Approved on 1-20-87

Minutes of the House Committee on Taxation. The meeting was called to order by E. C. Rolfs, Chairman, at 9:00 s.m. on January 14, in room 423-S at the Capitol of the State of Kansas.

All members of the Committee were present.

Committee staff present: Tom Severn, Legislative Research
Chris Cartwright, Legislative Research
Don Hayward, Revisor of Statues
Millie Foose, Committee Secretary

Chairman Ed Rolfs called the meeting to order and welcomed the new committee members. He than discussed the impact of the Tax Reform Act of 1986 on the Kansas Individual Income Tax. (Attachment 1) He also discussed how to utilize the extra revenue or return it.

Representative Rolfs then distributed copies of an Executive Order (Number 87-91) issued by Governor John Carlin on January 8, 1987. (Attachment 2) He encouraged the committee members to read this carefully.

Mr. Tom Severn discussed the Research and Development Tax Credit. (Attachment 3) He said that although this credit will not be in effect until FY 1988, it is important to clarify how the Act applies to a number of particular situations. At the request of the committee, he also defined "seed capital".

Mr. Shelby Smith outlined Taxation and Tax Structure in Kansas. (Attachment 4) He said that even though there may not be immediate solutions, it is important to recognize the problem. He said that some corporations have chosen not to locate in Kansas after analyzing the tax structure of bordering states.

Mr. Krider discussed tax incentives outside the Enterprise Zone and also recommended exemptions on sales tax for machinery, etc., as he believes this would encourage more firms to locate in Kansas rather than in bordering states.

Committee members then questioned the conferees further and made suggestions for improving the tax structure.

There being no further business to come before the committee, the meeting was adjourned.

Ed C. Rolfs

Ed C. Rolfs

1

THE IMPACT OF THE
TAX REFORM ACT OF 1986
ON THE
KANSAS INDIVIDUAL INCOME TAX

KANSAS DEPARTMENT OF REVENUE

HARLEY T. DUNCAN

SECRETARY

JANUARY 1987

House Tax Com. -- Attachment 1
1-14-87

Executive Summary

1. The Kansas income tax conforms in many respects to the federal income tax code. The state automatically conforms to the definition of federal adjusted gross income. Also, federal taxes paid are allowed as a deduction for state income tax purposes. Thus, the recently enacted federal reform (which contains a federal tax reduction) will substantially increase the state income tax base and state tax revenues under current law.

2. The estimates presented in the report have been derived from the Individual Income Tax Simulation Model of the Kansas Department of Revenue. A variety of assumptions and constraints must be used to project the impact. The results should be used with caution and are best considered as a range of expected impact rather than a precise point estimate.

3. With no change in taxpayer behavior, the Department estimates that the automatic conformity between the state and federal tax codes will cause state income tax revenues to increase by $124 million in tax year 1987 and $139 million in tax year 1988. The state increase will offset the projected federal reduction in 1987, but in 1988 and beyond the federal tax reduction approaches $300 million annually.

4. The Department has adjusted these estimates to reflect a reduced rate of capital gains realization in 1987 and 1988 and continued sheltering of some income no longer eligible for a deductible deposit in Individual Retirement Arrangements. **Thus, the official Department estimates are $105 million in tax year 1987 and $125 million in tax year 1988.**

5. Approximately 75 percent of this additional burden will fall on taxpayers with a pre-reform Kansas adjusted gross income of greater than $35,000. The average state tax increase runs from about 20 percent at the $35-50,000 AGI level to 44 percent for those with an AGI in excess of $100,000.

6. The Tax Reform Act also makes substantial changes in itemized deductions. These are not incorporated into the Kansas tax automatically. They are, however, of such a magnitude that if Kansas law is not updated to conform to the new federal definitions increased complexity and compliance problems should be expected. Various degrees of conformity could increase state revenues by an additional $40 million to $115 million in tax year 1988.

7. The federal reform also raises other tax policy issues that need to be considered as the State responds to the federal action. These include the effects of the tax reform on interstate tax competition, low income households and certain targeted groups such as the blind, disabled and elderly.

The Impact of the Tax Reform Act of 1986
on the
Kansas Individual Income Tax

Introduction

The Tax Reform Act of 1986 marks the most significant change in the federal income tax code in a generation. As is the case in most other states, the Kansas individual income tax conforms in many respects to the federal tax code. In certain areas, the state tax conforms automatically to the federal code; in others, legislation would be required to adopt the federal changes. The foremost result of these interrelationships is to increase substantially the Kansas income tax base. The federal reform also raises a variety of other state tax policy issues that the Kansas Legislature will need to address.

This report presents the Kansas Department of Revenue assessment of the impact of the federal Tax Reform Act of 1986 on the Kansas individual income tax. The report includes estimates of the impact on total individual income tax revenues as well as the distribution of the impact across income groups. In addition, several issues related to the effect of the Reform Act on such non-conforming items as personal exemptions, standard deductions and itemized deductions are discussed. The report addresses only the individual income tax and not the corporation income tax.

Basis of the Impact

The primary reason the federal Tax Reform Act affects Kansas income taxes is because of the conformity which exists between the state tax and the federal tax in certain areas. State law provides that the starting point for the computation of state income taxes is the federal Adjusted Gross Income (AGI) of the taxpayer for the year in question. Therefore, those features of the federal reform that affect the computation of income or adjusted gross income are incorporated **automatically** into the state tax code at the time they become effective at the federal level.

The Tax Reform Act substantially broadens the definition of federal AGI. It will, therefore, increase Kansas AGI and state revenues under current law. The major provisions of the federal reform affecting the definition of AGI and the Kansas individual income tax are: (a) repeal of the 60 percent exclusion for long-term capital gains; (b) limits on the deductibility of contributions to Individual Retirement Arrangements; (c) repeal of the special deduction for two-earner households; and (d) inclusion of all unemployment compensation payments as income. Also, those features of the federal reform affecting the computation of income, such as changes in allowable depreciation rates and restrictions on the ability to use tax shelters to offset ordinary income with passive investment losses, will be incorporated into the state tax base.

The second reason the federal reform affects Kansas income tax liability is because it provides a net federal income tax reduction of an average 1.6 percent in 1987 and 6.0 percent in 1988. All Kansas individual income taxpayers are allowed a deduction for federal income taxes paid. Therefore, the federal tax reduction will increase the state income tax base beyond what it otherwise would be.

The Tax Reform Act also makes significant changes in the itemized deductions which may be claimed for federal tax purposes. These changes will not be incorporated automatically into the state income tax because Kansas itemized deductions are tied to federal itemized deductions as they existed for tax years beginning after December 31, 1977 plus and minus certain state modifications. While the new changes will not become part of the state tax code, they will create state-level compliance and complexity problems which should be addressed. Similarly, changes in the federal personal exemption and standard deduction levels are not automatically adopted for state income tax purposes. They do, however, raise certain compliance and equity questions that must be addressed. (See later discussion.)

Source of the Estimates

The estimated impact of the Tax Reform Act on state revenues and individual taxpayers was derived from the Individual Income Tax Simulation Model developed by the Department of Revenue. The model consists of a random sample of 10,000 (about 1 percent) Kansas income tax returns for 1983. The model includes all information on the Kansas Form 40, the federal Form 1040, and the federal Schedule A - Itemized Deductions.

It is important to understand several features of the resulting estimates:

1. All items of income and expense have been inflated from 1983 to 1986 levels based on the actual change in Adjusted Gross Income and expenses shown on 1984 and 1985 returns and the consensus estimate of a 4.0 percent increase in personal income in 1986. The resultant figures are a 17 percent increase in income and a 23 percent increase in expenses.

2. The model has not been adjusted to reflect behavioral changes that may be caused by tax reform. That is, it assumes that activity and behavior for such items as realization of capital gains or tax deferred savings will be the same as in 1983. **Two modifications for behavioral change are reviewed later in the report.**

3. Certain items of change, such as restrictions on passive losses offsetting ordinary income and changes in depreciation, cannot be modelled.

4. The estimates presented are annual, tax year or calendar year figures. Fiscal year figures are contained in the report of the Consensus Revenue Estimating Group.

These assumptions and constraints, while necessary, are nevertheless significant and important to the resulting estimated impacts. The reader is urged to exercise caution in using the estimates contained in the report. They should be viewed principally as a range of expected impact, rather than as a precise point estimate of expected revenues.

Revenue Impact

It is estimated that Kansas individual income tax liability will increase by approximately $124.0 million in tax year 1987 and $139.0 million in 1988 because of those features of the Tax Reform Act to which the State automatically conforms. This represents a 20-22 percent increase over current law receipts. For 1987, the State increase exceeds somewhat the estimated federal tax reduction. In 1988 and thereafter, however, there will be a net tax reduction for Kansans. When the reduced federal tax rates are reflected fully in 1988, the estimated federal tax reduction approaches $300 million annually. The breakdown for 1987 and 1988 is as follows:

Revenue Impact of the Tax Reform Act of 1986
All Kansas Taxpayers -- Tax Year 1987

	State	Federal	Net
Married Resident	$ 91.3	($113.7)	($22.4)
Single Resident	$ 17.8	$ 5.2	$23.0
Total Residents	$109.0	($108.5)	$ 0.5
Non-Residents	$ 15.2	$ 5.1	$20.3
Grand Total	$124.3	($103.4)	$20.9

Dollar Amounts in Millions.

Revenue Impact of the Tax Reform Act of 1986
All Kansas Taxpayers -- Tax Year 1988

	State	Federal	Net
Married Resident	$ 95.1	($159.4)	($ 64.3)
Single Resident	$ 25.3	($ 84.3)	($ 59.0)
Total Residents	$120.4	($243.7)	($123.3)
Non-Residents	$ 18.8	($ 50.2)	($ 31.4)
Grand Total	$139.2	($293.9)	($154.7)

Dollar Amounts in Millions.

The above estimates are based on the earlier stated assumptions regarding change in income and expenses since 1983. To establish a range of expected impact, simulations have been run with no change in income and expenses since 1983 and with a 25 percent increase in income and a 29 percent increase in expenses. Under the "no growth" simulation, the automatic state revenue impact is $97.5 million in 1987 and $109 million in 1988. Under the higher growth scenario, the resultant figures are about $134 million in 1987 and $150 million in 1988. Thus, approximately 25-30 percent of the projected total increase in state liability is attributable to the inflation of the income and expense items. Moreover, in the range of assumptions used here, a 1.0 percent increase in income generates roughly a 1.5 pecent increase in liability.

Behavioral Changes

As stated, no behavioral changes have been incorporated in the income tax simulation model. Yet, it seems clear that taxpayers will change some habits in response to the major changes in the Tax Reform Act. In particular, as the maximum tax rate on capital gains increases from 20 percent to 28 percent in 1987, taxpayers should be expected to realize an increased level of gains in 1986. Also, taxpayers have become accustomed to the tax savings from Individual Retirement Arrangements (IRA). It seems reasonable that those who may no longer make excludable contributions will seek to find other ways to shelter that income, such as increased contributions to deferred compensation plans.

The Department of Revenue therefore has modified the estimates presented above to reflect a reduced rate of capital gains realization in 1987 and 1988 and to reflect some sheltering of income by taxpayers no longer eligible for IRA's. The estimate has been reduced by roughly $15 million to reflect an assumed 25 percent reduction in the capital gains realization rate and by about $5 million to reflect an assumption that one-third of the funds previously deposited to IRA's will be otherwise sheltered. **Therefore, the Department's official estimates are increases of $105 million in 1987 and $125 million in 1988.**

These reductions for behavioral change have not been reflected in the individual taxpayer data displayed below because the effects of them cannot be divided accurately among income groups. Still the data on the distribution of the impact among income groups is instructive and important to those policymakers concerned with the state response to federal tax reform.

Distribution Across Income Groups

The increased **Tax Year 1988** state liability **for all resident taxpayers** breaks down across Adjusted Gross Income groups as shown below. In the table, AGI groups are defined on the basis of pre-reform AGI, i.e., taxpayers are assigned to the income group in which they were prior to implementation of any reform measures which may change the AGI group in which they fall. In other words, the data below can be used to answer the question of **what is the impact of the federal tax reform on the state income tax liability of the average taxpayer in any given income group.**

Distribution of Additional Income Tax Liability by Income Group
All Resident Taxpayers -- Tax Year 1988

Adjusted Gross Income Group	Number of Taxpayers	Increased Liability	Percent of Total
No KAGI	18,737	$ 365.9	0.3%
$0-5,000	123,684	$ 660.2	0.5%
$5-15,000	245,368	$ 4,663.0	3.9%
$15-25,000	186,421	$ 10,201.2	8.5%
$25-35,000	144,737	$ 14,248.8	11.8%
$35-50,000	135,579	$ 28,736.0	23.9%
$50-100,000	70,105	$ 32,071.2	26.6%
Over $100,000	9,684	$ 29,469.0	24.5%
TOTAL	934,315	$120,415.3	100.0%

Dollar Amounts in Thousands.

As shown, the increases are concentrated at the middle and upper income levels with about 75 percent ($100 million) of the increase falling on those taxpayers who, prior to reform, had $35,000 or greater Adjusted Gross Income. Each of the three income groups over $35,000 AGI assumes about one-fourth of the total increase. The concentration among upper income groups is to be expected given that those features of the reform increasing federal Adjusted Gross Income are more common among these groups. Those taxpayers with greater than $35,000 AGI currently constitute about 23 percent of all resident taxpayers, and they pay about 60 percent of the current law liability.

These increases are sizeable relative to current law liability as shown below. Again, the data are **for 1988 for resident taxpayers,** and taxpayers are considered as being in the AGI group in which they were prior to reform.

Average Income Tax Increase by Income Group
All Resident Taxpayers -- Tax Year 1988

Adjusted Gross Income Group	Current Avg. Liability	New Avg. Liability	Dollar Change	Percent Change
No KAGI	$ 0.00	$ 19.53	$ 19.53	- -
$0-5,000	$ 7.97	$ 13.31	$ 5.34	67.0%
$5-15,000	$ 141.09	$ 160.09	$ 19.00	13.5%
$15-25,000	$ 425.03	$ 479.75	$ 54.72	12.9%
$25-35,000	$ 710.25	$ 808.69	$ 98.44	13.9%
$35-50,000	$1,037.26	$1,249.21	$ 211.95	20.4%
$50-100,000	$1,755.15	$2,212.62	$ 457.47	26.1%
Over $100,000	$6,873.45	$9,916.45	$3,043.00	44.3%
TOTAL	$ 586.39	$ 715.28	$ 128.88	22.0%

The increases in average tax liability show marked differences among income groups. Those below $35,000 AGI are relatively uniform at about 12-14 percent increase which reflects that their state liability is affected primarily by the federal tax reduction, rather than changes in the Reform Act. For those with pre-reform AGI in excess of $35,000 the relative change in average liability increases as income increases. This is indicative of the greater use of prior law tax preferences among these taxpayers. The automatic state tax increases under current law run from 20 percent, or just under $20 monthly, for the average $35-50,000 AGI taxpayer to 44 percent, or $250 monthly, for those with an AGI in excess of $100,000.

The data (67% increase) for those with less than $5,000 AGI require explanation. They are heavily influenced by a relatively few taxpayers who had large amounts of previously sheltered income that will now be subject to tax. A person with $5,000 of previously taxed income would not experience such an increase.

Federal tax reform will also affect the distribution of the Kansas income tax burden among income groups because of the magnitude of the impact and its distribution among income groups. The table below presents the distribution of the burden currently and with the effects of reform along with the distribution of taxpayers among Adjusted Gross Income groups on the same basis. The data are for **all resident taxpayers for tax year 1988.**

Distribution of Taxpayers and Income Tax Burden
By Income Group
All Resident Taxpayers -- Tax Year 1988

Adjusted Gross Income Group	TAXPAYERS		TAX BURDEN	
	Current	Reform	Current	Reform
No. KAGI	2.0%	1.7%	0.0%	0.1%
$0-5,000	13.2%	12.2%	0.2%	0.2%
$5-15,000	26.3%	25.5%	6.3%	5.9%
$15-25,000	20.0%	19.9%	14.5%	13.4%
$25-35,000	15.5%	15.5%	18.8%	17.5%
$35-50,000	14.5%	14.4%	25.7%	25.3%
$50-100,000	7.5%	9.5%	22.5%	23.2%
Over $100,000	1.0%	1.3%	12.1%	14.4%
TOTAL	100.0%	100.0%	100.0%	100.0%

A further breakdown of the impact of the Tax Reform Act on the state income tax liability by AGI group for both tax years 1987 and 1988 is presented in Appendix A of this report.

Itemized Deductions

The Tax Reform Act also makes significant changes in the itemized deductions allowed taxpayers. These include repeal of the deduction for state and local sales taxes, phase-out of the deduction for non-mortgage interest payments, further limits on medical expense deductions, conversion of the moving expense and unreimbursed business expense adjustments to itemized deductions, and limits on miscellaneous deductions and unreimbursed business expenses.

These changes do not flow through automatically to the Kansas tax because it is tied to federal itemized deductions as of a specific date (December 31, 1977.) However, if the Kansas reference date for conformity is not updated from 1977 to the new law, significant compliance tools will be lost and figuring Kansas itemized deductions will become more complex. Kansas already non-conforms to federal deductions on the gas tax, casualty losses and political contributions because we have not updated from 1977 to 1981. Failure to update would introduce at least five new non-conforming items. A list of areas in which Kansas law will non-conform to federal itemized deductions unless current law is changed is presented in Appendix B.

The data below present the estimated fiscal impact that would result from varying degrees of conformity with federal itemized deductions. The options include: (a) conforming to all federal itemized deductions but still allowing the current Kansas medical expense deduction and the deduction for social security and employment-related taxes and (b) conforming to the federal medical expense deduction and repealing the deduction for social security and employment-related taxes.

Revenue Impact of Conforming to Federal Itemized Deductions
As Contained in the Tax Reform Act of 1986
All Taxpayers

	1987	1988
Conform to all but Medical and Employment Taxes	$ 29.1	$ 38.9
Full Conformity	$103.8	$114.4

Dollar Amounts in Millions.

The distribution of this additional liability is similar to that of the increased burden arising from the automatic conformity. The $25,000 to $35,000 income group, however, assumes a somewhat larger proportion, while those over $100,000 AGI assume proportionately less. This reflects the relative importance of itemized deductions among income groups.

As with the changes to Adjusted Gross Income, it is reasonable to expect that taxpayers will to some degree adjust their behavior to the changes in itemized deductions. In particular, it appears that "equity" or "second" mortgages will be available to allow customers to shift some portion of their debt to loans on which the interest payments will remain deductible. The Department of Revenue has accordingly reduced its estimate of the effects of conforming to itemized deductions (from those shown above) by about $6 million in 1987 and $10 million in 1988.

Related Policy Issues

Interstate Tax Competition. Federal tax reform is likely to intensify the tax competition among states. Put another way, it will increase the degree to which interstate differences in tax levels are noticed by taxpayers. Under prior federal rates, upper income taxpayers could offset up to 50 percent of their state and local liability against their federal tax. As the maximum marginal federal rate drops to 28 percent, the value of the state and local tax deduction will drop correspondingly. The state should therefore consider using the opportunity offered by the expanded tax base to reduce its tax rates to the degree possible consistent with other policy objectives and with other issues raised by the federal reform.

Tax Equity. Kansas will also need to assess the effect of the federal reform on low income households. At the federal level, the "tax free" threshold (combination of standard deduction and personal exemptions) for a family of four will rise to $12,800 by 1988. This is expected to remove about 6 million taxpayers from the rolls. The same figure is $6,800 under current Kansas law. The result is that without changes in state law, many taxpayers will owe a state liability, but no federal tax. Given the regressivity of other state and local taxes, consideration should be given to raising the income tax thresholds. Further, since the starting point for state taxes is federal adjusted gross income, the state will lose some compliance tools, and taxpayers will have to complete federal returns on which no tax is owed.

Double Personal Exemptions. Kansas currently conforms to the number of personal exemptions allowed at the federal level. Under prior federal law, each blind, disabled and elderly taxpayer was accorded two personal exemptions. Under the Tax Reform Act, the double personal exemption is repealed, but the blind, disabled and elderly are accorded higher standard deductions and the personal exemption is increased for all taxpayers. Under current Kansas law, these changes will not be adopted automatically. Blind, elderly and disabled taxpayers will lose their second personal exemption and be disadvantaged compared to their current position.

Standard Deduction Filers. State law does not allow a taxpayer to itemize deductions on the state return unless the taxpayer also itemizes on the federal return. With the greater restrictions on federal itemized deductions, fewer taxpayers will be able to avail themselves of this opportunity. They will be compensated, at least partially, on the federal level by a higher standard deduction. This will not be the case at the state level unless the state standard deduction is increased. Currently about 39 percent of the taxpayers itemize deductions; this proportion will decline to an estimated 31.5 percent, a reduction of roughly 70,000 taxpayers, by 1988. This group will also be disadvantaged compared to their current position.

Conclusion

The Tax Reform Act of 1986 will have a significant impact on the Kansas individual income tax. Not only does it substantially increase state income tax revenues under current law, but it presents the State with several significant tax policy issues which must be addressed. As such, it presents state policymakers with the opportunity and challenge to accomplish a major reform of the state income tax code.

APPENDIX A

SIMULATION NO. 6172 TAX REFORM ACT OF 1986

TAX YEAR 1987

Kansas Department Of Revenue

Individual Income Tax In Tax Year 1986
Resident Taxpayers
Impact By Bracket

TAX REFORM ACT OF 1986

K.A.G.I. Bracket	Married					Single					Total Residents				
	No. Of Returns	Percent Increase	Dollar Change In Liability	Dollar Change Per Return	Effective Rate	No. Of Returns	Percent Increase	Dollar Change In Liability	Dollar Change Per Return	Effective Rate	No. Of Returns	Percent Increase	Dollar Change In Liability	Dollar Change Per Return	Effective Rate
No K.A.G.I.	11,263	0.0%	$0.00	$0.00	0.0%	5,789	0.0%	$0.00	$0.00	0.0%	17,053	0.0%	$0.00	$0.00	0.0%
$0 $5,000	14,947	1.5%	$204.08	$0.01	0.0%	104,105	5.0%	$48,163.27	$0.46	0.3%	119,053	4.9%	$48,367.35	$0.41	0.3%
$5,000 $15,000	73,895	3.7%	$250,183.67	$3.39	0.9%	166,421	4.5%	$1,257,118.37	$7.55	1.8%	240,316	4.4%	$1,507,302.04	$6.27	1.5%
$15,000 $25,000	98,842	1.5%	$502,191.84	$5.08	1.7%	85,158	7.3%	$3,334,348.98	$39.15	3.0%	184,000	4.8%	$3,836,540.82	$20.85	2.3%
$25,000 $35,000	106,947	5.0%	$3,569,663.27	$33.38	2.3%	34,421	1.4%	$431,739.80	$12.54	3.2%	141,368	3.9%	$4,001,403.05	$28.30	2.5%
$35,000 $50,000	118,842	9.1%	$11,179,739.80	$94.07	2.7%	15,263	11.6%	$2,081,773.47	$136.39	3.2%	134,105	9.4%	$13,261,513.27	$98.89	2.8%
$50,000 $100,000	78,842	40.6%	$44,088,774.49	$559.20	3.0%	6,947	17.4%	$2,530,378.57	$364.22	3.9%	85,789	37.9%	$46,619,153.06	$543.41	3.1%
$100,000 Over	10,947	59.3%	$31,660,301.02	$2,892.05	3.9%	1,684	61.7%	$8,118,979.59	$4,820.54	4.5%	12,632	59.6%	$39,779,280.61	$3,149.19	4.0%
Total	514,526	23.0%	$91,251,058.16	$177.35	2.7%	419,789	11.7%	$17,802,502.04	$42.41	3.6%	934,316	19.9%	$109,053,560.20	$116.72	2.7%
Fiscal Impact:			$91,251,058.16					$17,802,502.04					$109,053,560.20		
All Taxpayers:			$124,300,482.65			Non-Resident:		$15,246,922.45							

SIMULATION NO. 5172: TAX REFORM ACT OF 1986

TAX YEAR 1987

Kansas Department Of Revenue

Individual Income Tax In Tax Year 1986
Resident Taxpayers

Current Law

K.A.G.I. Bracket	Married: No. Of Returns	Married: Percent Of KAGI	Married: Liability	Married: Percent Of Total	Married: Effective Rate	Single: No. Of Returns	Single: Percent Of KAGI	Single: Liability	Single: Percent Of Total	Single: Effective Rate	Total Residents: No. Of Returns	Total Residents: Percent Of KAGI	Total Residents: Liability	Total Residents: Percent Of Total	Total Residents: Effective Rate
No K.A.G.I.	12,526	0.0%	$0.00	0.0%	0.0%	6,211	0.0%	$0.00	0.0%	0.0%	18,737	0.0%	$0.00	0.0%	0.0%
$0 $5,000	16,632	0.3%	$13,571.43	0.0%	0.0%	107,053	5.2%	$972,779.59	0.2%	0.3%	123,684	1.5%	$986,351.02	0.2%	0.3%
$5,000 $15,000	78,526	4.8%	$6,736,626.53	1.2%	0.9%	166,842	27.3%	$27,882,173.47	5.1%	1.8%	245,368	10.6%	$34,618,800.00	6.3%	1.5%
$15,000 $25,000	102,526	12.2%	$33,804,234.69	6.2%	1.7%	83,895	28.0%	$45,429,657.14	8.3%	2.9%	186,421	16.2%	$79,233,891.84	14.5%	2.2%
$25,000 $35,000	110,000	19.5%	$70,886,929.59	12.9%	2.2%	34,737	17.4%	$31,911,936.73	5.8%	3.3%	144,737	18.5%	$102,798,866.33	18.8%	2.5%
$35,000 $50,000	121,789	29.0%	$122,719,284.69	22.4%	2.5%	13,789	9.7%	$17,911,536.73	3.3%	3.3%	135,579	24.6%	$140,630,821.43	25.7%	2.6%
$50,000 $100,000	64,211	24.0%	$108,511,577.55	19.8%	2.8%	5,895	6.5%	$14,533,455.10	2.7%	4.0%	70,105	19.5%	$123,045,032.65	22.5%	2.9%
$100,000 Over	8,316	9.5%	$53,398,809.18	9.7%	3.4%	1,368	6.0%	$13,165,155.10	2.4%	3.9%	9,684	8.6%	$66,563,964.28	12.1%	3.5%
Total	514,526	100.00%	$396,071,033.67	72.29%	2.4%	419,789	100.00%	$151,806,693.88	27.71%	2.7%	934,316	100.00%	$547,877,727.55	100.00%	2.5%

Kansas Department Of Revenue

Individual Income Tax In Tax Year 1986
Resident Taxpayers

TAX REFORM ACT OF 1986

K.A.G.I. Bracket	Married: No. Of Returns	Married: Percent Of KAGI	Married: Liability	Married: Percent Of Total	Married: Effective Rate	Single: No. Of Returns	Single: Percent Of KAGI	Single: Liability	Single: Percent Of Total	Single: Effective Rate	Total Residents: No. Of Returns	Total Residents: Percent Of KAGI	Total Residents: Liability	Total Residents: Percent Of Total	Total Residents: Effective Rate
No K.A.G.I.	11,263	0.0%	$0.00	0.0%	0.0%	5,789	0.0%	$0.00	0.0%	0.0%	17,053	0.0%	$0.00	0.0%	0.0%
$0 $5,000	14,947	0.2%	$13,775.51	0.0%	0.0%	104,105	4.9%	$1,020,942.86	0.2%	0.3%	119,053	1.4%	$1,034,718.37	0.2%	0.3%
$5,000 $15,000	73,895	4.3%	$6,986,810.20	1.1%	0.9%	166,421	26.2%	$29,139,291.84	4.4%	1.8%	240,316	9.8%	$36,126,102.04	5.5%	1.5%
$15,000 $25,000	98,842	11.0%	$34,306,426.53	5.2%	1.7%	85,158	27.2%	$48,764,006.12	7.4%	3.0%	184,000	15.1%	$83,070,432.65	12.6%	2.3%
$25,000 $35,000	106,947	17.6%	$74,456,592.86	11.3%	2.3%	34,421	16.4%	$32,343,676.53	4.9%	3.2%	141,368	17.3%	$106,800,269.39	16.3%	2.5%
$35,000 $50,000	118,842	27.2%	$133,899,824.45	20.4%	2.7%	15,263	10.3%	$19,993,310.20	3.0%	3.2%	134,105	22.9%	$153,893,134.65	23.4%	2.8%
$50,000 $100,000	76,842	27.8%	$152,600,352.04	23.2%	3.0%	8,947	7.3%	$17,063,833.67	2.6%	3.5%	85,789	22.6%	$169,664,185.71	25.8%	3.1%
$100,000 Over	10,947	11.9%	$85,059,110.20	12.9%	3.9%	1,584	7.7%	$21,284,134.65	3.2%	4.5%	12,531	10.9%	$106,343,244.85	16.2%	4.2%
Total	514,526	100.0%	$487,322,091.84	74.2%	2.7%	419,789	100.00%	$169,609,195.92	25.8%	2.8%	934,316	100.00%	$656,931,287.76	100.00%	2.7%
Fiscal Impact:			$91,251,058.16					$17,802,502.04					$109,053,560.21		
All Taxpayers:			$124,300,482.65			Non-Resident:		$15,246,922.45							

SIMULATION NO. 6173: TAX REFORM ACT OF 1986

TAX YEAR 1988

Kansas Department Of Revenue

Individual Income Tax In Tax Year 1986
Resident Taxpayers
Impact By Bracket

TAX REFORM ACT OF 1986

Married

K.A.G.I. Bracket	No. Of Returns	Percent Increase	Dollar Change In Liability	Dollar Change Per Return	Effective Rate
No K.A.G.I.	11,263	0.0%	$0.00	$0.00	0.0%
$0 $5,000	14,947	1.5%	$204.08	$0.01	0.0%
$5,000 $15,000	73,895	4.2%	$285,795.92	$3.87	0.9%
$15,000 $25,000	98,842	1.8%	$603,110.20	$6.10	1.7%
$25,000 $35,000	106,947	5.0%	$3,563,940.98	$33.32	2.3%
$35,000 $50,000	118,842	9.5%	$11,701,984.69	$98.47	2.7%
$50,000 $100,000	78,842	43.5%	$47,205,203.06	$598.73	3.1%
$100,000 Over	10,947	59.5%	$31,747,954.08	$2,900.05	3.5%
Total	514,526	24.0%	$95,108,201.02	$184.85	2.7%
Fiscal Impact:			$95,108,201.02		
All Taxpayers:			$139,181,369.39		

Single

K.A.G.I. Bracket	No. Of Returns	Percent Increase	Dollar Change In Liability	Dollar Change Per Return	Effective Rate
No K.A.G.I.	5.789	0.0%	$0.00	$0.00	0.0%
$0 $5,000	104,105	5.7%	$55,612.24	$0.53	0.3%
$5,000 $15,000	166,421	4.5%	$1,261,097.96	$7.58	1.8%
$15,000 $25,000	85,158	7.6%	$3,467,002.04	$40.71	3.0%
$25,000 $35,000	34,421	4.5%	$1,420,968.37	$41.28	3.3%
$35,000 $50,000	15,263	21.3%	$3,813,148.98	$249.83	3.5%
$50,000 $100,000	6,947	29.3%	$4,251,076.53	$611.90	4.2%
$100,000 Over	1,684	63.8%	$11,038,163.27	$6,553.91	5.2%
Total	419,789	16.7%	$25,307,069.39	$60.29	2.9%
Fiscal Impact:			$25,307,069.39		
Non-Resident:			$16,766,098.98		

Total Residents

K.A.G.I. Bracket	No. Of Returns	Percent Increase	Dollar Change In Liability	Dollar Change Per Return	Effective Rate
No K.A.G.I.	17,053	0.0%	$0.00	$0.00	0.0%
$0 $5,000	119,053	5.7%	$55,816.33	$0.47	0.3%
$5,000 $15,000	240,316	4.5%	$1,546,893.88	$6.44	1.5%
$15,000 $25,000	184,000	5.1%	$4,070,112.24	$22.12	2.3%
$25,000 $35,000	141,368	4.8%	$4,984,917.35	$35.26	2.6%
$35,000 $50,000	134,105	11.0%	$15,515,133.67	$115.69	2.8%
$50,000 $100,000	85,789	41.8%	$51,456,279.59	$599.80	3.2%
$100,000 Over	12,632	64.3%	$42,786,117.35	$3,387.23	4.2%
Total	934,316	22.0%	$120,415,270.41	$128.88	2.8%
Fiscal Impact:			$120,415,270.41		

SIMULATION NO. 6173: TAX REFORM ACT OF 1986

TAX YEAR 1988

Kansas Department Of Revenue

Individual Income Tax In Tax Year 1986
Resident Taxpayers

Current Law

K.A.G.I. Bracket	Married: No. Of Returns	Percent Of KAGI	Liability	Percent Of Total	Effective Rate	Single: No. Of Returns	Percent Of KAGI	Liability	Percent Of Total	Effective Rate	Total Residents: No. Of Returns	Percent Of KAGI	Liability	Percent Of Total	Effective Rate
No K.A.G.I.	12,526	0.0%	$0.00	0.0%	0.0%	6,211	0.0%	$0.00	0.0%	0.0%	18,737	0.0%	$0.00	0.0%	0.0%
$0 $5,000	16,632	0.3%	$13,571.43	0.0%	0.0%	107,053	5.2%	$972,779.59	0.2%	0.3%	123,684	1.5%	$986,351.02	0.2%	0.3%
$5,000 $15,000	78,526	4.8%	$6,736,626.53	1.2%	0.9%	166,842	27.3%	$27,882,173.47	5.1%	1.8%	245,368	10.5%	$34,618,800.00	6.3%	1.5%
$15,000 $25,000	102,526	12.2%	$33,804,234.69	6.2%	1.7%	83,895	28.0%	$45,429,657.14	8.3%	2.9%	186,421	16.2%	$79,233,891.84	14.5%	2.2%
$25,000 $35,000	110,000	19.5%	$70,886,929.59	12.9%	2.2%	34,737	17.4%	$31,911,936.73	5.8%	3.3%	144,737	18.9%	$102,798,866.33	18.8%	2.5%
$35,000 $50,000	121,789	29.8%	$122,719,284.69	22.4%	2.5%	13,789	9.7%	$17,911,536.73	3.3%	3.3%	135,579	24.6%	$140,630,821.43	25.7%	2.6%
$50,000 $100,000	64,211	24.0%	$108,511,577.55	19.8%	2.8%	5,895	6.5%	$14,533,455.10	2.7%	4.0%	70,105	19.5%	$123,045,032.65	22.5%	2.9%
$100,000 Over	8,316	9.5%	$53,398,809.18	9.7%	3.4%	1,368	6.0%	$13,165,155.10	2.4%	3.9%	9,684	8.6%	$66,563,964.29	12.1%	3.5%
Total	514,526	100.00%	$396,071,033.67	72.29%	2.4%	419,789	100.00%	$151,806,693.88	27.71%	2.7%	934,316	100.00%	$547,877,727.55	100.00%	2.5%

Kansas Department Of Revenue

Individual Income Tax In Tax Year 1986
Resident Taxpayers

TAX REFORM ACT OF 1986

K.A.G.I. Bracket	Married: No. Of Returns	Percent Of KAGI	Liability	Percent Of Total	Effective Rate	Single: No. Of Returns	Percent Of KAGI	Liability	Percent Of Total	Effective Rate	Total Residents: No. Of Returns	Percent Of KAGI	Liability	Percent Of Total	Effective Rate
No K.A.G.I.	11,263	0.0%	$0.00	0.0%	0.0%	5,789	0.0%	$0.00	0.0%	0.0%	17,053	0.0%	$0.00	0.0%	0.0%
$0 $5,000	14,947	0.2%	$13,775.51	0.0%	0.0%	104,105	4.9%	$1,028,391.84	0.2%	0.3%	119,053	1.4%	$1,042,167.35	0.2%	0.3%
$5,002 $15,000	73,895	4.3%	$7,022,422.45	1.1%	0.9%	166,421	26.2%	$29,143,271.43	4.4%	1.8%	240,316	9.8%	$36,165,693.88	5.4%	1.5%
$15,000 $25,000	98,842	11.0%	$34,407,344.90	5.1%	1.7%	85,158	27.2%	$48,896,659.18	7.3%	3.0%	184,000	15.1%	$83,304,004.08	12.5%	2.3%
$25,000 $35,000	106,947	17.6%	$74,450,878.57	11.1%	2.3%	34,421	16.4%	$33,332,905.10	5.0%	3.3%	141,368	17.3%	$107,783,783.67	16.1%	2.6%
$35,000 $50,000	118,842	27.2%	$134,421,269.39	20.1%	2.7%	15,263	10.3%	$21,724,685.71	3.3%	3.5%	134,105	22.9%	$155,145,955.10	[illegible]	2.8%
$50,000 $100,000	76,842	27.8%	$155,716,780.61	23.3%	3.1%	6,947	7.3%	$18,784,531.63	2.8%	4.2%	55,789	22.6%	$174,501,312.24	[illegible]	3.2%
$100,000 Over	10,947	11.9%	$85,146,763.27	12.7%	3.9%	1,684	7.7%	$24,203,318.37	3.5%	5.2%	12,632	10.9%	$109,350,081.63	[illegible]	4.2%
Total	514,526	100.0%	$491,179,234.69	73.5%	2.7%	419,789	100.00%	$177,113,763.27	26.5%	2.9%	934,316	100.00%	$558,292,997.96	100.00%	[illegible]

Fiscal Impact: $95,108,201.02 $25,307,069.39 $120,415,270.41

All Taxpayers: $139,181,369.39 Non-Resident: $18,765,098.96

Areas of Non-Conformity Between State and Federal Itemized Deductions After the Tax Reform Act of 1986

1. **Medical and Dental Expenses** - Kansas allows all unreimbursed expenses in excess of $50 while the federal deduction allows only unreimbursed expenses in excess of 7.5% of AGI.

2. **Social Security and Related Employment Taxes** - Allowed as a deduction at the state level, but not at federal.

3. **Solar Energy Amortization** - More generous provisions allowed at the state level. To our knowledge has never been used.

4. **Contributions to Segregated Schools** - No longer necessary as federal law now interpreted to coincide with state law.

5. **Casualty Losses** - Non-conformed since 1983. State allows all unreimbursed losses in excess of $100 per occurrence. Federal is limited to losses in excess of 10% of AGI.

6. **Charitable contributions** - Our rate for mileage is 7 cents per mile which was the federal rate in 1977. Current federal rate is 12 cents. Also, TRA imposed additional limits on travel which can be included as charitable.

7. **State and Local Gas Taxes** - Still allowed as state itemized deduction. Repealed at the federal level in 1979.

8. **Political Contributions** - State allows deduction of $100/200. At the federal level, it was converted to a credit in 1979 and with TRA, the credit will be repealed.

9. **Work of Art Contribution** - Special excess deduction allowed at the state level. Never been utilized.

10. **State and Local Sales Taxes** - Federal deduction repealed in TRA. If continued at the state level, we should maintain deduction tables for all states to accommodate part-year residents which would involve considerable research time to keep current. Also, local option considerations make the non-conformity more cumbersome.

11. **Non-mortgage interest** - TRA phases out the deduction for non-mortgage interest from 1987 - 1991 with exceptions of home equity loans for educational and medical purposes. State law would still allow full deduction.

12. **Moving Expenses** - TRA makes moving expenses a miscellaneous itemized deduction not subject to the 2% of AGI floor. It is currently an allowable adjustment to gross income. At the state level, therefore, taxpayers would lose the adjustment to income but not have the itemized deduction available to them.

13. **Employee Business Expenses** - Those currently taken as an adjustment to income on the front of the 1040 are converted to a miscellaneous itemized deduction subject to the 2% of AGI floor. These would be lost to Kansas taxpayers at the state level.

14. **Other Miscellaneous Deductions** - Are allowed only to the extent they exceed 2% of AGI. Would be allowed fully at the state level. Taxpayers would be required to both delete some from the federal total and add back greater amounts of others.

NEWS

JOHN CARLIN

GOVERNOR OF KANSAS

Michael Swenson, Press Secretary The Statehouse, Topeka 66612 (913) 296-2716

FOR IMMEDIATE RELEASE: January 8, 1987

File

Governor John Carlin today issued Executive Order Number 87-91, directing the Kansas Secretary of Revenue to implement procedures excluding foreign dividends and gross ups from the state corporate tax base. The purpose of this executive order is to create a more favorable business climate for investors considering a Kansas location and those companies currently doing business in Kansas.

The order also issues a clear definition of those factors that will be used as an assessment for the issuance of any combined or unitary assessment for reporting corporate income tax. The combined method will be enforced only in situations where corporate functions are integrated on an operational level, such as transfers between the corporation of items, such as products, services, technical information, marketing information, purchasing and intangibles, in a manner that substantially affects the manufacture, distribution, production, extraction or sale of their products or services. Management oversight, supervision or control does not constitute functional integration at the operational level and shall not be used as the basis for the issuance of any combined or unitary assessment.

For both domestic and international corporations, these two measures should continue to increase the pro-business image of Kansas and make the state more competitive in attracting new investment.

For more information, contact Kansas Secretary of Revenue Harley Duncan at 296-3041.

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STATE OF KANSAS

FILED

JAN - 8 1987

[illegible]

OFFICE OF THE GOVERNOR
State Capitol
Topeka 66612-1590

John Carlin *Governor*

EXECUTIVE ORDER NO. 87-91

CONCERNING STATE DETERMINATION
OF UNITARY TAXATION

Executive Department
State House
Tcpeka, Kansas

WHEREAS, many states have instituted the requirement of combined reporting for corporations which have a unitary relationship; and

WHEREAS, a definitive determination and policy by the State of Kansas as to the criteria for unity will provide guidance to corporate taxpayers, aid them in their business decisions with regard to locating facilities in Kansas, and be beneficial to the continued economic growth and prosperity of both Kansas businesses and its citizens; and

WHEREAS, the question of including foreign dividends and gross-ups as defined in Section 78 of the Internal Revenue Code of 1954, as amended, in the state corporate tax base has been litigated by several states with those decisions resulting in no clear statement regarding the continued propriety of taxing such dividends and gross-up by the states.

NOW THEREFORE, in order to promote and encourage economic development in

Kansas yet not compromise the authority of the Secretary of Revenue to enforce Kansas tax statutes and pursuant to the authority vested in me as Governor and chief executive of the State of Kansas, effective for all taxable years beginning after December 31, 1986 I hereby order and direct that any interpretation of K.S.A. 79-32,141, or any other related statutes requiring the combined method of reporting corporate income tax, be enforced only in situations where there is, between the members of the corporate group, functional integration at their operational level, such as transfers between or pooling among the corporation of items such as products, services, technical information, marketing information, purchasing and intangibles (patents, copyrights, formulas, processes, trade secrets) in a manner that substantially affects the manufacture, distribution, production, extraction, or sale of their products or services. Management oversight, supervision, or control does not constitute functional integration at the operational level and shall not, without more, be used as the basis for the issuance of any combined or unitary assessment.

FURTHER, in order to further promote and encourage economic development in Kansas and eliminate any confusion regarding the proper treatment of foreign dividends and gross-ups as defined in Section 78 of the Internal Revenue Code of 1954, as amended, for state tax purposes, effective for all taxable years beginning after December 31, 1986 I hereby order and direct the Secretary of Revenue to implement procedures necessary to exclude from the state corporate tax base all foreign dividends and gross-ups as defined in Section 78 of the Internal Revenue Code of 1954, as amended.

This document shall be filed with the Secretary of State as Executive Order No. 87-91 and shall become effective immediately.

THE GOVERNOR'S OFFICE

By the Governor John Carlin

January 8, 1987

Jack H. Brier
Secretary of State

Carol Beard
Assistant Secretary of State

FILED
JAN - 8 1987
JACK H. BRIER
SECY. OF STATE

THE RESEARCH AND DEVELOPMENT TAX-CREDIT

Legal Structure

Status. Although the research and development tax-credit will not be in effect until FY 1988, it is important to clarify how the Act applies to a number of particular situations. When the Research and Development Tax Credit Bill was being developed in the spring of 1986, the focus was on research and development investments by large corporations. There is, however, another important use for the tax-credit in terms of the Kansas economy. It pertains research and development investments by small firms and venture capital partnerships.

Recommendations The Commission recommends the following changes:

1. When a taxpayer invests in a R&D partnership which does not expend all the funds in the year of investment, the credit should be prorated based upon the taxpayer's share of the funds actually expended by the partnership during the taxable year.

2. When a taxpayer disposes of an interest in a partnership prior to expenditure of the funds by the partnership, the credit should be received by the partner holding the interest in the partnership at the time the funds are expended.

VENTURE CAPITAL CREDIT -- TECHNICAL

Expenditure of Funds Triggers Credit. The Commission recommends that an investor who borrows funds to purchase stock in a Kansas venture capital company be entitled to a tax credit on the full investment amount. The lender and borrower should be free to work out the details of the repayment agreement of the loan among themselves. The venture capital company should assign the full amount of the investment to the individual investor to the Secretary of the Department of Commerce.

Recapture. The Commission recommends that, absent decertification, if a taxpayer disposes of a portion of the investment, no portion of the credit would be recaptured. Only in case of decertification would the tax credit be recaptured. In that case, the original investor who benefited from the tax credit should be responsible for repayment.

The Tax Credit and Kansas Venture Capital, Inc.

Need and Mission

Status. The Kansas Statewide Risk Capital Act (1986 S.B. 756), is designed to address inefficiencies within Kansas' risk capital markets and seeks to meet a range of financing needs -- from seed to venture to mezzanine capital. The Kansas Statewide Risk Capital Act recognizes Kansas Venture Capital, Inc. to address these needs. KVCI's average return on investments will be lower than that of private venture capital companies -- around 15 percent, based on the experience of successful risk-capital mechanisms such as the Massachusetts Business Development Corporation (MBDC), the Massachusetts Capital Resource Company (MCRC), and others.

Recommendation. Separate, unambiguous guidelines should be established to govern the tax credits for investment in KVCI. Current law establishes certification guidelines for Kansas venture capital companies which are not fully appropriate for KVCI. While some of those guidelines are universal targeting mechanisms; others are regulatory measures specifically designed for organizations which only structure equity investments.

Tools and Sources of Funds

Status. Guidelines for KVCI investments in current law are ambiguous, and are not fully explicit in terms of KVCI's risk capital investments, function or SBIC status.

Recommendations for KVCI. The Commission recommends that:

1. KVCI's investments be made solely in-state.

2. KVCI's investments be required to be structured as equity or as unsecured subordinated debt with warrants convertible to equity.

3. All of the $1.5 million already invested in KVCI that is reinvested should be classified as new investments eligible for the tax credit and credited towards the $10 million requirement.

4. The state invest in KVCI preferred stock only after the full $10 million has been raised.

5. The ceiling of $10 million investment eligible for the tax credit remain unchanged for FY 1987. The Task Force recognizes that if there is an oversubscription on the original $10 million, it should be honored. After FY 1987, and after the initial $10 million has been raised, the ceiling is subject to review and should be negotiable upon availability of additional, unused tax credit.

6. While KVCI's investment standards are of a higher order that those set by SBIC regulations, they must not jeopardize KVCI's SBIC license. In case of an apparent conflict between SBIC guidelines and KVCI's statute, the Secretary of the Kansas Department of Commerce should be

given authority to interpret KVCI's statute in ways which do not jeopardize the SBIC license at the same time that the Legislative intent of S.B. 756 is maintained.

7. Any firm located within Kansas should qualify as a "Kansas business" under the tax credit bill, regardless of the owner's residence.

Recommendation for Private Venture Capital Companies. The Commission recommends retaining the 60-40 provision for private Kansas venture capital companies in order to maximize the number of venture capital investments within the state. The Commission's recommendation is backed by four compelling reasons:

1. The provision will allow Kansas venture capital companies to import more capital into the state by forming joint-ventures with leading national and international venture capitalists.

2. Natural market areas extend beyond political boundaries. Economic activity in Kansas City, Missouri, is intertwined with economic activity in many Kansas cities and towns. Similarly, the natural economic market of St. Francis spills over the Nebraska and Colorado borders. Investments in Kansas City, Missouri start-ups are as likely to benefit Kansans as they are to benefit Missouri residents.

3. The entire history and nature of the venture capital industry does not allow capital to stray more than 200 miles from its source of origin.

4. The private venture capital industry in Kansas will be much more successful if it can spread risk to ensure its return. The rule that investors cling most avidly to is "don't put all your eggs in one basket." In order to secure reasonable rates of return at reasonable levels of risk for investors, venture capital companies need to diversify their portfolios. The 60-40 provision allows them to do so.

TAXATION

TAXATION AND TAX STRUCTURE IN KANSAS

After hearing testimony from a variety of businesses and business-location conferees, the Capital Markets and Taxation Task Force concluded that Kansas' tax structure and tax incentives should be viewed as an integral part of any successful economic development program. The Commission concurs with this conclusion. The ability of the state to appear competitive in its tax structure can send an important signal to outside firms and affect expansion plans of current Kansas businesses. Despite hearing testimony that most tax incentives are not cost-effective, the Task Force believes that Kansas should take steps to remove burdensome tax features and assure that the tax structure remains regionally competitive.

Some corporations recently have chosen not to locate in Kansas after analyzing the tax structure of bordering states. The Commission believes that this problem has arisen in part because of several features of Kansas' corporation income tax that make the effective rate significantly higher than any of its neighbors' effective rates, especially for large and very profitable corporations.

-- Kansas' 6.75 percent rate for all corporations with KAGI of $25,000 or more does not compare favorably with the 5 percent across-the-board rate in Missouri, Oklahoma, and Colorado.

-- Of the 43 states with corporation income taxes, Kansas is one of 37 states that does not allow federal taxes paid as a deduction. Missouri is one of six states with corporation income taxes that does allow that deduction. This deduction lowers Missouri's effective rate under current law to 2.7 percent.

-- Kansas and all of its neighboring states have adopted UDITPA, the Uniform Division of Income for Taxation Purposes Act. Three factors -- sales, payroll, and property -- are equally weighted when apportioning the amount of a corporation's income attributed to Kansas. Missouri, however, allows corporations the option of computing liability either under UDITPA or under a single-factor (sales) formula.

These distinctions in the states' corporation income taxes have combined to lead some publicly-held corporations, unable to justify payment of Kansas taxes, to locate in neighboring states, especially Missouri.

Another area in which Kansas compares unfavorably is that it charges sales tax on manufacturing machinery and equipment. Such equipment has been subject to a refund of the sales tax when located within an enterprise zone. However, the value of the refund was diminished by the time lag between initial payment of the tax and receipt of the refund. Occasionally, this delay has proven to be a burden for some corporations. Beginning January 1, 1987,

House Tax Com. -- Attachment 4
1-14-87

such equipment installed within an enterprise zone will be exempt from sales taxes.

Table 2, below, compares some tax features of Kansas and neighboring states with respect to the characteristics mentioned above.

TABLE 2

Selected Tax Features for Kansas and Neighboring States

	Kansas	Missouri	Oklahoma	Colorado	Nebraska
Corporation Income Tax					
Rates -- Maximum	6.75%	5.00%	5.00%	5.00%	6.65%
Rates -- Minimum	4.50%	5.00%	5.00%	5.00%	4.75%
Fed. Tax Deductible	No	Yes[1]	No	No	No
UDITPA	Yes	No[2]	Yes	Yes	Yes
Credits --					
Job. Exp.	Yes	Yes	No	No	No
Investment	Yes	Yes	Yes	No	No
Relative Collections[3]	$ 65.17	$ 31.93	$ 31.66	$ 31.46	$ 30.49
Sales and Use Taxes					
Rate	4.000%	4.225%	3.250%	3.000%	3.500%
Local Taxes	Yes	Yes	Yes	Yes	Yes
Exemptions --					
Manufacturing Mach.	No	Yes	Yes	Yes	No
Enterprise Zones	Yes	No	Yes	No	No

Notes:

1) This deduction lowers Missouri's effective rate under current law to 2.7 percent.

2) Missouri, although it has adopted UDITPA, allows the option of using only the sales factor.

3) FY 1985 collections per capita.

Source: Commerce Clearing House, State Tax Guide, 2d. Ed.

In order to make Kansas more competitive with surrounding states, the Commission believes that it is essential that all tax incentives be as cost-effective as possible for the state and local governments. The Commission, therefore, makes the following recommendations to the 1987 Legislature:

-- Extend the sales and use tax exemption for manufacturing machinery and equipment to the entire state. The exemption currently exists only within enterprise zones. The Department of Revenue has estimated that this would cause a $12-18 million reduction in State General Fund receipts. The Commission recommends that the exemption be funded in part by repealing the enterprise zones' enhancement of job expansion and investment credits, determined to be not cost effective by Task Force consultant, Charles Krider. The Department has estimated that receipts would increase by $2-3 million in response to such legislation. Thus, the combined cost of the two elements of this recommendation would be $9-16 million.

-- The Commission believes that Missouri's allowing the single-factor apportionment option presents a serious problem for Kansas and that jobs have been lost because of it. While Kansas should not immediately abandon UDITPA, the Department of Revenue should study the business-location situation along the Kansas-Missouri border and make recommendations to the Legislature about how Kansas can respond.

-- The Legislature should consider appropriate reductions in corporation income tax rates to make Kansas more competitive with neighboring states.

The Task Force also studied a number of other proposed tax changes that could enhance economic development in Kansas, including exempting the interest from general obligation bonds from the state income tax, adopting a single-factor apportionment option, and restoring corporate federal deductibility. However, given the realities of the state's fiscal situation, the Commission is not recommending these changes at this time.

The Commission wishes to place the highest priority possible on extension of the sales and use tax exemption for manufacturing machinery and equipment to the entire state. The Commission believes that this change would significantly improve the perception of the Kansas business climate. Economic activity would increase as a result of more manufacturing activity in Kansas. It is therefore imperative, particularly given the current economic situation, that this economic development initiative be enacted.

Adoption of these recommendations is also needed to stop an apparent trend of corporations choosing to locate elsewhere. A more competitive tax structure, coupled with an aggressive marketing strategy by the Department of Commerce to convince outside firms of the numerous advantages of locating in Kansas, can reverse the trend and serve as a crucial tool in Kansas' economic development strategy.