

M I N U T E S

SPECIAL COMMITTEE ON ASSESSMENT AND TAXATION

August 21-22, 1975

The Committee was called to order shortly after 10:00 a.m. by Vice-Chairman Stark, the Chairman being delayed by a court appearance relating to business of the Senate. All members later were present. Staff present: Richard Ryan, Roy Johnson, Mike Heim and Bill Edds.

Approval of Minutes

It was moved by Senator Christy and seconded by Representative Brooks that the minutes of the July 17-18 meeting be approved. Motion carried.

Proposal No. 7 - Job Expansion  
Act

Mr. F. Kent Kalb, General Counsel, Department of Revenue, accompanied by Mr. Donald O'Connor, representing the Kansas Association of Commerce and Industry, reviewed for the Committee a memorandum explaining 17 amendments proposed to resolve previously mentioned problems and thus facilitate administration of H.B. 2153 if it is enacted into law. (Copies of the memorandum and accompanying revised mock-up of the bill were provided for inclusion in the Committee notebooks.)

In reply to questions, Mr. Kalb stated that the first amendment would insure that the minimum of five employees required for qualification for the credit be maintained throughout the taxable year for which the credit is claimed, but that additional employees could increase the amount of the credit.

A question was asked as to whether addition of "feedlot" to the definition of "facility" in Section 2(a) would include cattle as such as part of the facility investment. The reply was that cattle would be an inventory item and thus excluded from "new business facility investment" by the provisions of Section 2(f) (page 6 of the mock-up).

Another question asked was whether a shopping center could qualify for the investment credit. Mr. O'Connor's reply was that individual units in the center could qualify, but not management itself where its only function is that of a lessor of space to others. He referred to Section 2(f) (page 6 of mock-up) where the value base for an operating lessee is established as net annual rent capitalized at 8%.

In reply to a question as to how the credit would apply in the case of a Subchapter S corporation, Mr. Kalb's reply was that ordinarily such corporation is not a taxpayer. However, in a case where a nonresident stockholder does not file consent, the Sub S corporation is a taxpayer. He indicated that further consideration would be given to how to best handle such a situation.

Another question concerned the application of the credit in the case of a partnership. Mr. Kalb stated that this could be covered by regulation under which the partnership would compute the credit and pass it on to the partners.

Another question concerned application to Coops. Mr. O'Connor's answer was that in the case of a totally exempt Coop there would be no credit. To the extent income of a Coop was taxable it would be handled the same as any other corporation. Mr. Kalb added that the Department would take another look at Coops in relation to the credit.

A question was asked as to whether an estate would be a "related taxpayer" under amendment number 11. The answer was: "No, but a testamentary trust could be." Mr. Kalb stated that this matter would be given further consideration.

Mr. Kalb also noted as needing further consideration a possible provision for adjustment of the credit in the case of a loss carry back or carry forward situation.

A further question was raised regarding distinguishing the feedlot from other farming in the case of a feedlot operated by a farmer. Mr. O'Connor stated that only the feedlot would qualify as the bill now stands, and that it would be a matter of accounting to separate this from other farming. Mr. Olson, another attorney for the Department of Revenue, said there might be some question under the "substantially identical" provision where additional land was acquired to support the feedlot, and that this would be given further consideration.

Representative Hineman asked why in view of the substantial investments involved in irrigation for instance, farming in general should not be included in the investment credit program.

Questions were raised regarding oil well operations, and one answer was that an oil well alone would not qualify, but that creation of or expansion of an oil producing company could.

It was suggested that in the case of utilities the credit for capital might be eliminated and credit allowed only for added employees. Mr. O'Connor's answer was that the investment should be recognized since it will be around and producing tax revenue for a long time.

Mr. Kalb referred to a letter from Governor Bennett relating to insuring that no loopholes are allowed if the credit is granted, and suggested that in this regard it might be desirable to disqualify any property financed with the proceeds of industrial revenue bonds.

Vice-Chairman Stark commented that in view of the number of further questions raised the subject probably would come up again at the September meeting.

Copies of a written statement by Representative Ronald Hein, who had asked to be heard but later found that a conflict prevented a personal appearance, were filed in the Committee notebooks. This statement expressed opposition to the method of computing the credit contained in the bill as passed by the House, and support for Senate Committee amendments changing the method of computation in Section 2(b)(1) and (2).

Proposal No. 8 - Agricultural Use  
Value Appraisal

Dr. Barry Flinchbaugh, K.S.U. Extension Economist, met with the Committee by invitation to discuss a study being conducted to determine the potential impact of HCR 2005. He started by noting that three questions voters must consider relate to the effect of HCR 2005 on: (1) land use, (2) per acre valuations of farmland, and (3) shifts in the property tax load. The study underway relates to the second and third questions, on (a) county and (b) school district bases.

The county study, preliminary data from which is expected to be available early in October (with publication after the first of the year), will include three types of agricultural land: grassland, dry land, and irrigated land. The computation for grassland will start with cash rental rates, which information is available; subtract specified costs, including a management charge and property taxes, to arrive at net earnings; and apply five capitalization rates to the net earnings. The computations for dry land and irrigated land will be similar, but will start with gross income from farm management program data.

Dr. Flinchbaugh commented that use value may increase assessed valuations in some counties where present assessed valuations are badly out of date.

Effects on the tax base will be determined by comparing use values with present assessed values, and on tax rates by using the two value bases to determine rates necessary to raise the same amount of revenue as at present.

Dr. Flinchbaugh described the school district study as being more difficult, with a February 1, 1976, target date for completion, depending on the availability of data on breakdowns of rural valuations by school districts. The goal is to develop new adjusted valuations to plug into the school finance formula.

With regard to the effect on land use, Dr. Flinchbaugh repeated the statement that land is "pushed" out of agriculture (because property taxes exceed an amount which can be paid readily out of income from farming) or is "pulled" out (because of development or investment demand). He suggested that use-value assessment as contemplated in HCR 2005 might eliminate much of the push but would have little effect on pull. Of the three basic forms of use value assessment, he stated that preferential assessment alone may eliminate the push but can actually encourage the pull; that deferred taxation can eliminate the push but have little effect on pull, though providing some revenue for local units; and that restrictive agreements are the most effective of the three as far as effect on land use is concerned.

Dr. Flinchbaugh went on to discuss a fourth approach, the use of development rights. (Materials relating to this subject provided by Dr. Flinchbaugh are filed in the Committee notebooks.) This is a new approach as far as this country is concerned involving more theory than practice thus far. It can be based on the purchase of development rights by state or local governments, or provision for a system of transferring such rights through private negotiations. In either case, the owner is reimbursed for the development rights and has the valuation of his interest in land correspondingly reduced for property tax purposes.

An illustration of actual use of the public purchase approach in Suffolk County, New York, is included among the materials furnished by Dr. Flinchbaugh. He stated that Vermont has experimented with voluntary donation of development rights and is extending it to state purchase; and that the New Jersey House has passed TDR concept legislation.

When asked how TDR would work in Gove County, for instance, Dr. Flinchbaugh stated that it probably would not be applicable in such a setting. He also commented that in some cases proposals re TDR are a substitute for lack of guts in strictly enforcing zoning regulations. In reply to another question, Dr. Flinchbaugh stated that while in theory strict land use control could be accomplished through either contract or police power zoning, the practical result is quite different.

Senator Janssen commented on an IAAO conference in June at which he heard that if the purpose of some 36 states in passing use value assessment laws was to preserve farmland, such objective has not been accomplished.

Differences between 79-503, which lists factors to be taken into consideration in determining market value, and the ratio study, which is based on sales, were discussed by Dr. Flinchbaugh and Committee members.

Dr. Flinchbaugh also provided for the Committee notebooks copies of a speech he delivered in May of this year at a Land Use Conference at K.S.U. on the subject of "Appraisal of Farmland for Tax Purposes and its Effect on Land Use."

When invited to comment, Mr. Raymond Vaughn, Director of Property Valuation, stated that land classification will be essential to any true equalization program, that for this purpose mapping is necessary, and that additional funds are needed for the mapping program. Mr. Bob Burke, Division of Property Valuation, reported that SCS mapping has been completed, but not published in all cases, in 53 counties. A year ago 48 or 49 counties were completed.

#### Sales Tax Problem

A sales tax problem, to which attention had been called by the Chairman of the Board of Tax Appeals, was reviewed for the Committee by Mr. Kalb. One of numerous changes made in the sales tax act in 1970 (effective July 1 that year) extended the sales tax to include gross receipts from the installation, maintenance, servicing and repairing of tangible personal property except services rendered in installing property in connection with the original construction of a building or structure. (A memorandum outlining the problem is in the Committee notebooks.)

Briefly, the word "structure" is not defined in the sales tax act. The Department at first adopted a restrictive definition; later, following an Attorney General's opinion, adopted a more liberal interpretation; and, finally, returned to a restrictive interpretation in disallowing claims for refunds.

Mr. James Caplinger, an attorney who represents contractors doing construction work in the power and communications (telephone) fields, spoke to problems that have been caused for his clients who bid on contracts on the basis of no sales tax liability, relying on the AG opinion.

Discussion of various alternatives led to agreement that some of the problems necessarily will have to be solved administratively, but that the legislature probably should, as suggested by the Department, decide whether to retain the word "structure" in 79-3603(p); and, if it is retained, provide a statutory definition thereof.

One member felt that the matter was of sufficient importance to warrant requesting the Legislative Coordinating Council to make it the subject of a study proposal specifically referred to the Committee. Others, however, felt that the Committee could include in its report a recommendation that clarifying legislation be enacted without first going to the LCC. The latter viewpoint prevailed.

#### Property Tax Exemption of Leased Property

Another problem, also first suggested for consideration by the Chairman of the Board of Tax Appeals, concerns application of the words "used exclusively" in the Constitution and statutes, to property leased to the state, to hospitals, or to others enjoying a constitutional and/or statutory exemption. A memorandum on this subject, presented by Mr. Kalb, also is filed in the Committee notebooks.

As far as the state government is concerned, Mr. Tom Pitner, Chief Attorney, Department of Administration, reported that a procedure manual directing state agency heads to claim exemption of property leased by the state and negotiate changes in leases to effect a reduction in the lease price equivalent to the benefit the tax exemption gives to the lessor will be rescinded.

#### Proposal No. 67 - Oil and Gas Incentives

Mr. Don Schnacke, Executive Vice-President, Kansas Independent Oil and Gas Association, presented a written statement outlining three areas of proposed legislative action to stimulate the oil and gas industry in the state: (1) restoring the full 22% depletion allowance in the state income tax law; (2) providing a tax credit incentive for investment in tertiary recovery methods, and (3) memorializing the Federal Power Commission to accord the Kansas ad valorem tax imposed on natural gas produced from wells commenced before January 1, 1973, the same "pass on" status as is accorded the "production" or "severance" taxes of other jurisdictions.

With the approval of the Chairman, the Revisor of Statutes office had prepared drafts of two bills and a proposed resolution to carry out the above proposals. Mr. Schnacke expressed approval of the first bill (depletion allowance) and of the resolution (property tax pass on), but indicated that the second bill (tax credit for tertiary recovery costs) needs more work.

Dr. William Hambleton, Director of the Kansas Geological Survey, presented a written statement "warmly supportive of the tax incentives proposed by the previous speaker."

Dr. Don Green, K.U., presented a written statement describing a Tertiary Oil Recovery Project (TORP) involving the Department of Chemical and Petroleum Engineering and the State Geological Survey.

Mr. Charles Coffman, Cities Service Oil Company, gave a slide presentation on a field demonstration test of micellar-polymer flooding in the El Dorado Field of Butler being conducted by Cities Service in cooperation with the Federal Energy Research and Development Administration. Copies of the written text of his presentation were provided.

Mr. Larman J. Heath, Bartlesville, Oklahoma, gave a slide presentation on the organization and activities of the U.S. Energy Research and Development Administration (ERDA) and distributed copies of publications relating to contracts and grants for cooperative research (such as the Cities Service project referred to above) on enhancement of recovery of oil and gas.

Mr. Dick Randall, General Counsel, Petroleum, Inc., Wichita, presented a summary of oil and gas depletion changes in the Tax Reduction Act of 1975 and data comparing drilling and producing costs of his company over a period of years. In reply to a question about the effect of de-regulation of oil prices, he expressed the opinion that prices would level out at around \$11 or \$12 per bbl., unless OPEC again increases its prices.

Mr. Mack Colt, representing Eastern Kansas Oil and Gas Association (EKOGA), presented a written statement supporting the KIOGA position, saying that: "Given proper incentives, regulations, and a fair political climate, eastern Kansas can produce more oil from presently known fields by enhanced (tertiary) recovery than it has produced in the past century."

Mr. Bob Anderson, representing Mid-Continent Oil and Gas Association, stated that evidence from refineries, had representatives been present, would have stressed the difficulty of procuring sufficient crude oil to process.

Senator Vincent Moore, Chairman of the Special Committee on Energy and Natural Resources, reported that he had been directed by that Committee to write to the Chairman of the tax Committee relative to possible tax incentives of various kinds, such as for installation of insulation as one example.

Mr. Paul Simpson, a small operator in SE Kansas, reported that many like him are working with their own capital or local sources to try to increase production.

Vice-Chairman Stark noted that at this meeting the Committee had heard only from proponents of the KIOGA proposals and that opponents would be given an opportunity to be heard at a later meeting.

Other Business

Staff members highlighted a memorandum (filed in Committee notebooks) reviewing the history of property tax relief claims for calendar years 1971 through 1974 and comparing claims through early August this year with the same period of 1974, and reported orally on state general fund revenue trends.

Plans for Next Meeting

Vice-Chairman Stark pointed out that further consideration of two priority subjects -- Motor Vehicle Taxation (Proposal No. 5) and the Ratio Study (Proposal No. 6) -- had been deferred to September, when only a one day meeting has been scheduled (September 18). In addition, more work on each of the other three proposals assigned to the Committee remains to be done. His suggestion that the Legislative Coordinating Council be asked to approve a two day meeting (September 18 and 19) was agreed to by consensus.

Prepared by Roy H. Johnson

Approved by Committee on:

9-18-75

(Date)