

M I N U T E S

SPECIAL COMMITTEE ON ASSESSMENT AND TAXATION

August 25-26, 1977

Room 510 - State House

Thursday, August 25, 1977

Morning Session

The meeting was called to order by Chairperson Simpson, with all members present. Staff present: Bill Edds, Richard Ryan, Roy Johnson, and Robert Taylor.

The staff noted two technical changes in the minutes on page 8, second full paragraph. The years noted "1968 to 1969" should be changed to "1978 to 1979."

It was moved by Senator Chaney and seconded by Representative Wilkin that the technical amendment be adopted and that the minutes be approved as amended. Motion carried.

Proposal No. 6 - Inheritance Tax

The staff reviewed a memorandum on the determination of the gross estate and the exclusion from the taxable estate of gifts made for the purpose of creating a joint tenancy. (A copy is in Committee notebooks).

The staff report concludes that while all such gifts are included in a decedent's gross estate, the value of the gift in determining the taxable estate would include only the decedent's taxable basis in the asset, or his contribution.

After a short discussion which included remarks from Mr. Ben Neill, General Counsel for the Department of Revenue, in response to questions from the Committee, the Committee agreed to discuss the matter further, if necessary, at a later meeting.

Proposal No. 8 - Income Tax

Mr. Dee Likes, representing the Kansas Livestock Association, presented testimony opposing the automatic conformity by Kansas to the federal basis for the income tax treatment of inherited assets. (A copy of Mr. Like's statement is in the Committee notebooks.)

In response to a question from the Committee, Mr. Likes noted that there has been a bill introduced in Congress which would abolish the current basis for valuing inherited assets for income tax purposes and revert to the pre-1976 procedure. However, he noted that the bill was given very little chance of getting through the House Committee.

Staff Reports. The Committee was presented a letter from Mr. Marshall Crowther, supplementing earlier testimony received on July 29th. (A copy of this letter is in Committee notebooks.) The Committee requested the staff to see if separate data were available on the average retirement incomes of retired judges and court reporters.

The staff reviewed the current activity reported by the Department of Revenue in regard to the Job Development and Investment Credit Act of 1976. There have been a total of seven claims for credits totaling \$6,338, on 1976 tax returns filed in 1977. (A copy of this staff memorandum is in the Committee notebooks.)

Policy Questions Checklist and Committee Discussion

The staff reviewed a policy questions checklist which outlined various alternatives for the Committee's consideration concerning changes to the Kansas income tax law.

The Committee asked Mr. F. Kent Kalb, Secretary of Revenue, to comment on which of the three basic approaches to income tax conformity (conformity to federal AGI, conformity to federal "zero rate base" concept, or conformity to a percent of the federal tax) noted in the checklist would be most preferable to the Department. Mr. Kalb noted that, given the current state of flux at the federal level and the very great possibility that there will be major federal tax law changes in 1978, which will completely rewrite the federal tax law, the most feasible alternative would be to conform to federal adjusted gross income (establishing a separate Kansas standard deduction, personal exemption, and tax rate schedule). He also noted that at such time that the federal Congress enacts a new law, the state's position would need to be re-evaluated.

Mr. Kalb further stated that his recommendation would not be to conform prospectively at this time. He urged the Committee to consider updating conformity one-year at a time to protect state revenues, given the major tax law changes presently being discussed by the Carter administration.

When asked to elaborate on the possible future federal law changes, Mr. Kalb noted that to his knowledge, the major items being discussed at this time include:

1. Elimination of most itemized deductions and substituting a credit system.
2. Single taxation of corporation profits.
3. Elimination of a separate tax for capital gains and treating all capital gains as ordinary income.

In responding to a question from the Committee, Mr. Kalb noted that to his knowledge Nebraska and Vermont are currently having problems with their income taxes based upon a percent of the federal tax. These problems are primarily related to maintaining state revenues given the many periodic changes in the federal law. He further noted that adopting a Kansas tax as a percent of the federal tax would result in a major shift in the Kansas tax incidence given the greater progressivity of the federal tax rates. However, he also noted, based upon his Nebraska experience, that very few taxpayers would be required to make adjustments to their federal AGI under a percentage system.

A Committee member commented that in order to protect the taxpayer, any legislation authorizing a Kansas tax based upon a percent of the federal tax would have to limit the instances in which the tax rate (as a percent of the federal tax) could be adjusted. Mr. Kalb noted that such limitations exist in Nebraska where the tax rate is set by a committee composed of the Governor, State Tax Commissioner, State Auditor, and State Treasurer. Mr. Kalb further stated that Nebraska has had severe cash flow problems as the result of the many federal law changes in recent years. Referring to what he called a "yo-yo effect," Mr. Kalb stated that just after a federal tax reduction Nebraska experiences a reduction in state revenues. He said that the resulting increase in state tax revenues following a state tax rate increase usually produced more money than was needed.

Following additional Committee discussion in this area, it was moved by Senator Janssen, seconded by Senator Chaney, that Kansas adopt a "piggyback tax system" which bases the Kansas income tax on a percent of the federal income tax. Motion failed (voting yes, were Senators Chaney and Janssen and Representative Fry.)

It was moved by Representative Braden, seconded by Senator Sowers, that Kansas conform its income tax prospectively to federal AGI (with a separate Kansas standard deduction, personal exemption, and tax rate system). Motion carried.

The staff was requested to work with the Department of Revenue and to report to the Committee at the next meeting on the amount of increased Kansas taxes that were caused by the reduced federal income tax deduction (caused by reduced federal income taxes following the enactment of the federal Tax Reform Act of 1976 and the Tax Simplification and Tax Reduction Act of 1977) compared to the decrease in Kansas taxes as the result of the passage of 1977 S.B. 494.

Afternoon Session

Staff Reports

Staff reviewed three recent Attorney General opinions with the Committee.

AG. Op. 77-253 concludes that the tax lid as found in K.S.A. 1976 Supp. 79-5001 through 79-5017 does not apply uniformly to all cities and that therefore, any city, under its constitutional home rule authority (and limitations) may adopt a charter ordinance exempting itself from the provisions of the tax lid for a specific purpose, for a specific period, or a total exemption for all purposes.

AG. Op. 77-272 concludes that the tax lid, found at K.S.A. 1976 Supp. 79-5001 et seq., does not apply uniformly to all counties. As such, counties (like cities) may exempt themselves from the provisions of the tax lid under statutory home rule authority (and limitations).

AG. Op. 77-261 provides that a community junior college located in a county levying a countywide retailers' sales tax is not entitled to share in the proceeds of this local sales tax after December, 1977 because: (1) the distributive share is based upon property taxes levied under the tax lid, and (2) community junior colleges are not subject to the limitations comprising the tax lid beginning in 1978.

Proposal No. 8 - Income Tax, Committee Discussion (Continued)

Following a brief discussion concerning the difference between the current Kansas standard deduction, and the imputed standard deduction under the new federal "zero rate base concept," it was moved by Representative Slattery, seconded by Representative Shelor, that the Kansas standard deduction be changed to \$3,200 for joint returns, \$2,200 for single returns, and \$1,600 for married persons filing separately. Motion carried.

It was moved by Representative Wilkin, seconded by Representative Slattery, that Kansas retain its current medical deduction. Motion carried.

Representative Eddy moved, seconded by Representative Braden, that all other Kansas itemized deductions be retained and given the same treatment as is provided for under the current Kansas law. Motion carried.

Representative Slattery moved, seconded by Representative Braden, that Kansas taxpayers be allowed to itemize on their Kansas tax returns regardless of their federal filing status; and that 1977 H.B. 2143 be recommended for favorable consideration by the standing committees. Motion carried.

The Committee discussed at some length the question of allowing tax credits, available to all taxpayers, rather than itemized deductions, available only to those who itemize expenses. The Chairman suggested that the Committee should take a "wait and see" attitude (until the Carter administration presents its new tax reform proposals to Congress later this fall or next spring) and take advantage of any relevant federal experiences in this area before committing Kansas to such a drastic change in policy that could have far reaching tax revenue consequences. Another Committee member commented that the Kansas income tax was designed primarily to generate state tax revenues and that it was a poor instrument through which to promote national or local social policies; and as such, conforming to the federal tax on the more extensive use of tax credits would serve no purpose except to erode Kansas tax revenues.

Committee discussion continued on the topic of the tax treatment of retirement income. The Committee requested the staff to provide additional information in this area at the next meeting. Specifically requested was information on how other states tax retirement income, how other states treat employee pension plan contributions (including social security contributions) for tax purposes, and the differential treatment, if any, between the tax treatment of public and private retirement incomes.

The reinstatement of optional tax tables based either on AGI or on taxable income was discussed. The Department of Revenue reported it was preparing tax computation tables based upon taxable income under its general rule making authority for 1977 tax returns to be filed in 1978. The Committee took no formal action on this subject. However, there was general agreement with the Department's action.

Following a discussion on the pros and cons of allowing a Kansas child or dependent care tax credit or deduction, Representative Wilkin moved, seconded by Representative Crowell, that Kansas adopt a child and dependent care tax credit as provided in 1977 H.B. 2564 and that H.B. 2564 be recommended for favorable action by the standing committees. Motion failed (voting yes were Representatives Crowell, Slattery, Wilkin, and Senator Simpson.)

After additional discussion on the subject of child and dependent care tax credits, the staff was directed to prepare additional background material to include various alternative plans for a tax credit based on a sliding scale income approach with larger credits for those with lower incomes, a phase out of the credit between adjusted gross incomes of \$10,000 and \$15,000, and a total cost ceiling of approximately \$1.0 million.

It was moved by Representative Crowell, seconded by Representative Shelor, that the Committee not consider any personal savings account tax deduction, and that 1977 H.B. 2562 not be given any further consideration during this interim. Motion carried.

It was moved by Senator Janssen, seconded by Representative Fry, that no changes be made to the current provisions concerning the tax treatment of retirement income. Motion failed (voting yes were Senators Janssen and Simpson.)

Representative Braden moved that the Committee recommend 1977 H.B. 2149 (lowering the age limit for military retirement income deduction from 65 to 50 years) favorably to the standing committees. The motion died for lack of a second.

Following additional discussion on the tax treatment of retirement income, the staff was directed by the Committee to report at the next meeting on the estimated revenue loss of exempting all taxable retirement income (public and private) for those persons over age 65 for selected levels of income. The staff was further directed to select several levels of household income between \$8,000 and \$15,000 for analysis.

Friday, August 26, 1977

Morning Session

The meeting was called to order by Chairman Simpson, with all members present except Senator Chaney, who was excused by the Chairman. Staff present: Bill Edds, Richard Ryan, Roy Johnson, Robert Taylor.

Hearing on Proposal No. 5 - Personal Property Tax

Staff Report. A background memorandum outlining the property tax treatment of personal property in other states was reviewed by the staff (a copy of this memorandum is in the Committee notebooks.)

Preparation of 1977 Personal Property Manuals

Mr. Raymond Vaughn, Director of the Division of Property Valuation, reviewed the Division's position on the definition of the "fair market value" of motor vehicles and farm implements as it relates to the preparation of the 1977 personal property manuals. Mr. Vaughn stated that fair market value should be what the vehicle or farm implement could be sold for by the taxpayer, not what a retail merchant would sell it for. In other words, he stated that its value for tax purposes should be determined by its "as is value" or "trade in" value (i.e., wholesale price).

In response to a question from the Committee, Mr. Vaughn stated that the value established in the 1977 manuals will probably be close to "as is value" or "average wholesale value." He further stated that if he had to make the decision today he would not use "average retail values," but he would use "as is value" or "average wholesale value." Mr. Vaughn also stated that another possibility would be to prescribe a percentage of "average retail price" quoted in various commercial valuation guides as the Kansas "fair market value" for appraisal purposes.

In response to a question from the staff, Mr. Vaughn stated that most of these commercial valuation guides quote average retail, average wholesale, and average loan values. He further stated that he could prescribe one of these values (or an amount in between these three values) as fair market value for Kansas appraisal purposes. However, he emphasized that regardless of where he established fair market value in the appraisal guide, the local appraiser has full authority to adjust that value "wherever it should be." (K.S.A. 1976 Supp. 79-306c(b) provides an adjustment may be made only if the vehicle is damaged.)

Mr. Vaughn further stated that one of the primary reasons he was reviewing the personal property valuation process with respect to motor vehicles and farm implements is that these types of property are reappraised on a uniform basis by the state every year and since all other property is not uniformly reappraised every year the owner of personal property is bearing a higher relative tax burden than owners of other types of property.

When a Committee member asked if the Property Valuation Director had the authority to use "average wholesale value" or "as is value" in determining the fair market value of personal property in light of the legislature's refusal to accept 1977 H.B. 2615 with a similar provision, Mr. Vaughn stated the current law gives him this authority notwithstanding the action on 1977 H.B. 2615. He further stated that he did not think the legislature wanted to get into the business of determining values of various types of personal property.

Mr. John Cooper, of the Property Valuation Division, briefly reviewed the law and the position of the courts in the establishment of market value. He noted that the NADA valuation guides are prepared by automobile dealers for the benefit of automobile dealers. He suggested that the average retail value in these guides should be used to establish the dealer's inventory values and not the value of an automobile owned by an individual. He concluded by stating that something less than the average retail value should be used for valuing an individual's motor vehicle because the typical disposal method used by the average taxpayer results in a selling price below the average retail price that a motor vehicle dealer would receive (a copy of Mr. Cooper's statement is attached).

In response to a question from the Committee, Mr. Cooper stated that the "key value" concept currently used by most farm equipment guides in determining the "as is" value is basically an original cost approach, less depreciation. By contrast, he noted that the fair market value approach assumes that everything is fully re-conditioned when, in fact, it is not. Several illustrations were given to the Committee on the difference between the "as is" value and "average retail" value of specific types of farm machinery.

A Committee member asked about the projected revenue loss and shift in tax incidence that would accompany a change in the valuation of motor vehicles and farm implements. Mr. Vaughn stated that, while he concurred with the Research Department's projection of the revenue loss and tax incidence shift, he felt that correcting the inequities be perceived in the current system of valuing this type of personal property was more important than any revenue loss or shift in tax incidence. In response to another question he stated that total tangible assessed valuations statewide in 1976 were \$8.3 billion, and that personal property valuations comprised approximately \$2.7 billion (or 32.5 percent) of that total.

Representative Dan Thiessen appeared to support the concept of using "as is value" or "average wholesale value" as the basis for determining fair market value of farm implements and motor vehicles. He stated that he has received many complaints from taxpayers concerning the high levels of value placed on some farm machinery and other vehicles. In many instances he noted the assessed valuation is higher than the original cost.

Representative Thiessen stated that the Division of Property Valuation should determine what fair market value is and suggested that the legislature should not prescribe restrictive standards in this area. He also stated that with the affect of inflation on the valuations of other types of property, there would be no revenue loss if the Director of Property Valuation used "as is" or "average wholesale" values in establishing fair market values for farm implements and motor vehicles.

Listing of Motor Vehicles for Appraisal

Staff Report. Staff reviewed the Attorney General's opinion (AG. Op. 77-214) which concludes that owners of motor vehicles are required to list such property for taxation prior to March 1, of each year, in the same manner as other personal property (a copy is in Committee notebooks).

Representative Robert Frey appeared to urge the Committee to recommend legislation that would override the Attorney General's opinion. He noted that in the larger counties the requirement to have all persons come in and list their motor vehicles would create many problems.

Representative Frey said that in his opinion the laws which relate to the listing of motor vehicles for taxation (K.S.A. 1976 Supp. 79-301, -304, -306, -306c, and -1422 and K.S.A. 79-303, -306a, -306b, -309, -316, and -1431) and which apply a 50 percent penalty for failure to list property, which some counties use differently than other counties are arbitrary, they deny due process and equal protection to all taxpayers in actual practice and are therefore unconstitutional. He further stated that a taxpayers group from his area was considering filing suit to have these laws declared unconstitutional.

Representative Frey stated that the 1970 amendments to the law referred to by the Attorney General in his opinion (AG. Op. 77-214) were not for the purpose of changing the appraisal process, they were intended only to aid in the implementation of the staggered vehicle registration system. Therefore, he concluded that, in his opinion, there was little basis for the Attorney General to reach the conclusion noted in the opinion.

Representative Frey concluded by saying that there was no valid reason why all counties could not use vehicle registration data to maintain and update vehicle property tax lists. He noted the law now requires a copy of the vehicle title and registration form to go to the county appraiser (K.S.A. 1976 Supp. 79-306c(d)).

Mr. Fred Allen, Executive Secretary of the Kansas Association of Counties appeared briefly to introduce several county officials who wished to be heard on this subject. He noted that if 1975 S.B. 52 had been enacted this problem would have been moot. He also observed that with the relative size of the various counties there is a need for flexibility in any law to allow county officials to best respond to their particular needs.

Mr. George Schnellbacher, Shawnee County Appraiser, presented a statement to the Committee (a copy is in Committee notebooks) which urged the Committee to take some action to overturn AG. Op. 77-214. He stated that it would be physically impossible to require all Shawnee County vehicle owners to come to the Court House, or to mail in personal property lists for motor vehicles. He noted that in Shawnee County, at present, vehicle registration data is used to compile and update motor vehicle tax rolls on the county's computer system. He also gave the Committee an illustration of the workload of his office as it relates to processing new vehicle listings.

Notwithstanding the Attorney General's opinion, Mr. Schnellbacher stated that K.S.A. 79-1411b gives the county the authority to devise the best method to appraise

property and that he intends to continue his current procedure of automatically listing motor vehicles from the vehicle registration lists. He recommended that the legislature take action to clarify this area by specifically authorizing automatic listing via the vehicle registration data.

In response to a question from the Committee, Mr. Schnellbacher stated that he would favor a system of property tax payment at the time of vehicle registration. However, he stated that he opposed the final version of 1975 S.B. 52 because of technical problems with the approach taken by that bill.

Mr. Pat Brown, Johnson County Appraiser, appeared in support of the testimony offered by Mr. Schnellbacher. He stated that there are over 5,300 types of vehicles registered in Johnson County and that to carry out the procedure in AG. Op. 77-214 it would cost Johnson County in excess of \$242,000 annually. He supported Mr. Schnellbacher's position that K.S.A. 79-1411b gave counties authority to devise their own procedures for appraising motor vehicles.

Mr. Bob Gardner, Wyandotte County Appraiser, stated that he concurred with the testimony offered by Mr. Schnellbacher and Mr. Brown. He urged the Committee not to take any action that would require taxpayers to come to the Court House to list motor vehicles for property taxation.

Mrs. Virginia Kersten, Osage County Clerk, stated that in Osage County taxpayers are required to come to the Court House to list their motor vehicles for taxation. She noted that it has always been done this way and that everyone seems happy with the procedure. She also said that the vehicle registration data is used to check or verify tax list data when questions arise. In response to a question from the Committee she stated that switching to a system based totally on vehicle registration data would not create a problem for her office.

Inventories

Mr. Bud Grant, representing the Kansas Association of Commerce and Industry (KACI), appearing with Mr. Joe Francis, a tax attorney representing the J.C. Penny Corporation, presented a statement to the Committee offering an alternative to the current personal property tax on merchant's, manufacturer's, and livestock inventories (a copy of Mr. Grant's statement is in Committee notebooks.) Mr. Grant recommended the sales and use tax be increased to four percent with the additional revenue generated from such an increase used to offset the revenue loss to the state and various local units of exempting inventories from the property tax and exempting all of the tax on food and 2/3 of the current tax on agricultural machinery from the sales and use tax.

In response to a question from the Committee, Mr. Grant said he would prefer an income tax credit for sales tax on food rather than a direct exemption at the point of purchase.

When asked by the Committee if KACI would support a constitutional amendment to allow exemption of inventories from the property tax, Mr. Grant stated that in his opinion, Ag. Op. 76-314 stated the legislature could repeal the inventory tax without a constitutional amendment. Staff noted that that action was possible only if it had a public purpose and promoted the public welfare and that reducing taxes for selected taxpayers might not be found to promote the public welfare.

A Committee member asked if it were possible to avoid the inventory property tax. Mr. Francis replied to the extent that beginning and ending inventories may be reduced, the tax is avoided. However, he also noted that since a copy of the taxpayers federal income tax form pertaining to inventories is now required to be filed, it is difficult to avoid the tax outright.

Afternoon Session

Mr. Melvin Jantz, a John Deere implement dealer from McPherson, presented a statement to the Committee that recommended a local earnings or income tax be enacted in conjunction with the elimination of the inventory property tax. He noted that an

earnings tax would be based on the ability to pay and would derive revenue to support local governments from all business and professional persons and not just the retail merchant as does the current inventory tax.

Mr. Jack Quinlan, representing the Kansas Motor Car Dealers Association (KMCD), urged the Committee to enact a bill to eliminate the inventory tax for motor vehicle dealers and substitute a new stamp tax in lieu of the property tax (a copy of Mr. Quinlan's comments are in Committee notebooks.) He also urged that the Committee give favorable consideration to 1977 H.B. 2454 which would establish a \$5.00 per vehicle stamp tax in lieu of the current inventory property tax. He stated that, in his opinion, this stamp tax could generate greater revenues than under the current tax because it would be harder to evade the stamp tax.

Mr. Quinlan also said, in his opinion, that the Legislature could repeal the inventory tax without a constitutional amendment so long as that action was not directly tied to another tax established in lieu of the inventory property tax (except for motor vehicles). To replace state and local revenues lost as a result of repealing the inventory tax he suggested consideration of a separate sales tax for inventory items or perhaps some form of a gross earnings tax.

In response to a question from the Committee concerning a stamp tax for vehicle inventories in lieu of the current property tax (1977 H.B. 2454), Mr. Quinlan noted that the bill currently before the Legislature would levy the same tax on a motorcycle as would be levied on a Cadillac. He also noted that there may be some problem with the current form of the bill in that it would distribute 98 percent of all stamp tax revenues to the county general fund (two percent retained by the state for administration) instead of distributing the revenues proportionally among all subdivisions within the county.

Mr. Dale Lyon, President of the Kansas Farmers Union presented a statement to the Committee advocating a repeal of the current inventory property tax (a copy is in the Committee notebooks.) He recommended that all inventory be given a "use value" or "capitalized income" appraisal and not a market value appraisal. For livestock and other agricultural inventories he suggested incorporating the appraisal of farm personal property into the farmland use value legislation now under consideration by another special committee. When asked by the Committee how use value concepts would apply to farm machinery, Mr. Lyon replied that the implement valuation should be related to the productivity of the land, or perhaps it could be a percentage of the land's use value.

Continued Discussion on Proposal No. 8 - Income Tax

After some Committee discussion concerning the income tax basis of inherited assets it was moved by Representative Wilkin, seconded by Senator Sowers, that nothing be done in this area and that Kansas continue to conform to the federal basis. Motion failed on a tie vote (Representative Braden voted no). In response to a question from the Committee, Mr. Ben Neill stated that there would be no major problem for the Department of Revenue with regard to the taxpayer audits or other procedural matters if Kansas did not conform in this area. He also stated that there would be no major problem for taxpayers with regard to the maintenance of separate records on inherited assets for federal and Kansas income tax purposes since the income tax basis for Kansas tax purposes would be the asset's value as of the date of the decedent's death.

Mr. Jim Stambaugh, of the Department of Revenue's Income and Inheritance Tax Bureau, presented testimony to the Committee concerning various forms of income that are taxable at the federal level but currently not taxable as Kansas income, and situations where a tax break is provided on the federal tax but a comparable tax break is not granted by Kansas law (a copy of Mr. Stambaugh's comments are attached.)

Representative Eddy moved, seconded by Representative Wilkin, that Kansas pick-up accumulated distributions as Kansas taxable income. Motion carried. Staff was directed to prepare alternatives for the Committee's consideration of various methods of taxation and tax rates and to prepare an estimate of the fiscal impact.

Representative Slattery moved, seconded by Representative Shelor, that the staff be directed to prepare an estimate of the fiscal impact of adopting a minimum

tax on preference income items and a maximum tax similar to the federal law in this area and to prepare various alternatives for the Committee's consideration as to how such a minimum tax and maximum tax procedure could be implemented. Motion carried.

Representative Braden moved, seconded by Representative Crowell, that the staff be directed to prepare an estimate of the fiscal impact of adopting an alternate capital gains tax procedure similar to the federal law in this area and to prepare various alternatives for the Committee's consideration as to how such an alternate tax procedure could be implemented. Motion carried.

Representative Slattery moved, seconded by Representative Braden, that the staff be directed to prepare an estimate of the fiscal impact of adopting an income averaging procedure similar to the federal law in this area and to prepare various alternatives for the Committee's consideration as to how such an income averaging procedure could be implemented. Motion carried.

Agenda for September Meeting

1. Proposal No. 81 - Solar Energy Tax Incentives, review of Committee report draft.
2. Proposal No. 6 - Inheritance Tax, review of bill drafts and fiscal notes.
3. Proposal No. 5 - Personal Property Tax, Committee discussion.
4. Proposal No. 8 - Income Tax, Staff reports and continuation of Committee discussion.

Prepared by Robert L. Taylor

Approved by Committee on:

Oct 27, 1977
(Date)

4916
11/1/77

M E M O R A N D U M

TO: C. David Newbery
Director of Taxation

DATE: August 2, 1977

FROM: James S. Stambaugh, Tax Examiner IV SUBJECT: Additional federal
income taxes

The following is a list and brief explanation of the various additional taxes paid on the federal income tax return:

1. **LUMP-SUM DISTRIBUTIONS** - A lump-sum payment is the distribution or payment within one tax year of the recipient of an employee's entire balance from all of the employer's qualified pension plans, all of the employer's qualified stock bonus plans, or all of the employer's qualified profit-sharing plans.

This is a special tax treatment which provides, in general, that the portion of a lump-sum distribution attributable to active participation in a plan before 1974 receives long-term capital gain treatment, while the portion attributable to active participation after 1973 is taxed as ordinary income. Generally, this ordinary income portion may be taxed under a special ten-year averaging method using federal form 4972. If this election is made, the lump-sum distribution is not included in federal adjusted gross income.

2. **TAX ON ACCUMULATED DISTRIBUTIONS** - A trust has an accumulated distribution when it distributes more than the distributable net income for the year.

If a trust does have accumulated distributions, there is a throwback rule. This rule prevents the tax avoidance that occurs when a trust in a lower tax bracket accumulates and pays the tax on its income rather than distributing the income to a beneficiary in a higher tax bracket. When the income is distributed at a future date, little or no additional tax would be paid by the beneficiary because distributions in excess of the distributable net income in the year of distribution are tax-exempt to the beneficiary. This trust income could be split between the trust and the beneficiary in a way that would avoid the higher tax to the beneficiary in a year his other income puts him in a higher tax bracket. To forestall this, the throwback rule taxes the beneficiaries as if the amounts had been distributed each year instead of being accumulated.

If the beneficiary is paying the tax on accumulated distributions from trusts, he must attach federal form 4970, and the accumulation of distributions is not shown in federal adjusted gross income.

Kansas Statute 79-32,117, provides that accumulation of distributions received by a taxpayer as a beneficiary of a trust to the extent that

the same are included in federal adjusted gross income is a subtraction modification in determining Kansas adjusted gross income.

Therefore, if the accumulation distribution is included in federal adjusted gross income, it is a subtraction modification and is not taxed by Kansas. And if the federal tax is paid by using federal form 4970, the accumulation distribution is not taxed by Kansas.

3. **MAXIMUM TAX** - The maximum tax is an optional tax rate of 50% on the earned income of individuals. Before implementation of the maximum tax, it was possible for an incremented dollar of earned income to be taxed at a 70% rate.

IRC 1348 provides for the maximum tax rate. It was not enacted as a relief measure, but to reduce the use of tax avoidance devices such as accelerated depreciation, depletion, and capital gains. The congressional committee concluded that one of the most effective ways to prevent the use of tax avoidance devices and to forestall the development of new methods of tax avoidance was to reduce the incentive for such activities by reducing the high tax rates on earned income.

The items taxed by the maximum tax are also taxed by Kansas, but they do not receive the preferential treatment by Kansas.

4. **MINIMUM TAX** - Congress recognized that through legal means, such as capital gains and accelerated depreciation on property, portions of large amounts of corporate and individual income escape taxation. Therefore, as part of the Tax Reform Act of 1969, Congress enacted code sections 56, 57, and 58 to implement a tax on certain preference items.

The minimum tax is imposed at a flat ¹⁰10% rate on tax preference items over \$30,000 to the extent they exceed the total of the income tax for the current year over any tax carryover.

Although all items are included in determining federal adjusted gross income, they are not taxed at the increased rate by Kansas.

5. **ALTERNATE TAX** - The alternative tax provisions place a ceiling on the effective rate applied to the excess of net long-term capital gains over net short-term capital losses. The basic rule is that ordinary income is taxed at the regular rates and long-term capital gains at the alternative rate. However, the alternative rate is to be used only when it results in a lower tax than the regular rates.

The items applicable to the alternate tax are also taxed by Kansas, but not at the preferential rate.

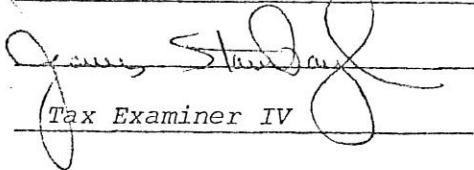
6. **INCOME AVERAGING** - Under the graduated rate structure of federal income tax, an individual whose income varies widely from year to year would pay more tax over a period of years than someone who earned comparable income evenly over the same period. To correct this hardship, Congress enacted provisions to equalize the tax.

August 2, 1977

Kansas does not have this tax preference provision for taxpayers whose income varies.

The above taxes are the major methods for determining the federal income tax and additional federal taxes. The other taxes included on the federal return are for social security taxes and taxes on recapture of certain credits.

If you have any questions, please feel free to contact me.

BUREAU: Income & Inheritance Tax
BY: 
TITLE: Tax Examiner IV

JAS:tjn

To: BOB TAYLOR
LEG. RESEARCH
5TH FLOOR
STATE HOUSE

From: JOHN R. COOPER
P.V.D. PERS. PROP.
8/29/77

The most important consideration in the preparation of the 1978 Kansas Assessment Guide is the selection of the figure that best reflects market value to the taxpayer for each personal property category.

MARKET VALUE

1. As defined by the courts, the highest price estimated in terms of money which a property will bring if exposed for sale in the open market allowing a reasonable time to find a purchaser who buys with knowledge of all the uses to which it is adapted and for which it is capable of being used.
2. Frequently it is referred to as the price at which a willing-seller would sell and a willing-buyer would buy, neither being under abnormal pressure.
3. It is the price expectable if a reasonable time is allowed to find a purchaser and if both seller and prospective buyer are fully informed.

ESA
79-501
1439
Market vs. = call for
(Per Price B)

The essential difference between market price and market value, as above defined, lies in the premises of intelligence, knowledge, and willingness, all of which are contemplated in market value, but not in market price. Stated differently, at any given moment of time market value connotes what a property is actually worth and market price what it may be sold for.¹ (Emphasis added)

MARKET PRICE - The price paid for a property; the amount of money that must be given or which may be obtained at the market in exchange under the immediate conditions existing at a certain date. The price paid for property regardless of pressures, motives, or intelligence. To be distinguished from market value.² (Emphasis added)

The important phrases are: "a reasonable time to find a purchaser who buys with knowledge . . ." and "a willing seller would sell and a willing buyer would buy."

1. "Appraisal Terminology and Handbook" Fourth Edition, 1962, American Institute of Real Estate Appraisers of the National Board of Realtors. Page 121.

2. I bid.

N.A.D.A. stands for National Automobile Dealers Association. It stands to reason that the figures listed are for the benefit of the association members. The N.A.D.A. guide for automobiles, trucks, recreational vehicles, and motorcycles is published for the use of dealers who are in business to profit from the sale of these items. The average values (prices) listed in the N.A.D.A. guides are based upon reports of purported transactions by dealers and wholesale auctions throughout each area for which a guide is published. The averages assume the property is clean and in average condition. Appropriate deductions are to be made for reconditioning costs incurred to put the property in salable condition. Therefore, the N.A.D.A. guide is a tool to be used by the dealer. If we are appraising the inventory of a dealer, then average retail selling price would probably be the best indication of market value because these are sales that have occurred within the past 60 days.

Because the trade guides are based on averages, the individual that owns property that is superior in condition, can probably receive as much or more than the average retail price indicated in the guide.

However, because mass appraisal deals with the average, the typical owner will not receive the average retail price for several reasons:

- (1) The taxpayer is not a salesman.
- (2) Unlike the stock market wherein every buyer or seller pays or receives the same price at any given time, the buyer of a used automobile, motorcycle, recreational vehicle, tractor, or combine generally will have his choice of several "average" offers to sell and depending on the weakness of the seller (taxpayer), probably several different prices plus the dealer's market from which to choose a property.
- (3) The seller gives no "guarantee", therefore, price alone will decide.
- (4) The taxpayer has only one property to sell.
- (5) The taxpayer has a limited market because he has limited exposure. For example, the 2.25 million inhabitants of Kansas are noticeably located in the eastern part of the state. The state has only three major regional centers - two of which are located 60 miles apart. Thirty counties (28%), all in the west, has populations of less than 5,000 as compared to an average of over 21,000 per county for the state as a whole. Therefore, how do these taxpayers find a buyer for their one property? Where is their market?

The answer must be in the disposal method used by the typical taxpayer: does he trade or does he sell outright and negotiate the best price for whatever property he buys?

The spread between average retail and average trade-in (wholesale) for automobiles varies because of the popularity of the model, the year and the price range - luxury vs. mid-price range. A typical spread might be 18% to 20%. A typical dollar figure: 1975 Chevrolet - Average retail = \$3,225 less average trade-in = \$2,600 or \$625 (19%). The \$625 difference on an assessed value basis is \$187.50 or based on the \$8.76 per hundred average 1976 mill levy, 16 tax dollars or a tax of \$85 vs. \$68. Not too severe on a typical two car family; maybe not enough to change value basis; but on the high side and when the average price range increases to \$25,000 (farm equipment) the spread between the two becomes significant.