Approved ~~Tuesday, January 31, 1989~~
Date

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION.

The meeting was called to order by Senator Dan Thiessen at
Chairperson

11:00 a.m./~~p.m.~~ on Tuesday, January 17, 1989 in room 519-S of the Capitol.

All members were present except:

Committee staff present:
Don Hayward, Revisor's Office
Tom Severn, Research Department
Chris Courtwright, Research Department
Marion Anzek, Committee Secretary

Conferees appearing before the committee:
Mark Burghart, General Counsel, Div. of Budget, Dept. of Revenue

Chairman Thiessen called the meeting to order and told the members, that the policy had been in the past, if a member was not in attendance he would be counted absent, if the committee was not notified in advance, and in our minutes of January 11, Senator Francisco was counted as absent but we are going to change that to show excused, but in future meetings you will be counted as absent, if the committee secretary is not notified in advance.

The Chairman said that the agenda for the day included briefing by staff member Chris Courtwright and the Department of Revenue on Senate bills 4 & 5.

SB4: AN ACT: relating to income taxation; repealing K.S.A. 1988 Supp. 79-32-183 to 79-32-187, inclusive, relating to the imposition of an alternative minimum tax upon corporation.

Chris Courtwright turned the members attention to (ATTACHMENT 1) proposal no. 7, and said Senate Bills 4 & 5 came out of this proposal, and he would briefly run through the proposal and would be glad to answer any questions the members might have.

The committee recommends that the AMT be repealed, and enactment of SB4 would accomplish that recommendation.

Chairman Thiessen asked Chris if he knew when the States that have this, passed it, and Chris said his impression was that a lot of them didn't pass it until after the 1986 Federal Tax Reform, so most of them didn't pass it until the last 2 years.

SB5: AN ACT: relating to income taxation; concerning rates of liability imposed upon corporations; amending K.S.A. 1988 Supp. 79-32-110 and repealing the existing section.

Chris Courtwright said the committee concludes that 1989 is an appropriate time to make the Kansas corporation income tax structure more competitive with the structure in place in neighboring states, particularly given the amount of corporation income tax receipts in FY 1988 and the condition of the State General Fund. Committee recommends that the corporate base rate and surtax be reduced by 0.25% each and that the level at which the surtax becomes effective be increased from $25,000 of corporate taxable income to $50,000. The combined fiscal note for these changes, based on returns processed in 1987, is approximately $10.5 million. Enactment of SB5 would implement these recommendations.

The Chairman recognized Mark Burghart.

Mark Burghart gave a brief background of SB4 (ATTACHMENT 2) and urged this

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION,

room 519-S, Statehouse, at 11:00 a.m./p.m. on Tuesday, January 17, 1989.

committee to recommend SB4 favorably for passage.

There was committee discussion and The Chairman asked Mark Burghart to continue and brief the committee on the Departments views on SB5.

Mark Burghart said SB5 would reduce both the corporate tax rate and surtax rate by one quarter percent as well as increase the income level at which point the surtax takes effect from $25,000 to $50,000. These proposed changes have an estimated fiscal impact of $10.5 million.

These proposed reductions are not contained in the Governor's Budget Message. In the past two years the Governor has recommended the enactment of legislation providing major tax relief for the business and farm sectors as follows: (1) Sales tax exemption for manufacturing machinery and equipment, fiscal impact $11.0 million annually. (2) Permanent sales tax exemption for farm machinery, fiscal impact $5.5 million annually. (3) Repeal of the corporate alternative minimum tax, $6.0 million annually. With a total $22.5 million fiscal impact annually.

Mr. Burghart said the department urges the Senate Committee to kill this particular component of the Interim Committee's legislative package. (ATTACHMENT 3, with attachments 1 and 2)

Mr. Burkhart said he had passed out another handout (ATTACHMENT 4) which talks about corporate windfall and it identifies some changes in the Federal level, which should carry over to the State and should generate more revenue.

The Chairman adjourned the meeting at noon.

RE: PROPOSAL NO. 7 -- CORPORATION INCOME TAX*

Proposal No. 7 directed the Special Committee on Assessment and Taxation to examine data related to the amount of the corporate windfall and, if the amount is deemed to be unexpectedly high, consider whether the alternative minimum tax (AMT) should be repealed or whether corporate rates should be reduced; study the types of businesses impacted by the AMT and make any recommendations necessary to implement the tax in 1989.

Background

The income tax reform bill passed by the 1988 Session, S. Sub. H.B. 2543, made a number of changes in the corporate, as well as individual, income tax. With respect to corporations, the bill eliminated the carryback of corporation net operating losses (NOLs); allowed a two-factor (sales and property) income apportionment option for corporations whose payroll in Kansas exceeds 200 percent of their property and sales in the state; and imposed an alternative minimum tax on corporations, beginning in tax year 1989.

The Legislative Research Department has estimated the fiscal impact of these changes as follows:

(Dollar Amounts in Millions)

	FY 1989	FY 1990	FY 1991 and thereafter
Apportionment Option	$ (0.7)	$ (1.0)	$ (1.0)
Elim. NOL Carrybacks	3.7	11.3	--
AMT	--	--	6.0
Net Corporate Changes	$ 3.0	$ 10.3	$ 5.0

* S.B. 4 and S.B. 5 accompany this report.

Attachment 1
Senate Assessment & Tax
1-17-89

Corporate Windfall

Unlike the individual income tax windfall, the Consensus Estimating Group did not specifically estimate a corporate windfall attributable to the Tax Reform Act of 1986. The Group did add $39 million to the November estimate at the April meeting, but noted that much of that increase was due to circumstances not related to the windfall. FY 1988 corporate receipts were $171.4 million, exceeding even the April estimate by $19.4 million. State General Fund (SGF) receipts from this source in FY 1985, FY 1986, and FY 1987 totalled $142.0 million, $135.8 million, and $104.6 million, respectively. Prior to FY 1988, the most revenue from the corporation income tax was $162.0 million in FY 1981.

Alternative Minimum Tax

The Governor's original tax reform plan would have implemented the AMT in tax year 1988. However, a conference committee agreement was reached to delay implementation of the tax for one year and to study its impact on business during the interim to determine if implementation was necessary.

Absent a repeal of the tax, Kansas will become the tenth state to impose an AMT on corporations, joining Alaska, California, Florida, Iowa, Maine, Minnesota, New York, North Dakota, and Pennsylvania. Nine states (California, Colorado, Iowa, Maine, Minnesota, Nebraska, New York, West Virginia, and Wisconsin) impose an AMT on individuals.

Rate Structure

Kansas corporations with taxable income of $25,000 or less pay tax at the 4.5 percent rate. Corporations with taxable income of more than $25,000 are subject to a 2.25 percent surtax on the additional income, making a top rate of 6.75 percent.

Over 82 percent of the corporation income tax returns processed by the Department of Revenue in 1987 had taxable income of $25,000 or less and were not subject to the surtax. In fact, 56 percent of the returns had no taxable income and incurred no liability at all. On the other hand, the 237 corporations with taxable income of $1 million or

The Committee also finds that the AMT represents a substantial economic development disincentive because no neighboring states impose such a tax on corporations. Moreover, since percentage depletion would not be excluded as a preference item, the tax would be particularly onerous on the oil and gas industry, already suffering from low oil prices. The amount of revenue that would be raised by the tax, estimated to be about $6.0 million, would therefore not justify its implementation. The Committee recommends that the AMT be repealed, and enactment of S.B. 4 would accomplish that recommendation.

Respectfully submitted,

December 1, 1988

Sen. Dan Thiessen, Chairman
Special Committee on Assessment and Taxation

Rep. Keith Roe, Vice-Chairman
Rep. Jayne Aylward
Rep. Arthur Douville
Rep. LeRoy Fry
Rep. Fred Gatlin
Rep. James Lowther
Rep. William R. Roy
Rep. Michael Tom Sawyer
Rep. Debara K. Schauf
Rep. Joan Wagnon*
Rep. Franklin E. Weimer

Sen. Neil Arasmith
Sen. Paul Burke
Sen. Leroy Hayden
Sen. Fred Kerr
Sen. William Mulich

* Ranking Minority Member

KANSAS DEPARTMENT OF REVEN
Office of the Secretary
Robert B. Docking State Office Building
Topeka, Kansas 66612-1588

MEMORANDUM

TO: The Honorable Dan Thiessen, Chairman
Senate Committee on Assessment and Taxation

FROM: Mark A. Burghart, General Counsel
Kansas Department of Revenue

RE: SENATE BILL NO. 4

DATE: January 17, 1989

Thank you for the opportunity to appear before you to express the Department of Revenue's support for Senate Bill No. 4. This bill would repeal the alternative minimum tax (AMT) on corporations which was enacted by the 1988 Legislature.

BACKGROUND:

The AMT was a component of the plan developed by the Governor's Task Force on Tax Reform. The purpose of the AMT is to ensure that no taxpayer who has substantial economic income can avoid significant tax liability by using exclusions, deductions and credits. The AMT works by disallowing the benefits provided by the various tax deductions and allowances.

The state AMT recommended by the Task Force conformed to and "piggybacked" onto the federal AMT to the greatest extent possible. The state AMT rate is 4% to be applied against a taxpayer's Kansas alternative minimum taxable income. The Kansas alternative tax base is the same as that at the federal level with certain adjustments required under the regular corporate tax system. Companies not required to compute a federal AMT also are not required to file a state AMT. The state AMT was projected to generate $6 million annually.

General Information (913) 296-3909
Office of the Secretary (913) 296-3041 • Legal Services Bureau (913) 296-2381
Audit Services Bureau (913) 296-7719 • Planning & Research Services Bureau (913) 296-3081
Administrative Services Bureau (913) 296-2331 • Personnel Services Bureau (913) 296-3077

Attachment 2
Senate Assessment & Taxation
1-17-89

RECOMMENDATION:

The Department strongly recommends repeal of the state AMT provisions. The state has made significant progress in enhancing its competitive position with surrounding states including the enactment of the sales tax exemption for manufacturing machinery and equipment in 1988. The AMT is viewed as an impediment by businesses making decisions to locate or expand in the State. The opportunity lost to the state could very well exceed the revenue expected to be generated by the AMT. Kansas would only be the 10th state to adopt an AMT.

In addition to the negative image that the AMT projects for those concerned with state economic development, the AMT also would impose significant administrative burdens on both corporate taxpayers and the Department. The AMT essentially represents a separate taxing system which requires considerable expertise to understand. The state AMT is even more complicated than the federal AMT because the taxpayer needs to be concerned with the proper apportionment of tax preference items between all of the states in which the corporation operates. Corporate taxpayers must maintain a separate accounting system and absorb the additional costs associated therewith.

For these reasons, the Department urges the Senate Committee to recommend Senate Bill No. 4 favorably for passage.

Committee Activity

The Committee devoted part of three meetings to consideration of the corporation income tax proposal. At one of those meetings, the Committee attempted to outline the conceptual basis of the corporate windfall. Business conferees and certified public accountants presented information on the features of the Tax Reform Act of 1986 that were likely to increase corporate revenues in Kansas.

In terms of quantifying the corporate windfall, the Department of Revenue and several accountants suggested that because of the large number of extensions, particularly among the larger taxpayers, the real impact of the windfall probably could not begin to be identified until at least October 15, 1988. The Department did indicate that approximately $10 million of the $40 million that was received from two large taxpayers in FY 1988 would be recurring revenue. Staff also briefed the Committee on the historical pattern of corporate receipts and on the status of the SGF through the first quarter of FY 1989.

A number of conferees opposed implementation of the AMT, citing the tax as a substantial economic development disincentive relative to the amount of revenue estimated to be received. Conferees from the oil and gas industry also said that their industry, already suffering from the decline in the price of oil, would have its tax burden increased by the AMT, particularly because percentage depletion would not be excluded as a preference item.

Conclusions and Recommendations

The Committee concludes that 1989 is an appropriate time to make the Kansas corporation income tax structure more competitive with the structure in place in neighboring states, particularly given the amount of corporation income tax receipts in FY 1988 and the condition of the State General Fund. The Committee therefore recommends that the corporate base rate and surtax be reduced by 0.25 percent each and that the level at which the surtax becomes effective be increased from $25,000 of corporate taxable income to $50,000. The combined fiscal note for these changes, based on returns processed in 1987, is approximately $10.5 million. Enactment of S.B. 5 would implement these recommendations.

more, while representing less than 1 percent of the corporations, incurred over 57 percent of the liability.

As the bill originally passed the Senate, S. Sub. H.B. 2543 would have provided a 0.5 percent reduction in the corporate base rate, making the base rate 4.0 percent and the top marginal rate 6.25 percent. Based on returns processed in 1987, this reduction would have decreased SGF receipts by $8.6 million. However, the returns processed in 1987 had only about $111 million of liability. If one were to assume a higher base of $171.0 million (possibly due to a windfall) with all additional taxable income placed in the surtax bracket, the fiscal note would be $13.1 million for each 0.5 percent base rate reduction.

Features of the Corporation Income Tax in Neighboring States

Information on the principal features of the corporation income tax of the four bordering states and selected other states is presented below. Most information is taken from Commerce Clearing House, State Tax Guide, 2nd Edition. Data on per capita collections are calculated from U.S. Bureau of the Census, State Government Tax Collections in 1987, Tables 3 and 7. UDITPA means the Uniform Division of Income of Tax Purposes Act, which contains the three-factor allocation formula (sales, payroll, and property).

State	Corporation Rate Lowest	Corporation Rate Highest	Federal Tax Deductible	Corporate AMT	UDITPA	Per Capita Collections 1987
Arkansas	1.0%	6.0%	No	No	Yes	$ 48.42
Colorado	6.0	6.0	No	No	Yes[a]	37.65
Iowa	6.0	12.0	Yes	Yes	No	52.79
KANSAS	4.5	6.75	No	Yes	Yes[a]	55.36
Missouri	5.0	5.0	Yes	No	Yes[a]	46.12
Nebraska	4.75	6.65	No	No	Yes[b]	42.30
New Mexico	4.8	7.6	No	No	Yes	66.09
Oklahoma	5.0	5.0	No	No	No	25.58

a) Allows an optional apportionment formula.
b) Single-factor formula being phased-in by 1992.

KANSAS DEPARTMENT OF REVEN
Office of the Secretary
Robert B. Docking State Office Building
Topeka, Kansas 66612-1588

MEMORANDUM

TO: The Honorable Dan Thiessen, Chairman
Senate Committee on Assessment and Taxation

FROM: Mark A. Burghart, General Counsel
Kansas Department of Revenue

RE: SENATE BILL NO. 5

DATE: January 17, 1989

Thank you for the opportunity to appear before you today to express the Department of Revenue's opposition to Senate Bill No. 5. This bill would reduce both the corporate tax rate and surtax rate by one quarter percent as well as increase the income level at which point the surtax takes effect from $25,000 to $50,000. These proposed changes have an estimated fiscal impact of $10.5 million.

The rate reductions proposed in Senate Bill No. 5 are not contained in the Governor's Budget Message. In the past two years the Governor has recommended the enactment of legislation providing major tax relief for the business and farm sectors as follows:

GOVERNOR'S PROPOSAL:	FISCAL IMPACT: (millions)
1.) Sales Tax Exemption for Manufacturing Machinery and Equipment	$11.0 Annually
2.) Permanent Sales Tax Exemption for Farm Machinery	$5.5 Annually
3.) Repeal of the Corporate Alternative Minimum Tax	$6.0 Annually
	$22.5 Annually

The ongoing tax savings resulting from the Governor's proposals amounts to $22.5 million annually. Since the state tax effect on corporations associated with federal tax reform is unknown (although believed to be modestly positive), further tax relief in the form of corporate rate reductions would be premature and imprudent. This is especially true when one considers the fact that the percentage of the state general fund receipts resulting from corporate collections has remained relatively constant over the past five years. (See attachments 1 and 2).

The Department urges the Senate Committee to kill this particular component of the Interim Committee's legislative package.

Attachment 1

Kansas Department of Revenue

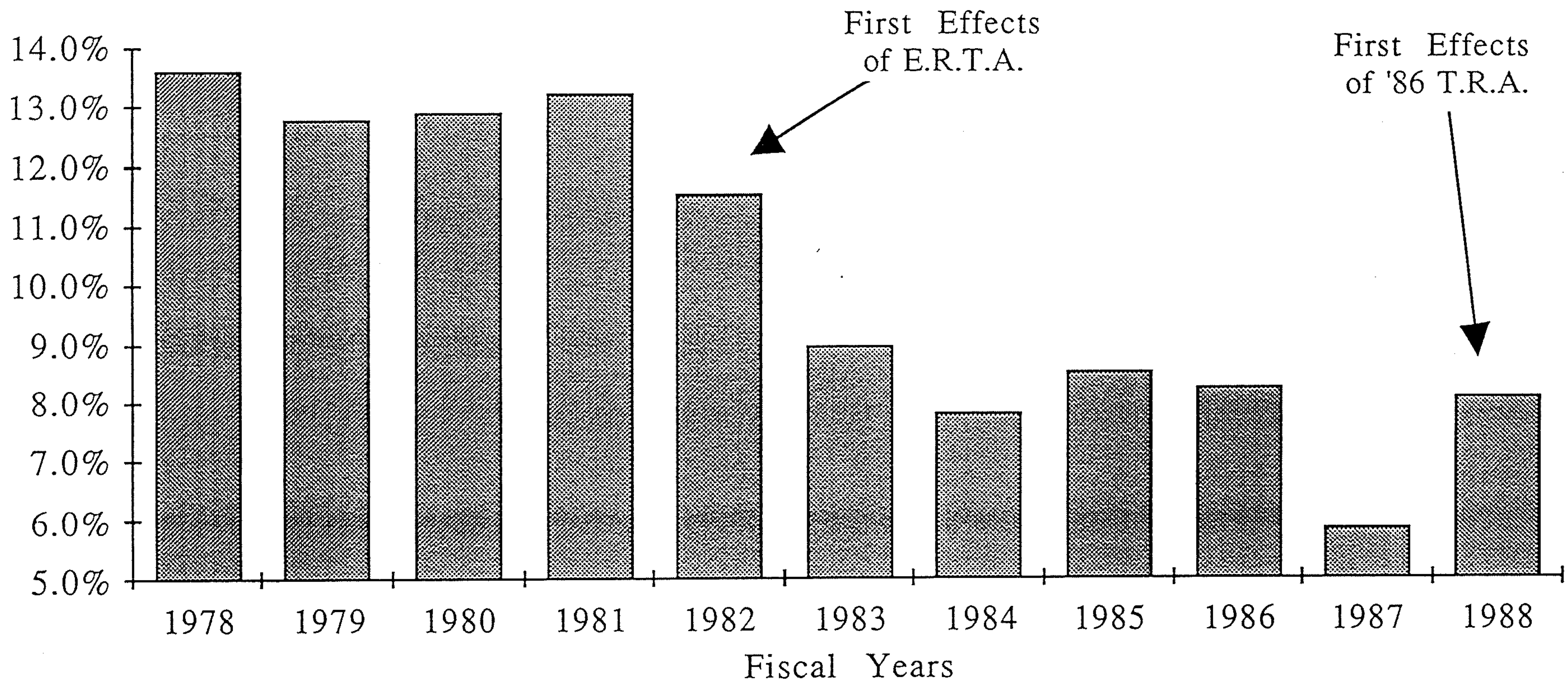
Corporate Tax Revenues
As a Percent of State General Fund Revenues

(Dollars are in Millions)

Fiscal Year	Corporate Collections	State General Fund	Corporate as a Percent of SGF
1978	$116.4	$854.6	13.6%
1979	$128.9	$1,006.8	12.8%
1980	$141.7	$1,097.8	12.9%
1981	$162.0	$1,226.5	13.2%
1982	$146.8	$1,273.0	11.5%
1983	$122.8	$1,363.6	9.0%
1984	$121.0	$1,546.9	7.8%
1985	$142.0	$1,658.5	8.6%
1986	$135.8	$1,641.4	8.3%
1987	$104.6	$1,778.5	5.9%
1988	$171.4	$2,113.1	8.1%

* 1988 includes $40.7 million from two taxpayers.

Kansas Department of Revenue
Corporate Revenues as a Percent of
State General Fund Revenues



Attachment 2

Kansas Department of Revenue

Federal Corporate Income Tax
Tax Reform Act of 1986

Law Prior to the 1986 Tax Reform Act	Current Law	Fiscal Impact
Tax Rates:	**Tax Rates:**	No impact
Four tax brackets ranging from 15% to 46%.	Three tax brackets ranging from 15% to 34%.	
Investment Tax Credit:	**Investment Tax Credit:**	No Impact
10% of the cost of certain depreciable equipment can be deducted from a corporations tax liability.	Repealed for equipment placed in service after January 1, 1986. The credit will be allowed for equipment placed into service during the first six months of 1986, as long as it was contracted for prior to January 1, 1986. Any credits carried over from previous years would be worth 65% of their previous value.	
Capital Gains:	**Capital Gains:**	No impact
The top capital gains rate is 28%.	The top capital gains rate is 34%.	
Depreciation:	**Depreciation:**	Negative/ Positive
Property and equipment can be depreciated over three to 19 years using an accelerated method or the straight line method.	The depreciation periods have been lengthened for most equipment, but bigger percentage write-offs will be permitted in the first years.	(Timing)
Dividends:	**Dividends:**	Positive
85% of dividends received by corporations are deductible from taxable income	80% of dividends received by a corporation would be deductible.	(Permanent)
Research and Development Tax Credit:	**Research and Development Tax Credit:**	No impact
Corporations receive a 25% tax credit for money spent on research and development that is in excess of money spent during a base period.	Corporations receive a 20% tax credit for money spent on research and development that is in excess of money spent during a base period.	
Business Meals and Entertainment:	**Business Meals and Entertainment:**	Positive
Fully deductible, including stadium skyboxes and season tickets to entertainment and sporting events.	80% of all expenses for business meals and entertainment would be deductible, with the deduction for skyboxes eliminated.	(Permanent)
Accounting Changes:	**Accounting Changes:**	Positive
Capitalization and production costs: Costs incurred in producing tangible property may be deducted currently.	Capitalization and production costs: All costs incurred in the production of tangible property must be capitalized into the overall cost of the property and recovered when the property is sold or used.	(Timing)

Attachment 4
Senate Assessment & Tax
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Term contracts: Better known as the "completed contract method" allows income to be deferred until the taxable year in which the contract is completed or accepted.	Long-Term contracts: Income from long-term contracts must be reported using the "percentage of completion method" which will match income and expenses.	
Cash Method of Accounting: Corporations using the cash method recognized items of income and expense in the taxable year in which the funds are received or disbursed.	Cash Method of Accounting: Corporations will no longer be allowed to use the cash method of accounting. Corporations must now use an accrual method of accounting which recognizes income and expenses when they occur.	
Bank Bad Debt Reserves:	**Bank Bad Debt Reserves:**	Positive
Fully deductible.	Banks with and averaged adjusted basis of all assets less than $500 million will be allowed to continue taking this deduction. Large banks may take a bad debt deduction only when the loan amount becomes wholly or partially worthless in tax years after 1986.	(Timing)