



Legislative Post Audit Performance Audit Report Highlights

Kansas Tax Revenues, Part I: Reviewing Tax Credits

Report Highlights

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Audit Concern

With the proliferation of credits over the years, legislators have expressed an interest in knowing whether some of those credits still are needed, or whether they have outlived their original purposes

Other Relevant Facts for Question 1

Kansas currently has 47 tax credits and two refund programs available to individuals, corporations, financial institutions, and insurance companies. Such credits can be refundable, non-refundable, carry-forward, or transferable.

A total of 13 credits were enacted between 2006 and 2009. These credits cost the State about \$400,000 in 2007, but many hadn't been used yet. These include many credits passed as part of the State's energy development initiative. Because so little information was available about these credits, it's too soon to know whether they will be effective at meeting the Legislature's policy goals.

The Department processes most tax returns and credits, but the Insurance Department processes all returns and credits that apply to insurance companies.

AUDIT QUESTION 1: *Does Kansas have tax credits that aren't accomplishing their intended purpose or have outlived their usefulness?*

AUDIT ANSWER and KEY FINDINGS:

- Tax credit and refund programs cost the State \$669 million in forgone revenues for tax year 2007.
- Eight credits and one refund program (costing \$446.3 million in 2007) clearly appeared to be accomplishing the Legislature's policy goals.
- Eight credits (costing less than \$100,000 in 2007) appeared to be likely candidates for repeal, primarily because of minimal or declining use. These include tax credits for agritourism liability insurance, a single city port authority, abandoned well plugging, swine facility improvement, child day care assistance, and three tax credits designed to encourage contributions to low-income Kansans.
- Six credits and one refund program (costing about \$100 million) appeared to be accomplishing their purposes but were more generous than some other states or credits. For example, Kansas' tax credit for angel investors is 50%, while many states' tax credit rates are 25% or less. Others we identified: the homestead property tax refund and tax credits for earned income, research and development, child dependent care, and community service contributions. These credits could be modified to bring them more in-line with others.
- The Legislature may want to re-evaluate the remaining 12 credits (costing about \$122.5 million). Among the reasons why: some have fairly minimal use, likely don't cause the actions being taken, are significantly more expensive than expected, may cause competitive inequities, or provide a 100% credit. For all these credits, we identified considerations that could support keeping, modifying, or repealing them, depending on the Legislature's policy goals.
- Kansas lacks a strong system for reviewing and evaluating tax credits, and the Department of Revenue's tax database system has a number of data reliability issues. Those issues included duplicate tax credits being reported, changes needed because of amended returns, taxpayer errors, and data entry errors.

We Recommended

- We recommended that future tax credits include a measurable public purpose, a mechanism for collecting information for assessing whether the purpose has been met, and a sunset provision that would allow a periodic review. We also recommended that the Legislature consider any changes it may want to make to the credits we identified as potential candidates for being repealed, modified, or re-evaluated, and consider removing confidentiality provisions about who benefits from tax credits and by how much, as some other states have done.
- We recommended that the Department of Revenue make the changes needed to improve the accuracy of tax credit information it provides to the Legislature, and that it incorporate tax return and credit information processed by the Insurance Department.

Agency Response:

The Department agreed with all the recommendations addressed to it, and indicated it had implemented or initiated steps that should help address the problems we identified with the accuracy of the tax credit database. The Department also agreed with our conclusions about the various tax credits, with the possible exception of the Single City Port Authority Tax Credit.

Other Relevant Facts for Question 1 *(continued)*

For tax year 2007, those credits totaled almost \$75 million. That information generally isn't included with the other tax credit information the Department of Revenue publishes.

AUDIT QUESTION 2: *What transferable tax credits exist in Kansas, and are they a cost-effective means of generating money to fund certain types of projects or causes?*

AUDIT ANSWER and KEY FINDINGS:

- Only 4 of the 47 tax credits currently available in Kansas are transferable—Angel Investor, Community Service Contribution, Deferred Maintenance, and Historic Preservation.
- The first three transferable credits appear to be a cost-effective way of generating money from the State’s perspective, because all the money the State loses in forgone revenues goes to the project or activity the State is subsidizing. Transferring these credits has no effect.
- The Historic Preservation Tax Credit isn’t a cost-effective way to generate money from the State’s perspective. On average for the credits that have been transferred (211 of 569), only 85¢ went to the project for every dollar the State gave up. That information is summarized in the figure.

Audit Concern

Legislators have expressed an interest in knowing whether transferable tax credits represent an effective use of taxpayer dollars.

Other Relevant Facts for Question 2

Information produced by the Department of Revenue hasn’t captured all credits taxpayers are claiming.

Department records only recorded \$2.3 million of the \$4.3 million in credits claimed for the Historic Preservation Credits we reviewed, and were understated by more than \$373,000 for the Angel Investor Tax Credits we reviewed. Such understatements weren’t isolated to tax credits that were transferred.

Initially, the estimated cost of the Historic Preservation Tax Credit was about \$1 million a year. Preliminary figures show that these credits had exceeded \$10 million in 2008. For 2010 and 2011 only, the Legislature capped the credit at \$3.75 million a year, but it’s possible the cost for this credit still will exceed those statutory caps.

Figure 2-6

Money Generated for Historic Preservation Projects As a Result of the Tax Credits For Tax Years 2001-2009 (amounts shown in millions)

Tax Year	Total Amount of Tax Credits Issued (number of projects)	Amount Transferred (number of projects)	Amount paid for Initial Transfer (a)	Cost Ratio of Transferred Credits
2001	\$0.4 (6)	\$0.011 (1)	\$0.009	\$0.80
2002	\$2.3 (36)	\$1.9 (9)	\$1.5	\$0.83
2003	\$6.1 (59)	\$5.8 (23)	\$4.8	\$0.82
2004	\$4.8 (66)	\$4.3 (22)	\$3.3	\$0.77
2005	\$11.2 (87)	\$10.6 (37)	\$8.8	\$0.83
2006	\$5.1 (111)	\$4.1 (37)	\$3.5	\$0.86
2007	\$8.7 (95)	\$7.7 (40)	\$6.8	\$0.88
2008	\$15.1 (70)	\$14.3 (29)	\$12.6	\$0.89
2009 (b)	\$4.4 (39)	\$2.4 (13)	\$2.1	\$0.89
Total	\$58.1 (569)	\$51.1 (211)	\$43.4	\$0.85

(a) We only reviewed the initial transfers since those determine whether the credit is cost-effective for the State. The reader should be aware that many of these credits are being transferred multiple times.

(b) Data includes tax credits issued only for the first nine months of 2009.

Source: LPA analysis of Kansas Department of Revenue data

We Recommended

- We recommended the Legislature consider options for restructuring how it provides funding to historic preservation projects to ensure its spending is cost-effective. We also recommended the Legislature consider imposing limits on the amount of credit that can be awarded because it’s so much more expensive than the Legislature initially expected.

**DO YOU HAVE AN IDEA FOR
IMPROVED GOVERNMENT EFFICIENCY OR COST SAVINGS?**

If you have an idea to share with us, send it to ideas@lpa.ks.gov, or write to us at the address shown. We will pass along the best ones to the Legislative Post Audit Committee.

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