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PRELIMINARY
MINUTES

SPECIAL COMMITTEE ON ASSESSMENT AND TAXATION

November 12, 1976

The meeting was called to order by Chairman Gaar shortly after 9:30 a.m., with all members except Senator Hudson present. Staff present: Bill Edds, Roy Johnson and Robert Taylor.

Minutes of Previous Meeting

Staff called attention to two typographical errors in the minutes of the October 8 meeting which had been corrected on the file copy of the minutes. It was moved by Representative Hineman and seconded by Representative Powell that the minutes as corrected be approved. Motion carried.

Proposal No. 5 - Sales Tax Revisions

Sales Tax on Leases. Mr. Ben Neil, Chief Counsel, Department of Revenue, submitted a memorandum as requested by the Committee at the previous meeting summarizing a problem relating to the application of the sales tax to leasing or renting of tangible personal property as follows:

"Under current law the renting or leasing of tangible personal property is subject to sales tax under two different imposition sections. Since the leasing or renting of such property is defined as a "sale" under 79-3602(c) a sales tax is imposed by 79-3603(a). Also, 79-3603(h) imposes a sales tax on the service of renting or leasing of tangible personal property. Thus, the renting or leasing of tangible personal property is taxable both as a sale and as a service. It seems to me that a double imposition is unnecessary but that in and of itself is not the problem. The problem is caused when you attempt to apply the exemption sections of 79-3606 while a double imposition exists. 79-3606 (a), (f), (g), (k), (l), (m), (n), (o) and (p) purport to exempt "sales" or "purchases" of tangible personal property by certain individuals or for certain purposes. 79-3606(b), (c), (d) and (e) purport to exempt not only sales or purchases as well as the sale or purchase of "services". 79-3606(h) and (i) purport to exempt two specific types of leases. In viewing 79-3606 as a whole it would appear that the intention was to exempt the sale or purchase of tangible personal property under some circumstances and in other circumstances the sale or purchase of such property as well as the sale or purchase of services (such as leasing or renting).

"Based upon the above interpretation the department took the position that any exemption section which did not specifically exempt "services" (renting or leasing being one of such services) would not entitle the individual or company involved to an exemption for leasing or renting. This position was challenged in two instances. One was under 79-3606(f) relating to the lease or rental of rolling stock by a common carrier and the other under 79-3606(m) relating to the leasing or renting of hotel linens which become an ingredient and component part of a taxable service. In both instances the taxpayer was successful because of the fact that lease or rental of tangible personal property is defined as a sale.

"There is considerable merit in the argument that where the sale of tangible personal property has been declared exempt, the leasing or renting of such property should also be exempt. However, the department takes no position as to what should or should not be exempt beyond the dictates of the statute. We feel that because of the dual imposition of tax on leasing or renting and the specifics recited in the exemption sections, it is somewhat unclear as to whether certain exemption sections apply to leasing or renting.

"Our recommendation is that the definition of sale in 79-3602(c) be amended to exclude the leasing or renting of tangible personal property. Thus it would be clear that a sales tax is imposed upon the service of renting or leasing and not on a fictitious sale. At the same time it would be advisable to review the exemption sections and in those instances when the renting or leasing is intended to be exempt as well as the sale, the appropriate additional language should be added, particularly 79-3606(f) and (m)."

Mr. John Vratil, an attorney representing Midwestern Distribution, Inc., Fort Scott, explained how his client is affected. He pointed out that to amend 79-3602(c) to eliminate the language defining sale as including the leasing of tangible personal property (with no other change in the law) would make rolling stock of an interstate common carrier subject to the sales tax when leased but exempt under 79-3606(f) when purchased. He argued that this would put some competitors at a disadvantage depending on how they acquire their equipment, and that there would be no ultimate advantage to Kansas since any gain in sales tax revenues could be offset by losses in other areas as the location of interstate common carriers in Kansas was discouraged. He recommended that either no change be made in 79-3602 or that the exemptions in section 79-3606 be amended to conform to the district court decision under which property acquired by lease is exempt the same as if purchased.

Miss Mary Turkington reported that the Kansas Motor Carriers Association would oppose elimination of the exemption in 79-3606(f) and any imposition of the 3 percent sales tax on gross receipts from all leasing arrangements.

It was moved by Senator Janssen and seconded by Senator Simpson that the Committee recommend legislation to clarify the sales tax law to agree with the result of the district court decision. Motion carried. (In effect, this adopts the recommendation in the last paragraph of the Department's memorandum quoted above.)

Representative Frey suggested that an effort be made to achieve a similar consistency with regard to application of the sales tax to repair services on rolling stock of carriers.

H.B. 3057. Further discussion of this 1976 bill included an explanation by the Department of Revenue that the fiscal note estimate of a \$2 million increase in revenue is based solely on the difference between wholesale and retail prices, and that one alternative to requiring registration of some 4,000 to 4,500 contractors would be increased audit activity relating to their suppliers.

It was moved by Representative Hineman and seconded by Representative Thiessen that the Committee not recommend a bill at this time (giving the Department time to try increased auditing). Motion carried, with Representative Wilkin voting "No."

H.B. 2932. It was moved by Senator Simpson and seconded by Representative Nesmith that the content of this bill not be recommended. Motion carried.

H.B. 3111. In reply to a question, the Department stated that if this bill were passed as written (removing "or structures" from the exclusion from tax liability) most construction on pipelines, and poles, lines, etc., of other utilities, would be subject to the sales tax. It also was reported that the hearing by the Supreme Court of the Kansas City Millwright Case, in which the constitutionality of 79-3603(p) is at issue, has been moved up to the January term.

After further discussion, it was moved by Representative Hineman and seconded by Senator Janssen that no bill of this nature be recommended. Motion carried.

Proposal No. 65 - Income Tax Conformity

Secretary of Revenue Kalb reviewed a Department of Revenue memorandum relating to the effect of the Federal Tax Reform Act of 1976 on Kansas income tax procedures and revenues, and answering questions asked by the Committee at its October meeting. It was reported that the estimated total impact of the 1976 federal act on Kansas individual income tax receipts will be an increase of approximately \$708,000 for 1976 returns filed in 1977, if the present Kansas tax tables are retained. This increase was reported to be due entirely to change of child care expenses from an itemized deduction to a credit in the federal act (the effect of other federal provisions continued from 1975 and earlier 1976 legislation already having been reflected in Kansas estimates).

It also was reported that the optional tax tables now required by Kansas law to be provided for use of taxpayers with adjusted gross incomes of \$15,000 or less tend to allow a deduction for federal taxes paid that is in excess of the actual payment, thus decreasing Kansas taxable income and income tax revenues. The reason is that the Department has no way of projecting the amount of credits each individual taxpayer will be entitled to take. This problem has been accentuated by a change from deductions to credits in several areas in the most recent federal act. The Department estimated that if Kansas were to base its tables on taxable income rather than adjusted gross income, as the federal act of 1976 does, approximately \$2.8 million in additional state revenue would be realized. This is described as the opportunity cost associated with retention of the present optional tax tables.

The Committee also had requested an estimate of the cost of a Kansas child care credit provision, since Kansas deductions conform to federal deductions and the latest federal act allowed a credit instead of a deduction. The end result is that the Kansas law now gives no consideration to child or dependent care expenses. The Department's estimates, assuming a state credit expressed as a percentage of the federal credit, ranged from \$1,704,100 at 5 percent to \$5,112,000 at 15 percent.

After further discussion, it was moved by Senator Janssen and seconded by Senator Simpson that the Committee recommend that the standing committees in the next session recognize the problems associated with the optional tax tables and child care expenses and address themselves to such problems. Motion carried.

Proposal No. 4 - Merchants' Inventory Taxation

The Committee reviewed a staff prepared checklist of possible alternative courses of action with regard to the taxation of inventories, such as: (1) providing an adjustment in the valuation process to take into account the turnover rate of each individual business or changing the percentage of operating costs allowed as a deduction; (2) providing a state tax credit to compensate for or offset the inventory property tax; (3) exempting all inventories; (4) enacting an in lieu tax for motor vehicle inventories; or (5) proposing a constitutional amendment to permit separate treatment of inventories, or all personal property, or all property.

The apparent consensus was that local units could not afford the revenue loss of an outright exemption of all inventories. While some interest in a possible constitutional amendment was expressed, no agreement as to form was reached.

It was moved by Senator Simpson and seconded by Representative Hineman that the Committee recommend no change in the present method of taxation of inventories. Motion carried, with Senator Janssen voting "No."

Proposal No. 7 - Mineral Interests Taxation

There were no comments on the partial report draft distributed at the October meeting. Committee discussion of the withholding bill draft stressed the testimony of county officials that where proper use is made of K.S.A. 1976 Supp. 79-2017 and 79-2101 delinquent personal property taxes on leasehold interests are collected in full.

It was moved by Representative Powell and seconded by Representative Nesmith that the Committee not recommend the withholding bill draft. Motion carried, with Senator Janssen voting "No."

Committee Reports

It was agreed that the staff will mail out drafts of Committee reports, as completed, with the understanding that they will be considered approved if no objections or suggestions for change are received within a week in each case. Any suggested changes will be subject to clearance with the Chairman, and any member may submit statements of disagreement or reservations for inclusion with a report.

Prepared by Roy H. Johnson

Approved by Committee on:

Date