

MINUTES OF THE Senate COMMITTEE ON Assessment and Taxation

The meeting was called to order by Senator Fred A. Kerr at  
Chairperson

11:00 a.m. ~~XXX~~ on Tuesday, February 5, 1985 in room 526-S of the Capitol.

All members were present ~~XXXX~~:

Committee staff present:

Tom Severn, Research Department  
Melinda Hanson, Research Department  
Don Hayward, Revisor's Office  
LaVonne Mumert, Secretary to the Committee

Conferees appearing before the committee:

Senator Frank Gaines  
Tom Severn, Research Department  
Senator Eric Yost  
Ernie Mosher, League of Kansas Municipalities  
Rick Enewold, AT&T  
James P. Kratochvill, AT&T Information Systems  
Harley Duncan, Department of Revenue

S.B. 74 - Sales tax; situs of telephone service  
S.B. 84 - Local sales tax situs for leasing of telephone equipment  
(Note - these bills are identical)

Senator Frank Gaines said that S.B. 74 proposes that the sales tax on leased telephone equipment be assessed at the location of the subscriber.

Tom Severn distributed a Summary of Recent Local Sales Tax Enactments (Attachment 1). He briefly described the history of legislation dealing with situs.

Senator Eric Yost provided some news clippings (Attachment 2) relating to the sales tax on AT&T leased equipment. He said S.B. 74 and 84 would return telephone instruments to their status before divestiture, i.e., that the actual instrument is considered part of the utility.

Ernie Mosher testified in support of the bills. He said one of the advantages of a local sales tax is the simplicity of administration, and he feels the bills would be an enhancement. He stated that his organization supports the idea of situs relating to sales tax.

Rick Enewold introduced James P. Kratochvill.

James P. Kratochvill summarized his written testimony (Attachment 3). He described his company as involved with the leasing and selling of a broad range of communications and data processing equipment, including installation and maintenance. Some of the equipment his company provides was formerly provided by such companies as Southwestern Bell as a part of their local telephone service. Mr. Kratochvill said they have received complaints about the sales tax situs and understand the problem. He suggested an amendment which would provide that communications and data processing equipment and services as well as telephonic equipment would be included in the bills. He feels this would alleviate difficulties in determining whether equipment and services are telephonic or not. Mr. Kratochvill commented that, in general, it is small vendors that sell this type of equipment, and large companies that lease.

Harley Duncan said he has discussed the matter with AT&T and feels that some action needs to be taken in this area. He pointed out that because of the way accounts were transferred because of the divestiture, there is now different situs treatment for different accounts, and the treatment should be the same. Secretary Duncan said the proposed amendment seems workable, but suggested that it would be advisable to hear from other companies providing similar services. He said it would be necessary to have specific rules to cover the leases entered into between January 1, 1983 and the effective date of the bills.

CONTINUATION SHEET

Minutes of the Tax Committee on February 5, 1985

Senator Hayden moved that the minutes of the February 4, 1985 meeting be approved. Senator Salisbury seconded the motion, and the motion carried.

Meeting adjourned.



SUMMARY OF RECENT LOCAL  
SALES TAX ENACTMENTS

I. County Sales Tax Activity

The following counties instituted a 1.0 percent sales tax effective November 1, 1984:

- Decatur
- Gove
- Meade
- Stafford
- Stanton

Effective January 1, 1984, Wyandotte increased its sales tax from 0.5 percent to 1.0 percent.

II. City Sales Tax Activity

The following cities instituted sales taxes as indicated:

<u>City</u>	<u>Rate</u>	<u>Effective Date</u>
Anthony	0.5%	11/1/84
Auburn	1.0	7/1/84
Delphos	1.0	11/1/84
Elwood	1.0	11/1/84
Emporia	0.5	9/1/84
Fort Scott	1.0	1/1/84
Moran	0.5	7/1/84
Oxford	1.0	11/1/84
Syracuse	1.0	6/1/84
Tonganoxie	0.5	11/1/84
Weir	1.0	11/1/84

The following cities raised the sales tax rate from 0.5 percent to 1.0 percent, effective on various dates in 1984:

- Clay Center
- Coffeyville
- Galena
- Kansas City
- Leawood
- Lenexa
- Merriam
- Olathe
- Overland Park

(over)

Prairie Village  
Roeland Park  
St. Marys  
Spring Hill  
Westwood  
Westwood Hills  
Winfield

The most recent local sales tax enactments were as follows:

Plainville, by a special election on November 6, 1984, enacted a 0.5 percent sales tax, effective February 1, 1985.

Leavenworth, by a special election on December 4, 1984, increased its sales tax from 0.5 percent to 1.0 percent, effective March 1, 1985.

# From AT&T comes sales tax windfall

## Johnson County, Mission to profit from Kansas law

By Rick Alm

staff writer

The breakup of Ma Bell's telephone empire will unexpectedly fatten the public treasuries of Mission and Johnson County.

Because of a quirk in Kansas sales tax law and because American Telephone & Telegraph Co.'s billing office for those customers is in Mission, thousands—perhaps tens of thousands—of small businesses statewide that lease telephone equipment from AT&T Information Systems must begin paying the two governments' local half-cent sales taxes.

The first round of bills to include the local taxes began arriving in Kansas businessmen's mailboxes in recent weeks.

Jim Kratochvill, AT&T senior tax attorney, said the situation came about because, since the breakup, the phone company's separate equipment leasing arm is considered an ordinary retail firm that must, like any other store, charge a sales tax.

Before the federal court-ordered breakup, he said, the leasing operation was regarded as just one element of a state-regulated utility and exempt from passing on sales taxes.

However, because of the unusual wording of the Kansas law, he said, applicable sales taxes must be charged to all in-state customers from the location where the sale took place. He said AT&T attorneys determined that, for tax purposes, all of its lease agreements are transacted at the Mission billing office.

The law affects all small business customers in Kansas that lease between

Attachment 2

Page 68A The Kansas City Star, Sunday, December 16, 1984

## Profit *continued from pg. 49A*

two and 11 telephones and related communications equipment from AT&T.

Large business customers—those leasing a dozen telephones or more—and all residential equipment lease customers in Kansas and western Missouri are billed from Missouri-based AT&T offices, Mr. Kratochvill said.

And the Missouri law—like those in most other states—limits the imposition of local sales taxes to residents of the taxing jurisdiction.

For instance, a Blue Springs lease customer who is billed from AT&T's North Kansas City office will be charged Blue Springs' half-cent sales tax and that money eventually will be paid to Blue Springs.

Because AT&T's regional equipment leasing offices now are all regarded as retailers, officials said, every local government in the country that imposes a sales tax is in line for the extra tax col-

lections.

Just how much money Mission and Johnson County will rake in from every corner of Kansas won't be known for a few more weeks, however.

For competitive reasons, AT&T refuses to divulge how many equipment lease customers it has and how much in sales taxes it expects to collect from them for the Kansas governments.

But Cleo Murphy, chief of the Kansas Revenue Department's sales tax bureau, who will be funneling the tax funds to the governments from the phone company, said she expects the payments to be substantial.

Kansas City, Kan., lawyer Bob Feiring is one small-business man who has promised a fight.

He was hopping mad when he got his office phone bill a few weeks ago. It itemized a total of 48 cents each in sales taxes imposed by Johnson County and

Mission for his six office phones.

"I've never signed anything with anybody in Mission," Mr. Feiring said. "I got these phones a year ago from a Southwestern Bell agent right in this (Kansas City, Kan.) building," he said.

Jackie Grey, an AT&T spokesman, has an answer to that complaint, which she said wasn't the first and isn't expected to be the last on the subject.

When the Bell system was dismantled by the federal courts, she said, all of the telephone equipment that had been leased by Southwestern Bell became the property of AT&T Information Systems. "His (Mr. Feiring's leased) equipment becomes our equipment and that tax applies."

AT&T's Mission office has been fielding complaints and questions since customers began receiving their November bills.

"We had some customers who think

this is a big conspiracy by Mission," said Gene Beery, manager of the Mission billing office.

But Mission and Johnson County officials have had no official word of the windfall.

"This just really blows my mind," said Mission City Clerk Suzie Gibbs, when told of the situation. "We didn't know anything about it. I'll have to tell the mayor. He'll just die."

Bob Bacon, a Johnson County commissioner, said Friday he was aware of the quirk in the state tax law and has been expecting calls about the windfall.

He said the owners of a Mission office equipment leasing firm advised him recently that they are moving to Missouri because they also are affected by the law and they want to avoid being forced to charge their out-of-county customers the Mission and Johnson County sales tax.

ATTACHMENT 2

DATE

*Sunday* 1-6-85

TOPEKA CAPITAL - JOURNAL	<input type="checkbox"/>	PITTSBURG MORNING SUN	<input type="checkbox"/>	PARSONS SUN	<input type="checkbox"/>
WICHITA EAGLE - BEACON	<input type="checkbox"/>	HUTCHINSON NEWS	<input type="checkbox"/>	SALINA JOURNAL	<input type="checkbox"/>
KANSAS CITY STAR	<input checked="" type="checkbox"/>	EMPORIA GAZETTE	<input type="checkbox"/>	HAYS DAILY NEWS	<input type="checkbox"/>
KANSAS CITY TIMES	<input type="checkbox"/>			LAWRENCE JOURNAL WORLD	<input type="checkbox"/>

# Telephone windfall

Johnson County's windfall in sales taxes paid by statewide American Telephone & Telegraph small business customers sounds too good to be true. It may not last, however, if business owners in other areas get upset enough to petition their legislators for a change in the sales tax law.

Kansas law requires sales taxes to be charged to customers from the place where the sale took place. AT&T Information Systems' equipment leasing store is in Mission, and Kansas revenue officials have determined that is the location of the leases, even though the customers may live elsewhere in Kansas. The ruling applies to small business customers only, because large business customers and residential customers are billed from Missouri AT&T offices.

So although a business owner who is leasing an AT&T phone system is located in Wichita or Topeka, he or she is being charged the Johnson County and Mission

half-cent sales taxes.

Kansas law, although different from that in some other states where sales taxes are charged based on the customer's business or residence location, normally does make sense. It is easier for the state to collect the taxes if they are assessed against the business at the principal location of business. And why not return sales taxes collected by a business to the county and city where that business operates?

But in this case, the law seems a little out of whack. Some people understandably are upset. Other localities with sales taxes logically could argue there is no good reason these sales tax dollars aren't going to them, because the place where the equipment is being leased actually is in their county or city. Whatever resolution there is to this problem may depend on an uprising in the Legislature and whether Mission and Johnson County choose to fight for their money.



# AT&T to Give Johnson County, Mission Tax Windfall

By Forrest S. Gossett  
Staff Writer

When Bob Jennings got a bill in December covering rental charges for the telephone equipment in the Decorator & Craft Corp. stores he owns in Wichita, he was angry.

At the bottom of his \$61.91 bill were normal charges for federal excise taxes and Kansas state tax. But in addition, there were charges of 30 cents each for Johnson County and Mission, just outside Kansas City, Mo.

Jennings said he sensed that something was wrong. His businesses are not in Johnson County and he couldn't figure out why he was being billed for sales taxes there. But when he called representatives of AT&T Information Systems, the equip-

ment arm of American Telephone & Telegraph, he discovered that everything was legal under Kansas law.

Jennings is not alone.

Hundreds of businesses are receiving similar bills with sales tax collections set aside for Johnson County and Mission. The exact number of the company's 500,000 telephone rental customers affected in Kansas is impossible to determine because AT&T Information Systems refuses to say, citing "competitive considerations."

The reason that the tax is appearing on the business bills is clear. Prior to the November billing period, AT&T's rental fees appeared on Southwestern Bell Telephone Co. bills for regular telephone service. No sales tax appeared on Jenning's

bill because Wichita, which was then the point of sale for his rental equipment, has no local sales tax.

However, in November, AT&T canceled its agreement with Southwestern Bell and started its own billing system. In the process, the company consolidated business accounts in its Mission office. Residential telephones are not affected because they are billed from an office in Missouri.

Cleo Murphy, director of sales and excise tax collections in the Department of Revenue, says at least 100 businesses have called her staff to complain since the AT&T bills started sending out its new bills December.

"This has happened because of the breakup of AT&T and our local tax laws," Murphy said. "All sales occur at the place

of the retailer — in this case, AT&T in Mission. It's a loophole in the law. The only people who can change it are in the Legislature."

Though Murphy predicts that the tax collections could produce a significant windfall for Mission and Johnson County, she has no idea how much. That's because sales tax collections are paid by the retailers to her office anywhere from 30 to 60 days after a billing period, meaning that it will be next month or even March before the two governmental bodies notice any increase in their revenues.

For the first 11 months of 1984, the latest period that the Revenue Department has statistics available, Johnson County collected \$12.1 million in sales

taxes, while Mission collected \$609,768. Those numbers are certain to go up.

Jennings says that he doesn't mind paying the one-half percent sales tax that Johnson County and Mission each collect. He's angry because the tax goes to those two governmental bodies rather than Wichita or Sedgwick County, where he lives and works.

"If there are taxes like that, they should go to Wichita," Jennings said. "The 60 cents doesn't make any difference on my bill, but where it goes does. Johnson County shouldn't reap these kind of tax benefits."

● TAX, 3C, Col. 1

## Mission Gets Windfall

● TAX, From 1C

In Mission, a city of 8,643 people, City Clerk Suzie Gibbs says she was as shocked as business owners were that Mission will soon be reaping the new tax windfall.

"So far, no one is saying much here because we really don't know for sure what is happening," Gibbs said. "It has come as a surprise to us."

Regardless, next month, Mission and Johnson County will each receive checks from the state covering their new-found sales-tax windfall, and will continue to receive checks unless state law changes, something that Murphy of the Revenue Department says could happen.

"If we get that many phone calls, they (the legislators) get that many. I'm sure they'll try to do something about it," Murphy said.



TESTIMONY OF JAMES P. KRATOCHVILL  
SENIOR ATTORNEY-TAX FOR AT&T INFORMATION SYSTEMS  
BEFORE THE SENATE ASSESSMENT AND TAXATION COMMITTEE  
ON SENATE BILLS 74 AND 84

February 5, 1985

My name is James P. Kratochvill. I am the Senior Attorney-Tax for AT&T Information Systems Incorporated (AT&T-IS). My business address is 100 Southgate Parkway, Morristown, New Jersey, which is the headquarters location of AT&T-IS. I am here today as a representative of AT&T-IS to present its position regarding Kansas Senate Bills 74 and 84 and to respond to the related concerns of this committee. AT&T-IS welcomes the opportunity and is grateful to the Committee for extending this invitation to address this important tax matter.

AT&T Information Systems is a wholly owned subsidiary of American Telephone and Telegraph Company (AT&T), incorporated in Delaware in June of 1982. AT&T-IS has been doing business in Kansas since January 1, 1983. Within Kansas, and nationwide, AT&T-IS is principally engaged in the sale and lease of communications and data processing equipment (including the installation and maintenance thereof) in competition with a wide variety of large and small vendors. Principal competitors include such firms as Rolm, Northern Telcom, IBM, RCA, Hewlett Packard and their distributors. There is a multiplicity of equipment that AT&T-IS and these other vendors market to their customers. These include not only a variety of telephone instruments for residential and small business use but also complex large business systems which integrate telecommunications, data processing and office automation functions, as well as computers and video-text terminals.

In addition to newly manufactured equipment, some of the residential and business equipment now leased and sold by AT&T-IS in Kansas was formerly provided in conjunction with local telephone transmission service by Southwestern Bell Telephone

Company. It was acquired by AT&T-IS on January 1, 1984 as a result of the court ordered reorganization of the Bell System and the removal of such equipment both physically and legally from telephone service. Unlike Southwestern Bell and other telephone companies in Kansas, AT&T-IS does not provide telephone service nor is it subject to common carrier regulations by either the Federal Communications Commission (FCC) or the Kansas Corporation Commission (KCC).

The intent of Kansas Senate Bills 74 and 84 is to change the situs at which sales tax is applied for the lease of such equipment from the place of business of the retailer (Sec. 12-191, K.S.A. Reg. 92-21-6 et seq.) to the customer location. The bill proposes to accomplish this by amending Section 12-191 to broaden the definition of "telephone service" for local sales tax purposes to include "the leasing of telephone receiving and transmittal equipment." This would in effect treat the sales tax situs of certain equipment leased by AT&T-IS in the same manner as when it was provided by Southwestern Bell as part of its provision of telephone service prior to January 1, 1984. AT&T-IS wishes to present three principal points regarding this bill.

First, AT&T-IS shares the concerns of this legislature and the many municipalities which have incurred reductions in sales tax revenues as a result of the above events, particularly with regard to that equipment which was formerly situated in accordance with telephone service rules. AT&T-IS supports the principle that sales tax be applied at the customer location and is prepared to alter its billing systems to accomplish this result. In fact, such a change would bring Kansas into conformity with the majority of other states that have local sales taxes in which AT&T-IS does business. AT&T-IS looks forward to assisting this committee and the Legislature in achieving this result through legislation that minimizes customer confusion and problems of administration by the Department as well as which is feasible and practicable from a compliance standpoint.

Second, To accomplish these goals, AT&T-IS believes it is essential that the legislation at minimum recognize the same situs for sales tax application for all AT&T-IS customers, and preferably, those of its competitors. As noted, the product inventory of AT&T-IS and similar Kansas vendors includes a vast array of equipment types capable of a multitude of functions, only one of which is receiving or transmitting communications. AT&T-IS is concerned that it would not reduce customer confusion, ease administration or simplify the compliance burden if similar products marketed by the same firm or competing vendors were subject to varying sales tax rates and rules. Limiting the scope of the legislation to merely "telephonic equipment", therefore, may not accomplish these objectives.

Technological development in this area during recent years has created a situation where there is virtually an unlimited number of products capable of being attached to or used in connection with telephonic lines. It has become increasingly difficult, if not impossible, to distinguish between equipment performing "telephonic" functions from that performing data processing functions or both. It was principally to eliminate the need for such a distinction that equipment of this nature was removed from utility regulation and the provision of telephone service. To require certain lessors of this equipment to attempt to make the same kind of distinctions among its many product lines is neither feasible for the vendors nor desirable to the State. Such a system, AT&T-IS believes, would generate uncertainty in compliance and administration as well as inconsistent local tax applications among lessors similarly situated.

Third, AT&T-IS requests that the committee be especially mindful of the recent dramatic changes in the communications industry. While many may disagree with these changes and their

ultimate effect on the populace, we are nevertheless faced with the reality of a transformed industry. This transformation is far broader than the reorganization of the Bell System and affects nearly every facet of the telephone services and products that are offered to the general public. One of the more noticeable and fundamental changes is that consumers and businesses must now acquire their communications related equipment from private vendors, and no longer have the option of receiving it from telephone companies such as Southwestern Bell in conjunction with their subscription to telephone service. These private vendors including AT&T-IS, are not, nor are they similar to telephone companies and they do not provide telephone services, as these terms are recognized in common usage and defined and interpreted under the law in most states, including Kansas.

AT&T-IS believes it is unnecessary and inappropriate for this legislation to reclassify the leasing of equipment "telephone service", both in view of this transformed communication industry as well as its apparent inconsistency with the long standing interpretation of the concept of "telephone service" applicable to sales tax under Kansas law. The leasing of such equipment is not and was never meant to be included under the definition of "telephone service" under Section 79-6303 and Regulation 92-19-19. This is evidenced by a ruling to that effect issued by the Department of Revenue to AT&T-IS (May 9, 1984) in response to the company's inquiry regarding application of the non-commercial telephone service exemption (Section 79-3606(2)) to equipment leasing. The resulting imposition of sales tax upon equipment leased by AT&T-IS to non-commercial customers has generated revenues to both the state and local communities which were not collected by Southwestern Bell when it provided equipment as part of its telephone service. Since the exemption is equally applicable on the local level, the characterization of equipment leasing as "telephone service" would raise anew the

question of the exemption's application to such activity. We note also that in other areas of Kansas tax law, such as Section 79-5a01 (property tax), the leasing of equipment is expressly excluded from the scope of telephone service.

The creation of such statutory inconsistency and uncertainty is not required to accomplish our mutual goal of equitably changing the sales tax situs and should be rejected.

Consistent with all of the above objectives, AT&T-IS proposes for this committee's considerations an alternative suggestion for amending Section 12-191, as follows:

Insert on page 1, line 29 of Senate Bill 74 after the word "retailer":

"However, transactions involving the leasing of communications and data processing equipment (and any related services) are to be considered as having been consummated at the situs of the leasee."

The proposed language on page 1, lines 42-43 would be deleted.

This alternative would alleviate the problems caused by the limited scope and telephone service characterizations of the original bill. It would also provide a basis for uniform local tax treatment by vendors of similar equipment.