One of the difficulties of taxing services is determining the situs of intangible services, their allocation, and the application of the use tax to such services.
  - Without the use tax, purchases from out-of-state sources would be encouraged to the disadvantage of local suppliers.
  - Thus, it would be difficult to apply the use tax to purchases of services.

## Taxing Educational, Health Care, and Eleemosynary Organizations and Transactions

- The Hodge Committee (1970: 12) recommended that the educational exemption should be retained because to remove it would merely mean an increase in property taxes.
- The Hodge Committee (1970: 12) recommended that that the exemption of purchases by hospitals operated by religious or other non-profit organizations should be continued.
- The Hodge Committee (1970: 11) recommended that the exemption of purchases by religious, charitable, and benevolent organizations should be repealed.