TASK FORCE ON TAX EXPENDITURES

Minutes of the 4th Meeting
of the 2018 Interim

October 25, 2018

Call to Order and Roll Call

The 4th meeting of the Task Force on Tax Expenditures was held on Thursday, October 25, 2018, at 3:00 PM, in Room 102/104 of the Health Innovation Center on the campus of Northern Kentucky University, Highland Heights, Kentucky. Representative Ken Fleming, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Representative Ken Fleming, Co-Chair; Senators David P. Givens, Morgan McGarvey, Dennis Parrett, and Wil Schroder; Representatives Jason Petrie, Diane St. Onge, and James Tipton.

Guests: Jason Bailey, Executive Director, Kentucky Center for Economic Policy; Pam Thomas, Senior Fellow, Kentucky Center for Economic Policy; Jordan Harris, Executive Director, Pegasus Institute.

LRC Staff: Jennifer Hays, Cynthia Brown, and Chase O'Dell.

Approval of Minutes

Representative Tipton moved that the minutes of the August 30, 2018, meeting be approved. Representative Petrie seconded the motion, and the minutes were approved by voice vote.

Tax Expenditures

Jason Bailey, Executive Director, Kentucky Center for Economic Policy, and Pam Thomas, Senior Fellow, Kentucky Center for Economic Policy, discussed tax expenditures.

Mr. Bailey testified that the effects of state and local taxes on the behavior of businesses and individuals are small. All business taxes account for 1.8 percent of total costs for businesses on average. Other factors are more important when a business determines where to locate or expand. More than 80 percent of yearly job creation in any state comes from businesses already in-state. Taxes at the state and local level only have a small or negligible impact on an individual’s decision to migrate.

Mr. Bailey stated that public investments in education and infrastructure increase workforce productivity and the strength of the economy. Taxes are not a strong contributor to growth that comes from outside the state. The income tax in Kentucky is slightly progressive, and the sales tax is very regressive.

Mr. Bailey testified that unless a tax expenditure has a sunset date, it will exist in perpetuity and never be revisited or evaluated. The goal should be to limit tax expenditures as much as possible, but pointed out that the exemption of sales tax on groceries is an expenditure that should be kept. A sales tax on groceries is regressive. Tax exemptions should be kept on utilities and prescription drugs.

Related to an additional tax expenditure that should be created, Mr. Bailey said that the Earned Income Tax Credit (EITC) is a tax expenditure that has a strong base of evidence to show cost effectiveness.

Pam Thomas testified that action on several tax expenditures should be taken, including eliminating the retirement income exclusion, capping the itemized deductions for individuals, and performing more analysis on the film industry tax credits, the angel investor tax credit, and the Tax Increment Financing (TIF) Program.

Ms. Thomas stated that no one in Kentucky has the data to analyze the effectiveness of these economic development incentive programs in the state. There needs to be more data to analyze whether the incentive programs really work.

Ms. Thomas said that the film industry tax credits need to be analyzed and looked at again. The angel investor tax credit should be reviewed. The Tax Increment Financing (TIF) program should receive more analysis.

Ms. Thomas advocated for the freezing of the state property tax rate and for applying the hospital provider tax to current revenues rather than 2006 revenues. She advocated for taxing Advanced Deposit Wagering (ADW) and Instant Racing at the same rate as live bets.

In response to questions from Representative Petrie, Ms. Thomas stated that the Kentucky Center for Economic Policy (KCEP) recommendation was not to let the state property tax rate fall any further. Results from a frozen rate would depend on how the assessment base grew. Mr. Bailey said that the assessment base had not grown and pushed the rate down in recent years due to the recession. The rate would begin to go down again as the economy grew. Ms. Thomas testified that freezing the rate would not be an immediate revenue raiser, but that it would prevent further decline from the tax.

In response to a question from Representative St. Onge, Ms. Thomas stated that her information on the film tax credit, angel investor tax credit, and TIFs was based on looking at what other states do with their business tax break programs. She looked at the programs as a legislative staff member.

In response to questions from Representative Tipton, Mr. Bailey said that a state normally sets its Earned Income Tax Credit (EITC) as a percentage of the federal EITC. The percentage set by each state varies. KCEP did not have a recommended income level to apply the retirement income exemption phase-out to. Many states do not exempt retirement income.

In response to a question from Representative Fleming, Mr. Bailey explained that studies indicate that even small amounts of additional income in a household when a child is young can have long-lasting positive effects.

In response to questions from Representative Petrie, Mr. Bailey stated that KCEP's philosophy is that tax expenditures should be limited as much as possible, except for expenditures that have been shown through research to be cost effective, needed for an improvement to the equity of the tax system, or both. Newly created tax expenditures should have built-in systems for collecting data, doing analysis, and sun-setting. Sunset provisions would cause the legislature to proactively extend or eliminate tax expenditures. Ms. Thomas stated that, to effectively evaluate tax expenditures to be eliminated or extended, the legislature would need to know the purpose of the expenditure and have the data to analyze the effectiveness of it.

Jordan Harris, Executive Director, Pegasus Institute, discussed Kentucky's economic picture. He said the tax code is one of the primary issues with Kentucky's economic growth problem. Since 1977, Kentucky's economic growth has been 30 percent below the national average, which ranks 44th in the United States, and that between 2006 and 2016, Kentucky's per capita GDP growth was about 0.3 percent. Kentucky's average household income is 18 percent below national average; Kentucky is ranked 45th nationally in that category. Labor force participation in the state is below 60 percent, which ranks Kentucky 44th in the nation.

Mr. Harris stated that earlier in the year the unemployment rate in Kentucky was the lowest in the history of the Bureau of Labor Statistics data for the state. There are more Kentuckians employed than at any point in the state's history. However, since the recession ended, paychecks in Kentucky have grown 12 percent slower than the national average, and per capita income in Kentucky ranks 47th in the United States.

Mr. Harris stated that production has been overburdened in Kentucky, and that businesses need the burden of taxation shifted so that they can grow. Taxation is naturally economically burdensome. The role of any government entity should be to stay out of the way of individuals and businesses to the greatest extent possible. He implored committee members to consider tax expenditures to eliminate with the intention of lowering the rate, broadening the base, and creating a system that is more competitive with Kentucky's neighbors.

In response to a question from Senator Parrett, Mr. Harris testified that Kentucky's labor force participation rate has been well below the national average since before the opioid crisis began.

In response to a question from Representative Petrie, Jordan Harris stated that he agreed with the proposal of sun-setting. He said that there must be a mechanism in state government to periodically review tax expenditures. Mr. Bailey said that lowering the rate and broadening the base was the most important thing that would have influence on economic growth.

With no further business, the meeting was adjourned.