Kansas Tax Incidence Study:
Who Pays Kansas Individual Income, Retail Sales, and Residential Property Taxes

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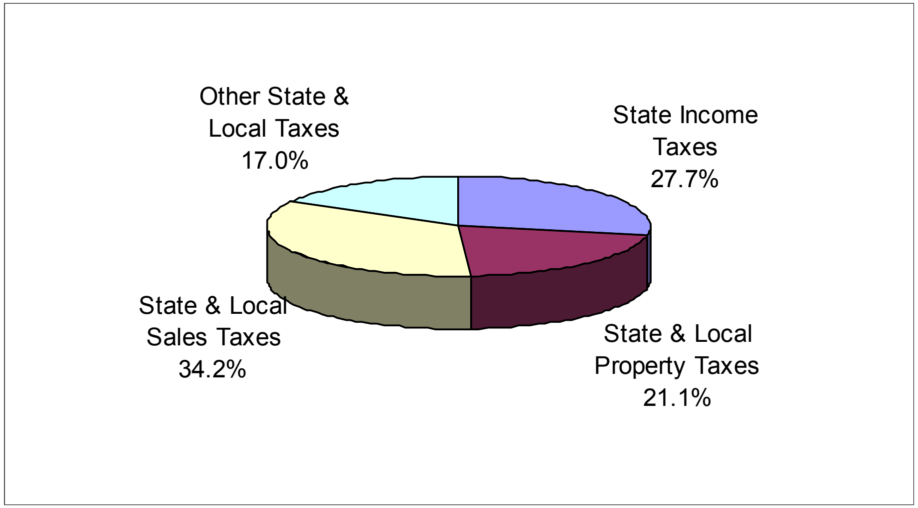
Percentage of Combined State and Local Tax Revenue, 2003



Tax Incidence

- *Tax incidence* analysis is the study of who ultimately bears the economic burden of a tax.
- The *effective tax rate* (ETR) is the tax rate paid as a percentage of income.
- According to the *ability-to-pay principle, t*ax liability should be based on the taxpayer's ability to pay
- Vertical tax equity
  - *Progressive tax*–Proportion of income paid as tax increases as income increases
  - *Proportional tax*–Proportion of income paid as tax remains constant regardless of income
  - *Regressive tax*–Proportion of income paid as tax decreases as income increases

Principal Findings

Individual Income Tax ETR

- The average effective tax rate for individual income taxes for the state as a whole is 3.2 percent.
- Effective tax rates rise significantly with increases in household income.
  - At the low end the ETR for the income tax is −7.4 percent for the lowest income group.
  - It rises steadily to 4.7 percent for the highest income group.
- Based on household composition single households without children and non-family households have the highest ETR at 4.1 percent while married couples with children have the lowest ETR at 2.0 percent.

Individual Income Tax Incidence

- Because of its graduated tax rate structure and allowance of personal exemptions and deductions the individual income tax is by design progressive.
- Lower income households can receive refundable tax credits which can more than offset any income tax liabilities.
- The Kansas individual income tax is modestly progressive.
  - Although the Kansas individual income tax is only modestly progressive it tends to be more progressive than many other states because it is comprised of only three brackets with some taxpayers subject to the highest rate with taxable income as low as $30,000.
  - The progressivity of the individual income tax nearly offsets the regressivity of the other taxes.

Residential Property Tax ETR

- The average effective tax rate for the state as a whole is 2.3 percent with the lowest income population group paying an effective tax rate of 23.6 percent while the highest income population group paying an effective tax rate of 0.6 percent.
- Property taxes were regressive across all household groups.
- Overall households paid 2.3 percent of their income in property taxes.
- The lowest income group (under $10,000) paid 23.6 percent of their income in property taxes.
- In contrast the highest income households ($200,000 and over) spent an average of 0.6 percent of their income on property taxes.

Residential Property Tax Incidence

- The Kansas residential property tax is significantly regressive.
  - This result derives because lower income households tend to spend a higher proportion of income on housing than higher income households.
  - In some cases effective tax rates of over 100 percent may be reported in cases where the taxpayer may be occupying a high value residence while receiving a low level of Kansas adjusted gross income.
- Since the residential property tax includes both a uniform state component and non-uniform local government components regional variations are the result of the distribution of wealth and income in the respective regions, the composition of that income, and local discretionary tax policy decisions.

Retail Sales Tax ETR

- Average Kansas household pays $1,595 in retail sales taxes annually.
- The largest amount goes to housing ($416), food ($395), and transportation ($352).
- The average effective tax rate for the state as a whole is 3.7 percent.
- For 2003 the effective consumer sales tax rate for the lowest income group was 16.5 percent compared to the rate for the highest income group of 2.3 percent.

Retail Sales Tax Incidence

- The Kansas retail sales tax is moderately regressive.
- Retail sales taxes in Kansas tend to be more regressive than many states because of the base of the tax is relatively broad and has relatively few major exemptions for such as for food and clothing.

Combined Taxes ETR

- The combined average effective tax rate for the state as a whole is 9.2 percent.
- The lowest income group (under $10,000) paid 32.7 percent of income in taxes.
- The effective tax rates decreased slightly for the middle-range of households ranging from 14.6 percent to 7.6 percent. These households had income between $10,000 and $199,000.
- The highest income group ($200,000 and over) paid 7.7 percent of income in taxes.

Combined Taxes Incidence

- Combined state and local taxes are proportional to slightly regressive.
- On average the sales tax (3.7 percent) accounted for the largest burden most households.
  - The second largest tax was the sales tax (3.2 percent).
  - Although the property tax is the most regressive of the three taxes, it accounted for the smallest burden (2.3 percent).
- Refundable tax credits increase the progressivity of the Kansas tax structure.
  - The earned income tax credit makes the individual income tax increases progressive at low-income levels.
  - The homestead credit sharply reduces though it does not eliminate the regressivity of the property tax for low-income homeowners and renters.
  - While refundable credits significantly reduce the burden of the poorest households they do not completely eliminate the regressivity of the property tax.

Policy Choices

Relationship Among Taxes

- Because the income tax is the only one of the three major state and local revenue sources that is progressively distributed based on income it must by definition bear the burden of balancing the regressivity of the residential property and retail sales taxes.
- The income tax system is the most efficient means to reduce the tax burden on lower income households since it is the only one of the three major state and local taxes that directly takes income into consideration.

Some Alternatives for Reducing the Income Tax Burden on Lower Income Households

- Indexing of brackets, deductions, and credits;
- Increasing credit allowances for child and dependent care expenses;
- Increasing the earned income tax credit;

Some Alternatives for Reducing the Property Tax Burden on Lower Income Households

- Increasing the homestead refund;
- Combining the school finance exemption with the homestead refund and relating it to household income; or
- Reducing reliance on the property tax for school finance

Some Alternatives for Reducing the Retail Sales Tax Burden on Lower Income Households

- Increasing the food sales tax refund;
- Closing sales tax exemptions and exclusions;
- Broadening the sales tax base to include services; or
- Broadening the sales tax base to include remote sales.

Caveats

- If the objective is to specifically reduce the tax burden on lower income households the tax reduction must be specifically based on income.
- Selectively exempting a specified value from residential property taxation such as with the school finance exemption applies to all residences irrespective of income.
- Selectively exempting or excluding specific items from the tax base make those items artificially less expensive and more preferable relative to other taxed items.
  – In addition exemptions and exclusions apply to all purchasers irrespective of income
  – If the objective is to specifically reduce the tax burden on lower income households the tax reduction must be specifically based on income.
- However, it must be kept in mind that while these changes may decrease the tax burden on lower income households these changes may also reduce state revenues.