

Approved On: 2/24/87

Minutes of the House Committee on Taxation. The meeting was called to order by E. C. Rolfs, Chairman, at 9:00 a.m. on February 23, 1987 in room 519 South at the Capitol of the State of Kansas.

The following members were absent (excused):

Representatives Adam, Fuller, Gatlin, VanCrum and Francisco

Committee staff present:

Tom Severn, Legislative Research  
Chris Courtright, Legislative Research  
Don Hayward, Reviser of Statutes  
Millie Foose, Committee Secretary

Hearings were held on HB-2222, an act relating to the requirement for corporations to submit security bonds to obtain a sales tax number. Representative Lowther, R. Todd Wright and T. C. Anderson appeared in support of the bill. Cleo Murphy appeared in opposition to the bill representing the Department of Revenue. After committee discussion, the chairman appointed a subcommittee consisting of Representatives Lowther, Fox and Grotewiel to work the bill and report back to the committee. (Attachments 1-3)

Hearing were held on HB-2196 relating to fees assessed by the Board of Tax Appeals. Keith Farrar appeared as a proponent.

The chairman resumed discussion of HB-2080 relating to local sales taxes. The motion before the body was the substitute motion of Reardon to apply the bill to Wyandotte County. Representative Leach moved, second by Lowther, that the committee reconsider its action in localizing the bill. The motion carried. Representative Leach, second by Reardon, that the bill authorize the counties at the 1% limit to go to up to 1 1/2%. Substitute motion failed. Representative Reardon moved, second by Spaniol, that the bill be localized to Montgomery and Wyandotte counties and that Wyandotte County be authorized to exceed the county option tax limit by 1/2%. Motion carried. Representative Smith moved, second by Spaniol, that HB-2080 be recommended favorably as amend. Motion carried.

HB-2209 relating to statistical sampling for sales tax audits, was brought before the committee. Representative Roe moved, second by Leach, that the bill be conceptually amended to provide for valid and reliable statistical sampling methods. Motion carried. Representative Lowther moved, second by

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Leach, that the Department be required to submit a sampling plan to the taxpayer and provide for an appeal mechanism. Motion carried. Representative Fox moved, second by Lowther, that HB-2209 be recommended favorably as amended. Motion carried.

The minutes of the previous meeting were approved.

There being no further business, the meeting was adjourned.



E. C. Rolfs, Chairman

M E M O R A N D U M

TO: House Committee on Assessment and Taxation

FROM: Harley T. Duncan, Secretary  
Kansas Department of Revenue

SUBJECT: House Bill No. 2222

DATE: February 23, 1987

The present policy with respect to bonding requirements which is followed by the Department is contained in K.A.R. 92-19-35. Under this regulation, corporations applying for a new sales tax certificate of registration must post a bond equal to six months' average sales tax liability or \$1,000.00, whichever is greater. This same bonding requirement is imposed upon sole proprietorships and partnerships when these businesses become delinquent in remitting sales taxes to the state.

The \$1,000.00 minimum was selected since private clubs (liquor excise tax accounts) and motor fuel tax accounts must have a \$1,000.00 minimum bond, and liquor stores must have a \$2,000.00 minimum bond. In addition, the smallest surety bond which can be purchased is \$1,000.00.

The proposed legislation will have the effect of eliminating the \$1,000.00 minimum. Although the Department does not believe a change is needed, if this is the desire of the legislature, the Department recommends that the bill be amended so that the only accounts which will be affected will be those on an annual reporting basis. (Accounts which collect and remit less than \$80.00 sales tax per year are on an annual reporting basis.)



PROPOSED CHANGES TO SALES TAX BONDING REQUIREMENTS  
FOR SMALL CORPORATIONS

R. TODD WRIGHT, CPA  
SINNARD & WRIGHT, CPA'S  
EMPORIA, KANSAS

OUTLINE

- I. Current rules and regulations discourage small business development and non-profit projects which benefit the disadvantaged.
- A. Current rules:  
For corporations without prior sales tax history, a sales tax bond equal to the greater of one-half annual expected liability or \$1,000.00.
- B. Purpose of current rules:  
Current rules and regulations are designed to reduce sizeable losses of unpaid sales tax which the state suffers.
- C. Damage to small businesses and non-profit corporations:
- (1) Corporate form is desirable for liability reasons.
  - (2) New bonding requirement greatly increases the cost of doing business. The average small business we deal with has a cost of \$250.00 to \$750.00 for incorporation costs and related services. Often, non-profit corporations have the incorporation work donated or use standard articles of incorporation supplied by the national affiliates. The \$1,000.00 cash bond more than doubles the start-up cost required.
  - (3) Insurance bonds are not readily available.
  - (4) Amount is unreasonable in relation to expected liability. In Emporia, it would take approximately \$45,000.00 in annual sales before one-half of the annual liability would equal \$1,000.00.

(5) Result is that projects are not undertaken.

(a) Small businesses:

The out of pocket cash cost to form business has more than doubled. As a result, our clients faced with this situation have considered simply terminating the project.

(b) Non-profit corporations:

These entities often obtain sales tax numbers in order to run small projects (less than \$5,000.00 in sales, often less than \$1,000.00 in sales) which will produce profits to be donated to a worthwhile cause (retarded children, muscular dystrophy, churches, schools, etc.). If a project anticipates to have \$1,500.00 in sales with a \$1,000.00 profit to be donated, the Kansas Department of Revenue requires a \$1,000.00 cash bond; therefore, the project probably will not be run.

## II. Solution which will meet all needs.

A. Real problem is guaranteeing collection.

B. Avenues to insure collection exist.

(1) Personal guarantees by directors.

(2) Bond equal to 100% of liability.

C. Current rules may reduce collections.

If entity does not have sales due to bonding requirements, less sales tax is collected than if entity had taxable sales and only a portion of the sales tax were collected.



# SINNARD & WRIGHT, CPAs

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Michael M. Byrne, C.P.A. Manager / J. Thomas Young, C.P.A.  
Cindy A. Klumpe / Timothy L. Wright

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Honorable Sirs:

Current rules and regulations regarding sales tax bonds for corporations which have no sales tax history produce a detrimental impact on Kansas. While the rules were developed to reduce major losses in sales tax collections, they in practice discourage small business and non-profit projects designed to aid disadvantaged Kansans.

Current rules require that a minimum \$1,000.00 bond be posted prior to a new corporation obtaining a sales tax bond. These rules are part of an effort to reduce major losses by the state in sales tax collections. For the very small corporation, however, the bonding requirement has no relationship to actual expected liability. The excess bond protects against nothing, but produces a major hardship for the new corporation.

Corporate form is often chosen to provide liability protection to investors or members of non-profit corporations. It is attractive especially with the recent unavailability of affordable liability insurance. The cost of operating as a corporation has been greatly increased due to the sales tax bond requirement. The cost of incorporating a small business in our area frequently runs from \$250.00 to \$750.00. When the sales tax bond is added to this, the cost (related to incorporation) more than doubles. Non-profit corporations frequently either have their incorporation work done free or obtain standardized articles of incorporation from their national affiliates. As a result, the out-of-pocket cost of the bond is a major burden for these entities. It should be pointed out that in our area, sales tax bonds are no longer easily obtained.

The actual amount of the bond required is unreasonable based upon many entities actual liability. The rules require a bond equal to one-half expected annual liability or \$1,000.00, whichever is greater. These two rules meet at approximately \$45,000.00 in annual sales (based upon Emporia rates). Many non-profit corporations have annual taxable sales of \$1,000.00 to \$5,000.00. The sales are projects designed to provide funds for a worthwhile cause. For an entity with \$1,500.00 in sales, the annual liability would be \$67.50. A \$1,000.00 bond would still be required. The extra \$932.50 protects against nothing as no liability exists to protect from.

The reaction which we have received from our clients has been very strong. Many have terminated projects rather than deal with the unreasonable amount. This has been the case whether the contemplated corporation was a small shop, a side business attempting to manufacture and market a new product, or where a non-profit corporation had discussed obtaining a sales tax number in order to run a project to aid retarded children. This leads me to question whether any benefit was provided to the state. After all, if no sales are made, did the state collect more sales tax than if the sales are made and only partially collected?

A simple solution to the current problem is to require a bond equal to no more than 100% of expected liability. This would protect the state and make the amount reasonable in relation to actual liability. If necessary, personal guarantees could be obtained from corporate officers. In all of the situations we worked with, officers were happy to personally guarantee the sales tax liability. This solution would help protect against state losses and continue the state's goal of promoting business development.

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*Leo Murphy - Chief of Sales Tax Bureau*