

AUDIT PROPOSAL

Kansas Tax Revenues: Reviewing How Other States Inventory and Evaluate Tax Credits and Exemptions

SOURCE

This audit proposal was requested by Senator Julia Lynn.

BACKGROUND

The Kansas State General Fund (SGF) is primarily funded in approximately equal parts through income and excise taxes. In fiscal year 2015, personal and corporate income taxes accounted for \$2.6 billion (43%) of SGF revenues whereas excise taxes—which include retail sales, cigarette, liquor, and severance taxes on gas and oil—accounted for \$2.9 billion (48%).

The number of tax credits and exemptions enacted in Kansas over the years increased significantly. Tax revenues are generated by applying a rate to a taxable base. Granting sales or property tax exemptions takes certain transactions out of the base. When that happens, the same tax rate applied to the smaller tax base results in reduced revenue. The number of Kansas tax credits and sales and property tax exemptions has grown since 1985. For example, between 1985 and 2009, the number of sales tax exemptions increased from 30 to almost 100, and the number of property tax exemptions more than doubled from 43 to more than 100.

In 2010, we released a series of audits on Kansas tax credits and exemptions which noted Kansas lacks a strong system for reviewing and evaluating tax credits. As part of our work, we identified numerous best practices related to evaluating tax credits. Those best practices included ensuring that each credit or exemption had a clear and measurable purpose specified in statute, had a sunset provision to ensure periodic review, and had clear beneficiaries. Our audit found Kansas credits rarely had a clear purpose specified in statute and often did not include a sunset provision. Similarly, we found some tax exemptions resulted in unfair treatment for similar types of taxpayers.

AUDIT OBJECTIVES AND TENTATIVE METHODOLOGY

The audit objectives listed below represent the questions that we would answer through our audit work. The proposed steps for each objective are intended to convey the type of work we would do, but are subject to change as we learn more about the audit issues and are able to refine our methodology.

Objective 1: How does Kansas' process for inventorying and evaluating tax credits and exemptions compare to those in other states? Our tentative methodology would include the following:

- Work with staff from Legislative Research, the Department of Revenue, the Kansas Insurance Department, and others as necessary to understand which agencies administer Kansas tax credits and exemptions, what types of information they track, and how often it is updated.

- Work with agency and legislative staff to determine what processes, if any, are used by state officials use to evaluate the effectiveness and necessity of state tax credits and exemptions.
- Work with officials from a sample of other states (including both neighboring states and others nationally recognized as having a strong process to evaluate tax credits and exemptions) to determine what processes those states use to inventory and evaluate tax credits and exemptions.
- Compare Kansas' process for inventorying and evaluating tax credits and exemptions to those used in other states to identify significant differences, similarities, or potential areas for improvement.
- Work with officials from our sample of other states to determine if they have recently eliminated tax credits or exemptions, learn why they were eliminated, and understand the process they used.

ESTIMATED RESOURCES

We estimate this audit would require a team of **three (3) auditors** for a total of **three (3) months** (from the time the audit starts to our best estimated of when it would be ready for the committee).