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Kentucky's Blue Ribbon Commission on Tax Reform Completes First Meeting

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On Tuesday, March 6, 2012, Kentucky's Blue Ribbon Commission on Tax Reform ("Commission") held its first meeting. All twenty-three (23) members of the Commission, including the chair, Lt. Governor Jerry Abramson, were present.

Governor Steve Beshear established the Commission by Executive Order in early February. The Governor described the mission of the Commission as follows:

- Conduct a comprehensive study and examination of the Commonwealth's tax structure and recommend changes to the tax code in order to meet the long term needs of the state and its citizens.

- Study the burden of taxation on Kentucky taxpayers, both individuals and businesses, as compared to taxpayers in other states.

- Review recent changes and proposed modifications in the tax structures in other selected states.

- Thoroughly examine and address tax policy considerations concerning the issues of adequacy, efficiency, fairness and equity, as well as economic competitiveness to determine whether the state's tax code currently operates in furtherance of these stated objectives.

- Recommend changes to our tax system in order to:

  - fairly distribute the tax burden while keeping tax rates competitive;

  - create a favorable business environment for existing firms and entrepreneurs and help to attract and retain firms and industries that will spur growth for the Commonwealth;

  - provide sufficient elasticity so as to perform in accordance with changes in the economy;

- produce revenue sufficient to adequately meet the needs of the state's highest priorities including but not limited to education, jobs and protecting our most vulnerable citizens; and
- ensure efficiency in the collection and administration of taxes, such that our system is cost-effective for the state and straightforward for taxpayers.

The Commission is authorized to hire a consultant to assist it in performing its assigned duties.

The Commission is to hold public meetings across the state to "receive input from the public and interested parties and … testimony from experts in public finance, taxation and other stakeholders." The Commission must deliver its recommendation on "issues, policies and programs affecting the Commonwealth's tax structure" by November 15, 2012.

A web page dedicated to the Commission may be found at www.ltgovernor@ky.gov/taxreform/pages/default.aspx. The website has several important links including a link to short biographies of each Commissioner and a form for registration to provide testimony. It is anticipated that the site also will include summaries of each Commission meeting prepared by the staff of either the Governor or Lt. Governor.

In addition to the consultant, the Commission is being advised by Mary Lassiter, State Budget Director and Secretary of the Governor's Executive Cabinet; Lori Flanery, Secretary of the Finance and Administration Cabinet; Larry Hayes, Secretary of the Economic Development Cabinet; Tom Miller, Commissioner of the Department of Revenue; the Taxation Committee of the Kentucky Society of CPAs; and the Section of Taxation of the Kentucky Bar Association. Also, both the Kentucky House and Senate each have three members that serve as ex-officio, non-voting members. Two of these legislators have proposed radical changes to Kentucky's tax structure in the last few years.

Tuesday's presentation to the Commission was made by Greg Harkenrider, Deputy Executive Director of Financial Analysis. Mr. Harkenrider is the Commonwealth's chief economist and is a well-respected and long-standing employee of the Commonwealth. Mr. Harkenrider's presentation was based on nearly 80 PowerPoint slides. He began with information on economic terms used in tax policy discussions, such as "progressivity," "regressivity," "economic efficiency," "elasticity," "fairness," "competitiveness," and "predictability".

Next, Mr. Harkenrider provided the Commission with a review of numerous Kentucky taxes. The taxes described included the individual income, corporation income, limited liability entity ("LLET"), sales, property, and coal severance tax. For each of these taxes, Mr. Harkenrider described the tax base, tax rate, how Kentucky ranked compared to other states, total amount collected for the fiscal year ended June 30, 2011 ("FY11"), and the total "tax expenditures" related to the tax. The Office of the State Budget Director defines "tax expenditures" as "provisions such as special exemptions, exclusions, deductions, credits, deferrals, and preferential rates in tax law that result in a loss of tax revenue." Lt. Governor Abramson suggested that the Commissioners think of "tax expenditures" as "tax exemptions".

For purposes of illustration, Mr. Harkenrider listed exemptions from sales tax for food, prescription drugs, and residential utilities as “tax expenditures”.

In FY11, Kentucky’s total tax revenue was approximately $8.8B. Using this amount as a touchstone, the following chart depicts how Kentucky’s taxes and “tax expenditures” compare.

Tax	FY11 Receipts (in billions)	Percent of Total	FY12 Est. “Tax Expenditures” (in billions)	Percent of Total
Individual Income	$3.4	38.6%	$8.2	70.0%
Sales and Use	2.9	33.0	2.7[1]	20.0
Property	.5	5.7	.1	7.0
Corporation Income	.3	3.4	.3	2.0
LLET	.2	2.3	.1	1.0
Coal Severance	.3	3.4	-[2]	-
Cigarette	.3	3.4	-	-
Lottery	.2	2.3	-	-
Other	.7	7.9	-	-
Total	$8.8	100%	$11.5	100%

During the presentation, Mr. Harkenrider also relayed the following to the Commissioners:

- Kentucky’s business taxes are “competitive” with neighboring states.
- Kentucky taxes corporations’ net profits, but economists would say “gross receipts” is the proper tax base.[3]
- In the context of comparing Tennessee’s combined state and local sales tax rate of approximately 9.75% to Kentucky’s 6% rate, it was noted that a constitutional amendment is required to provide local governments with the option of imposing a local sales tax.[4]
- Per statute, Kentucky’s state tax rate on real estate is 31.5¢ per $100 of value, but in 1979 legislation was passed that effectively caps growth in total real estate taxes.[5] As a result, the *actual* state tax rate being imposed in 2012 is 12.2¢ per $100 of value.
- Fifty-two percent (52%) of Kentuckians live in a border county; and

[1] Not included in this total is the estimated “tax expenditure” on the exemption from sales tax of most services. This “tax expenditure” is estimated at $1.761B.
[2] The “-” indicates the tax expenditure related to this tax is minimal.
[3] Indiana repealed its gross income tax in 2002.
[4] The Kentucky Task Force on Local Taxation recommended a local option sales tax in 2006. The recommendation was rejected by the General Assembly in 2008.
[5] 1979 HB 44.

- Kentucky exports a significant volume of cigarettes selling approximately 550M packages while having a total population of approximately 4.4M people.

For the most part, the Commissioners listened and asked very few questions. The Commissioners that are members of the General Assembly had to leave early as a result of the Legislature being in session. Commissioners Jason Bailey and John Williams asked the most questions. Commissioner Williams noted that only three states impose a sales tax on *all* services and that those three states recognize a "business-to-business" exception.

The next meeting of the Commission is scheduled for April 10, 2012 at 1:00 p.m. The meeting is to be held in Room 154 of the Capitol Annex. Agenda items for the meeting include a report on the hiring of a consultant and a discussion of proposals generated by previous tax reform panels and commissions.