

M I N U T E S

SPECIAL COMMITTEE ON ASSESSMENT AND TAXATION

October 8, 1976

The meeting was called to order by Chairman Gaar shortly after 9:30 a.m. Senator Janssen was absent. Staff present: Bill Edds, Revisor of Statutes Office, Richard Ryan, Kansas Legislative Research Department; Roy Johnson, Kansas Legislative Research Department; and Robert Taylor, Kansas Legislative Research Department.

Minutes of Previous Meeting

The minutes of the previous meeting were reviewed by the Committee. It was moved by Senator Simpson and seconded by Representative Jarchow that the minutes be approved. Motion carried.

Hearing on Proposal No. 7 - Mineral Interests Taxation

Don Schnacke, representing the Kansas Independent Oil and Gas Association, spoke in opposition to the adoption of the bill draft for withholding of Kansas personal property tax from royalty payments made by unit operators or first purchasers. (Hereinafter this proposal will be referred to as "withholding proposal.")

Mr. Schnacke introduced three members of his association to the Committee (Mr. Randall, Mr. Andre, and Mr. Sullivan) and stated that these three individuals desired to address specific problems inherent in the withholding proposal. Prior to their testimony, he stated that although he had worked with the Committee staff on certain matters of definition and other technical aspects of preparing the withholding proposal, he wanted to assure the Committee that he was opposed to the proposal because it would work hardships on small production companies in the following ways:

- it would damage the relationship between small production companies and royalty owners.
- it would be impossible for the small producer to keep track of changes in division orders or changes in royalty owners.
- it would shift the burden and cost for collecting taxes from government to private enterprise.
- a law which works in Colorado could not be applied in Kansas because Kansas is an "old oil" producing state with most production from "stripper wells" whereas Colorado is a "new" production state with larger production per well.
- because of the high number of plugged wells in Kansas the small producer would be forced into seeking a refund of the withheld tax on a plugged well from the royalty owner or absorbing the royalty owner's tax liability.

Mr. Schnacke concluded that there is nothing wrong with the current system for collecting personal property taxes and that his association would be more interested in augmenting the current law with stiffer penalties than in placing this alleged withholding burden on small producers.

Dick Randall, General Counsel, Petroleum, Inc., presented a prepared outline and statistical illustration to the Committee (a copy is in Committee notebooks) and spoke in opposition to the withholding proposal. He stated that his firm is currently required to assess itself for ad valorem tax purposes, and he stated that the addition of this proposal would make private industry a tax collector as well as the tax assessor for local governments. He further stated that the actual tax loss from delinquent property taxes on royalty interests is very small and the withholding of this tax by private industry would cost more than the current procedure.

Mr. Randall referred to the comparison between Kansas and Colorado oil production in his handout, and he noted that this illustration would prove that a property tax withholding program based on the Colorado law would not work in Kansas. He stated that if a well were plugged during the year, the accounting requirements of this proposal would be a "nightmare."

He further stated that the property tax is a local and not a state tax and that the state should not place the burden of collecting local taxes on private enterprise.

In concluding, Mr. Randall stated that the Colorado law is not well-liked by Colorado operators because the production company or first purchaser of the oil or gas was required to absorb the property taxes on plugged wells where the royalty owner would not return the prorated share of the tax to the firms. In this way he stated that the tax burden is shifted from the royalty owner to the production company.

Mr. Paul Andre, Controller, Pickrell Drilling Company, appeared in opposition to the withholding proposal. He stated that the implementation of this proposal would create "massive" accounting problems for small producers. He stated that only a small number of Kansas operators are computerized and that most would be required to manually administer the accounting provisions called for by this bill. With the burden being placed upon the small producer as the result of the Federal Tax Reform Act of 1976, he stated that the additional burden of this proposal would now require all oil and gas producers to keep three separate sets of books.

The Chairman questioned the alleged need for three sets of books, and suggested that in most instances just another column entry in existing records would be required. Mr. Andre stated that the record-keeping burden placed upon the small producers still would be excessive for the amount of tax to be collected under the withholding proposal.

Barney Sullivan, representing Energy Resources Corporation, appeared in opposition to the withholding proposal. Mr. Sullivan said that the Colorado property tax withholding system should not be used as a model for Kansas because of what he alleged was a poor procedure for administrative control in the Colorado law. He said that under this procedure the taxpayer would have no right of appeal.

Mr. Sullivan further stated that Kansas should have "zero" delinquency problems under tax current Kansas procedure. He also said that taxpayers should have the right to pay their own taxes and that this proposal would eliminate that right.

A Committee member asked the persons representing KIOGA to comment on whether, in their opinion, this withholding proposal would reduce the workload of county officials. Mr. Andre said that he assumed it would cut out a part of the cost currently required to process and mail out tax statements. Another Committee member stated that the primary purpose of this proposal was to reduce operating costs for county officials.

Fred Allen, Kansas Association of Counties, in response to a question from the Committee, noted that the current delinquent procedure does not always work due to non-uniform enforcement practices of the several county sheriffs.

Mr. Joe Preston, of City Service Company and Mid Continent Oil and Gas Association, appeared in opposition to the bill. His testimony illustrated the mechanics of the property appraisal and tax collection process as it currently exists.

Several Committee members questioned the extent to which the enactment of this proposal would affect the small oil and gas producer. Following a brief Committee discussion and further questioning of the conferees, a question still remained as to the extent to which the withholding proposal would affect small operators.

Mr. Schnacke interjected at this point that instead of pursuing the withholding proposal with its "unknown" ramifications, perhaps the most appropriate action would be to continue under the current procedure and increase the penalty for non-payment of the tax. He stated that his association would recommend the adoption of this alternative. In addition, he stated that KIOGA would not object to having the county bill the unit operator or first purchaser for the tax due when the first delinquency notice is sent out by the county.

George Sims, representing Mobil Oil Company, appeared in opposition to the withholding proposal. Prior to making his statement he raised two technical questions about the language of the proposal. The Chairman directed the staff to make any changes necessary to clarify the intent of the bill draft.

Mr. Sims stated the withholding proposal had merits as it would relate to collection of personal property taxes on natural gas used in interstate commerce. He emphasized, however, that the proposal would not work for oil production because it would be too complicated for small intrastate operators.

A Committee member asked if it would be too complicated for all small operators. Mr. Sims replied that it would not be a problem for all small operators, only some of them. He then gave an example of a well in the Hugoton field where there was a radical change in production over a short period of time as an illustration of why this proposal should not apply to oil production.

A Committee member asked if anyone would opt for the withholding proposal under a voluntary or permissive approach. Mr. Sims said interstate gas companies would go for the approach but not oil production firms.

Don Boyer, representing the East Central Oil and Gas Producers and Boyer Oil Company, appeared in opposition to the proposal. Mr. Boyer said that the increased administrative costs to the small operator could not be passed on to the consumer and that the small oil producer and small oil purchaser would lose money if this proposal were adopted. He stated he knew of no problems with the current procedures for collecting property taxes oil and gas royalties in the several counties in which he operated in Southeast Kansas.

Tim Hagemann, Appraiser for Greeley, Haskell, Lane and Stevens counties, testified that the withholding proposal would work very well where interstate natural gas production was concerned. However, he said he could not support the proposal if it applied to small oil producers. He also stated that in the four counties he serves the statutory sheriff's warrant procedure results in 100 percent collection of delinquent taxes on mineral royalties.

Staff reported that the president of the Kansas County Treasurers Association, Mrs. Dorothy Hula, Marshall County Treasurer, could not appear. However, Mrs. Hula advised the staff, via the telephone, that county treasurers supported the withholding proposal. She said that she was mindful of the problems such a proposal might cause for some small operators, but that the benefit to county officials by reducing the tax billing and processing workload would be significant in certain counties.

Staff distributed a draft of a partial Committee report on Proposal No. 7 for review prior to the November meeting.

Proposal No. 4 - Merchants Inventory Taxation

Staff reviewed Attorney General's Opinion No. 76-314 on the questions raised by the Committee at the last meeting. (A copy of the opinion is in the Committee notebooks.) The opinion concluded, "The legislature has authority, without constitutional amendment, to extend the scope of property tax exemptions beyond that stated in the constitution, but such exemptions must treat all members of a class equally and the exemptions must serve a public purpose and promote the public welfare." Beyond that, with the exception of taxation of automobile inventories, a constitutional amendment would be required to treat inventories as separate classes for property taxation purposes.

Staff pointed out several areas of apparent ambiguity in the opinion and noted that further clarification may be required if serious consideration were given to a specific alternative.

Charles Huston, Executive Secretary of the Kansas Tobacco-Candy Distributors and Vendors, Inc., encouraged the Committee to adopt an alternative method for taxing merchants inventories that would reduce the burden of such taxes on merchants with small inventory turnover.

A Committee member stated that the real problem was not to exclude inventories from taxation but how to account for inventory turnover when applying the property tax. Staff reported that a previous Committee had considered a proposal for use of average turnover factors by industry classes and found that it would work satisfactorily only for firms whose individual turnover rates corresponded closely to the average for that type of business.

The Chairman directed the staff to review prior committee studies to see if there was anything of significance for the Committee to consider as an alternative method for valuing inventories or for use as an in-lieu tax.

Final action on this matter was scheduled for the November meeting.

Afternoon Session

The Vice Chairman presided over the afternoon session of the Committee.

Federal Tax Reform Act of 1976

The Secretary of Revenue discussed some effects that the Federal Tax Reform Act of 1976 will have on the administration of the Kansas Income Tax. A copy of appropriate sections of the Kansas statutes was distributed to Committee members (a copy is in the Committee notebooks).

Mr. Kalb noted the increasing use of tax credits by the federal government in this new law. The use of credits, instead of deductions, yields a greater tax break for low income persons.

Mr. Kalb also noted that in Kansas statutes there is a difference in the way persons may compute their tax liability depending upon whether their tax is computed on the long form or through the use of the optional tax tables. Persons using the optional tax tables are not required to subtract federal tax credits in determining their deduction for federal taxes paid on their Kansas tax return. As a consequence, these persons pay a lower amount of Kansas income tax than would be the result of computing the tax by the long form method. As the result of the expanded use of these tax credits by the federal government, Mr. Kalb stated that the revenue loss to Kansas will range from \$1.0 to \$2.0 million annually if nothing is done to amend existing statutes.

Mr. Kalb recommended that, since the federal government has abolished the use of optional tax tables, since the continued use of these optional tax tables under the Kansas law would result in a greater reduction of tax revenues, and since Kansas has adopted a philosophy of generally conforming to the federal law, K.S.A. 79-32,112 be repealed.

Mr. Kalb also noted that the revised treatment of alimony payments as an adjustment to income rather than an itemized deduction will also reduce the revenues derived from the Kansas Income Tax. However, he said he did not have an estimate of the loss at this time.

A Committee member commented on the fairness of the federal government giving a tax break while Kansas adds a part of it back. Mr. Kalb responded that at the present time the law treats persons in a non-uniform manner as the result of conforming with the federal law. Now that there is no basis for the conformity, the Department recommends this inconsistency be abolished, one way or another.

A Committee member asked what the effect would be of adding back the new federal credits on all returns instead of just those who use the optional tables. Mr. Kalb said he did not know, but he would have the information available for the next Committee meeting.

Mr. Kalb noted that when the original conformity law was enacted in 1967 a distinction was made between tax credits for "taxes paid" and tax credits for "general welfare" purposes. Originally, Kansas law followed the federal law in allowing tax credits for taxes paid. However, since that time there has been a proliferation of the use of tax credits for general welfare purposes at the federal level. Given the expanded use of these general welfare tax credits in the Tax Reform Act of 1976, he stated that it might be appropriate for the legislature to review its total policy on the matter of tax credits.

A Committee member noted that action appeared to be needed in this area, but that more information was required before the Committee could make a recommendation.

Senator Simpson noted the significance of the effect of the federal law change and moved that the Committee request the Legislative Coordinating Council to approve a proposal to study the effect of this new federal law on the Kansas Income Tax and to approve another meeting day if necessary to allow the Committee additional time to examine this matter for the purpose of making a recommendation to the 1977 Legislature. Representative Wilkin seconded. Motion carried.

Proposal No. 5 - Sales Tax Revision

Ben Neill, General Counsel, Department of Revenue, presented summary excerpts from several sales tax statutes relating to an apparent conflict between K.S.A. 79-3602(c) and 79-3603(h). (Copies of these excerpts are in the Committee notebooks.) Mr. Neill had discussed this matter at the September 17 meeting.

As the result of the conflicting language of these two statutes, according to Mr. Neill, a question has arisen in the courts as to when certain leases are or are not taxable for sales tax purposes. Mr. Neill stated the Department recently conducted 13 audits in this area which led to additional sales tax assessments of \$175,000. As the result of the adverse court decision this amount was lost as sales tax revenue. Mr. Neill stated that if this same logic were applied to the rental and leasing of rolling stock the revenue loss to the state could become considerable.

After some Committee discussion Representative Nesmith moved that the words at the end of K.S.A. 79-3602(c), ". . . and including the sale and use of tangible personal property by way of lease or the rental thereof." be amended out of the current statute. Representative Hineman, seconded. Motion carried.

The Vice Chairman directed the staff to draft a bill for consideration at the November meeting. He further asked Mr. Neill to reduce his testimony to a written statement outlining the need for this amendment and to provide a copy to the Committee staff for forwarding to all Committee members prior to the next meeting.

Senate Bill No. 927 - (Agricultural Machinery). Staff presented a summary of the issues and testimony concerning this bill. After brief Committee discussion Representative Hineman moved the Committee recommend a new bill for introduction in the House. Representative Nesmith seconded. Motion carried; seven affirmative, two negative. (Senator Simpson voting affirmative.)

Senate Bill No. 1019 - (Irrigation Districts). Staff presented a summary of the testimony concerning this bill. After a brief Committee discussion, Senator Simpson moved that the Committee recommend a new bill not be introduced. Representative Nesmith seconded. Motion failed; four affirmative, five negative. (Senator Simpson voting affirmative.)

Representative Powell moved that the bill be amended to provide the exemption only for districts where 100 percent of the water is used for irrigation only. Representative Nesmith seconded. Motion carried.

Senator Hudson moved that a new bill, as amended, be recommended for introduction in the Senate. Representative Hineman seconded. Motion carried; five affirmative, four negative. (Senator Simpson voting negative.)

House Bill No. 2526 - (IRB's). Staff presented a summary of the issues and testimony concerning this bill. After some discussion, Senator Simpson moved that the Committee recommend a new bill not be introduced. Representative Jarchow seconded. Motion failed; one affirmative, five negative. (Senator Simpson voting affirmative.)

Representative Nesmith moved that the Committee recommend a new bill for introduction in the House. Senator Hudson seconded. Motion failed; three affirmative, four negative. (Senator Simpson voting negative.)

House Bill No. 2734 - (Aircraft Modification). Staff presented a summary of the issues and testimony concerning this bill. After brief discussion, Representative Nesmith moved a new bill be recommended for introduction in the Senate. Senator Hudson seconded. Motion carried; five affirmative, three negative. (Senator Simpson voting negative.)

Staff Reports

General Fund. Staff presented preliminary estimates of September General Fund receipts, indicating that first quarter receipts were .1 percent below the budget estimate.

Agenda for Next Meeting

The Vice-Chairman directed the staff to schedule consideration of all matters still before the Committee for the November 12 meeting.

Prepared by Robert Taylor

Approved by Committee on:

11/12/76
(Date)