

Approved Feb. 17, 1988  
Date

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT & TAXATION

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

11:00 a.m./p.m. on February 16, 1988 in room 519-S of the Capitol.

All members were present except:

Committee staff present:

Tom Severn, Research  
Chris Courtwright, Research  
Don Hayward, Revisor's Office  
Sue Pettet, Secretary to the Committee

Conferees appearing before the committee:

Jim Cox, Ernst & Whinney  
Gerhard Metz, KCCI  
Barnard Koch, Wichita Area Chamber of Commerce  
Ron Gaches, Boeing  
Basil Covey, Retired Teachers Assoc.  
Richard Funk, Ks. Assoc. of School Boards

SENATE BILL 580

Chairman Kerr called the meeting to order and explained the agenda for the week, including extra meetings at 4:00 on Wednesday, Feb. 17 and 8:00 a.m. on Friday, Feb. 19.

Jim Cox of Ernst & Whinney testified. (Att. 1) He stated that many corporate taxpayers will soon be filing Kansas tax returns which include 1986 tax code changes. He stated that the following changes are ones which will affect corporate federal taxable income the most over the next decade and beyond:

1. Uniform capitalization
2. Accounting methods
3. Depreciation methods
4. Deduction limitations

He gave further explanation of his changes in Att. 1. He stated that he felt the most relevant change relates to the new uniform capitalization rules for inventory. All "manufacturers" are subject to these rules regardless of the level of sales. In the past, many businesses were able to expense many items in the year incurred. The 1986 tax act now requires the allocation of these costs to inventory. They will only be expensed when the inventory is sold. Mr. Cox stated that the changes to such items as travel and entertainment are more substantial than were first imagined. Many taxpayers are unaware that out of town meals for sales men and other employees are subject to the 20% disallowance rule. Also, the disallowance of trademark expenditures will also impact Kansas taxpayers. He felt that the inability to deduct these costs, as well as any costs to defend these patents will cause Kansas corporate taxable income to increase.

In response to questions from Chairman Kerr Mr. Cox acknowledged that during the years since 1981 his corporate clients have paid substantial income tax increases even though corporate income taxes statewide have dropped some 35-40% since that time. The observation was made by Chairman Kerr that the manufacturing industry may not be typical of the corporate trends on the whole while in Kansas.

Gerhard Metz testified. (Att. 2) He stated that KCCI specifically approves the exemption of manufacturers' machinery from the sales and use tax, a change in the apportionment formula for corporations filing as unitary entities, and a reduction of the corporate income tax rate. He said that S.B. 580 would result in the reduction of Kansas corporate tax rates over five years by 1.25%. He said that based on information received he believed that the extent of corporate tax increases would justify a reduction in the corporate tax rate, as corporations will be paying more taxes, and would not result in undercutting

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT & TAXATION

room 519-S, Statehouse, at 11:00 a.m.~~pm~~ on February 16, 1988

ending balances. He stated that corporations' contributions to the state's tax revenues has allegedly declined over the past several years. He felt this could be attributed to either the same number of firms paying taxes on smaller incomes because of declining profits or fewer firms paying taxes because others have gone out of business or left the state. He said that the Council of State Chambers of Commerce has estimated that the Kansas corporate windfall will be in the neighborhood of \$20.4 million on 1987 tax returns and \$191 million over the next five years.

Bernard Koch testified. (Att. 3) He stated that he felt the "windfall" confused this issue. He also encouraged exemption of machinery and equipment, the two-factor formula for multi-state firms, and a corporate income tax reduction to attract new businesses in Kansas. He acknowledged that previous testimony he had submitted to the committee estimated that the corporate "windfall" would be 11%. (In Kansas this would be about \$11.5 million based on 1987 collections.) He said that the information came from Allen, Gibbs & Honlick, CPA's.

Ron Gaches testified. He stated that he felt the decisions regarding personal and corporate income tax issues were very important. He urged the committee to use only one set of consensus revenue estimates. He stated that the corporate tax reductions in S.B. 580 are not phased in immediately. This gives a chance to view additional windfall for two years before it takes effect. Mr. Gaches said that he hopes the committee moves forward on the machinery and equipment sales tax exemption.

Basil Covey testified. (Att. 4) He stated that his organization supported S.B. 580 because they liked the long range concept and because the bill calls for excluding social security benefits from Kansas income tax in 1990. He stated that the retired citizens in Kansas including retired teachers have asked for a social security benefit exemption for four years. In response to a question, Mr. Covey stated that only 8% of his organizations members pay tax on social security income and these are the highest income members.

Richard Funk testified in opposition to S.B. 580. (Att. 5) He stated that the school districts received some benefit from S.B. 490, but that policies in S.B. 580 appear to be a hardship to the school districts of Kansas.

Senator Montgomery made a motion to adopt the minutes of the Feb. 12 and Feb. 15 meetings. Senator Hayden seconded. Motion carried.

Meeting adjourned.

ASSESSMENT AND TAXATION

OBSERVERS  
(PLEASE PRINT)

DATE **2-16** NAME ADDRESS REPRESENTING

DATE	NAME	ADDRESS	REPRESENTING
	Dana Ferrell	Topeka	Budget
	Rich McKee	Topeka	K.L.A.
	JOE A. MORRIS	TOPEKA	KLSI
	Kevin Kelly	Oakland Park	SUN
	Robert Buchholder	Buhler	AARP
	B.W. Bower	Topeka	Revenue
	Jack Smith		"
	Christy Young	Topeka	Topeka Chamber of Com
	TREVA POTTER	TOPEKA	PEOPLES NATIO
	Tom Taylor	Topeka	KPL Gas Service
	Jerry Counsel	TOPEKA	KC & E
	Tom Whitaker	Topeka	Ks Motor Carriers Assn
	James Schwartz	Topeka	United Telephone
	Rebecca Beutler	Larrens	Sen. Parish Inter
	Ted Finken	Topeka	KPL
	Janet Stubb	"	HBAK
	Ruth Wilbur	"	AAUW
	RON CALBERT	NEWTON	U. I. U.
	Rich Dame	Herington	BLE
	Clare Johannes	Manhattan	NC-FHAAA
	Alaina Parker	Manhattan	NC-FHAAA
	Craig Grant	Topeka	K-WEA
	Basel Covey	Topeka	KRTA
	Richard Fink	"	KASO
	SHELBY Smith	Wichita	Sawson
	Amy Apitz	Topeka	KMHA
	FOREST PITTS	WICHITSA	APPRAISERS IFA
	Ed Hughes	Bygones	Appraisers
	Chris Draher	Kunzman	IFA-Appraisers





# Ernst & Whinney

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February 16, 1988

Sen. Fred Kerr

Chairman

Dear Mr. Chairman:

I am pleased to appear today before your committee. My comments will center around the impact that federal tax reform in 1986 and 1987 will have on Kansas corporate taxpayers.

As you are aware, most of the changes that were made to the Internal Revenue Code during 1986 became effective during calendar 1987. As a result, many corporate taxpayers will soon be filing Kansas tax returns which include these changes. Since Kansas corporate tax returns are prepared beginning with federal taxable income, the changes made to federal taxable income are included in the Kansas tax base. Only statutory adjustments are made to this beginning amount to arrive at Kansas taxable income. I am not aware of any changes that Kansas has made to federal

taxable income of corporations that will serve to mitigate any of this broadening of the federal tax base. Any change to federal taxable income that the Treasury estimates will be a positive increase to income, and hence increase federal tax liabilities, will have the identical impact on Kansas corporate taxes. The dollar impact will of course be proportionately less.

To better understand the impact that federal tax reform will have on corporate taxpayers I think it is prudent to briefly outline the major changes. It is these changes that the revenue estimators must review when determining the net increase to Kansas corporate taxes that logically seems to result. The following changes are ones which will affect corporate federal taxable income the most over the next decade and beyond:

Uniform capitalization

Accounting methods

Depreciation methods

Deduction limitations

Attached as exhibit I is a brief explanation of each of the above changes. Exhibit II shows the Treasury's federal revenue impact for each of the years 1987 to 1991. Kansas will recognize a portion of this increase based on the portion of business the

corporate community transacts in Kansas.

Many of the federal changes outlined above are based on the timing of the transaction, while others relate to deductibility. Due to the nature of most businesses, items which appear on the surface to be timing differences in reality become permanent differences. It is only when the business liquidates that many differences reverse. It is for this reason that the Treasury and Congress considers the above mentioned changes as "revenue raisers".

Perhaps the most relevant change mentioned relates to the new uniform capitalization rules for inventory. All "manufacturers" are subject to these rules regardless of the level of sales. Retailers become subject after a specific level of sales. The first change is that opening inventories for 1987 must be restated to reflect the fact that more "overhead" must be allocated to inventory. In the past, many businesses were able to expense many items in the year incurred. The 1986 tax act now requires the allocation of these costs to inventory. They will only be expensed when the related inventory is sold. While at first it would appear that the timing of the item has been only minimally affected, further analysis dictates otherwise. For a company that has some inventory all of the time, the additional amount of "overhead" capitalized becomes more like a permanently nondeductible item. In addition, the impact of inflation on the types of items allocable to inventory makes the capitalizable

item increase income exponentially. This occurs because each year the corporation must recalculate the effect the current year costs have on any increase or change to its inventory. Suffice it to say that the amount of time necessary to accurately calculate this information for opening 1987 inventories and 1987 activity is substantial. For this reason, I believe that many corporations won't file returns until later this summer. This will allow further clarification of rules, at least this is their hope. Accurate determination of the revenue impact of this change is therefore impossible. Preliminary results of our work in this area indicate all affected companies will see taxable income increase. Any economic expansion of the corporation's business will cause the effect of these capitalization rules to be even greater. These rules will have an adverse affect on growing manufacturing businesses and other growth oriented businesses. Exhibit III shows a comparison of capitalization rules for the old law versus the new law.

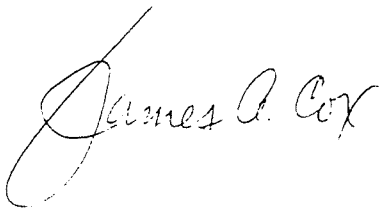
Many of the statements made relative to the inventory capitalization rules also are valid for other changes made by the 1986 tax act. The changes to such items as travel and entertainment are more substantial than were first envisioned. For example, many taxpayers were intially unaware that out of town meals for salesmen and other employees are subject to the 20% disallowance rule. Some taxpayers may still be unaware. The disallowance of trademark expenditures also will impact Kansas taxpayers. With the advent of the Venture Capital fund, I assume



that businesses will hope to take advantage of this fund to create new products and ideas that can be patented. The inability to deduct these costs, as well as any costs to defend these patents, will cause Kansas corporate taxable income to increase.

Once again I appreciate the opportunity to appear before this committee. I would be happy to answer any questions about my remarks.

Respectfully submitted,

A handwritten signature in cursive script that reads "James A. Cox". The signature is written in dark ink and is positioned above the typed name.

Mr. James A. Cox

Sr. Tax Manager

## EXHIBIT I

### A. UNIFORM CAPITALIZATION

The 1986 Act requires the use of uniform capitalization rules by any producer of tangible property including self-constructed assets, and by any taxpayer who acquires and holds property for resale, including retailers and wholesalers.

The new rules are patterned after the "extended-period, long-term contract" rules. These rules are not always compatible with inventory accounting, but provide the basis for including substantially more indirect costs in inventories than current practice. The Treasury Department has issued temporary and proposed regulations which should facilitate the application of the long-term contract rules to inventory accounting. However, these proposed regulations establish requirements beyond traditional inventory costing principles. They provide only general guidance for inventory costing, based on the principle that costs should be allocated to inventories if they are merely identified as benefiting or being associated with inventory production. This represents a departure from the traditional accounting concept of only capitalizing those costs that are directly related to the production process and add utility to the goods in inventory. Therefore, significant judgment will be required in determining what constitutes inventoriable costs under these new rules.

Because the rules are intended to raise tax revenues, we expect the IRS will interpret the requirements broadly, with an eye towards including rather than excluding specific items in inventory calculations. Companies can best respond to the new rules and possible IRS challenge by carefully planning a strategy for complying with the new rules and maintaining clear records to support the company's treatment of each cost.

The amount of effort required to adopt the new rules will depend, in large part, on the extent a company has previously capitalized indirect costs. In 1973, the IRS adopted the full absorption rules, which required all manufacturers to include certain indirect costs in inventories. These costs were segregated into those that required allocation to inventories, those that did not, and those that were allocated to inventories only if they also were allocated for financial reporting purposes.

The new rules take the three categories of indirect costs and compress them into two - those that must be allocated to inventories and those that do not require allocation. Many of the costs that were previously not allocated to inventories, or were allocated based on their financial reporting treatment, must now be allocated regardless of their treatment for financial reporting purposes. Therefore, at a minimum, manufacturers will have to modify their cost accounting systems to capture the additional costs requiring allocation. See Exhibit III for a comparison chart.

## B. ACCOUNTING METHOD CHANGES

### 1. Limitation on the Use of the Cash Method of Accounting

The 1986 Act requires the use of the accrual method of accounting for corporations, partnerships that have a corporation as a partner, tax shelters, and certain tax-exempt trusts. Prior to the 1986 Act, taxpayers could adopt either the cash method or the accrual method of accounting, provided the method chosen clearly reflected income. The accrual method was required any time the production, purchase, or sale of inventories was a material income - producing factor. Under the new law, with certain exceptions, entities with average annual gross receipts over the three previous tax years of \$5 million or more must use the accrual method.

### 2. Percentage of Completion Method

The 1986 and 1987 Acts require that a taxpayer accounting for long-term contracts must do so under the "percentage of completion" method. Under previous rules, a taxpayer could report income from a long-term contract under the accrual method, the cash method in certain circumstances, or a long-term contract method, i.e., either the percentage-of-completion method or the completed contract method. The "percentage of completion-capitalized cost method" is now required for use by any taxpayer not using the percentage-of-completion method. Under this method, 40 percent of a contract must be reported under the percentage-of-completion method, while the remaining 60 percent of the contract is reported under the taxpayer's regular method. Second, the Act requires these taxpayers to use the more inclusive costing rules currently used for extended period long-term contracts. These rules apply to any contracts entered into after February 28, 1986.

The Revenue Act of 1987 further changed these rules for contracts entered into after October 13, 1987. The rules governing accounting for long-term contracts are modified to provide that under the percentage-of-completion capitalized-cost method, 70 percent of items with respect to a long-term contract must be reported under the percentage of completion method. This 70-percent rule replaces the 40-percent rule under the 1986 Tax Act. The remaining 30 percent of the items with respect to the contract must be taken into account under the taxpayer's normal method of accounting.

### 3. Calendar Year-End Adoption

The 1986 Act requires all partnerships, S corporations, and personal service corporations (PSCs) to adopt the same tax year

as that of their owners, unless they could establish a business purpose for a different year (e.g., the requested year is the taxpayer's natural business year). In most cases, this would require fiscal year partnerships, S corporations, and PSCs to change from a fiscal year to a calendar year in 1987, thereby accelerating the taxation of income from the deferral period.

An electing partnership or S corporation wishing to retain its current fiscal year or adopt a different fiscal year with a deferral period of three or fewer months generally must make a single-deposit payment approximately equal to the tax on the deferred income created by the entity's use of a fiscal year.

Rather than making the special deposit required of partnerships and S corporations, an electing personal service corporation will be limited in the amount of deductions it can take for payments to employees who are more than 10 percent owners on any day during the tax year, unless certain minimum distributions are made to such employee-owners before the end of the calendar year. If such requirements are not met, a calendar year-end must be adopted.

According to current practice, however, the administrative difficulties of making the fiscal year election (provided all requirements are met) have acted as a substantial deterrent, and a calendar year-end will probably be adopted in most cases.

#### 4. Accrual of Vacation Pay

The deduction for vacation pay for any tax year generally will be limited to amounts paid during the year plus accrued amounts paid within 2 1/2 months after the end of the year.

#### 5. Bad Debt Reserve

The 1986 Act generally eliminated the reserve method of accounting for bad debts for all taxpayers except for thrifts and commercial banks with less than \$500 million in assets. Taxpayers can deduct bad debts only as they become wholly or partially worthless under the specific charge-off method. Any balance in an existing reserve account will generally be taken into income over four taxable years.

### C. DEPRECIATION METHODS

The 1986 Act requires that the cost recovery for property placed in service after 12/31/86 will be changed. The highlights of the changes prescribe -

- Reclassifying certain assets, according to their present class life, (or ADR midpoint life), including creation of a 7-year and 20-year class.

- Providing more accelerated depreciation for the 3-, 5- and 10-year ACRS classes.
- Requiring the cost of realty to be recovered using the straight line method over extended recovery periods.
- New averaging conventions for use in determining when property is treated as placed in service or disposed of during a tax year.

#### D. DEDUCTION LIMITATIONS

##### 1. Limitations on Travel and Entertainment Expenses

The 1986 Act requires that for tax years starting after 1986, only 80 percent of the amount of an otherwise allowable entertainment expense can be deducted. The reduction applies before any other limitations on deductions, like the 2 percent floor for employee travel and transportation expenses.

The taxpayer's entertainment, amusement and recreation expenses ordinarily must be "directly related" to active conduct of a trade or business, or to production of income. However, the cost of entertainment immediately before or after a substantial and bona fide business discussion (including business meetings at a convention) can be deducted subject to the 80 percent limit if the taxpayer can establish that the items are "associated with" the active conduct of his trade or business. No deduction will be allowed for an entertainment expense that is lavish or extravagant.

For tax years starting after 1986, meal expenses come under requirements similar to those of entertainment expenses (i.e. the 80 percent limitation). Thus, the "quiet business meal" rule is eliminated. Specifically, to deduct a meal expense: (1) the item must be "directly related to" or associated with" the active conduct of taxpayer's trade or business; and (2) the "lavish or extravagant" standard applies. In addition, penalties apply to "overstated" meal expenses.

##### 2. Trademark and Trade Name Expenditures

The 1986 Act requires that trademark and trade name expenditures must be capitalized. Under prior law, a taxpayer could elect to amortize any trademark or trade name expenditure paid or incurred during a taxable year over a period of not less than 60 months.

Such expenditures will not be expensed until the asset is disposed of.



### 3. Dividends Received Deduction

The 1986 Act reduced the corporate dividends received deduction to 80 percent of domestic dividends received. Prior law allowed an 85 percent deduction for dividends received. The 1987 Act further reduced this deduction. Corporations that own less than 20 percent of the distributing corporation may deduct 70 percent (formerly 80 percent) of post-1987 dividends received or accrued. There is no change in the rule that corporations that own at least 20 percent, but less than 80 percent, of the stock of a corporation are entitled to deduct 80 percent of the dividends received from a domestic corporation. (A 100 percent deduction may apply to dividends received by a parent corporation that owns 80 percent or more of the distributing corporation.)

Table A. 2.—Estimated Budget Effects of the Provisions of H.R. 3838, as Approved by the Conference Committee, Fiscal Years 1987-1991

[Millions of dollars]

Title and Provision	1987	1988	1989	1990	1991	1987-91
<b>II. Capital Cost Provisions</b>						
Depreciation, expensing						
Individual .....	-502	-584	498	1,980	3,304	4,696
Corporate .....	-3,280	-2,844	192	444	9,231	7,740
Investment tax credit						
Individual .....	3,860	3,862	4,679	5,653	6,119	24,173
Corporate .....	18,801	20,979	25,132	25,618	28,148	118,678
Repeal finance leasing						
Corporate .....		125	335	449	444	1,353
Credit limitations <sup>10</sup>						
Corporate .....	346					346
Incremental research tax credit						
Individual .....	-92	-78	-59	-15	-9	-253
Corporate .....	-1,337	-1,105	-774	-414	-250	-3,880
Orphan drug credit						
Corporate .....	-7	-15	-15			-37
Amortization of trademarks and trade-names						
Individual .....	1	4	8	14	20	47
Corporate .....	3	9	17	27	38	94
<b>IV. Agriculture, Timber, Energy, and Natural Resources</b>						
Special expensing provisions						
Individual .....	81	25	23	22	22	123
Corporate .....	19	12	11	11	10	63
Dispositions of converted wetlands and highly-erodible croplands						
Individual .....	(*)	(*)	(*)	(*)	(*)	(*)
Preproductive period expenses of farmers						
Individual .....	56	161	144	121	110	592
Corporate .....	42	62	53	50	48	255
Prepayments of farming expenses						
Individual .....	14	30	10	11	14	79
Discharge of farm indebtedness						
Individual .....	-9	-10	-8	-7	-5	-39
Intangible drilling costs						
Corporate .....	70	118	119	114	54	470
Oil, gas, geothermal depletion						
Individual .....	20	49	45	45	45	204
Mining exploration and development						
Corporate .....	23	34	28	24	21	130

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Table A. 2.—Estimated Budget Effects of the Provisions of H.R. 3838, as Approved by the Conference Committee, Fiscal Years 1987-1991—Continued

[Millions of dollars]

Title and Provision	1987	1988	1989	1990	1991	1987-91
<b>VI. Corporate Taxation</b>						
Corporate rate reductions						
Corporate .....	-6,711	-20,068	-27,505	-29,999	-32,415	-116,698
Dividends received deduction						
Corporate .....	140	223	225	239	253	1,080
Dividend exclusion						
Individual .....	212	573	580	605	631	2,601
Extraordinary dividends						
Corporate .....	30	52	54	57	60	253
Stock redemption payments						
Corporate .....	2	3	3	3	3	14
NOL carryovers						
Corporate .....	9	29	39	38	29	144
Recognition of gain or loss in liquidations						
Individual .....	-1	-13	-32	-44	-53	-143
Corporate .....	16	193	380	504	604	1,697
Basis allocation						
Individual .....	-2	2	9	13	16	38
Corporate .....	60	55	58	63	66	302
Related party sales						
Corporate .....	4	5	5	5	5	24
<b>VIII. Accounting Provisions</b>						
Limitation on the use of cash accounting						
Corporate .....	290	595	631	646	650	2,812
Simplified LIFO for certain small businesses						
Individual .....	-11	-18	-28	-44	-69	-170
Corporate .....	-120	-189	-289	-469	-738	-1,805
Recognition of gain on pledges of installment obligations						
Individual .....	12	42	31	32	33	150
Corporate .....	1,319	1,719	1,387	1,401	1,439	7,265
Capitalization of inventory, construction and development costs						
Individual .....	146	479	583	639	608	2,455
Corporate .....	4,110	6,972	7,405	7,746	6,009	32,242
Long-term contracts						
Individual .....	98	109	103	62	42	414
Corporate .....	2,791	3,188	2,175	907	567	9,628
Repeal of reserve for bad debt for nonfinancial institutions						
Individual .....	32	97	100	101	76	406
Corporate .....	1,177	1,816	1,737	1,751	967	7,448

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II-873

Table A. 2.—Estimated Budget Effects of the Provisions of H.R. 3838, as Approved by the Conference Committee,  
Fiscal Years 1987-1991—Continued

[Millions of dollars]

Title and Provision	1987	1988	1989	1990	1991	1987-91
<b>IX. Financial Institutions</b>						
Limitation on bad debt reserves						
Corporate.....	647	1,092	1,218	1,406	631	4,994
Disallow interest to carry tax-exempt bonds:						
Individual.....	-117	-370	-682	-940	-1,188	-3,279
Corporate.....	168	420	687	923	1,154	3,352
Special NOL carryover rules for depository institutions						
Corporate.....		-59	-93	-92	-77	-321
Special reorganization rules for troubled thrifts						
Corporate.....			46	105	164	315
Treatment of losses on deposits in insolvent institutions						
Individual.....	-3	-1	-1	-1	-1	-7
<b>Subtotal, Financial Institutions</b>						
Individual.....	-120	-371	-683	-941	-1,189	-3,304
Corporate.....	815	1,453	1,858	2,342	2,872	8,340
<b>Total.....</b>	<b>695</b>	<b>1,082</b>	<b>1,175</b>	<b>1,401</b>	<b>683</b>	<b>5,036</b>
<b>X. Insurance Products and Companies</b>						
Life insurance products						
Corporate.....	2	5	6	7	8	28
Life insurance companies						
Corporate.....	430	787	857	919	959	3,952
Property and casualty insurance companies						
Corporate.....	871	1,454	1,636	1,745	1,842	7,548
<b>Subtotal, Insurance Products and Companies</b>						
Corporate.....	1,303	2,246	2,499	2,671	2,809	11,528
<b>Total.....</b>	<b>1,303</b>	<b>2,246</b>	<b>2,499</b>	<b>2,671</b>	<b>2,809</b>	<b>12,528</b>

Table I. Comparison of Capitalization Rules

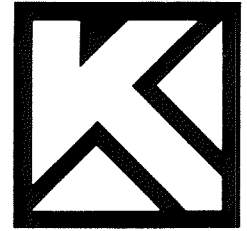
	Former Law			New Law	
	<u>I</u>	<u>II</u>	<u>III</u>	<u>Capitalize</u>	<u>Expense</u>
Maintenance and Repairs	X			X	
Utilities	X			X	
Rent	X			X	
Indirect Labor	X			X	
Indirect Materials	X			X	
Small Tools & Equipment	X			X	
Quality Control	X			X	
Marketing		X			X
Advertising		X			X
Selling		X			X
Distribution and Handling*		X		X	
Interest**		X		X	
Research & Experimental		X			X
Engineering (Product Development)		X		X	
Casualty and Theft Losses		X			X
Percentage Depletion in Excess of Cost Depletion		X		X	
Depreciation and Amortization in Excess of Financial Reporting		X		X	
Income Taxes		X			X
Pensions (Past Service)		X			X
General & Administrative (Overall Activities)		X			X
Officers' Salaries (Overall Activities)		X			X
Bidding Expenses (Unsuccessful)		X			X
Bidding Expenses (Successful)		X		X	
Taxes (Other Than Income)			X	X	
Financial Depreciation			X	X	
Employee Benefits and Pensions (Current Service)			X	X	
Rework, Scrap, and Spoilage			X	X	
Strikes			X		X
Officers' Salaries (Incident to Production)			X	X	
Factory Administration			X	X	
Insurance (Incident to Production)			X	X	
General & Administrative (Incident to Production)			X	X	

\*Distribution costs related to warehousing must be capitalized. Distribution costs related to customer delivery are not capitalized.

\*\*For real property, long-lived property, property requiring more than two years to complete, or property costing more than \$1 million and requiring more than one year to complete.



# LEGISLATIVE TESTIMONY



## Kansas Chamber of Commerce and Industry

500 First National Tower One Townsite Plaza Topeka, KS 66603-3460 (913) 357-6321

A consolidation of the  
Kansas State Chamber  
of Commerce,  
Associated Industries  
of Kansas,  
Kansas Retail Council

SB 580

February 16, 1988

### KANSAS CHAMBER OF COMMERCE AND INDUSTRY

Testimony Before the  
Senate Assessment and Taxation

by

Gerhard Metz  
Director of Taxation

Thank you, Mr. Chairman and members of the committee. I am Gerhard Metz, representing the Kansas Chamber of Commerce and Industry. We appreciate the opportunity to appear before you today concerning SB 580.

The Kansas Chamber of Commerce and Industry (KCCI) is a statewide organization dedicated to the promotion of economic growth and job creation within Kansas, and to the protection and support of the private competitive enterprise system.

KCCI is comprised of more than 3,000 businesses which includes 200 local and regional chambers of commerce and trade organizations which represent over 161,000 business men and women. The organization represents both large and small employers in Kansas, with 55% of KCCI's members having less than 25 employees, and 86% having less than 100 employees. KCCI receives no government funding.

The KCCI Board of Directors establishes policies through the work of hundreds of the organization's members who make up its various committees. These policies are the guiding principles of the organization and translate into views such as those expressed here.

As we have testified previously before this committee, KCCI's board approved in December the adoption of three of the specific recommendations of Kansas Inc.,

specifically, the exemption of manufacturers' machinery and equipment from the sales and use tax, a change in the apportionment formula for corporations filing as unitary entities, and a reduction of the corporate income tax rate. The bill before you today would result in the reduction of Kansas corporate tax rates over five years by 1.25%, which would make Kansas more attractive as a place for doing business. In support of such a provision, we believe that it is necessary to look at a factor that has heretofore been given inadequate consideration--the presence of a "windfall" in the taxes paid by Kansas corporations. Initial estimates have been inconclusive, or tended to estimate such an increase in corporate tax revenues to be negligible. Based upon information we have been hearing from our members, we believe that the extent of corporate tax increases resulting from federal tax reform to be understated. The likelihood of such increases would justify a reduction in the corporate tax rate, as corporations will be paying more taxes, and would not result in undercutting ending balances.

It has been alleged that corporations' contributions to the state's tax revenues has declined over the past several years. Because there have been no tax reductions to the corporate sector, such a decline may be attributed to only two causes: either the same number of firms are paying taxes on smaller incomes owing to declining profits, or fewer firms are paying taxes because others have gone out of business or left the state. If Kansas is to remain competitive, we must reverse this trend.

In response to requests for data to substantiate our position on corporate taxation, KCCI sent out mailgrams to twenty-four members, followed by a mailing to all three thousand of our members. Firm figures are hard to come by this early in the tax season, but twenty-seven respondents thus far can account for an approximate increase of nearly two million dollars. These figures are not restricted to the largest firms; indeed, the respondents ranged from small corporations with two members and an increase of several hundred dollars, to large corporations with hundreds of employees and increases in excess of \$500,000. There are an estimated 68,000 business firms in

the state of Kansas, and our figures represent obviously only a small fraction of that total, but we believe that they demonstrate a clear trend.

The Council of State Chambers of Commerce has estimated that the Kansas corporate windfall will be in the neighborhood of \$20.4 million on 1987 tax returns and \$191 million over the next five years. Our informal survey has documented a tenth of that 1987 amount in only a week's time, with the vast majority of firms not having completed their tax filings. Time and again we have spoken with corporate tax departments or accounting firms which handle corporate clients, and the response has been that although it is too early to ascertain exact amounts, Kansas corporations will see a significant increase in their tax liability as a result of the so-called windfall. All of these data point in the direction of a need to consider and reconsider the issue of the corporate sector's contribution to state revenues, as well as the desirability of reducing the tax burden on corporations. We would urge you to consider the recommendations of Kansas, Inc., including a reduction in corporate rates, as embodied in SB 580, to build a stronger, more healthy Kansas economy upon which we can build a better future for all Kansans.

Thank you. I will gladly stand for questions.

SENATE ASSESSMENT AND TAXATION COMMITTEE  
FEBRUARY 16, 1988  
BERNIE KOCH  
WICHITA AREA CHAMBER OF COMMERCE

Mr. Chairman, members of the committee...

I'm Bernie Koch with the Wichita Area Chamber of Commerce. You've heard me testify before on the corporate side of tax reform, so I'll make my comments brief.

We appreciate the work you're doing in this committee on the issue of tax reform. We know it's a difficult job. Thank you for the efforts you've made and the efforts you're going to make.

Senate Bill 580 contains an element that those of us who represent the business community have been asking for in tax reform, a corporate income tax reduction. We're pleased that it's being considered.

I believe that the "windfall" tends to confuse this issue. If there were no windfall...no federal tax reform which resulted in a state income tax increase...you would still be considering corporate tax reform. There would still be the need to identify and enact changes in tax law to make our state more competitive. Kansas Inc. has identified those changes for you.

Please remember as you thrash through the paper blizzard on this issue that the bottom line is jobs. Changes such as the sales tax exemption on machinery and equipment, the two-factor formula for multi-state firms, and a corporate income tax reduction are all designed as a package to keep the industry we have and to attract new businesses to our state. That means those changes are also designed to keep the jobs we have in Kansas and attract new jobs to the state.

You've heard testimony that there is little windfall on corporate income taxes. You've heard testimony that there is a sizeable corporate windfall. We believe the latter. Whatever you believe, windfall or not, please remember the bottom line of corporate tax reform is jobs for Kansans.

Thank you for the opportunity to testify once again on this issue.



# Kansas Retired Teachers Association

Retired — Not Withdrawn

1987 - 1988



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February 15, 1988

Members of the Senate Taxation Committee:

My name is Basil Covey and I represent the Kansas Retired Teachers Association.

We support SB 580 for two reasons. First, we like the long-range concept built in the bill. Secondly, the bill calls for excluding social security benefits from Kansas income tax in 1990.

We have heard many criticisms concerning the tax reform features in the bill. We should not allow these criticisms, however, to dim the main long-term concept in the bill. Several tax reform bills have been introduced and all have been criticized. Most plans are for one or two years.

We feel a long-term plan is best for Kansas. Those of us working with school boards in school districts make long-term plans. Legislators, like school boards, should make a priority list. School districts cannot do everything in one year. Neither can Kansas. First things first, then list the requests in order to be done in other years.

The retired citizens in Kansas including retired teachers have asked to have social security benefits excluded from Kansas income tax for four years. We are willing to wait until 1990 if a long-term tax reform plan can be accepted by all legislators including the Governor.

Democracy thrives on compromises. The best practical tax reform features from all proposed tax plans tied to a long-term plan may include year by year funding for the multitude of requests you have. Some requests may not be met; others may be delayed in a long-term plan.

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We suggest that a bipartisan group from the Senate and House Taxation Committees take a look at the most practical tax reform features of all the plans. With compromises and a long-term plan as stated in SB 580, Kansas with new revenue coming in can carry out some of the requests made by the taxpayers, and fulfill pledges made by candidates.

Sincerely,

*Basil Covey*  
Basil Covey  
KRTA

KANSAS  
ASSOCIATION



OF  
SCHOOL  
BOARDS

5401 S. W. 7th Avenue Topeka, Kansas 66606  
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TESTIMONY ON S.B. 580

by

Richard S. Funk, Assistant Executive Director  
Kansas Association of School Boards

February 15, 1988

Mr. Chairman and members of the committee, we appreciate the opportunity to appear today on behalf of the 302 members of the Kansas Association of School Boards. KASB opposes the provisions found in S.B. 580.

The 1987 Delegate Assembly of the Kansas Association of School Boards overwhelmingly adopted a resolution urging the Kansas Legislature "to retain the federal income tax 'windfall' for state general fund purposes..."

It is our understanding that the provisions found in S.B. 580 will, over a five-year period of time, eventually reduce the expected "windfall" to zero or nearly so. This will have a profound effect upon the statutory income tax rebate provision resulting in less money for local school districts. This is especially distressing to us at a time when more and more demands are being made upon school districts. Many of these demands are non-educational in nature, i.e., asbestos inspection and management planning, proposed radon testing, and facilities expansion due to increasing enrollment and service to pre-school students. Many of the demands are education in nature, i.e., human sexuality and AIDS education, drug and alcohol abuse education, and maybe expanded Kansas history.

Therefore, KASB urges this committee to not act favorably on S.B. 580.

A & T

2/15/88

Att. 5