

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION

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

11:00 a.m./~~1:00~~ on Tuesday, February 7, 1989 in room 519-S of the Capitol.

All members were present except:

Committee staff present:

Don Hayward, Revisor's Office
Chris Courtwright, Research Department
Marion Anzek, Committee Secretary

Conferees appearing before the committee:

Lucky DeFries, Attorney representing Martin Tractor Company, Inc.
Harry Craig, President-Martin Tractor Company, Inc.
Alan F. Alderson, Attorney representing Western Retail Implement & Hardware Assoc.
Bill Waters, Division of Property Valuation

Chairman Thiessen called the meeting to order and told the members, before them were minutes dated January 31, and he would ask for action on those at the end of the meeting.

The Chairman turned attention to SB42 and recognized Lucky DeFries representing Martin Tractor Company.

SB42: AN ACT relating to property taxation; concerning the exemption of merchants inventory; amending K.S.A. 1988 Supp. 79-201m and repealing the existing section.

Lucky DeFries said he was representing Martin Tractor Company, Inc., and our purpose here today is to appear on behalf of SB42. With me today is Harry Craig, president of Martin Tractor Company and Greg Martin, Executive Vice President of Martin Tractor, and they can assist me here today with any questions that might arise.

Mr. DeFries said a state constitutional amendment approved by voters in 1986, exempted merchants' inventories from property taxes. During last year's session the Legislature passed a law redefining inventories so that equipment that is occasionally leased would not be exempt.

That interpretation of inventory is different from what most people believed was the status quo at the time the constitutional amendment was adopted. After the legislative session ended last year is when we became aware of some of the changes that had been made in SB453 with the definitions of "merchants" and "inventory". With the addition of the language in the bill last year, if a merchant had equipment out on lease, but brought back into inventory on January 1, then the people that had been receiving a 40% adjustment as a merchant for their inventory, would no longer receive this because they no longer would be construed as a merchant for purposes of those particular kinds of equipment.

I would like to point out through inadvertence language in SB42-lines 44 through line 48 that talks about inventory that was subject to depreciation or cost recovery accounting for federal income tax purposes shall not be classified as inventory.

This language was added by the legislature last year and in our opinion should be stricken from the bill. We would urge this committee to pass SB42 with the omission I have just mentioned. (ATTACHMENT 1)

Senator Fred Kerr said if the problem of the bill is "without any intervening use", why not just strike that language and stop so we don't have the danger of a loss of leased equipment coming in under your intention?

Mr DeFries said we are sensitive to that concern and we are aware that probably most of the concern that does exist on this bill is with regard, to the opening of (Pandora's box and letting a lot of other people in). I think if for whatever reason it is not possible to get the language in that we are talking about, I think it would be a significant step in the right direction if the language in the definition of "merchant" and "inventory" were stricken.

Harry Craig said what we want, is to just get the definition back to where it was

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 1:00 a.m./~~p.m.~~ on Tuesday, February 7, 1989.

before. We would like some clarification to help us with the different appraiser's that we deal with, so there is uniform treatment throughout the State, as we deal in several counties.

If the bill is left the way it is, you will be significantly penalizing our industry.

Committee concerns were that if we change it or if we leave it as it is, it seems it will hurt someone either way, because some people don't have inventory, so why not leave it where it is.

The Chairman recognized Alan Alderson, attorney for Western Retail Implement and Hardware Association.

Alan Alderson said most of the points I wanted to make are in my written testimony (ATTACHMENT 2) and have already been addressed. I think it is totally irrelevant as to how many dollars are involved in this amendment, the one made last year or the one proposed in this bill. I think we are dealing with constitutional issues here, and there is very little doubt in my mind that 79-201m is unconstitutional, as it presently reads. The language that I really care about is the specific language that says "and without any intervening use". The fact that this type of property had an "intervening use" as leased property does not alter the fact that it is being held by dealers for sale.

When people voted to approve the constitutional amendment, they believed equipment being leased and sold by dealers would be exempt.

I do not believe it is permissible to redefine terms, so that property which would otherwise be exempt now becomes taxable.

After committee discussion the Chairman recognized Bill Waters an attorney for the Department of Revenue.

Bill Waters said he was appearing in behalf of the Division of Property Valuation, and it is our opinion the provisions of SB42 would exempt from property or ad valorem taxation all personal property in the State of Kansas. Such exemption would severely erode the tax base and cause real property to bear the entire property tax burden in the State of Kansas. (ATTACHMENT 3) Mr. Waters said a portion of the bill that defines inventories as property acquired for eventual resale could cover almost everything, including personal cars.

After committee discussion the Chairman concluded hearings on SB42, and asked if there was a motion on the minutes?

Senator Karr made a motion to approve the minutes of January 31, 1989 seconded by Senator Petty. Motion to approve the minutes carried.

The Chairman adjourned the meeting at 12:03 p.m.

GUEST LIST

COMMITTEE: SENATE ASSESSMENT & TAXATION

DATE: Tuesday 2-7-89

NAME (PLEASE PRINT)	ADDRESS	COMPANY/ORGANIZATION
Harry W Craig Jr, President	P.O. Box 1698 Topeka	Martin Tractor
Bob Martin	"	" "
Lucker Detrius Adams	Topeka, Ks.	" "
Janice Marcus		P.V.D.
Bill Waters, Attorney	Topeka, KS	P.V.D.
Eva Perena	Topeka	Wagoning Office
Alise Rubin	Topeka	@ Eagle Beach
Mary Ellen Conlee	Wichita	Ks Assoc. for Sm Business
Jim Geter	"	" " " " "
Fast Barnes	Topeka	Ks. Motor Car Dealer's Assoc.
KEITH FARRAR	"	BOA
Jim Davidson	"	"
Kent McCune	Wichita	KLA
Marcia Weibert	Oberlin	KLA
Jack Jones	PRATT	KLA
Paul Wetmore	Larned	KLA
Stuart Mattier	Newton	KLA
Robert Merie	Marion, Mo	KLA
Tom P. Sabourgh	Topeka	Ka. Ind. Dealer's Assoc.
FRANK WASHBURN	Topeka	Ka. Ind. Dealer's Assoc.
Ed Riemann	Topeka	KDOC
Craig Talkington	HAYS	K/Inst. Assoc.
LISA PARIKH	Topeka	Ka. Ind. Dealer's Assoc.
John Smith	Madison	KLA
Juli Bilbren	Lyon	KLA

MEMORANDUM

To: Members of the Senate Assessment and Taxation Committee
From: S. Lucky DeFries, Attorney for Martin Tractor Co., Inc.
Re: Senate Bill No. 42
Date: February 7, 1989

I appear today on behalf of Martin Tractor Company, Inc., a Caterpillar dealer, that also markets agricultural machinery and equipment. Martin Tractor's corporate headquarters is here in Topeka, but they have additional branches in Colby, Concordia and Chanute. When the constitutional amendment providing for classification and the exemption for merchants' and manufacturers' inventories was passed by the people of Kansas, Martin Tractor Company and others similarly situated were very pleased that, as of January 1, 1989, the inventory tax, which represents a significant cost of doing business, would no longer be a factor. Unfortunately, everyone's understanding regarding the intended scope of the merchants' and manufacturers' inventory exemption was changed significantly with the passage of Senate Bill No. 453 during last year's session, which amended the definitions of "merchant" and "inventory" which are set forth at K.S.A. 1988 sub. 79-201(m).

After first becoming aware of the revisions included as part of Senate Bill No. 453 last year, I contacted the Property Valuation Department regarding their interpretation of the newly added language. I was informed that, with the addition of the language "without any intervening use", PVD believed that any piece of machinery or equipment that was out on lease as of January 1, or that had been previously out on lease and was now back in the inventory on January 1, would be excluded from the exemption from merchants' and manufacturers' inventory. Unfortunately, this interpretation represented a significant departure from what most individuals believed the status quo to be at the time the exemption for merchants' and manufacturers' inventory was passed. Because of my concerns that the

Legislature had exceeded its authority with the changes to the definitions of "merchant" and "inventory", through Senate Bill 453, I began inquiring regarding the understanding of the Legislature at the time this amendment had been passed last year. As part of those inquiries, it became very clear that the Legislature had not understood the significance of the changes to "merchant" and "inventory" and what impact the changes would have on the intended scope of the merchants' and manufacturers' inventory exemption. With the assistance of Rep. Wagnon and Sen. Thiessen, I was able to appear before the interim committee on assessment and taxation last summer to address these concerns. The interim committee appeared to be very concerned that something they had passed last year had limited the constitutional amendment passed by the people of the State of Kansas, and seemed open to the possible repeal of the language that had been added during the past session.

At that time, based on my communications with the Legislative Research Department and the Revisor's office, it appeared that my client's concerns could be resolved by simply repealing the language that had been added by the Legislature last year. However, based on certain information from various county appraisers received since that time, it became clear that there were some questions about what kinds of equipment qualified for the merchants' inventory exemption even under the prior language of the statute, and that in order to fully address our concerns, a further revision would be necessary.

Specifically, the two areas that we are attempting to address through Senate Bill 42 are as follows:

1. Machinery or equipment that is specifically acquired for the purpose of resale that is subsequently leased but is back in inventory for sale on January 1 of the tax year in question.
2. Machinery and equipment that is specifically acquired for the purpose of resale but is out on a short-term lease as of January 1 of the tax year in question.

The language added by the Legislature last year would specifically exclude both of these categories of machinery and equipment from the scope of the merchants' inventory exemption.

In the past, my client and most other similarly situated have routinely rendered these categories of equipment as merchants' inventory and received 40% adjustment, which heretofore has been available for merchants' inventory. Consequently, if these categories of equipment are not now considered to be part of the merchants' inventory exemption, we will have significantly departed from the existing scheme of taxation with respect to this class of property and forced it to be taxed at full value with no reduction for obsolescence.

While the repeal of the language added during the last session would seem to clearly take care of machinery and equipment purchased for resale that was subsequently leased but is back in inventory as of January 1 of the tax year in question, we have some concerns about whether the other category of equipment listed above would adequately be covered without specifically being addressed as part of the new bill. Our concern is based on the fact that some county appraisers have indicated that, in their opinion, leased equipment that was out on lease as of January 1 of the tax year in question would not previously have been covered irrespective of whether it had originally been acquired for resale. While we do not believe that reflects the state of the law at the time the merchants' and manufacturers' exemption was passed, we do believe that, to make certain there is absolutely no question, an affirmative reference to leases should be made in the bill. In our opinion, this concern is addressed by the language utilized in Senate Bill 42.

From a constitutional law standpoint, we believe it is clear that the Legislature has no authority to limit a constitutional amendment passed by the people of the State of Kansas. While the Legislature can expand upon a constitutional amendment, any limitations would have to be part of a subsequent constitutional amendment resubmitted to the people for a vote. Unfortunately, it appears that the Legislature had just not understood the significance of what had been submitted to them last year and had passed it without realizing the unintended impact. The Legislature now has the opportunity to rectify that situation and restore the vitality of the constitutional amendment previously passed, and to clarify this one additional element which we feel was contemplated by the people and represents what the state of the law actually was at the time the amendment was passed.

Additionally, through inadvertence, some of the additional language added by the Legislature last year to the definition of "inventory" was included with the current draft of Senate Bill 42. That language, which begins on line 44 and ends on line 48, should be excluded from the proposed draft of Senate Bill 42, and we would ask that this committee make that revision. This language was not part of the definition of "inventory" at the time the constitutional amendment providing for the merchants' and manufacturers' inventory exemption was passed. Furthermore, trying to exclude assets from the exemption because they are subject to depreciation or cost recovery accounting, is not contemplated by the constitutional amendment and should not be contemplated by the Kansas scheme of taxation, since many true inventory items are in some instances required to be treated as capital assets for federal tax purposes. Such language is simply not compatible with the intended scope of the merchants' and manufacturers' inventory exemption. And in any event, to the extent that this additional language serves as a limitation upon the constitutional amendment, it would represent an impermissible infringement upon what the people of the State of Kansas had passed.

For all of these reasons, we would respectfully ask that Senate Bill 42 with the one revision mentioned above be reported favorably.

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MEMORANDUM

TO: MEMBERS OF SENATE ASSESSMENT AND TAXATION COMMITTEE
FROM: ALAN F. ALDERSON, ATTORNEY FOR WESTERN RETAIL IMPLEMENT
AND HARDWARE ASSOCIATION
RE: SENATE BILL NO. 42
DATE: FEBRUARY 7, 1989

Although this Legislature has been very good to the implement dealer members of the Western Retail Implement and Hardware Association, the passage of K.S.A. 1988 Supp. 79-201m represents a significant step backwards for implement dealers and many other retailers. In fact, we believe it amounts to redefining, after the fact, of the terms "merchant" and "inventory" to the detriment of those retailers who had believed that all of their inventory would be exempt at the time of the passage of the constitutional amendment.

Implement dealer members of the Association have assumed, and have been told repeatedly, that all of their inventory would be exempt from property taxation effective January 1, 1989. K.S.A. 1988 Supp. 79-201m would make a number of pieces of farm machinery and equipment not only subject to taxation, but at the full rate without any reduction for obsolescence. It is highly probable that many implement dealers are holding pieces of machinery and equipment previously subject to leases which have been returned or traded in to the dealer and are now being held for resale. The fact that this property had an "intervening use" as leased property does not alter the fact that it is being held with a view to sale when it sits on the dealer's lot at this time.

Attachment 2
Senate Assessment & Tax
2-7-89

Unless Senate Bill No. 42 is passed, it is our understanding that the Division of Property Valuation will interpret K.S.A. 1988 Supp. 79-201m to treat property which has once been leased in the same manner as any other personal property owned by that retailer. As I stated, it would not even have the benefit of the forty percent reduction.

I believe that 79-201m presents a serious constitutional question inasmuch as terms used in a constitutional amendment are construed to mean what they did at the time people voted on the amendment. Clearly, farm machinery and equipment sitting on a dealer's lot which may have been leased at one point in time was considered to be inventory when the people of this state voted to exempt inventory. I do not believe it is permissible to redefine terms so that property which would otherwise be exempt now becomes taxable.

For the reasons stated herein, we would urge your support for the passage of Senate Bill No. 42. I would be glad to try to answer any questions you may have.

SENATE BILL NO. 42

Mr. Chairman, members of the Senate Committee on Assessment and Taxation: The Division of Property Valuation appears before you today to provide the Committee with our interpretation of the provisions of Senate Bill No. 42. In our opinion it would exempt from property or ad valorem taxation all personal property in the State of Kansas. Such exemption would severely erode the tax base and cause real property to bear the entire property tax burden in the State of Kansas.

Senate Bill No. 42 redefines "merchant" to mean and include every person, company or corporation who shall own or hold, subject to their control, any tangible personal property within this state which shall have been purchased for resale, lease, or both. More importantly, inventory is redefined to mean those items of tangible personal property which are held for sale in the ordinary course of business regardless of whether or not there is an intervening use of such property including the lease thereof. Essentially, every person, company or corporation will maintain that all of their tangible personal property was purchased for ultimate resale.

Basically, the question becomes one of intent. Intent is a very subjective thing. Black's Law Dictionary (5th Edition, 1979) defines intent as: A state of mind, which is rarely susceptible of direct proof, but must ordinarily be inferred from the facts; a mental attitude, which can seldom be proved by direct evidence, but must ordinarily be proved by circumstances from which it may be inferred. Consequently, it is likely that intent must be determined by simply inquiring of the taxpayer whether or not they intend to eventually resell their personal property. The answer should be obvious.

Basically, any person, company or corporation may purchase tangible personal property, use it for any purpose, modify or change it, even lease it, and if they contend that their intention is to eventually resell it, they may obtain an exemption of such property from all property or ad valorem taxation.

Finally, even if Senate Bill No. 42 were narrowly interpreted to merely expand the present definitions of merchant and inventory to include lessors and leased inventory, and not to exempt all tangible personal property, the leased tangible personal property of companies like IBM, Xerox, AT&T, NCR, Hertz, Avis, etc. would qualify for exemption under Senate Bill No. 42. While we have no way to estimate with any precision the fiscal impact of this more

limited exemption, we can say that millions of dollars of tax liability would be shifted to the remaining taxable property.