

Approved _____

Date

March 4, 1991

MINUTES OF THE HOUSE COMMITTEE ON Taxation

The meeting was called to order by Joan Wagnon
Chairperson

9:10 a.m./~~p.m.~~ on Tuesday, February 27, 1991 in room 519S of the Capito

All members were present except:

Committee staff present:

Tom Severn and Chris Courtwright, Legislative Research,
Don Hayward and Bill Edds, Revisors, Linda Frey, Committee
Secretary, Douglas Johnston, aide

Conferees appearing before the committee:

Chairman Wagnon called the committee to order at 9:10 a.m. for
hearings on HB 2112 and HB 2113.

Tom R. Docking, of Ayesh, Docking, Herd & Theis Lawyers,
testified in favor of HB 2113 (attachment 1).

Harley Duncan, Executive Director of Federation of Tax
Administrators, discussed information on the degree of taxation
of services in other states, activities in consideration of
services in other states, and issues that have been addressed in
the area by other states (attachment 2).

Duncan replied to a question regarding the state of Florida
repeal of sales tax on services that had been used as an example
of why not to tax services. He said Florida's attempts were the
most recent action to broaden the tax base and that the attempt
was made during an election year and that the Governor of
Florida changed his position on the issue, leading to the
repeal. Duncan state it was repealed for a variety of reasons
including a perception of what the new taxes were doing to the
state even though Florida had "reasonable success" in the six
months it was implemented. As an alternative they raised the
already existing sales tax. In reply to a similar question
regarding Massachusetts, Duncan said Mass. had excepted a large
number of personal services and that Mass. had one of the most
narrow service tax bases.

Duncan stated in reply to a question that there were two ways
that a sales tax on services could be collected: If a out of
state firm performed a service in Kansas they would have the
responsibility to collect the state tax; if the business did not

CONTINUATION SHEET

MINUTES OF THE House COMMITTEE ON Taxation,
room 519 Statehouse, at 9:10 a.m./~~p.m.~~ on Tuesday, February 27, 1991

have the responsibility to collect the tax then it would be the responsibility of the purchaser to report to the Dept. of Revenue. Duncan stated that if the law was drafted carefully, businesses would not be forced into moving out of Kansas. Duncan answered two hypothetical questions regarding enforcement by saying that if the entire transaction took place out of state then no Kansas sales tax could apply. He said three elements were necessary for implementation of additional service taxes: policy guidance as to which services would be taxable, education component, and enforcement and compliance.

The following people submitted written testimony, but were unable to testify due to time constraints.

Larry Fischer, Kansans for Fair Taxation (attachment 3)
Mary Ella Simon, League of Women Voters of Kansas (attachment 4)
Pete McGill & Assoc., Securities Industry Assoc. (attachment 5)
Tuck Duncan, Medevac Medical Services, Inc. (attachment 6)
Laura Kelly, Kansas Recreation & Parks Assn. (attachment 7)

The following conferees testified against HB 2113.

Jim Gordon, President of the Public Accountants Assoc. of Kansas (attachment 8)
Harriet Lange, Executive Director of the Kansas Assoc. of Broadcasters (attachment 9)
Penny Tuckel, President and owner of Mark I Travel (attachment 10)
Elwaine Pomeroy, representing the Kansas Collectors Assoc., (attachment 11)
Bill Robinson, representing Beech Aircraft Corp., The Boeing Company, Cessna Aircraft Company and Learjet Inc. (attachment 12)
Don Schnacke, representing the Kansas Independent Oil & Gas Assn. (attachment 13)
Sarah Corless, representing the Greater Kansas City Homebuilders Assn. (attachment 14)
Fred L. Hasler of Topeka
George Barbee, Executive Director of the Kansas Consulting Engineers (attachment 15)
Dan Severt, Secretary-Treasurer of the Wichita Bar Assn., (attachment 16)

CONTINUATION SHEET

MINUTES OF THE House COMMITTEE ON Taxation,
room 519S, Statehouse, at 9:10 a.m.~~pm~~ on Tuesday, February 27, 1991

Trudy Aron, representing the American Institute of Architects
(attachment 17)

David Hanson, representing Kansas Life Assoc. (attachment 18)

The following people submitted written testimony against HB
2113.

Bill Henry, Executive Vice President of the Kansas
Engineering Society (attachment 19)

Ron Smith, representing the Kansas Bar Assn.

Larry Magill, Jr., Executive Vice President of Independent
Insurance Agents of Kansas (attachment 20)

John C. Eisele, attorney (attachment 21)

Hearings on HB 2113 were closed.

The committee adjourned at 11:01 a.m.

GUEST LIST

COMMITTEE: 9 Reputation

DATE: 2/27/91

NAME (PLEASE PRINT)	ADDRESS	COMPANY/ORGANIZATION
FRANCES KASTNER	Topeka	Ks Food Dealers Assn
BRAD SMOOT	Topeka	Boate IV
Jacquie Oakes	Topeka	Ks Auctioneers
Steve Richards	Overland Park	Yellow Freight System
Pat Higgins	Topeka	Leg. Affairs
BEV BRADLEY	TOPEKA	KS ASSOC of COUNTIES
LAURA KELLY	TOPEKA	KS RECREATION & PARC ASSN
MIKE REECHT	TOPEKA	AT+T
HENRY G. METZ	Topeka	K.F.F.T.
IRVIN C. METZ	Topeka	K.F.F.T.
Glenn M Metz	Topeka	K.F.F.T.
SUSAN SOMERS	Topeka	KSCPA
JANET STUBBS	Topeka	HBAK
Leroy Jones	Lenexa	BLE
BILL HENRY	Topeka	Ks Engineering Society
Shelley Sutton	Topeka	Ks Engineering Society
Judy Aron	TOPEKA	Am Inst. of Architects
Catherine Holdeman	Wichita	City of Wichita
Don Schnacke	Topeka	KI OGA
Penny J. TUCKEL	Topeka	Mark I Travel
Arnie Samelson	Horton	Self
Harriet Lange	Topeka	Ks Assn Broadcasters
ALISA M. DOTSON	TOPEKA	KS DEPT OF REV./TAX.
Terry Guy	Meriden	Perman

GUEST LIST

COMMITTEE: Topeka

DATE: 2/27/91

NAME (PLEASE PRINT)	ADDRESS	COMPANY/ORGANIZATION
<i>Jim 174 Bridge</i>	<i>Topeka</i>	<i>Observer</i>
HAROLD P. RITS	"	AARP-CCTF
Wendell Strom	Topeka	AARP-CCTF
R ANDERSON	OTTAWA	NEW CONT OIL
Elwaine F Pomeroy	Topeka	KS Collectors Assn
KAREN FRANCE	TOPEKA	KAR
FRED HAGLER	TOPEKA	LATIMER, SOMMERS & ASSOC.
George Goebel	Topeka	AARP SIC-CCTF Chr.
<i>Christy Young</i>	<i>Topeka</i>	<i>Topeka Chamber of Comm</i>
<i>Mary Ellen Dinn</i>	<i>Topeka</i>	<i>Lg. of Women Voters</i>
<i>George Barber</i>	<i>Topeka</i>	<i>KS Consulting Engneer</i>
<i>Jean Barber</i>	<i>Topeka</i>	<i>Barber & Associates</i>
LARRY MAGILL	"	IND. INS. AGENTS OF KS.
Lori Fink	Topeka	Self
ED BRUSICE	TOPEKA	ICCOI
<i>Chas C Gille</i>	<i>Overland Park</i>	<i>Attorney - CSE</i>
DAVID C. STEPHENS	LENEXA	PROFESSIONAL SOFTWARE CONSULTING
<i>Ed Craft</i>	<i>Topeka</i>	<i>PCG, Inc</i>
Will Belden	Topeka	LWUK
<i>Amy Johnson</i>	<i>Manhattan</i>	<i>Anten</i>
<i>James L. Gordon</i>	<i>Manhattan</i>	<i>Public Accountants Assoc of Ks.</i>
<i>Scott's Leonard</i>	<i>Salina</i>	<i>" " " "</i>
<i>Ann Brown</i>	<i>Lincoln</i>	<i>ICS USA Denver Assn</i>
<i>R. E. Todd D. H. W.</i>	<i>TOPEKA</i>	<i>Medeval</i>

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TO: The Honorable Joan Wagnon, Chairwoman
House Taxation Committee

FROM: Thomas R. Docking

DATE: February 27, 1991

RE: House Bill 2113

=====
I. Introduction

House Bill 2113 would significantly expand the Kansas tax base by eliminating numerous sales tax exemptions and causing the taxation of many services currently not subject to the Kansas sales tax. If enacted, the proposal would result in a dramatic reduction in our dependence upon the property tax as a percentage of total state and local revenues, and would bolster the long-term stability of our state revenue base. These twin objectives directly address two real and pressing issues facing the Kansas populace and our government: public turmoil over property taxes in the wake of the adoption and implementation of reappraisal and classification, and on-going state budget difficulties in light of available tax revenues and perceived program needs.

HOUSE TAXATION
Attachment #1
02/27/91

II. Reduction of our Dependence upon Ad Valorem Property Taxes.

Previous testimony before this Committee has documented Kansas' relatively heavy reliance upon the property tax as a percent of our state and local tax revenues. This has been documented by prior independent studies as well. Although the long term trend for Kansas in this regard has been declining, Kansas still relies heavily upon the property tax in the overall revenue mix. This factor alone has likely been a principal cause of the general unpopularity of the property tax; the pre-reappraisal disparities in valuation and taxation of similar properties only served to compound the notion that the property tax has been viewed as too large and unfairly administered.

While the adoption and implementation of reappraisal and classification has addressed many of the legitimate complaints about the property tax, the very impact of those two measures has lit a firestorm of public controversy of its own, resulting in any number of legislative proposals, from the relatively innocuous (extending payment and protest deadlines), to the dramatic (freezing pre-existing values pending submission of new constitutional amendments). One of the fundamental objectives of House Bill 2113 is to take meaningful steps to reduce our relative dependence on the property tax in recognition that the concerns and even anger which have been expressed stem not just from "tax protester" groups, but from typical homeowners, mainstreet businesses and other concerned taxpayers

III. Broadening the Revenue Base.

Without regard to concerns already expressed about the property tax, the state of Kansas faces short term budget difficulties arising from slow growth in tax revenue, reductions in federal revenues to the state, and increasing demands for expenditures in social and human services and other program areas. It is respectfully submitted that, given the existing revenue base for the state of Kansas, these short term difficulties can accurately be described as long term, structural impediments to meeting the program needs which most Kansans believe are worthy and important for our future. The notion of broadening the tax base through the elimination of exemptions is certainly not new; the extension of this notion to include the taxation of many services may seem relatively new to Kansas, although similar measures are being considered and debated elsewhere in the United States. This is in part due to similar concerns about the long term stability of our state revenue base.

House Bill 2113 addresses these concerns by significantly expanding the revenue base in ways which are likely to constitute a continuing and growing percentage of the total economic activity in Kansas.

IV. Regressivity; Jurisdictional Problems; Compliance.

Legitimate concerns which have been raised regarding the general regressivity of the sales tax, the taxation of services, especially in counties near the borders of our neighboring states, and compliance problems, have all been addressed by Secretary

Beshears in previous testimony and will not be repeated here. What is submitted in addition to what has been offered previously is that House Bill 2113 does comport with many of the recommendations of the Revenue Transition Team, such as the very important recommendation that wholesale and other non-retail transactions continue to remain exempt from taxation; that many isolated or de minimus transactions continue to remain exempt, and that there do exist methods contained within this proposal which will lessen the regressivity of the overall package.

V. Alternatives and Conclusions.

House Bill 2113 does not represent a "pretty" or "painless" means by which the goals of property tax reduction and broadening the tax base can be achieved. Many taxpayers would be asked to share in the burden of achieving these goals, and this committee is no doubt hearing from each and every one of them. Nevertheless, if government accepts that reduction in property taxes and stability in our revenue base must be accomplished, then House Bill 2113 forms a reasonable basis upon which these objectives can be met.

Federation of Tax Administrators

**The Sales Taxation of Services:
Activities in the States**

Prepared for

**Committee on Taxation
Kansas House of Representatives
February 27, 1991**

**Harley T. Duncan, Executive Director
Federation of Tax Administrators
444 North Capitol St. NW
Washington, DC 20001
(202) 624-5890**

HOUSE TAXATION
Attachment #2
02/27/91

Committee on Taxation
Kansas House of Representatives
February 27, 1991

I. Introduction

- Do not appear as a proponent or opponent of the proposed bill. Instead I appear to provide information that may be helpful to the committee on the degree of taxation of services in other states, activities in the consideration of services in other states, and issues that have been addressed in this area by other states.
- Federation of Tax Administrators is a non-profit corporation that is an association of the tax and revenue collecting agencies in the 50 states, District of Columbia, New York City, and the Province of Ontario.

II. Current Taxation

- FTA prepared survey in Summer 1990 on state taxation of some 160 different categories of transactions under the general retail sales/gross receipts tax or under a special excise levy imposed by the state. Work was performed by FTA Associate Laird Graeser, Director of Tax Research for the New Mexico Department of Taxation and Revenue, and included a review of the issues involved in taxing services, a policy analysis of service taxation, and an extensive bibliography on the subject. (These papers, along with the complete survey results, have been compiled into a single report, *Sales Taxation of Services*, Research Report No. 135, which is available from FTA.)
- General results of the survey are presented in the attached map and Table I.
- If one construes the term "service" broadly to include such non-tangible items as utilities, admissions/amusements, lodging and labor services, states currently tax services to a considerable extent. All states and the District of Columbia tax hotel and motel lodging in some fashion, and most states with a retail sales tax impose the same on a variety of admissions, amusements and rentals.
- Beyond these general categories, however, the states exhibit great diversity in the extent to which they tax the full range of services covered in the survey. Hawaii, New Mexico and South Dakota have general sales tax systems with broadly defined bases which tax a great number of services. Of the 160 different services covered in the survey, Hawaii and New Mexico tax 154, while South Dakota taxes 131 different services. West Virginia is the only other state to tax over 100 services with its general sales tax. However, while its sales tax base is broader than most, it still leaves professional services largely untaxed (taxing only land surveying.)
- In two other states exhibiting a high degree of service taxation in the chart, the ranking is attributable in large part to a broad-based, low rate gross receipts or occupational tax applied to most businesses. Delaware, which imposes no general sales tax, assesses a 0.4 percent gross receipts tax on most businesses. All but 25 of the services taxed in Delaware are at the 0.4 percent rate. Similarly, Washington taxes many services through its occupation tax with 96 services taxed at a rate below the general sales tax rate. While these taxes are intended to be imposed on business activities, the incidence of the tax generally falls on the consumer as it does with a

general sales tax. Indeed, there is little difference in the economic effect of a business occupational tax and a sales tax. Thus they are included in the survey.

- The survey was conducted before passage of legislation extending the Massachusetts sales tax to certain services sold to medium and large businesses. Effective September 1, 1990, Massachusetts began applying its 5 percent sales taxes to telecommunications and utility services. The new legislation also imposes the sales tax on many legal, accounting, engineering, architectural, repair, building maintenance, and miscellaneous services purchased by businesses. The measure exempts nearly all personal purchases of services as well as purchases by firms with five or fewer employees. There is also an exemption for the first \$20,000 in annual purchases of each legal, accounting, engineering and architectural services. The tax will also be imposed on a variety of admissions and amusements where the cost exceeds \$30 per event.

At the request of the incoming governor, the legislature extended the effective date from December 1, 1990 to March 6, 1991. The governor has proposed a budget which calls for the repeal of the tax on business services. The tax was also extended to telecommunications and utility services effective September 1, 1990. Of the 160 examined in this survey, the new law will expand the number of services taxed from 4 to 64.

- The survey also does not capture 1990 legislative changes. Certain services were taxed pursuant to 1990 legislation in New Jersey and New York.
- While only three states have a broad-based services tax, several other states tax a large number of selected services. These include: Connecticut, Iowa, Minnesota, Mississippi, Tennessee, Kansas, Wisconsin, and Texas. These states widely tax utilities, admissions/amusements, and labor repair services, but leave professional services largely untaxed. Within this group, three states--Connecticut, Iowa and Texas--set themselves apart by taxing personal and business services more extensively, and in the case of Connecticut and Texas, more computer services than is the norm for most states. In total, these states tax somewhere between 60-85 of the 160 services in the survey.
- At the other end of the spectrum, there are some states which make comparatively little use of services in their sales tax base, including even the more commonly taxed services of utilities and amusements. There are 15 states with a general retail sales tax which tax 25 or fewer of the enumerated services. These come from all areas of the country including 4 from the Northeast, 3 from the Southeast, 5 from the Midwest, and 3 from the West.
- There are 23 sales tax states which tax fewer than 10 of the 19 enumerated labor and repair services. Again, these are from all parts of the country with somewhat greater representation from the Midwest and Southeast. These labor services seem a "natural" for taxation because of their relationship to tangible personal property, the traditional focus of sales taxes. On the other hand, many state sales taxes have their origin in the "Great Depression," which likely accounts for a reluctance to tax the repairs and labor of the "common man."
- As states examine expansion of the sales tax base, they generally direct their attention to personal services, business services, computer services and professional services. For various reasons, professional services tend to be the last area examined.

Table 1

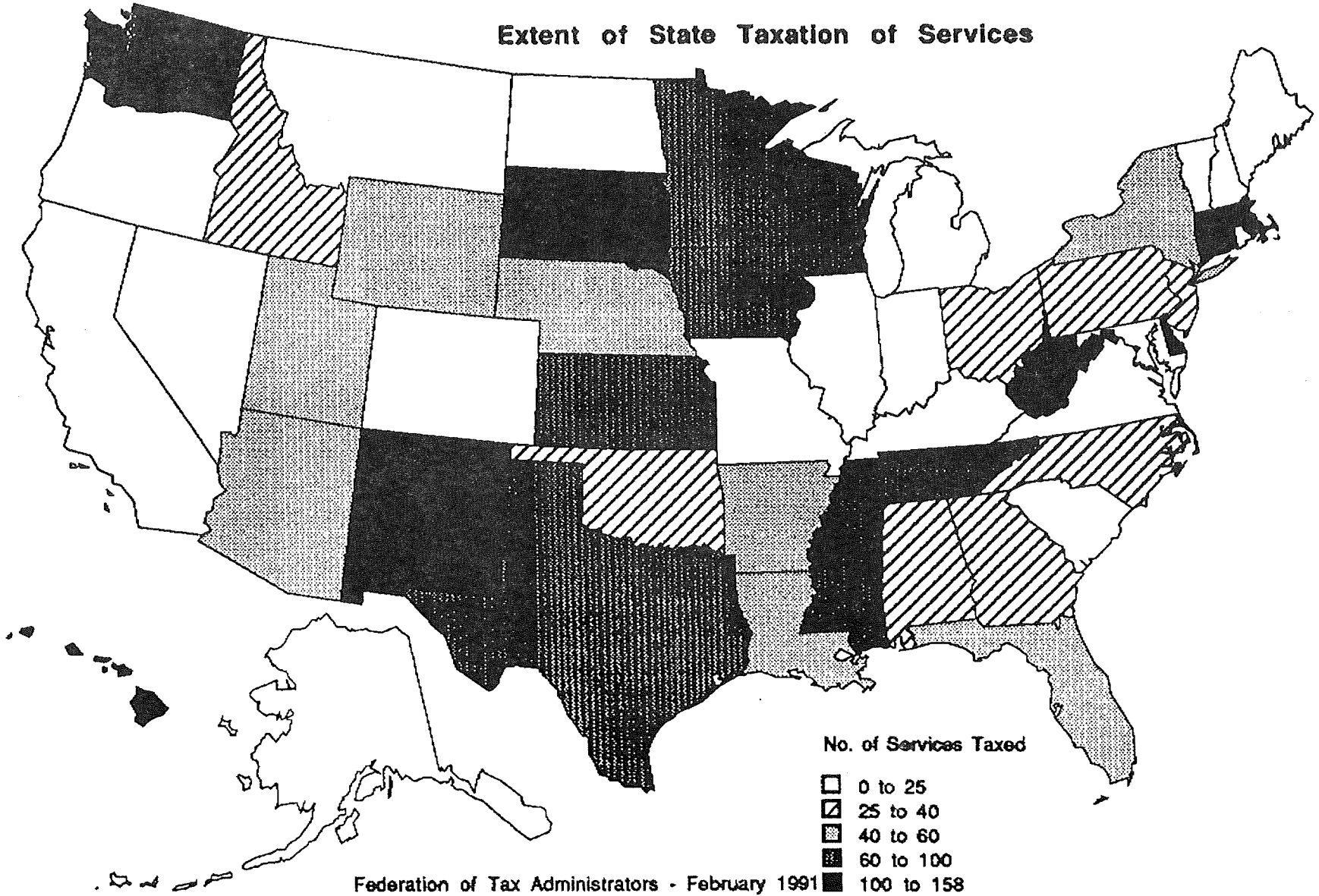
	Utilities	Personal Services	Business Services	Computer Services	Admiss. & Amusements	Professional Services	Fabrication, Repair & Installation	Other	Total
NORTHEASTERN STATES									
CT	7	7	21	6	10	1	14	10	76
DE	8	20	34	6	10	8	19	42	147
DC	10	5	4	6	5	0	13	9	52
ME	7	1	3	3	2	0	4	3	23
MD	3	2	4	1	10	0	3	2	25
MA **	0	0	0	1	0	0	0	2	2
MA #	7	7	20	0	11	4	8	4	61
NH	8	0	0	0	0	0	0	3	11
NJ	0	1	4	0	6	0	14	10	35
NY	7	2	6	3	7	0	17	16	58
PA	4	2	5	0	1	0	16	9	37
RI	8	1	5	3	2	0	3	2	24
VT	3	0	3	1	10	0	0	2	19
SOUTHEASTERN STATES									
AL	9	2	4	1	10	0	1	4	31
AR	12	0	4	1	12	0	11	7	47
FL	5	3	3	3	10	0	16	13	53
GA	8	2	2	1	10	0	2	6	31
KY	8	1	3	0	7	0	3	1	23
LA	8	7	4	1	7	0	13	8	48
MS	6	4	8	3	10	0	13	23	67
NC	8	3	4	1	8	0	1	1	26
SC	2	3	3	4	2	0	0	2	16
TN	9	11	6	3	12	0	13	12	66
VA	1	2	2	0	1	0	4	5	15
WV	10	17	27	4	13	1	13	26	111
MIDWESTERN STATES									
IL	10	0	1	1	0	0	1	2	15
IN	6	2	1	2	2	0	0	4	17
IA	10	14	15	0	11	0	13	20	83
KS	6	11	7	2	13	0	16	9	64
MI	8	3	3	1	1	0	1	1	18
MN	13	7	10	2	13	0	4	11	60
MO	6	0	1	1	10	0	0	6	24
NE	12	2	5	3	11	0	3	4	40
ND	4	1	1	0	10	0	2	1	19
OH	6	4	4	2	1	0	12	5	34
OK	7	1	4	2	13	0	0	6	33
SD	9	19	29	6	13	4	18	33	131
WI	9	10	4	1	13	0	15	14	66
WESTERN STATES									
AK	0	0	0	0	0	0	0	2	2
AZ	10	1	4	3	11	0	2	23	54
CA	4	1	3	0	1	0	2	4	15
CO	2	0	2	1	2	0	2	3	12
HI	12	20	34	6	13	8	18	43	154
ID	0	4	3	2	12	0	7	5	33
MT	8	0	0	0	2	0	0	4	14
NV	0	1	5	0	1	0	2	3	12
NM	14	20	33	6	13	8	18	42	154
OR	12	0	0	0	0	0	0	3	15
TX	8	12	13	6	10	1	11	15	76
UT	5	6	5	2	8	0	13	8	47
WA	14	20	34	6	10	8	16	43	151
WY	9	4	1	3	9	0	15	15	56
Total in Category	14	20	34	6	14	8	19	46	161

* In addition to state and local sales taxes, the survey includes special gross receipts (excise) taxes, and business occupation/gross income taxes that are similar to sales taxes.

** Services taxed effective July 1, 1990. Does not include recent legislation passed in Massachusetts. Revised December 1990.

Services taxed under current legislation effective March 6, 1991.

Extent of State Taxation of Services



III. Recent State Activity In the Taxation of Services

- In recent years, about 20 states have considered the taxation of services in one forum or another and to one degree or another. These efforts are summarized in Attachment A.
- States where a reasonably significant expansion of the tax to services has been enacted in the last 5 years include Connecticut, Minnesota, New York, Florida (subsequently repealed), Texas, District of Columbia and Massachusetts. Of these, Florida and Massachusetts are the most far-reaching.
- Tax study commissions have recommended such expansions in Alabama, Arizona, Maryland, Florida, and Texas in recent years.

IV. Tax Policy Issues Involved with the Taxation of Services

- **Purpose of Tax.** Proponents argue that extension of the sales tax is consistent with the general purpose and intent of retail sales tax as a consumption tax, i.e., impose a tax on the final consumption of all goods and services. Limiting the tax to the consumption (purchase) of tangible goods causes the tax to fall short of its goal and to ignore a significant component of economic activity and personal consumption expenditures. To achieve any given level of revenue, the taxes on productive activities or income must be relatively higher.
- **Revenue Reliability and Stability.** The primary rationale offered for extending the tax to service transactions revolves generally around the shift in economic activity from the production and consumption of tangible goods to the production and consumption of services. This long-term trend reached the point in October 1986 where, for the first time, services constituted a greater proportion of U.S. gross national product than did the tangible goods sector. During the 1980's, purchases of services has grown from 47 percent of total personal consumption expenditures to more than 53 percent.

This continuing shift raises concerns about the long term vitality of traditional retail sales taxes which are levied primarily on tangible personal property. Without rate increases or some form of base broadening, sales taxes will reach a declining portion of total consumer purchases. For example, in 1960, a 1 percent sales tax in the 46 sales tax states generated revenue equal to \$6.90 per \$1,000 personal income. In 1988, this figure had declined to \$5.60 per \$1,000 of personal income.¹ While some of this erosion is attributable to statutory exemptions, a significant portion must also be assigned to the growing role of untaxed services in household consumption patterns. Continuation of this trend, over time, will limit the ability of traditional sales taxes to meet the increasing service demands placed on state government. In tax policy terms, extending the sales tax to services will improve its ability to meet governmental needs

¹ Steven D. Gold, *The State Fiscal Agenda for the 1990s*, National Conference of State Legislatures, July 1990, p. 116. Based on work by John Mikesell, University of Indiana.

(adequacy) and its elasticity, i.e., its responsiveness to changes in income. This should also improve the stability of the sales tax as a revenue source.²

- **Economic Distortions.** Another widely cited argument for extending the sales tax to service industries deals with the economic distortions introduced through their exemption. Taxing sales of tangible property raises the after tax price of the good relative to the price of a competing service that is not taxed. By distorting the decisions made by individuals and business, the exemption of services from the sales tax base leads to a less than optimal (inefficient) allocation of resources. For example, if labor services to repair a commodity are not taxed, but a new purchase to replace the commodity is taxed, the after tax price of repair is lower, relative to the price to replace the commodity, thus causing individuals and business to demand more repair services than would be economically efficient.

However, it should also be noted that extending the sales tax to service transactions may also produce some distortions. Taxation of business services can introduce a potential distortion by encouraging more vertical integration in corporations. Since services provided by employees (and in some cases, employees of related corporations) are not taxable, there is an incentive for firms to provide many services in house that may be better performed by others. Smaller businesses which must, of necessity, procure their services from other providers may be at a competitive disadvantage as their purchases of these services would be taxable.

- **Tax Pyramiding.** Taxing business services introduces a similar tax policy concern given the nature of business operations. Many business purchases of both goods and services are directly or indirectly incorporated into the final products as factors of production. Since the final good is taxed when sold, taxation of these intermediate goods and services will lead to tax pyramiding or cascading. This issue is not unique to the taxation of services. It occurs in the taxation of tangible goods to the extent that business inputs are taxed. Most states attempt to minimize pyramiding with respect to tangible personal property by exempting goods consumed in the production of or incorporated directly into a product subsequently sold at retail. They also exempt wholesale transactions or "sales for resale." Application of the sales tax to business services reintroduces the issue of pyramiding and raises the question of whether the traditional exemption method of reducing pyramiding can work with service industries.

Using utility services as an example, the survey points out how some states get around this problem. While 38 states tax business use of fuels, 15 of these states exempt fuel used in production if separately metered or measured. Still, some business purchases either are not incorporated in the final good or are of the sort where the business is the ultimate consumer. These could reasonably be taxed without undue concern about tax pyramiding. The survey results point to a rather lengthy list of business services of this type.

² Empirical evidence that service taxation increases the income elasticity of the sales tax is mixed. Friedlaender, Swanson and Due, "Estimating Sales Tax Revenue Changes in Response to Changes in Personal Income and Sales Tax Rates," National Tax Journal, March 1973, p. 103-110, found no increase in the elasticity for states heavily taxing services. Bohm and Craig, "Recent Sales Tax Trends: Services as a Point of Departure," National Tax Association, Proceedings of the 78th Annual Conference, 1987, p. 54-62, on the other hand, found a higher income elasticity in states which tax many services.

- **Tax Equity.** Proponents of imposing the tax on services generally argue that it will improve the horizontal (treatment of similarly situated taxpayers) and vertical (treatment of taxpayer at different income levels) equity of the tax system. It improves horizontal equity because the repair of an item and purchase of a new item are treated similarly (i.e., distortions are minimized) and consumption is taxed more broadly so that differences in consumption patterns do not result in differences in tax burdens. It improves vertical equity because higher income individuals tend to purchase more services, particularly professional services.

Others argue that the tax equity argument is a mixed bag. Because it is an excise levy, the sales tax is regressive across income levels and that certain services which may be taxed (i.e., labor and repair services, utilities etc.) have a disproportionate burden on lower income households. Thus taxing certain services can exacerbate the inherent regressivity of the sales tax.³

Three states which tax services widely--Hawaii, New Mexico and South Dakota--have some form of credit or rebate to provide sales tax relief to lower income households.

- **Interstate Tax Competition.** Another issue raised with respect to the taxation of services concerns interstate tax competition. This is commonly characterized as can a state afford to be different from its neighbors? Since sales taxes are traditionally levied on the consumer, they should not affect business competitiveness. However, expanding sales taxes to include business services could raise the cost of doing business in one state relative to another, having an impact on a state's competitiveness.⁴
- **Labor Services.** Finally, an important issue in some states may be the manner in which policy makers view labor services. Since many states enacted their sales tax during the Great Depression, elected officials were generally reluctant to impose the tax on labor services. This pattern is still present in many states today. While all 46 jurisdictions with a retail sales tax apply the tax to materials used in general repair, only 23 states also apply sales taxes to labor repairs generally. Of the remaining, twenty states exempt labor services if it is separately stated on the invoice. This pattern is also present in cases where states will exempt certain services if labor is included, while they would tax the same service without the labor. For example, 33 states tax auto rentals while only 24 tax limousine services with a driver. Similarly, 41 states tax aircraft rentals while only 10 tax aircraft rentals with a pilot included (chartered flights).

³ For a more complete discussion of this issue, see William Fox and Mathew Murray, "Economic Aspects of Taxing Services," National Tax Journal, March 1988, p. 19-36.

⁴ Empirical studies provide only limited evidence that sales taxes affect business activities. Fox, "Tax Structure and the Location of Economic Activity Along State Borders," National Tax Journal, December 1986, p. 387-401, provides evidence that different sales tax rates along a state's border can cause a significant effect on employment. Bartik, "Small Business Start-Ups in the U.S.: Estimates of the Effects of Characteristics of States," Working Paper No. 87-W15, Nashville: Department of Economics and Business Administration, Vanderbilt University, 1987, finds that only the differential sales tax rates on machinery and equipment was a significant variable in his equations determining business location.

VI. Administrative and Compliance Issues

A. Use Tax on Services

- **Level Playing Field.** The primary issue here is that by imposing a sales tax on service transactions, the state does not want to disadvantage in-state providers in competing for out-of-state business. Neither do they want to create an incentive to purchase services out-of-state.
- Not unlike the need to impose a compensating use tax on the interstate purchase of tangible personal property. Somewhat more complex because of intangible nature of service, i.e., do not have actual property to follow for situs rules. Makes it difficult to employ "destination" principle consistently as is done with tangible property.
- Must develop a blend of situs rules which recognize where service is performed (origin rules) and where service is used or "benefit is enjoyed" (destination rules.)
- Need to avoid over-emphasizing the issue in that it is relevant only to a handful of professional services (e.g., legal and accounting/financial consulting). In nearly every other case, the situs of the performance or the use of the service can be traced because they tend to be related to personal or real property. Do not want the "tail to wag the dog."
- **Basic Approaches.** Distinction tends to be between relative reliance on point of performance (i.e., where did service take place or where was it performed) vs. enjoyment of the benefit of the service (i.e., where was service used.) South Dakota, New Mexico and Hawaii have tended to rely more extensively on the point of performance. Florida relied more extensively on beneficial use, and draft Massachusetts rules have incorporated certain of the concepts from Florida.
- To some considerable degree, this choice has been straightforward because of the relatively "closed" nature of the economy in SD, NM, HI, i.e., they are relatively self-contained and do not have large border metropolitan areas.
- Florida had a more open, interstate economy and was more concerned with theoretical consistency and avoiding an "uneven playing field." Lead to apportionment of certain professional services. Also led to charges of overreaching by some. Massachusetts has the same open economy situation and has adopted some of the same principles as Florida.
- **Point of Performance.** Situs is where service is performed or where majority of performance (as determined by proportionate cost) occurs. Where service is to real estate or to tangible personal property, performance or situs is where the property is located. For non-property services, situs is at point of performance
- Hawaii, New Mexico and South Dakota allow exemption for "services delivered out of state."
- SD also has a use tax on services purchased out-of-state, but used in the state. Trying to treat it like tangible personal property. Have also gotten into some apportionment where "mixed" use occurs. NM and HI not have use tax (other than for Research and Development in New Mexico) on services performed out of state, but first or beneficial use enjoyed in state. Is rough justice which may favor out-of-state purchases, but

relatively closed economy allows it. Some special rules for certain types of services, e.g., interstate telephone services.

- **Beneficial Use Concept.** Greater reliance on enjoyment or use of the service and the concept of apportionment where the service may be used or provided in more than one state.
- In Florida, for the majority of services (property (real or personal) related) situs was essentially same as outlined above. Only with respect to that category of professional services not related to real or personal property were the rules significantly different.
- General rules for business purchases: (a) If service related directly to realty, personal property or a local market of the purchaser, then situs was in the state where the realty, personal property or local market was; (b) If service did not relate to a particular location, situs was determined to be where the purchaser was doing business; (c) for a multi-state business, Florida required the apportionment of the cost of the services purchased by the standard three-factor corporate apportionment formula. The effect is to say that non-geographic specific services are enjoyed in Florida to the extent that the company is doing business in Florida as defined by corporate income tax formula. Gets away from the difficulty of trying to identify the location of use.
- This apportionment rule was also applied to all "overhead", non-geographic services purchased by a multistate business doing business in Florida, regardless of whether the particular service had a direct "connection" to Florida.
- A concern of multistate businesses with the apportionment was the record-keeping. Florida allowed a multistate business to apportion all service purchases, but this was also not satisfactory because it made it impossible to qualify for certain exemptions.
- Special rules governed transportation - 50/50 between state of origin and state of destination; advertising - in proportion to market or audience in the state; and services to estates of decedents - where person last resided. For individual purchases of services, situs was where property was located, where any tangible personal property resulting from service (e.g., legal documents) was delivered or if no tangible personal property (e.g., haircut) where service was performed.
- Massachusetts has followed similar concepts in its draft rules to implement the services tax in March 1991.⁵ Service is presumed to be used in Mass. if
 - relates to tangible personal property delivered into Mass., regardless of where service is performed;
 - relates to real property located in Mass., regardless of where service is performed;
 - is performed for an individual located in Mass., for a business that is engaged in business primarily in Mass. (i.e., apportionment percentage exceeds 50 percent),

⁵ Massachusetts Department of Revenue, Draft Regulations 830 CMR 64H.6.8, Allocation and Apportionment of the Use of Services, dated November 8, 1990.

or for a business whose principal place of business is in Mass., regardless of location of performance of service.

- If service cannot be allocated to a separate identifiable line of business in Mass., the apportionment rules come into play. Separate identifiable line of business in Mass. Includes: services related to a local market; amusements, entertainment taking place in Mass., transcription/court reporting of events taking place in Mass., credit reporting for a loan applied for in Mass. or if loan secured by tangible or real property in Mass. Legal services allocated to Mass. if includes litigation, at least one cause of action is deemed to have accrued in Mass. because of an event taking place in Mass. or activity of the taxpayer in Mass., and the attorney files papers, etc. with the judicial or administrative system of Mass.
- If not allocated into or outside of Massachusetts under above rules, a business must apportion to Mass. the use of other taxable services. A business is deemed to use an apportionable service to the extent of its business activity in the state. Extent of business activity may be determined by any reasonable apportionment method. Apportionment percentage from three-factor formula used for franchise tax purposes (modified for financials and insurance) is deemed reasonable. Apportionment percentage is to be determined annually by Jan. 1, based on prior tax year activities. There are special rules for services involving transportation, motor vehicles, aircraft, etc.
- Affiliated companies (i.e., essentially unitary groups) are to be treated as a single entity. Services purchased by all members of the group are apportionable and the apportionment percentage for the group as a whole is used. Affiliated companies may choose to be treated as a single entity even though not all members may be in a related business activity.
- A business or affiliated group may choose to apportion all purchases of legal and accounting services, rather than using the combination of allocation and apportionment rules outlined above. Use apportioned use certificates and direct pay permits to ease compliance, recordkeeping, and vendor involvement.

B. Sale for Resale

- Needs to be a "sale for resale" provision to reduce pyramiding and to parallel the tax on tangible personal property.
- Still needs to recognize that businesses in many cases will be the final consumer of many services in order to provide their service to their customers. Must be carefully and narrowly drawn or considerable administrative and compliance difficulty for the taxpayers (service providers) and the tax administration agency will occur.
- Most states have looked to such circumstances as whether the procurement of a particular service is separately stated in the final bill to a client (with tax computed), whether the provider simply acted as a broker for the purchaser and what was the object of the final purchaser in procuring the service.
- Florida provided five rules for determining sale for resale
 - Purchaser does not consume or use service, but acts as a broker;
 - Purchase is pursuant to a written contract with the seller;

Kansas House Committee on Taxation

Page 10

- Value of service is separately stated on final invoice;
- Service will be taxed on final invoice;
- Resale certificate executed.
- Massachusetts outlines similar tests:
 - Purchased only to provide a specific taxable service to an identifiable consumer;
 - Price plus tax is separately stated on the final billing;
 - Service is essential, recognizable ingredient of the final service;
 - Not a customary/usual expense of maintaining/operating the vendors' business;
 - Cannot involve telecommunications, amusements, printing, meals, or transportation.

C. Definition of Certain Services

- States have encountered some difficulty in defining the transactions or types of particular services which are subject to tax. This is true when the legislature chooses to list particular services which are subject to tax, rather than to make all services subject to tax unless specifically exempted.
- This has especially risen with respect in certain technological areas where rather generic terms are often used interchangeably or where a particular taxable service is often performed by enterprises which also perform a number of nontaxable services and the taxable and nontaxable are closely related and often provided together.
- Some of the more common examples in the first category include telecommunications, data processing, information services. These issues have been present in Texas, Connecticut and the District of Columbia. The most prominent example of the 2nd category is Massachusetts where accounting services are taxable, but consulting, computer programming, etc. are not.⁶
- The solution to this issue has been to draft rather extensive regulations to defined the services and transactions subject to tax. Doing so requires the cooperation of the affected business/industry group. Tax agency must become intimately familiar with how the industry operates.

D. Information and Education

- Sufficient lead time and staffing must be allowed. The task of implementing a tax on services is not impossible or inordinately complex. It is, however, a major undertaking that will require many new activities by the tax agency and involve many new taxpayers not now involved extensively in the administration of the sales tax.
- Activities required include registration of the taxpayers, increased return processing (minimal), drafting guidance to taxpayers on how to handle various transactions, and educating taxpayers on their obligations.
- Particularly if it is decided to impose the tax on a selected set of services, considerable time must be allowed for developing rules to define the types of transactions subject to

⁶ See Massachusetts Department of Revenue, Draft Regulations 830 CMR 64H.6.10, Professional Services, dated November 8, 1990.

tax. This will require close consultation with the affected to industry to understand how it operates. Will require cooperative attitude on the part of all.

- Some lead time necessary to adjust to additional complexity which will be present at the outset.

VII. Conclusion

- Several trends make it likely that the sales taxation of service transactions will be a major state/local tax issue in the 1990s. Those include:
 - Continued demands placed on state governments;
 - Inexorable shift to services in the U.S. economy;
 - Sensitivity/lack of flexibility in income taxes and income tax rates;
 - Need to replace property taxes in elementary and secondary education finance;
 - Ceiling on sales tax rates.
- There are significant opportunities for sales tax base expansion in many states, including labor services, personal services and business services.
- Professional services do present certain special problems when they involve interstate transactions and multistate businesses. States have, however, developed approaches to these issues. Requires cooperation of all involved. Need to achieve some "rough justice" in certain instances.

Attachment A**Recent Activity in the
Sales Taxation of Services**

- Alabama** January 1991 report of a "blue ribbon" commission study of the tax structure recommends expanding the sales tax to most business, professional and personal services. Cellular telephone services made taxable in 1990.
- Arizona** The recently published (1989) "Arizona 2000" report, among many other recommendations, strongly advocates that the state sales tax be expanded to services.
- Arkansas** Considered broadening sales tax base to include professional services (e.g. attorneys, accountants, and advertising), but tax them at the rate of 2%, which is lower than the 4% state general sales tax rate. The final bill which passed the legislature in 1987, taxes only cable TV, interstate telephone and lease and rental services at the rate of 4%.
- California** Governor has in 1991 proposed adding selected services (rentals primarily) to the sales tax base. Certain legislators are looking at a somewhat broader list. Senate fiscal agency has cited substantial base expansion as possible partial remedy to estimated \$9 billion shortfall.
- Connecticut** From 1987-1989, Connecticut added a number of services to its sales tax base. Public relations, fabrication, architectural services, landscape and engineering services, repairs to tangible property, property sales agents, janitorial, custom computer programming, carpentry and painting, detective services, lobbying, janitorial services, health clubs and refuse disposal (among others) are now taxable. In 1991, the Governor has proposed expanding the tax to cover additional services, but also repealing the tax on architectural, landscaping and engineering services.
- District of Columbia** In 1989, the mayor proposed taxing numerous services, including business services. In two months from introduction to passage, the council approved taxes on landscaping, janitorial and maintenance services, information and data base services. The taxes went into effect July 1, 1989. Further expansions of the base have been proposed, and a recent commission reviewing the fiscal affairs of the city noted that sales tax base expansion was a possible revenue source.
- Florida** In 1987, enacted a sales and use tax on a wide array of services, including many business services. On December 10, 1987 the Florida legislature rejected the law effective January 1, 1988. The sales tax rate increased from 5% to 6% on February 1, 1988. Associated Industries of Florida has prepared a revised bill extending the tax to most personal, business and professional services for consideration by the 1991 Legislature. Extended tax to health clubs and pay television in 1990.
- Illinois** Upon his election in 1986, the Governor of Illinois proposed the broad taxation of services, and a reduction in the sales tax rate. The proposal was withdrawn after it met stiff opposition.

Indiana In 1987, the Governor proposed major base expansion, but the proposal was immediately dismissed by the legislature.

Kansas A 1987 interim legislative committee considered sales and use tax reform, including the taxation of services, broadly defined. Legislation was introduced in both houses in 1990. Some bills would tax a few mixed services. Other bills proposed broad ranging taxation. Some further consideration of the concept was given in the 1990 Legislature, and for 1991, the Governor has proposed taxing most business, personal and professional services as a means of providing property tax relief.

Kentucky In 1985, Kentucky extended the sales tax to equipment leases and rentals. In 1990, to address a court decision declaring unconstitutional the school finance arrangements, the legislature enacted \$1.4 billion in new revenues. Originally, the governor proposed expanding the tax to encompass most services, but the proposal died virtually on introduction. The sales tax rate will increase from 5% to 6%.

Louisiana Extended the tax to telecommunications services in 1990.

Maine In 1986, Maine broadened the base to include telephone access charges, auto rentals and other selected services.

Maryland Gubernatorial tax study commission proposed increasing the state sales tax and extending it to personal, business and professional services as part of its comprehensive tax and fiscal reform recommendations. The Governor has recommended that the legislature enact the plan.

Massachusetts To solve serious revenue problems, the legislature extended the sales tax to most business purchases of services effective December 1, 1990. An exemption for firms with fewer than 5 employees and \$25,000 each in annual purchases of legal, accounting, architectural and engineering services is provided. Personal purchases of services are largely exempt. The effective date has been extended to March 6, 1991, and the newly elected governor has proposed repeal of the business services tax. Effective September 1, 1990, the sales tax was imposed on utilities and telecommunications.

Minnesota The House, Senate and Governor all considered proposals for sales/use tax reform in 1987. The Governor's proposal would have included taxing non-profit groups and sales to state and local governments. The final compromise extended the base to include activities such as security services, lawn care, non-prescription drugs, pet grooming and laundry and dry cleaning.

Nebraska A base broadening proposal was considered, in 1985, that was as comprehensive as the original Florida proposal. The bill was eventually withdrawn due to opposition. Some minor services are now taxed, including cable TV and some utilities. A tax study prepared by Syracuse University in 1990 proposed extending the tax to services.

New Jersey In March 1990, the Governor introduced a proposal to extend the sales taxes to telecommunications, cable TV and commercial building maintenance services. The package passed the legislature all except for cable TV. Implementation date is July 1, 1990.

New York Over the past several years, New York has added services to its tax base on a piecemeal basis. Services added in 1990 included parking, cleaning and janitorial, protective and detective services and certain information services. Governor has proposed some base expansions and a special 2 percent tax on interstate and international telecommunications in 1991.

North Dakota In 1987, the cable TV lobby used a referendum procedure to block a tax

Oklahoma A 1987 proposal to broaden the sales tax base and capture \$200 million in additional revenues was not passed by the legislature. A scaled down version was also rejected. The sales tax rate was finally raised from 3.25% to 4%.

Texas A \$2 billion base broadening proposal was introduced into the legislature in 1987 to meet the deficit crisis induced by the decline in the oil and gas industry. The bill did not pass the legislature, and the sales tax rate was increased from 5.25% to 6% effective Oct. 1, 1987. Some select services were added to the base, including credit reporting services, debt collection services, insurance services and real property services. Effective Jan. 1, 1988, the base will include data processing, real property repair and remodeling services. Finally, a two-year professional occupations tax of \$110 was imposed on doctors, architects, engineers and some other professionals. The Texas Select Committee on Tax Equity recommended expansion of the tax to other services as a means of raising revenue.

Washington A proposal to extend the sales tax base to include most services (except medical and financial), and reduce the sales tax rate from 6.5% to 6% was considered in 1987..

Wisconsin Legislation taxing most personal and business services as a way to replace a real estate tax was introduced in 1987.

KANSANS FOR FAIR TAXATION, INC.

PO Box 3820

Topeka, Kansas 66604

273-0401

Designated Speaker--Larry Fischer

Honorable Chairperson and Members of the House Taxation Committee

I am speaking for a Topeka-based group of citizens, Kansans For Fair Taxation, Inc. (KFFT), concerned about high property taxes. We stand in favor of House Bill 2113 as a **temporary remedial approach** to reduce the trend towards confiscatory property taxation. Today KFFT will document that the taxation of services will occur on a national basis by the end of the year 2000.

REFERENCES:

① "THE UNFINISHED AGENDA OF STATE TAX REFORM", EDITED BY STEVEN D. GOLD, NATIONAL CONFERENCE OF STATE LEGISLATORS, NOVEMBER 1988.

② "SALES TAXATION OF SERVICES", FEDERATION OF TAX ADMINISTRATORS, WASHINGTON, D.C., RESEARCH REPORT NO. 190, OCTOBER 1990.

"Taxation of service transactions by the states is widespread on a selective basis and inevitably will become more general. As states and localities face mounting fiscal pressures, the inequity and economic distortion inherent in exempting the majority of service transactions while taxing most goods transactions will become increasingly unacceptable." pg. 129 ①

"There is no legitimate economic reason for service transactions to be broadly excluded from a sales tax base. To effectively build support of the tax, legislators must capitalize on the inherent unfairness of a tax system that discourages the consumption of manufactured goods and encourages the consumption of services. Similarly, the most favorable change that inclusion of services can create in the overall incidence or economic burden of a sales tax will occur only with the inclusion of professional services in the tax base. Apart from political timidity, there is little to justify the taxation of barber and pest control services today while paying only lip service to the possibility of taxing legal and accounting services in some future year." pg. 133 ①

Many will immediately point to Florida's failure to tax services. However, Florida's "concept and execution of the tax were basically sound. Of the three key mistakes that led to the downfall of the tax, none had to do with the working of the tax itself," pg. 130 ① ...The tax fell because of three logistical failures:

1. The Governor's campaign rhetoric gave opponents an antitax message that was sellable to the electorate;

2. The media, aggravated by inclusion of advertising services within the tax base, were only too happy to bombard Florida's households with that message, and

3. Ill-conceived responses by leaders within both parties dissolved the coalition supporting the tax before an effective counterattack could be mounted. pg. 142 ① The whole scenario has been termed an incident "of snatching defeat from the jaws of

victory." pg. 144 1 "Those interests that resist the taxation of service transaction have cited and likely will continue to cite Florida's experience in attempting to convince state legislature to take minimal or naive approaches in expanding their sales tax bases. Only by **mischaracterizing the events** that shaped Florida's experience can such cases be made" pg. 129 (1)
(Incidentally, Florida has no income tax! And Florida is going to propose another bill on sales taxation of services.)

According to Research Report No. 135, "the United States economy is becoming more service oriented. Looking only at personal consumption data, services were 40.5% of total consumption expenditure in 1965...by the first quarter of 1990, 54.4%..by 2005, services will take 64% of the total U.S. consumer spending." pg. 22. (2)

The same source also says that "States that do not tax the consumption of services may find increasing difficulty raising the revenue necessary to provide the level of government services demanded by the electorate. Of course, state governments can fund the cost of government through other taxes and fees but the **sales tax remains the most productive tax** for state governments." pg. 23. (2)

And, "While rate increases are familiar and somewhat popular, **base broadening may be the preferable method of increasing the yield from the sales tax.**" pg. 23. (2)

"From an economic standpoint the distinction between a service and a commodity is **not** very significant one, since both satisfy personal wants..." pg. 52. (2)

Research Report No. 135 has a word of caution in that "States tend to be incremental in their approach to taxation...However, because the **incremental approach is generated by political expediency**, it is also fraught with the potential for idiosyncratic exemption and deductions for certain **powerful taxpayer groups.**" pg. 57. (2) "The alternative to the incremental or "laundry list" approach is the **general taxation of all services with minimal exemptions** to avoid double taxation, pyramiding or to achieve social policy goals." pg. 57. (2)

"One telling criticism of the taxation of business services is the potential of larger companies to "vertically integrate." For instance, a large company can afford to hire an in-house legal staff...Critics point to the fact that small businesses cannot afford to hire lawyers and accountants on staff and must purchase these services subject to tax...There are a number of unproved assumptions in these arguments...a small increase in the price of a price-inelastic service will have very small impact on the quantity of the service provided. Secondly, large companies purchase about the same relative amount of outside professional services as do small companies..the **arguments themselves seem to be primarily emotional.**" pgs. 60-61. (2)

"A tax that cannot be administered is a tax that has poor compliance. To the extent that a sales tax on services removes distinctions among taxable activities, administration is improved. Forcing taxpayers and tax agencies to comply with illogical distinction guarantees litigation, cost, and **disgruntled citizens**. Fortunately, extending the reach of sales taxes to include many services removes many illogical and arbitrary distinctions between goods and services." pg. 67. (2)

"Taxes on services will be a frequent theme. Some states will aim to tax a wide range of services...And reducing exemptions from current taxes on sales and income." Kiplinger Washington Letter, Feb 22, 1991.

KFFT feels HB-2113 can generate enough money to temporarily give relief to those businesses and homeowners on the borderline of catastrophe. As you can see, the ability to own property in Kansas is a major concern to our group. So is the number of available jobs. In the past two years we have seen the unemployment climb by about 1.5%. This represents a 50% increase from the previous 3% range. We attribute this to two scenarios:

1. The large businesses in Kansas that received the most benefit from reappraisal\classification have done nothing to alter the increase in unemployment.

2. The small businesses in Kansas that received the greatest tax increase have been forced to lay off their employees, some even quitting business.

If this problem is not corrected, we perceive the unemployment will increase in the near future.

In conclusion, KFFT

1. **CHALLENGES** the legislators to really look at what big business is saying. They leveraged millions of dollars from the classification amendment and threaten to leave the state if legislation takes any of that back. Kansas' population hasn't grown in the last 10 years; where are the promised of jobs they flaunt to obtain favored tax treatment? Why did Santa Fe Railroad cry foul last year when their rolling stock exemption was threatened. Yet ATSF laid off nearly 600 employees after their case was safe? We submit this is a big game of poker, the stakes are very high, and the ordinary citizen is playing against a stacked deck! The people are asking the legislature for help--they are hurting!

2. **CHALLENGES** the legislators to invite Mr. Jim Francis of Florida Department of Revenue (904-488-2900) and Mr. Laird Graeser of New Mexico (505-827-0720) to testify before the House and Senate. As mentioned earlier, Florida is going to tax services again--New Mexico has been doing it extensively for 60 years.

3. **ENCOURAGES** legislators to consider going all the way to eliminate all exemptions and tax all services. The people will go for it if there is no favoritism by allowing exemptions. Our own small survey shows a 90% preference for elimination of property tax by such a method.

4. **CHALLENGES** the legislators to apply **ALL MONEY GENERATED BY**

HB-2113 DOLLAR-FOR-DOLLAR TOWARDS PROPERTY TAX REDUCTION. Otherwise the electorate, angry at increased government spending, will rightly perceive this as a tax increase.

5. **CHALLENGES** the legislators to look at HB 2113 as an academic approach to an emotional problem. As previously mentioned, there are many people reeling from excess property taxation. This is why governor Finney derailed incumbent Mike Hayden. KFFT strongly desires a reduced dependence on property taxes to be funded by elimination of sales tax exemptions and the sales taxation of services. A do nothing scenario will do little to endear senators and representatives to the electorate. Please help us obtain meaningful property tax relief.

FAIR AND EQUAL

LWVK LEAGUE OF WOMEN VOTERS OF KANSAS

Feb. 27, 1991

To: House Assessment and Taxation Committee
Rep. Joan Wagnon, Chair

I am Mary Ella Simon speaking for the League of Women Voters of Kansas.

State Finance has been of continuing interest and study for the League since 1936. In 1976, the League adopted standards of equity, adequacy, ease of administration, and consistency with state economic goals as standards for a state tax system.

We are not sure that HB 2112 and 2113 meet those standards.

The League does support a broad based tax system that includes sales tax, property tax, income tax, and user fees, and under those ground rules, a tax on services could be included.

However, we are concerned about the effect of HB 2113 on those small businesses that have to contract for services, those same businesses that were hard hit by reappraisal.

It may be true that as incomes rise so do payments for services such as house cleaning and lawn mowing, but we do not believe this will make up the amount of revenue needed to provide adequate funding for social programs affecting women and children, low income families, and medicaid recipients.

Therefore, the League as a proponent for social programs that can have a positive effect on the lives of those in need advocates:

1. an increase in state income tax, as the most progressive tax,
2. elimination of the sales tax on food which would bring instant tax relief to every one,
3. a 1% increase in the sales tax base to make up for that lost revenue

Thank you for the opportunity to appear before your committee.

Mary Ella Simon

HOUSE TAXATION
Attachment #4
02/27/91

STATEMENT

PRESENTED TO

THE

TAXATION COMMITTEE
OF THE
KANSAS HOUSE OF REPRESENTATIVES

ON BEHALF

OF THE

SECURITIES INDUSTRY ASSOCIATION

PRESENTED BY
PETE MCGILL & ASSOCIATES

FEBRUARY 27, 1991



SECURITIES INDUSTRY ASSOCIATION

120 Broadway, New York, N.Y. 10271 • (212) 608-1500 • Facsimile: (212) 608-1604

TAXATION OF BUSINESS SERVICES

SIA Position

The Securities Industry Association represents over 600 securities firms headquartered throughout the United States and Canada. Its members include securities organizations of virtually all types which are active in all markets. Collectively, they provide investors with a full spectrum of investment services and account for approximately 90 percent of the securities business being done in North America. Four SIA member firms are headquartered in Kansas. Nearly 100 member branch offices are located in the state.

While any proposed sales tax on business services may raise revenue in the short run, such a tax:

1. would be detrimental in the long run to the health of the entire economic base of the State of Kansas.
2. would place in-state investment firms at a competitive disadvantage.

The Securities Industry Association urges Kansas policymakers not to extend the sales tax to investment services.

THE SECURITIES INDUSTRY

The securities industry, on the so called "retail" level, i.e., dealing with individual investors, is a high volume, low profit margin industry. As such, it would be seriously hurt by a sales tax on brokerage commissions and other investment services.

The severe contraction in retail business since October 1987 is evidence that individual investors have avoided the securities markets for over three years. The tax would reduce demand even further and would be counterproductive to the long-term growth of this sector and of the State's economy.

A Savings Disincentive

The securities industry provides a vital service by channeling the savings of individual and institutional investors to the capital markets where it is invested in the securities of corporations and governments. A sales tax on the services leading to such investment would inhibit the use of markets and could have a detrimental impact on capital formation, market liquidity and the ability of municipal governments, for one thing, to raise funds for infrastructural needs.

Attachment 5-2

A sales tax on investment services would in effect be a tax on savings. Savers would be taxed both on the purchases and sales and, of course, on any capital gain they realized. In addition, under the current system, investors are limited in their ability to offset losses against ordinary income. A tax on business services would exacerbate this problem and would diminish the incentive to invest. This is contrary to sound public policy.

A Disadvantage for In-State Firms

Securities firms generally have clients from a multitude of states and transactions are carried out over the phone or through other telecommunications devices. Since most firms have "800" telephone numbers, these clients would not be lost if the firms changed locations.

If the service sales tax were imposed on the commission an investor pays for buying or selling stock, mutual funds, municipal bonds, etc., a Kansas investor could simply open an account with an out-of-state broker to avoid the tax. Use taxes on services, moreover, are generally unenforceable.

As for out-of-state investors with Kansas brokers, there certainly would be nothing stopping customers from switching to a different broker in another state without a sales tax on business services.

Because the securities industry is a nationwide business with firms able to locate anywhere without being placed at a significant disadvantage, the sales tax on brokerage and investment services could be avoided as long as there was one state without the tax.

THE SECURITIES INDUSTRY IN ITS FOURTH YEAR OF RECESSION

Shrinking Employment

While most economists are forecasting the national recession will last no more than a year, it is clear that the recession faced by the securities industry is entering its fourth year.

Over 50,000 jobs have been lost by New York Stock Exchange firms dealing with the public since the fourth quarter of 1987 -- a 20 percent retrenchment! Up to 10,000 more layoffs are likely, given continued parebacks and recent announcements in the financial press of further downsizing by major securities firms.

Multiplier Effect

The ramifications of cutbacks in the securities industry extend well beyond its borders. The multiplier effect becomes clearer when the myriad of services used by the securities industry is contemplated. Attorneys, accountants, printers, messengers, and restaurants are just a few service providers affected by trends in the securities industry.

Profitability Problems

The deteriorating conditions in the securities industry are easily reflected in profitability numbers. Pre-tax returns on equity average 7 percent from 1987 to 1989, down from 50 percent in 1980. Profit margins averaged under 4 percent from 1987 to 1989; preliminary indications for 1990, on the other hand, show a net loss of \$500 million, the first yearly loss since 1973.

SIA believes Kansas policymakers should consider the current state of the securities industry. As James W. Wetzler, New York State's Commissioner of Taxation & Finance recently cautioned, "In looking at the tax system, it's important to be mindful that, just as manufacturing firms have the option of leaving, it's just possible that service firms might leave." (See New York Times, 1/30/91, B2) Higher taxes may actually result in lower revenues for the state as firms decide to relocate to lower cost sites.

CONCLUSION

Most states have rejected the notion of a broad sales tax on business services. Unlike the tax on goods, which can be applied to all finished products with a few exceptions, those services which would be affected by a sales tax would have to be specifically enumerated. A broad application would bring into the tax arena many services deemed inappropriate for taxation. The reluctance of policymakers to tax services thus far shows how difficult it would be to decide which services to tax and which not to tax. It is unlikely that a consistent and sound policy of exclusion could be enacted.

Furthermore, because the tax runs the risk of being uneven and arbitrarily applied, economic efficiency would be lost as firms began to provide for themselves the services previously performed by other independent firms. The result would be an unplanned structural change within the business community. Smaller securities firms would be doubly damaged since it is generally uneconomical for them to set up in-house business services.

The taxation of services would represent an unfriendly message from Kansas policymakers to business in the state and would further jeopardize its competitive position and fragile economy.

We urge Kansas not to extend the sales tax to investment services.

William Jordan
Director of Regulatory
and State Affairs

Celia Curtis
State and Local Tax Manager



TO: HOUSE COMMITTEE ON TAXATION
FROM: R. E. "TUCK" DUNCAN
MEDEVAC MEDICAL SERVICES, INC.
RE: SALES TAXES ON AMBULANCE SERVICES (HB 2113)
DATE: FEBRUARY 25, 1991

On behalf of Medevac Medical Services, Inc. we wish to bring to the Committee's attention that if the Committee decides, as a matter of public policy, to apply sales taxes to services, the language of HB 2113 would currently also apply such taxes to ambulance services.

While emergency medical services are generally considered health services in Kansas, the reference in HB 2113 (page 11, Lines 25-30; KSA 79-3606(s)) adopting the O.M.B. Standard Industrial Classification Manual, 1987, does not include (and thereby exempt) ambulance services.

We believe that in as much as the Governor has proposed that the public policy be that health services remain exempt, an amendment to exempt ambulance services, which are not now subject to sales taxes, should also be adopted.

Thank you for your attention to and consideration of this matter.

HOUSE TAXATION
Attachment #6
02/27/91



KANSAS RECREATION AND PARK ASSOCIATION

700 JACKSON, SUITE 705
TOPEKA, KANSAS 66603

(913) 235-6533
Laura J. Kelly, Executive Director

To: Honorable Joan Wagnon, Chair, and Members
House Taxation Committee

From: Laura Kelly, Executive Director
Kansas Recreation and Park Association

Re: HB 2113 SECTION 2 PAGE 5 LINES 13-20

If passed in its current form, HB 2113 would remove the sales tax exemption from fees and charges levied on participation in tax-supported public recreation programs.

The Kansas Recreation and Park Association, on behalf of the citizens in the 175 Kansas communities with tax-supported recreation services, urges you to amend HB 2113 to reinstate this exemption.

Organized, public recreation has its roots in social welfare having originated in 1885 in urban areas to ease some of the social problems created by the harsh living conditions. The role of public recreation has expanded over the years to meet the increasing needs of families and individuals, young and old, well and disabled, urban, suburban and rural, for affordable and accessible opportunities for productive, wholesome leisure involvement. Today, comprehensive public recreation services include programs that are educational, promote physical and mental health, provide opportunities for social interaction and respite, enhance self-esteem through achievement as well as those designed for amusement and entertainment.

All Kansans residing in a community with a municipal recreation department or a recreation commission are contributing to its functions through taxes. Further, nominal participation fees are added to those programs that appeal to special interests (eg. full day summer and latchkey programs for working parents, basketball programs for youth, golf greens and tennis court fees, wellness programs for the sedentary adult, senior center programs, special recreation programs for persons with disabilities). To tax these fees would be to put the participant in double jeopardy.

No doubt there are Kansans for whom this double taxation would be little more than a nuisance. But public recreation serves ALL Kansans. To cause the cost of participation in public recreation programs to rise beyond the reach of fixed and lower income citizens defeats one of the fundamental reasons for the development of public recreation.

In a survey of surrounding states, none was found to levy sales tax on public recreation program participation fees. All reported collecting and paying sales tax on concession sales (food and supplies) as do public recreation departments in Kansas.

Again, the Kansas Recreation and Park Association asks you to maintain the exemption on public recreation program fees.

Thank you for your consideration.

HOUSE TAXATION
Attachment #7
02/27/91

THE PUBLIC ACCOUNTANTS ASSOCIATION OF KANSAS

TESTIMONY BEFORE THE
KANSAS HOUSE OF REPRESENTATIVES
TAXATION COMMITTEE

by
James L. Gordon, CPA
President

HOUSE TAXATION
Attachment #8
02/27/91

Madam Chairman and the distinguished members of the House Taxation Committee:

Thank you for the opportunity to address this group today on the issue of expanding the Kansas sales tax base. My name is Jim Gordon, I am the President of the Public Accountants Association of Kansas, and I am here to express our members opposition to this method for raising state revenues.

After reviewing the proposed sales tax expansion, we have concluded that for reasons, which we will discuss shortly, the enactment of this measure would severely hurt the business community situated in the state and would encourage new and emerging businesses to begin their operations in jurisdictions more hospitable to them.

As is typical elsewhere, the entrepreneurs in the State of Kansas are so-called "small business" people. Most of the clients served by our members are not large enough to maintain the internal professional staff and specialists that a large organization would employ. Because of their size, their purchases of consulting and other professional services are mandatory business needs -- not discretionary -- and are disproportionately high as compared with larger organizations.

We are aware that state government must address existing budgetary and related fiscal problems. While we in no way minimize the importance of those concerns, our comments today will focus on other potentially negative consequences of the proposed tax for businesses, employees and residents of the State of Kansas. We will also address its potential injurious impact on the vitality of the State's economy. Our comments are organized along the following areas:

- . The State's economy.
- . Nature of the business base.
- . Need for competitive pricing and pool of purchases.
- . Small and emerging-growth businesses and businesses with special needs for services of professional advisers.

- . Sales and use tax issues.
- . Collection problems - non-Kansas clients.
- . The competitive environment and the mobility of business.
- . Effect on the service industry.
- . Compliance costs to small business.
- . Compliance costs, impact on government.
- . Double taxation.

THE STATE'S ECONOMY

The State is faced with difficult choices in structuring taxes that do not destroy its tax base. Its nongovernmental economy is based upon small to medium sized businesses. Kansas is surrounded by states which can structure their taxes to provide their commercial residents with a competitive advantage vis-a-vis a business located in Kansas. Kansas should consider, before enacting a tax, whether it would serve to increase the competitive advantage of Missouri, Nebraska, Oklahoma or Colorado.

THE NATURE OF THE BUSINESS BASE

Our experience tells us that the majority of businesses in Kansas are small: farmers, restaurants, printing companies, food stores, clothing stores, etc. Larger companies have more flexibility in choosing their service providers. These purchasers may go outside the State by using either in-house staffs at corporate headquarters or non-Kansas professional service providers located close to corporate headquarters.

NEED FOR COMPETITIVE PRICING AND POOL OF PURCHASERS

Small business enterprises succeed primarily because of price and convenience. They have access to a limited pool of potential customers. Those potential customers will shop in Kansas for the convenience of doing so provided the cost for that convenience is not excessive.

SMALL AND EMERGING GROWTH BUSINESSES AND BUSINESSES WITH SPECIAL NEEDS FOR ADVISORS

If an entrepreneur's cost of doing business increases because he or she must pay more for professional services, then that entrepreneur can accept a lower gain from the business or raise prices. The former option limits the potential for growth, and the latter increases vulnerability to price competition. In either event, the cost of doing business rises. As experienced business advisors, we are aware that when costs rise and profits fall, a business must retrench to remain profitable. One option is to reduce expenditures -- payroll, advertising, etc. -- expenditures that enrich the State's economy.

Many of those whom we serve come to us simply because they are not large enough to maintain an internal professional staff of accountants and specialists that a large organization would employ. A small business that turns to us for professional services does so because it is neither large enough nor possesses the financial resources to maintain internal departments for such services. As a result, the small business would be taxed under this proposal merely because it is "small." A small business simply does not have any alternative.

Thus, a professional services tax that increases the cost of accounting and other services for a small business places that business at a competitive disadvantage to a larger business that conducts these functions in-house.

Our clients would pay in proportion to their problems, not in proportion to their ability to pay. The professional services tax proposed by the State would fall disproportionately on certain types of business, such as start-up businesses, or businesses in financial difficulty, which traditionally are heavy users of professional services. When a business first begins operations it generally needs considerable accounting, tax, and legal advice. Contracts, bookkeeping, and management systems need to be negotiated and implemented. If start-up ventures are considering where to do business, they will take into account the cost of these professional services. If the cost from a Kansas service provider is not competitive, the business will simply go elsewhere. Similarly, the tax would serve as a deterrent to businesses considering relocation to the State of Kansas.

SALES AND USE ISSUES

An underlying goal of a use tax is to equalize the treatment between residents who purchase locally and residents who purchase in another state. The difficulty in establishing where the use of a professional service (such as tax advice) led, in part, to the quick repeal of

Florida's efforts to tax these services. The use tax component died, in part, under the weight of its compliance burden. However, if a use tax is not imposed the state would encourage Kansas residents to purchase their professional services from professionals who are not subject to the tax (i.e., accountants, attorneys, etc. in other states)

COLLECTION PROBLEMS - NON-KANSAS CLIENTS

The proposal is labeled as a sales and use tax on professional services. However, in reality, it is a tax on Kansas professionals to the extent of service purchasers located outside the State. The State may not be able to enforce collection against an out-of-state purchaser from a Kansas service provider. Thus, the legal incidence of the tax falls on the shoulders of the service provider. The result is a direct tax on the provider. In effect, Kansas professionals and others subject to the proposed tax are being asked to assume a position that goes far beyond merely collecting the tax as an agent for the State; they are being asked to assume the economic burden of the tax.

THE COMPETITIVE ENVIRONMENT AND THE MOBILITY OF BUSINESS

The State of Kansas does not exist in a vacuum. Economically the State's survival is inextricably linked to that of its neighboring States. A fair assessment of the State economy does not view it in isolation.

Perhaps at one time a state could have gotten away with the exercise of its governmental powers in a manner that might inhibit the competitive position of businesses within its borders. However, that day is long gone. Technology thru fax machines and on-line computer networks continue to make it easier to service clients from almost unlimited distances.

EFFECT ON THE SERVICE INDUSTRY

The service industry as a whole has enjoyed a reasonable degree of growth and success in Kansas, and nationwide. We suggest extreme caution when enacting legislation which would cause the service industry to regress in economies stability, causing economic problems for the state.

COMPLIANCE COSTS TO SMALL BUSINESS

Small businesses will bear a proportionately higher cost of the service tax because of the additional compliance burdens associated with such a tax. Compliance costs run two to three times higher for small businesses than for department stores or chain supermarkets which use automated systems. Higher collection and compliance costs further erode the ability of small businesses to effectively compete against large competitors.

COMPLIANCE COSTS IMPACT ON GOVERNMENT

The cost to the state of administering and enforcing a tax on services is more expensive than the collection costs involved in the taxation of tangible personal property. Numerous additional state tax personnel would be necessary to ensure compliance by newly affected businesses. State bureaucracies would expand resulting in a larger government.

Although a larger state, Florida appropriated 240 new positions for collection and enforcement of the services tax. Included in governors proposed Department of Revenue budget are six new positions. These six people will be charged with the enormous responsibility of educating, registering, recording monthly reports, collecting and enforcing this proposed tax on tens of thousands of businesses, most of whom have never collected sales tax in the past. I seriously question if the tax plan can be effectively implemented by June 30, 1991 as proposed. If implemented, more than six state employees will be required.

DOUBLE TAXATION

Several of the proposals would impose a sales tax on other taxes. Including imposing a tax on services which are provided to comply with other laws. An example is the taxation of fees for tax preparation services to meet the requirement of paying income tax. Our laws have become so complicated that many people have to pay for assistance in order to comply with them. It is inequitable to impose a tax on services that are necessary to comply with legal, regulatory and social issues.

SUMMARY

The Public Accountants Association of Kansas believes the proposed tax on professional services would be injurious to the State's economy and specifically, would have an especially adverse impact on small business owners. These small business owners were hardest hit by reappraisal and classification. This proposed tax would impose a disproportionately large portion of the burden on the very group you are trying to help. In our view you should not try to collect a huge new tax for broad property tax relief. If you proceed with this proposal those taxpayers who received a tax windfall from reappraisal and classification would receive even more tax cuts.

We would support a targeted real estate tax reduction plan.

We realize that some tax reform is likely this year. Before any tax bill is passed by this body I would hope that the governor's promise of budget cuts will be provided and acted upon. These policy decisions are needed prior to a tax increase.

We encourage the legislature to consider our assessment of why enactment of the proposed tax would be a mistake.

ABOUT PAAK

The Public Accountants Association of Kansas (PAAK) is a statewide organization dedicated to the promotion of public accounting within the State of Kansas. As professional accountants serving the small business community we also speak as advocates for our clients.

PAAK is comprised of more than 400 members which include large and small accounting firms. Both certified public accountants (CPA's) and public accountants (PA's) are members of PAAK. PAAK receives no government funding.

The PAAK Board of Directors establishes policies through the work of its committees. These policies are the guiding principles of the organization and translate into the views expressed here.

TESTIMONY
Before the House Taxation Committee
February 27, 1991
By
Harriet J. Lange, Executive Director
Kansas Association of Broadcasters

RE: HB 2113

Madam Chair, Members of the Committee, I am Harriet Lange, executive director of the Kansas Association of Broadcasters (KAB). The KAB represents a membership of 120 radio stations and 21 television stations in Kansas.

We appreciate the opportunity to appear before you concerning HB 2113.

The KAB supports the position of Kansans for Tax-Free Services. Our membership adopted the attached resolution opposing a services tax, at our annual meeting in October of 1990.

Although the sale of advertising time is not targeted for taxation in this proposal, we have concerns with the impact that a tax on professional and other business-to-business services would have on the economy of this state and on small business in particular.

The vast majority of our member stations are small businesses. In fact, 80 percent of our member commercial properties have annual sales of under \$1 million.

Some of the services which radio and television stations purchase that would be taxed in HB 2113 include: news services, programming, music fees, legal and accounting, engineering, audience research, consulting, satellite services, art and graphic design, and membership dues, to name just a few.

A few weeks ago, we surveyed Kansas radio and television stations in order to determine the net effect on their businesses of a broad-based services tax and a 35 percent rollback in their property taxes.

All of the surveys that have been returned to date indicate a net negative impact, with stations paying more in services taxes than they would get back in property tax relief. The net impact ranges from \$200 to \$29,140 more in taxes, with a station average of \$8,250 more in taxes. This does not

include the increase in income taxes that would occur due to the non-deductibility of sales taxes.

This proposal clearly would negatively impact the expense side of our ledger, and we fear also, the income side. Advertising is the only source of revenue for radio and television stations; and a majority of that ad revenue comes from small local businesses. We believe this proposal would tend to erode our revenue base, because of the negative impact it would have on small businesses who are our advertisers.

In these difficult economic times, stations all across Kansas are struggling to survive. In fact broadcast employment in Kansas decreased by nine percent from 1985 to 1989. The loss of revenue AND the increased cost of doing business, inherent in this proposal, would necessitate cutbacks in community services (local programming, hometown news, public affairs, and public service) which broadcast stations provide and on which your constituents depend.

To summarize, broadcasters are concerned with the health of the state's economy - a critical factor in a station's success or failure, and in their ability to provide the community services which they are licensed to provide. A services tax will hurt small and emerging firms which provide the majority of jobs in this state; it will place existing Kansas businesses at a disadvantage with their competitors in other states; and it will increase the cost of doing business in Kansas, placing us at a competitive disadvantage with other states in the region, in seeking new and expanding businesses. We urge you not to support a tax increase through the imposition of a tax on services.

Thank you for your consideration.

RESOLUTION

WHEREAS, a new sales tax on the services which small businesses purchase would place those small businesses at a competitive disadvantage with their larger competitors; and

WHEREAS, a tax on services would place many service businesses in Kansas at a competitive disadvantage with their competitors in other states which do not collect a services tax; and

WHEREAS, a tax on services places a multiple tax on products violating the tenet of a single tax; and

WHEREAS, the fair administration and enforcement of a services tax would be a burden on government as well as business; and

WHEREAS, very few states assess a services tax, placing Kansas' economic development efforts at a competitive disadvantage, if a services tax in Kansas was to be implemented; and

WHEREAS, placing a tax on services would not "expand" the tax base, but rather would increase the cost of doing business and the tax load of all Kansas taxpayers; and

WHEREAS, a tax on advertising and advertising services would result in a net loss of tax revenue because advertising increases sales; and

WHEREAS, a tax on advertising would do harm especially to small and emerging firms, many of whom operate with a marginal profit or at a loss;

THEREFORE, BE IT RESOLVED, that the Kansas Association of Broadcasters, representing 120 radio stations and 21 television stations, strongly opposes the imposition of a new sales tax on services, due to the detrimental effect such a tax would have on the Kansas economy, Kansas businesses, and Kansas taxpayers.

BE IT FURTHER RESOLVED, that a copy of this resolution be sent to all Kansas broadcast stations and provided to each member of the Kansas Legislature and to the Governor of Kansas.

Adopted by the KAB Board of Directors, September 25, 1990, Hutchinson

Adopted by the KAB General Membership, October 11, 1990, Lawrence



*Stuart Melchert, KSCB AM/FM
President*

Mark I
Travel

February 27, 1991

TO: Members of the House Taxation Committee

RE: Sales Tax on Travel Agencies

Thank you Madam Chairman and members of the Committee for inviting me to appear before the Committee to express concern about the prospects of extending the Kansas sales tax to the travel industry of Kansas.

I am Penny Tuckel, CTC, President and owner of Mark I Travel of Topeka. I have twenty years experience in the travel business in Kansas. I wish to express my opposition to any plan that would apply the Kansas sales tax to commissions of travel agents in Kansas.

I feel if a sales tax is applied to sales made by travel agents, it will have a very detrimental effect on our future business in Kansas. No other state surrounding Kansas has such a tax, and if it was enacted, our customer base would simply call a travel agent in Kansas City, Missouri to book their travel. Many travel agents have a "1-800" free telephone number and can be easily contacted to avoid the tax.

Even worse, a travel customer can deal directly with airlines or cruise lines by calling direct - normally free of charge, by-pass a Kansas travel agent and work their own arrangements - just to avoid the tax. The following airlines have listings in the Topeka phone directory with national "1-800" out of state telephone numbers: American Airlines, Delta, Japan Airlines; KLM, Royal Dutch Airlines; Air New Zealand; Midway; Midwest; Northwest; Philippine Airlines; SAS, Southwest Airlines; United and USAir. Eighty percent of most all travel agents' income arises from airline bookings.

Applying the sales tax in Kansas will tilt the consumer away from the Kansas travel agents and severely cripple this segment of the Kansas economy. The travel Agency industry is comprised mainly of female constituents and employees, many of whom rely upon this industry for their sole means of support. These jobs are seriously at risk.

HOUSE TAXATION
Attachment #10
02/27/91

I am a member of the American Society of Travel Agents, Inc. (ASTA) which has as its purpose to promote and advance the travel agent industry. ASTA has furnished me the attached material that they have prepared and have authorized me to share with you their views. I'll not read their very informative statement, all of which contains very convincing arguments and points that support not imposing a tax on commissions received by a travel agent.

The most impelling and convincing argument, it appears to me, is the fact that the Federal Aviation Act prohibits a state from imposing a tax on transportation. I am attaching a copy of Section 1113 of the Federal Aviation Act that says that no state is allowed to levy or collect a tax, directly or indirectly, on persons traveling in air commerce as on the sale of air transportation or the gross receipts derived therefore. A discussion of this federal law is contained in the ASTA position paper.

In conclusion, I wish to convey to you that we are working in a very competitive and fragile economic atmosphere. I urge you to not tax the Kansas Travel industry.

Penny J. Tuckel, CTC
President

Encl.

POSITION OF THE AMERICAN SOCIETY OF TRAVEL AGENTS, INC.
(ASTA)

The American Society of Travel Agents, Inc. (ASTA), the world's largest trade association of professional travel agents, has 13,000 travel agent members throughout the United States, and a total worldwide membership of agents and industry suppliers totalling 23,000. ASTA's purpose is the promotion and advancement of the interests of the travel agency industry and the safeguarding of the traveling public against fraud, misrepresentation and other unethical practices.

ASTA opposes the imposition of a state sales tax on the consideration received by a travel agent for performing a service.

A travel agent represents his supplier/principal by selling tickets for transportation and by making reservations for hotel accommodation, rental cars, and other services in behalf of third-party travelers. A travel agent generally does not charge the traveler a fee; an agent receives a commission from the principal who provides the transportation, hotel room or rental car to the traveler. Therefore, the supplier is the purchaser of the travel agent's services. For the most part, the supplier/purchaser has its principal place of business outside the state where the transaction takes place.

THE FEDERAL AVIATION ACT PROHIBITS A STATE FROM IMPOSING A TAX ON TRANSPORTATION. 49 U.S.C. 1513 prohibits the imposition by a state of any tax on transportation by an air carrier. Because an airline ticket costs the same to a traveler whether purchased from a travel agent or directly from an air carrier, a sales tax on the agent's commission (included in the price of a ticket when sold through an agent to a traveler) is, in fact, a tax on transportation in violation of the federal statute. The same argument obtains when applied to a cruise ship operating in foreign commerce or to any supplier whose principal place of business is located outside the State. 80% of a travel agent's sales are air sales.

A TAX ON TRAVEL AGENT SERVICES CANNOT BE COLLECTED FROM THE PURCHASERS OF THOSE SERVICES. A travel agent is unable to simply "bill" an air carrier for reimbursement of the tax. Although there is nothing specific to prohibit non-airline suppliers from reimbursing a travel agent for a tax by augmenting the commission payment, it is unrealistic to believe a supplier would undertake the expense voluntarily. Individual suppliers unilaterally establish their commission rates. The travel agent has only two options: to sell the service of the supplier and receive the commission offered by that supplier, or not to sell that service at all.

ASTA - P2

In addition, a travel agent must remit the money received for air sales every seven days. These payments are made through an organization called the Area Settlement Plan (ASP). The agent deposits cash in a bank account representing seven days' worth of airline ticket sales and makes a report of this deposit to the ASP. The ASP then drafts the agent's bank account for the amount of ticket sales reported. Should the agent begin, on July 1, 1991, depositing less in the ASP account to recover a sales tax, he is in breach of the agent's agreement and subject to sanctions by his principal. These sanctions include "pulling plates" so that the agent cannot issue airline tickets.

A TRAVEL AGENT IS ALSO UNABLE TO COLLECT THE TAX FROM A TRAVELER BY RAISING PRICES. Fares for interstate and foreign air travel are governed by federal law. Airlines control the discounting of their fares, and an agent may charge only the fare specified by the carrier; to charge a different fare is a breach of the agent's agreement with the carrier.

THERE ARE PRACTICAL IMPEDIMENTS TO COLLECTING ANY TAX FROM TRAVELERS WHO USE A TRAVEL AGENT. The price of hotel accommodations or car rentals (basis of both the agent's commission and any tax) is calculated when the customer's bill is paid at the termination of the hotel stay or when the car is returned. After the traveler has used these services, the travel agent is paid a commission based on the amount of the final bill. This final information can arrive weeks or even months after the day that the travel agent's client comes in to request the arrangements. There is no practical way for the travel agent to collect the tax from the client after the fact.

ANY ATTEMPT BY A TRAVEL AGENT TO COLLECT A TAX FROM A CLIENT WOULD BE MORE THAN SELF-DEFEATING. Most airlines, car rental companies and hotels sell their services through a dual distribution system: through travel agents and directly to the public. A client can easily deal directly with the most travel service suppliers by means of numerous "800" tollfree or direct access telephone numbers or by mail. The nuisance to the client of paying an additional tax for the agent's services would likely cause the client to deal directly with the supplier in the future.

ASTA - P3

A SERVICE BUSINESS TAX APPLIED TO TRAVEL AGENTS WOULD ALSO RESULT IN MULTIPLE TAXATION IN VIOLATION OF THE COMMERCE CLAUSE OF THE UNITED STATES CONSTITUTION. A federal transportation tax is presently levied on the price of air tickets, including the portion retained as a commission by the travel agent. Many jurisdictions impose a tax on the total rental price of a hotel room, which is the basis of the agent's commission. Suppliers who pay commission to travel agents in many states would be exposed to multiple state taxation if each agent charged back a local tax to the supplier. A Kansas tax on the commission portion of airline tickets and other supplier services would constitute a form of double taxation.

BECAUSE A TAX ON TRAVEL AGENT SERVICES COULD NOT BE COLLECTED FROM EITHER SUPPLIERS OR TRAVELERS, THE TAX WOULD HAVE TO BE ABSORBED BY THE TRAVEL AGENTS THEMSELVES. Travel agents exist on extremely narrow profit margins (somewhere between (1.5% and 3%) while performing an integral role in maintaining the transportation system serving Kansas and its citizens. This tax yields a small amount of revenue but imposes an enormous and unreasonable burden on interstate travel by restricting already limited travel agency facilities.

Federal Aviation Act of 1958
Section 122.49

STATE TAXATION OF AIR COMMERCE

SEC. 1113. [Added by 87 Stat. 90, 49 U.S.C. 1513] (a) No State (or political subdivision thereof, including the Commonwealth of Puerto Rico, the Virgin Islands, Guam, the District of Columbia, the territories or possessions of the United States or political agencies of two or more States) shall levy or collect a tax, fee, head charge, or other charge, directly or indirectly, on persons traveling in air commerce or on the carriage of persons traveling in air commerce or on the sale of air transportation or on the gross receipts derived therefrom; except that any State (or political subdivision thereof, including the Commonwealth of Puerto Rico, the Virgin Islands, Guam, the District of Columbia, the territories or possessions of the United States or political agencies of two or more States) which levied a tax, fee, head charge, or other charge, directly or indirectly, on persons traveling in air commerce or on the carriage of persons traveling in air commerce or on the sale of air transportation or on the gross receipts derived therefrom prior to May 21, 1970, shall be exempt from the provisions of this subsection until December 31, 1973.

(b) Nothing in this section shall prohibit a State (or political subdivision thereof, including the Commonwealth of Puerto Rico, the Virgin Islands, Guam, the District of Columbia, the territories or possessions of the United States or political

122.50

AERONAUTICAL STATUTES

T-3 (3-79)

[§ 1114]

agencies of two or more States) from the levy or collection of taxes other than those enumerated in subsection (a) of this section, including property taxes, net income taxes, franchise taxes, and sales or use taxes on the sale of goods or services; and nothing in this section shall prohibit a State (or political subdivision thereof, including the Commonwealth or Puerto Rico, the Virgin Islands, Guam, the District of Columbia, the territories or possessions of the United States or political agencies of two or more States) owning or operating an airport from levying or collecting reasonable rental charges, landing fees, and other service charges from aircraft operators for the use of airport facilities.

(c) In the case of any airport operating authority which—

(1) has an outstanding obligation to repay a loan or loans of amounts borrowed and expended for airport improvements;

(2) is collecting without air carrier assistance, a head tax on passengers in air transportation for the use of its facilities; and

(3) has no authority to collect any other type of tax to repay such loan or loans,

the provisions of subsection (a) shall not apply to such authority until December 31, 1973.

Febraury 27, 1991

COMMENTS CONCERNING HOUSE BILL 2113
PRESENTED TO HOUSE TAXATION COMMITTEE

I am Elwaine F. Pomeroy, appearing on behalf of the Kansas Collectors Association, Inc. The collection industry feels that this tax proposal would create numerous problems not only for the industry but, more importantly, for the general public as well. I will briefly highlight some of those problems.

First, the tax will result in increased costs to the consumer. I don't think there is any doubt in anyone's mind that any tax on services that's levied against businesses will inevitably be passed on to the consumer, either directly or indirectly. That's a foregone conclusion.

Second, there's the problem of the indirect taxation of exempted items. For example, a tax on collection services would indirectly increase the cost of many items exempt from sales tax--items such as medical services. Medical accounts are collectors' top market. Thus, while medical services are exempt from taxation, the collection of accounts relating to the provision of these services would be taxed under this proposal.

Third, where the collections are for items that were not exempt from sales tax, there is the problem of double taxation. A retail account has already been taxed at the time of sale: for example, if a retailer sells a piece of furniture, that sale is subject to the sales tax already. But if the consumer fails to pay the retailer and the retailer then turns that account over for collection, the collection of the account is taxed again under this proposal.

Fourth, this tax would put an increased burden on small business. Many of the businesses who will be responsible for paying the proposed tax on services are

HOUSE TAXATION
Attachment #11
02/27/91

small businesses, as are many of the clients of those service businesses to which the tax will be passed on. The business climate of Kansas would be worsened by this tax. Adding a tax on business services would put additional pressure on many of those surviving businesses that are barely keeping their heads above water. For one type of small business, collection agencies, the profit margins average in the neighborhood of 4 to 6 percent, and you can easily see what a 4.25 percent tax would do to those margins.

Fifth, this tax would discriminate against local collection agencies in favor of large, out of state agencies, perhaps putting many small agencies out of business.

We would urge the full committee to accept the recommendation of the sub-committee that collection services not be subject to sales taxes.



Elwaine F. Pomeroy, for
Kansas Collectors Association, Inc.

TESTIMONY

Presented to the Taxation Committee
of the Kansas House of Representatives

On Behalf of
Beech Aircraft Corporation
The Boeing Company
Cessna Aircraft Company
Learjet Inc.

February 27, 1991

HOUSE TAXATION
Attachment #12
02/27/91

I am John Moore, Senior Vice President for the Cessna Aircraft Company. With me this morning are these representatives from other Kansas aircraft manufacturers -- Beech Aircraft Corporation, The Boeing Company, and Learjet, Inc.

I am pleased to be here this morning and provide our industry's perspective on the importance of sales tax exemptions which apply to most aircraft sales, some service and modification work, and the parts businesses which we all have.

The aviation industry in Kansas currently employs approximately 37,000 individuals and collectively has a Kansas payroll of \$1.246 billion. We also buy more than \$575 million worth of supplies from other Kansas companies each year.

1990 was a very good year for many of us as increased sales and profits were reported by Beech, Cessna, and Boeing. However, our companies have always been cyclical as the legislature knows very well. The general aviation companies here, despite solid performance in 1990, are already feeling the results of a domestic recession and uncertainty in our marketplace due to the international situation. Indeed, Beech and Learjet have announced layoffs in the past three months.

Kansas is clearly the strongest general aviation center in the country and the presence of Boeing in Wichita greatly strengthens our position in the entire aviation industry. However, for this to continue to be the case, the business environment which state government has created must remain consistent and conducive to first stability and then growth in the aviation industry. Current sales tax exemptions which this committee is reviewing are extremely important to the aircraft industry and, to a very real extent, reflect the state's attitude toward the industry. Our manufacturers are concerned that this discussion is even taking place and is impacting the business decisions being made today.

The sale of our aircraft is currently exempt from sales tax under a number of statutes. Two of the most important are K.S.A. 79-3606(g) which exempts sales to foreign customers and K.S.A. 79-3606(k) which exempts sales, domestic and foreign, if the aircraft is flown out of Kansas within ten (10) days. This latter exemption is known as the 10-day fly-away exemption. Sales to the military or foreign governments cannot be taxed because of the U. S. Constitution.

Any possible perception that the repeal of these tax exemptions would have no impact upon our industry is erroneous. To begin with, 22 states have lower use tax rates than 5.25 percent (if the statewide 4.25 percent tax applies, local taxes at 1 percent would also be applicable) which would be applicable in Kansas. Four states give no credit for sales tax paid in Kansas, and four states have no use tax at all.

More importantly, there is no applicable use tax for aircraft sold to foreign customers. Currently, 40 percent to 60 percent of all Cessna aircraft sales are made to foreign customers.

The 10-day fly-away rule exempts 97 percent of our sales because it includes sales at Cessna to foreign and domestic customers. Whenever sales tax would be imposed and a use tax of less than 5.25 percent is not applicable in the customer's state, the cost of aircraft is increased or our financial results will be negatively impacted. This would always be the result with sales to foreign customers. This change clearly does one of two things -- increases the price of our products or hurts financial performance. It would also occur at a time when pricing increases already do not fully pass along cost increases. Indeed, many models today are policy priced to stimulate sales as history clearly shows all of our products are price sensitive.

There is another result this would have and that would be to provide a competitive advantage to non-Kansas manufacturers.

The Kansas general aviation manufacturers have product competitors outside the State of Kansas who do not have this tax issue and a competitive disadvantage against them would exist as you can most clearly see with respect to foreign sales. These competitors include Piper in Florida, British Aerospace and Falcon Jet in Arkansas, Gulfstream in Georgia, and Fairchild in Texas. Furthermore, the State of Nebraska has just granted Piaggio a sales tax exemption as a part of the economic inducements package to have Piaggio locate its final assembly and delivery operations there.

But the environment which exists in this state is equally important to Boeing. Competition in the commercial aircraft marketplace in which Boeing competes is more fierce today than it has ever been. More than 200 modification and maintenance facilities compete worldwide for market share. Historically, U.S. aircraft manufacturers have maintained a dominant share of the new commercial jet transport market, led by Boeing. Today, that market position is being seriously challenged by Airbus Industrie, a European consortium.

Airbus, formed just 20 years ago, is almost completely subsidized by its respective European governments. Richard Evans of British Aerospace, an Airbus Industrie partner, recently stated: "Airbus is going to attack the Americans, including Boeing, until they bleed and scream. And we are going to make a lot of money in the process." Airbus has captured 35 percent of the new jet transport market since 1970, eliminating Lockheed and slicing McDonnell Douglas jet aircraft sales in half.

If these exemptions were repealed, there could very well be a major dislocation among Kansas manufacturers. Learjet has a facility in Arizona from which it can deliver airplanes without sales tax. Beech also has a facility in Alabama which specifically passed a sales tax exemption for Beech. In addition to being at a competitive disadvantage with Piaggio, British Aerospace, Falcon Jet, Fairchild, and

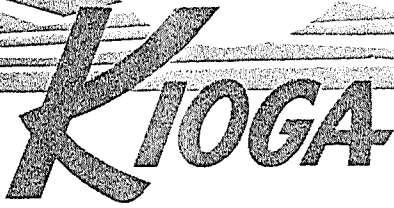
Gulfstream, Cessna would, in all probability, have to eventually relocate its delivery operations and related work to be on equal footing with these present Kansas manufacturers. It is estimated that approximately 350 jobs would be lost if they were to have to take these steps. Other manufacturers could have similar impacts.

Other exemptions are also very important. Aircraft sales for resale and trade-ins are also exempt from sales tax through other statutory exemptions. Parts sales to out-of-state customers are exempt due to a ruling by the Kansas Department of Revenue based upon the commerce clause. Service and parts used in the modification or repair of aircraft are taxed in Kansas for domestic customers but tax exempt for foreign customers.

These exemptions for parts and services are extremely important as they represent major business segments for Kansas Manufacturers which are growing. Equally as important, parts and service business have historically reduced the impact of depressed aircraft sales during recessions as these business activities increase in those times.

Finally, a good example of how changing tax policy drives business decisions is the question of Cessna resuming its piston manufacturing. At one time we produced 8,000 single engine piston aircraft and employed 5,000 in doing so. Product liability costs caused us to cease production of those airplanes, but we have said publicly we would resume production immediately if that issue would be resolved. While resuming production in Kansas is not assured, if we do begin producing piston aircraft again in Kansas the availability of these exemptions would be a major factor in that business decision.

Thank you for the opportunity to appear before your committee and to present this testimony.



KANSAS INDEPENDENT OIL & GAS ASSOCIATION

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February 27, 1991

TO: House Committee on Taxation

RE: HB 2113 - Sales Tax

Thank you for permitting me to appear today on both exemptions and services subject to the Kansas sales tax. I've been in Washington, D.C. earlier this week on matters concerning our industry in Kansas.

We have estimated that our industry pays annually in excess of \$100 million in sales tax. We also benefit directly from several exemptions that are considered under HB 2113.

The first, and a very important one to our industry, is under KSA 79-3603 (p) relating to original construction. That begins on page 6, line 42, of HB 2113. Eliminating this exemption would have a serious impact on the the future drilling program for oil and gas wells in Kansas.

There was some discussion in your subcommittee about the merit of exempting services relating to new construction. This has been the subject of prior legislatures and the message is clear that KSA 79-3603 (p) is there to stimulate short term construction in Kansas' infrastructure. After it's built, services are taxed regularly - for many years to come. We urge you to keep that section exempt.

We also fall into the category of exemptions from the sales tax for materials consumed in the process of drilling and servicing oil and gas wells. We believe HB 2113 continues this exemption on page 12, line 16, and we urge you not to remove the exemption from sales tax on consumables.

We believe natural gas, propane, and electricity used in the process of pumping our oil wells are provided for in HB 2113 when used as consumables and are exempt. We urge you to continue that policy.

The legislature, two years ago, added drill bits and explosives to KSA 79-3606 (rr) instead of having the Department class them as consumables. We think they should remain exempt. HB 2113 would tax these consumables. To be consistent, we believe they should remain exempt.

Additionally, our industry uses professional services extensively, such as geological, engineering, accounting, and legal services which are not now taxed. We feel professional services should not be taxed, as recommended by your subcommittee.

HOUSE TAXATION
Attachment #13
02/27/91

House Committee on Taxation

February 27, 1991

RE: HB 2113

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It's very important for you to distinguish the Kansas oil and gas industry from other business and industry in the state. Oil and gas producers must bear the brunt of any new tax because they are unable to pass the tax along to the consumer. The pricing mechanics of selling oil and gas parallel that of an independent farmer who is at the mercy of the market price and cannot pass the tax along.

The net result is that as taxes increase on the Kansas oil and gas industry, profitability decreases and the industry is encouraged to invest its money in other producing states - those with a more favorable tax climate and where prospects for finding and producing oil and gas are much better. Less activity equates to less production and the waste of a valuable natural resource.

We believe the Kansas oil and gas industry has far exceeded its capacity to bear further taxation. We particularly feel since an added sales tax burden cannot be passed along and must be borne by individual operators attempting to produce a raw product to be sold, this tax policy will be a disincentive to this important Kansas industry.

Our comments relating to taxation have been confirmed by Kansas, Inc. which has been making recommendations to the legislature to lower oil and gas industry taxes - not raise them.

Donald P. Schnacke



**Home Builders
Association**
of Greater Kansas City



600 EAST 103rd STREET • KANSAS CITY, MO 64131 • PHONE 816-942-8800 • FAX 816-942-8367

HOUSE COMMITTEE ON TAXATION

HB 2113

February 27, 1991

Chairman Wagnon and Members of the Committee:

My name is Sara Corless, Governmental Affairs Director for the Home Builders Association of Greater Kansas City.

I wish to address the proposed tax on labor in new residential construction.

Recognizing the need to alleviate an overly-burdened property tax in Kansas, the Home Builders Association is concerned about the proposal under discussion that would add at least \$1300 in taxes to the new homebuyer's bill on a \$150,000 home. And, if other services such as attorney's fees, engineering fees, etc. are taken into account, the new home buyer could easily see an increase of \$1500-1800. These taxes would come on the heels of quickly escalating fees that local governments with their budget shortfalls have begun imposing for everything from roads, parks, sewers, and bike trails--fees that are ultimately passed on to the new home buyer.

A \$1500-1800 tax on the cost of a new home may not seem unreasonable since it is passed on to the buyer and can be financed over a 30 year mortgage, but it becomes thousands of dollars over the life of a mortgage and can add enough to the monthly payment to make the home unaffordable.

As we look at what this tax does to the cost of a new home, we tend to forget that new home prices have a direct impact on existing home values, driving them up more quickly. As existing home values go up, so do their assessed valuations--and finally--so do property taxes, creating the same effect the legislature is working to alleviate.

I appreciate the opportunity to appear before you today.

HOUSE TAXATION
Attachment #14
02/27/91



GEORGE BARBEE, EXECUTIVE DIRECTOR
810 MERCHANTS NATIONAL BANK
8TH & JACKSON
TOPEKA, KANSAS 66612
PHONE (913) 357-1824

STATEMENT

Date: February 26, 1991
To: House Committee on Taxation
From: George Barbee, CAE
Executive Director
Re: HB-2113 (Sales Tax on Professional Services)

The proposed amendments of HB-2113 would have the effect of taxing all services under the sales tax provisions of the state statutes. Engineering services have not been taxed in the past because they were not listed as a taxable service and for good reason.

As I reviewed the sales tax statutes it became evident that the entire retailers sales tax statutes were clearly intended for the retailer to collect from the consumer a tax on the final retail transaction. The providing of a professional service such as engineering is not a retail transaction.

The design of a project is a necessary step toward providing the builder the necessary contract documents and plans from which the builder can determine ways, means, materials and methods to build according to the design and specifications.

Sales taxes are paid by the engineer, architect, contractor and subcontractors as they individually make final retail transactions for materials that are incorporated as components of the final constructed project.

The engineering firm pays sales tax on paper, pencils, computers, automobiles, trucks and equipment. The contractor pays tax on construction materials and the sophisticated construction equipment of the 90's. It is not as if taxes are not being paid. They are being paid at the proper time when the final retail transaction is conducted on component parts of the project. To do otherwise than at the final retail transaction would be an administrative nightmare.

First let me share with you what a consulting engineer does.

Consulting engineering services vary in scope from short-term consultations to the development and design of large and complex projects. These professional engineering services, commonly summarized into four basic classifications, are provided directly to owner-clients or in association with architects.

HOUSE TAXATION
Attachment #15
02/27/91

AFFILIATED WITH:

The services included are widely diversified. Typical examples are:

- Collecting and interpreting data
- Engineering studies and reports
- Cost studies
- Economic comparisons
- Long-range facility planning
- Conducting public hearings
- Appraisals and evaluations
- Feasibility studies
- Investigations
- Government agency liaison
- Applications for government grants or advances

To provide any of those often requires a coalition of professionals working together through sub-contracts.

Imagine that we are finally going to get a new major convention hotel in downtown Topeka. The owner of this new imaginary high-rise is located in Chicago. The owner has options on property, knows how many units, restaurants and meeting rooms are needed and it is time to hire an architect to coordinate with a team of design firms to design the project.

The architect will eventually hire an electrical engineering firm to design the electrical distribution system; a structural engineering firm to design the skeletal support frame; a mechanical engineering firm to design the air conditioning, heating and ventilation system, and water and fire sprinkling system; a geo-technical engineering firm to perform site investigation and many other specialists to develop the construction documents, plans and specifications.

Will the owner hire a team of Kansas designers on this project and pay a sales tax at every sub-contracting level of engineering, or will the owner simply hire a non-Kansas team to save the sales tax? What would you do?

Remember the service of design is not performed on the site of construction. It is performed in the location or locations where the design team members have their offices. That very likely will not be Kansas if this bill passes without exemptions.

We have heard a lot about how the taxing of services will be the norm by the end of the century and that services are being taxed in Iowa, Massachusetts, Connecticut, Florida, South Dakota, New Mexico and Hawaii. Professional services are presently only taxed in South Dakota, New Mexico and Hawaii. All three of these states are either economic or geographical islands and not affected by a neighboring state separated only by a street as is the case in Kansas and Missouri.

To tax engineering services would cause a competitive disadvantage at both interstate, intrastate and international levels which will cause a loss of jobs in Kansas. We are fortunate to have very large engineering firms located in Kansas that perform services world-wide. They cannot possibly compete in an environment that taxes them while their competitors go untaxed.

The result would be a loss of jobs as the firms realign their particular design facilities to be performed in other branch offices.

Finally, revenue projections for a tax on engineering and architectural services have been estimated by the Department of Revenue to be at \$10 million. Attached to this statement you will find some information that projects a different revenue picture. This information was compiled by a nationally known publication, Professional Services Management Journal (PSMJ). This publication was active in compiling information in Massachusetts, Connecticut and Florida as these states considered a tax on services.

These figures show that revenue projections for Kansas were based on 1987 U.S. Census Bureau statistics and that they include areas known as Metropolitan Statistic Areas or MSA's. The MSA in Kansas includes 6 counties in Missouri. These counties are Cass, Clay, Jackson, Lafayette, Platte, and Ray. These 6 counties make up a major portion of one of the two economic trade centers in the state of Missouri.

Madam Chairperson, there are other problems with the concept of taxing prior to the final retail transactions, but the very fact that these services are only component parts of a project leads me to request that this committee delete the provisions of taxing engineering services.

Thank you for the opportunity to speak to this issue and I would be glad to respond to questions.

February 15, 1991

Mr. George Barbee
Executive Director
Kansas Consulting Engineers
810 Merchants National Bank
Topeka, Kansas 66612

REF: Draft Services Sales Tax Proposal

Dear Mr. Barbee:

We have reviewed both the draft sales tax legislation (House Bill No. 2113) and the Secretary of Revenue's estimate of taxes (January 10, 1990) and we find the revenue estimates are grossly overstated due to errors in the assumed value of taxable sales..

Our analysis and data show the proper estimates of revenues and costs are as follows:

Revenue Estimates for Sales Taxes

	Secretary of Revenue Estimate	PSMJ Estimate	Difference
A/E Services	\$10 million	\$1.26 million	\$8.74 million decrease
Additional Cost to Government of Higher A/E Costs	not estimated	\$2.12 million	\$2.12 million increase
Revised Estimate of Sales Tax on A/E Services	\$10 million	(\$.86 million)	\$10.86 million decrease
Construction (New)	\$60 million	\$24 million	\$36 million decrease
Construction (Renovation)	\$3.0 million	\$1.2 million	\$1.8 million decrease
Revised Estimate of Sales Tax on Construction	\$63.0 million	\$25.2 million	\$37.8 million decrease

Quite obviously, our estimates vary significantly from the Secretary of Revenue. Our reasons for these changes are as follows:

Mr. George Barbee

February 15, 1991

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First, the revenue estimate relative to architectural and engineering services and construction, is wrong for the following reasons:

- A. The Census Bureau includes in the Kansas data the Kansas City Metropolitan Area, which includes Cass, Clay, Jackson, Lafayette, Platte and Ray counties in Missouri. Attached is a page from the census guide which shows this.
- B. The value of A/E services reported is the revenue generated by A/E firms located in Kansas, not the value of A/E services performed on projects located in Kansas.
- C. The Census Bureau data used for A/E revenues that would be subject to the tax is for gross revenues, including subconsultants. Thus, subconsultant revenues are double counted. This was an error by the Census Bureau.

To illustrate this, you have, in the Kansas City MSA, several large A/E firms, including Black & Veatch, HNTB and Burns and McDonnell. These firms perform engineering services on projects located all over the world in their local offices. The sales value of engineering services these firms perform for projects outside of Kansas, or for government users, both of which would not be taxable under the proposed law is included in the Census Bureau A/E revenue data. Thus you should not use Census Bureau data to develop a tax revenue estimate.

The key point which is not reflected in either the A/E or the construction revenue estimate figures is that government is the biggest user of both A/E and construction services. Since the present proposal continues the exemption for government services, the portion of these estimates reflecting government use is in error.

The revenue estimates also do not contain any factor for increased costs for government due to higher costs of their suppliers.

The current draft legislation contains the three most expensive provisions of sales tax laws:

- A. **Local Option Taxes** - Since A/E services would be "used" at the project site, a single office firm would be forced to track and report sales by each local jurisdiction that imposes a local option tax, greatly expanding filing requirements and costs.
- B. **Individual Project Sale for Resale Exemption Certificate** - Since each A/E project would be a separate sale and subcontracting is prevalent in the profession, this adds a considerable volume of paperwork.

Mr. George Barbee

February 15, 1991

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- C. **Compensating Use Tax** - This is a full time employment for accountants provision in any firm that purchases services out-of-state and has sales out-of-state. It often requires a complete re-building of a firms' accounting system.

Beside these administrative costs, firms also incur higher costs due to the tax on their purchases.

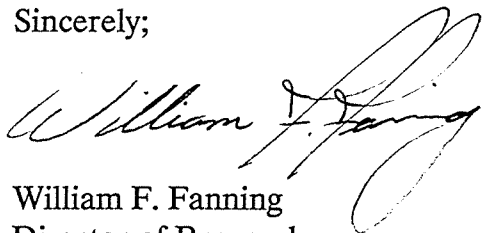
Our surveys of firms in Florida while their services sales tax was in effect showed the tax increased their cost of doing business by 4%.

As the largest user of A/E services, government would pay this increased cost of doing business in higher A/E fees. Firms could not absorb this cost as the median profit margin for A/E firms is 3.3% and no firm can have costs in excess of revenues and continue to stay in business.

Finally, I would add, it would be impractical to delete A/E services from the tax without also deleting construction, accounting, legal and business consulting services. These firms have become very similar in the services they offer (contractors have design build, A/Es and accounting consulting firms do planning and environmental consulting, accounting and legal do financial consulting, etc.) thus imposing a sales tax should not be done on the type of business.

Attached is the basis for our revised estimates on this tax. We will be happy to discuss these with you, at your convenience.

Sincerely;



William F. Fanning
Director of Research

WFF/cp
Enclosure

Revised Revenue Estimate - Construction

Original Secretary of State Estimate - Construction

Construction Services - New	\$60.0 million
Construction Services - Renovation	<u>\$3.0 million</u>
Total	\$63.0 million
Adjust for 60% (1) of construction that is included in revenue estimate but is for government users (roads, water, sewer, schools, etc.)	<u>(\$37.8 million)</u>
Net New Sales Tax Revenue from Construction (2)	\$25.2 million

Revised Revenue Estimate - Architectural and Engineering Services

Comment: The Secretary of Revenue's estimate of \$10 million was based on the 1987 Census Bureau data on revenues of Architectural, Engineering and Surveying Services performed in Kansas. This is not an appropriate base, since this value includes services performed in Kansas for projects outside of Kansas, plus revenues on government projects.

The correct base to use is the value of taxable construction in Kansas, which can be determined by extrapolating the tax revenues to be generated from construction.

Gross Value of Taxable Construction - \$25.2 million divided by 4.25% tax rate	\$592 million
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Eliminations:

Value of Housing not using A/E services (20%) (3)	\$118.0 million
Value of Construction performed by Design/Build where A/E services are not performed by A/Es (10%) (3)	\$59.2 million
Value of Construction performed by owners in-house design and not performed by A/Es (15%) (4)	\$85.9 million
Net Value of Construction Designed by A/Es (2)	\$328.9 million
Average Fees for A/E Services (4)	9%
Value of A/E Services for Sales Tax	\$29.6 million
Estimated Sales Tax Revenues (4.25%)	\$1.26 million

Additional Costs of A/E Services to Government

Value of Government Engineering Services (5)	\$53 million
Additional Costs of A/E firms (6)	4%
Additional Costs of A/Es to be paid by Government (7)	\$2.12 million

Notes:

- (1) Allocation of Government/Private sector division of revenues based on historical average of construction use. Figures may vary from year to year, but over longer time frame, most likely will approximate these factors as sub-categories of construction expand and contract.
- (2) May be overstated due to inclusion of Missouri counties in Kansas City Metropolitan Statistical Area.
- (3) A/E services are typically not used for low and mid price single family housing. A/E services are typically limited to very high end single family housing and multi family housing projects.

Some construction performed is by design/build where the contractor performs the design as part of the construction price, and no A/E services are used.

Many large property owners maintain in-house design staffs who perform the design services for projects without the use of A/E firms services.

All deductive estimates in the value of taxable construction are based on typical long term average values for the specific types of construction.

- (4) Based on **PSMJ Design Services Fee Structure Surveys** 1983 to 1990 as overall average A/E fee as a % of construction costs for private sector construction.
- (5) Based on % of government fees reported in **PSMJ Financial Statistics Surveys** 1984 to 1990. Note this does include federal, state and local government revenues, so cost estimate is not limited to state government only.
- (6) Based on studies of Florida firms during the term of their services sales tax, which included the same provisions on local option, detailed project by project exemption certificate, and compensating use tax as the proposal for Kansas.
- (7) All government contracts are based on payment of costs incurred, thus increased costs of doing business will be passed on to government users of A/E services.

Comment: No estimates are included for additional government costs associated with collection and enforcement of this tax, or for loss of other revenues due to loss of jobs as firms relocate people and operations out of Kansas. Both of these factors have also contributed to declines in state revenues in Florida and South Dakota where similar taxes have been repealed, and in Connecticut where this type of tax remains in force.

Huntington-Ashland, WV-KY-OH MSA
 Boyd County, KY
 Carter County, KY
 Greenup County, KY
 Lawrence County, OH
 Cabell County, WV
 Wayne County, WV

Huntsville, AL MSA
 Madison County, AL

Indianapolis, IN MSA
 Boone County, IN
 Hamilton County, IN
 Hancock County, IN
 Hendricks County, IN
 Johnson County, IN
 Marion County, IN
 Morgan County, IN
 Shelby County, IN

Iowa City, IA MSA
 Johnson County, IA

Jackson, MI MSA
 Jackson County, MI

Jackson, MS MSA
 Hinds County, MS
 Madison County, MS
 Rankin County, MS

Jackson, TN MSA
 Madison County, TN

Jacksonville, FL MSA
 Clay County, FL
 Duval County, FL
 Nassau County, FL
 St. Johns County, FL

Jacksonville, NC MSA
 Onslow County, NC

Janesville-Beloit, WI MSA
 Rock County, WI

Jersey City, NJ PMSA—see New York-Northern
 New Jersey-Long Island, NY-NJ-CT CMSA

Johnson City-Kingsport-Bristol, TN-VA MSA
 Carter County, TN
 Hawkins County, TN
 Sullivan County, TN
 Unicoi County, TN
 Washington County, TN
 Scott County, VA
 Washington County, VA
 Bristol city, VA

Johnstown, PA MSA
 Cambria County, PA
 Somerset County, PA

Joliet, IL PMSA—see Chicago-Gary-Lake
 County, IL-IN-WI CMSA

Joplin, MO MSA
 Jasper County, MO
 Newton County, MO

Kalamazoo, MI MSA
 Kalamazoo County, MI

Kankakee, IL MSA
 Kankakee County, IL

Kansas City, MO-KS MSA
 Johnson County, KS
 Leavenworth County, KS
 Miami County, KS
 Wyandotte County, KS
 Cass County, MO
 Clay County, MO
 Jackson County, MO
 Lafayette County, MO
 Platte County, MO
 Ray County, MO

Kenosha, WI PMSA—see Chicago-Gary-Lake
 County, IL-IN-WI CMSA

Killeen-Temple, TX MSA
 Bell County, TX
 Coryell County, TX

Knoxville, TN MSA
 Anderson County, TN
 Blount County, TN
 Grainger County, TN
 Jefferson County, TN
 Knox County, TN
 Sevier County, TN
 Union County, TN

Kokomo, IN MSA
 Howard County, IN
 Tipton County, IN

La Crosse, WI MSA
 La Crosse County, WI

Lafayette, LA MSA
 Lafayette Parish, LA
 St. Martin Parish, LA

Lafayette-West Lafayette, IN MSA
 Tippecanoe County, IN

Lake Charles, LA MSA
 Calcasieu Parish, LA

Lake County, IL PMSA—see Chicago-Gary-
 Lake County, IL-IN-WI CMSA

Lakeland-Winter Haven, FL MSA
 Polk County, FL

Lancaster, PA MSA
 Lancaster County, PA

Lansing-East Lansing, MI MSA
 Clinton County, MI
 Eaton County, MI
 Ingham County, MI

Laredo, TX MSA
 Webb County, TX

Las Cruces, NM MSA
 Dona Ana County, NM

Las Vegas, NV MSA
 Clark County, NV

Lawrence, KS MSA
 Douglas County, KS

Lawrence-Haverhill, MA-NH PMSA—see Boston-
 Lawrence-Salem, MA-NH CMSA

Lawton, OK MSA
 Comanche County, OK

Lewiston-Auburn, ME MSA
 Androscoggin County, ME (part)
 Auburn city, ME
 Greene town, ME
 Lewiston city, ME
 Lisbon town, ME
 Mechanic Falls town, ME
 Poland town, ME
 Sabattus town, ME

Lexington-Fayette, KY MSA
 Bourbon County, KY
 Clark County, KY
 Fayette County, KY
 Jessamine County, KY
 Scott County, KY
 Woodford County, KY

Lima, OH MSA
 Allen County, OH
 Auglaize County, OH

Lincoln, NE MSA
 Lancaster County, NE

Little Rock-North Little Rock, AR MSA
 Faulkner County, AR
 Lonoke County, AR
 Pulaski County, AR
 Saline County, AR

Longview-Marshall, TX MSA
 Gregg County, TX
 Harrison County, TX

Lorain-Elyria, OH PMSA—see Cleveland-
 Akron-Lorain, OH CMSA

Los Angeles-Anaheim-Riverside, CA CMSA
 Anaheim-Santa Ana, CA PMSA
 Orange County, CA
 Los Angeles-Long Beach, CA PMSA
 Los Angeles County, CA
 Oxnard-Ventura, CA PMSA
 Ventura County, CA
 Riverside-San Bernardino, CA PMSA
 Riverside County, CA
 San Bernardino County, CA

Los Angeles-Long Beach, CA PMSA—see
 Los Angeles-Anaheim-Riverside, CA CMSA

Louisville, KY-IN MSA
 Clark County, IN
 Floyd County, IN
 Harrison County, IN
 Bullitt County, KY
 Jefferson County, KY
 Oldham County, KY
 Shelby County, KY

Lowell, MA-NH PMSA—see Boston-Lawrence-
 Salem, MA-NH CMSA

Lubbock, TX MSA
 Lubbock County, TX

Lynchburg, VA MSA
 Amherst County, VA
 Campbell County, VA
 Lynchburg city, VA

Macon-Warner Robins, GA MSA
 Bibb County, GA
 Houston County, GA
 Jones County, GA
 Peach County, GA

Madison, WI MSA
 Dane County, WI

Manchester, NH MSA
 Hillsborough County, NH (part)
 Bedford town, NH
 Goffstown town, NH
 Manchester city, NH
 Merrimack County, NH (part)
 Allenstown town, NH
 Hooksett town, NH
 Auburn town, NH
 Candia town, NH

Mansfield, OH MSA
 Richland County, OH

McAllen-Edinburg-Mission, TX MSA
 Hidalgo County, TX

Medford, OR MSA
 Jackson County, OR

Melbourne-Titusville-Palm Bay, FL MSA
 Brevard County, FL

Memphis, TN-AR-MS MSA
 Crittenden County, AR
 De Soto County, MS
 Shelby County, TN
 Tipton County, TN

Merced, CA MSA
 Merced County, CA

Miami-Fort Lauderdale, FL CMSA
 Fort Lauderdale-Hollywood-Pompano
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 Dade County, FL

House Committee on Taxation
H. B. 2113
February 27, 1991

Outline of Testimony of Daniel J. Sevart
SEVART & SEVART
Suite 810 Century Plaza
111 West Douglas
Wichita, Kansas 67202
(316) 269-4215

Secretary-Treasurer of the Wichita Bar Association

- I. The Bill proposes to assess sales tax on "the gross receipts received from the rendering or furnishing of services at retail within this state. . ." Sec. 2. Obviously, as now written, legal services would be included. We believe that this Bill would create a number of nightmares to those of us in private practice, as well as our clients.
- II. The approximately 1260 member Wichita Bar Association has asked me to testify in opposition, and to point out to this Committee those difficulties which in our opinion would be virtually insurmountable.
- III. Perceived difficulties.
 - A. No definition of "services at retail."
 - i. Double taxation problems - my service-providing client is taxed upon my fees for legal advice, which he then passes on to his clients, who are also taxed.
 - ii. "In-house" counsel - surely an amount for the expense of in-house counsel is passed on to the customers of such businesses, yet the bill does not provide that a sales tax will be assessed for the reasonable value of in-house counsel.
 - a. Penalizes the small business, which cannot afford in-house counsel, or other service providing professionals.
 - B. Interstate representation - many attorneys provide services to clients which involve work performed out of state, but for use in this state, or services performed in this state, but for use out of state.
 - i. Depositions, tax audits, OSHA proceedings, general legal advice, for example.

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- ii. Cases pending in other states - part of work performed in Kansas, part performed in another state or states.
 - iii. Out of state clients, telephone advice, personal conferences out of state.
 - iv. Sec. 2(b) provides for the taxation of services rendered or furnished within this state. If an attorney takes a deposition in Kansas for use in a case pending in another state, is that charge taxable? Or, if an attorney takes a deposition in another state for use in a Kansas case, is that charge taxable?
- C. Confidentiality problems on audit.
- i. The mere fact that we have consulted with someone may be confidential.
 - ii. Doctors and other health care providers would share this problem.
- D. Collection problems.
- i. We frequently have clients who can only pay \$20 or \$25 per month. How do we assess the tax?
 - ii. What if client pays only a part of our bill, or refuses to pay the tax?
 - a. We are prohibited from paying by ourselves K.S.A. 79-3605.
 - b. K.S.A. 79-3604a requires the consumer to pay the tax, but we in the legal profession, at least, do not have the advantage of requiring the service to be paid for, with the tax, before the customer leaves the store.
- E. Contingency fee contracts.
- i. A lawyer under a contingency fee contract may provide 500 hours in prosecuting an unsuccessful case, while a defense lawyer spends perhaps the same in defense, at perhaps \$100 an hour. The plaintiff would pay no tax, while the defendant would pay tax on \$50,000, while they both received presumably equal services.
 - ii. Services performed in more than one state, as discussed above. We might have, and frequently do, a case pending in Kansas which requires

depositions, or even ancillary court proceedings, in another, or several other, states.

- iii. Pro bono services - those provided free to those who cannot afford to pay as we are encouraged ethically to do - would pose special difficulties under K.A.R. 92-19-16, which says that "Each person who gives away or donates tangible personal property or who renders or furnishes without charge services taxable under the sales tax act is deemed for tax purposes to be the final user or consumer." (Emphasis added.)
 - a. Does this mean that if we provide free services to the poor we will pay the tax? In the February issue of the Bar-o-Meter, our Wichita Bar magazine, there were 51 attorneys listed who had handled pro bono cases in 1990, with free representation provided to over 500 clients. A simple domestic case, whether pro bono or not, can easily take over 10 hours. If the customary charge of the lawyer is \$100 per hour, does that mean the lawyer would also have to pay the state \$42.50 for the privilege of serving the poor?
 - b. What if the case is a contingency fee case and is lost, and thus the services provided for free? Does the lawyer cough up the sales tax?

F. Particular cases.

- i. Criminal appointments - fees paid by city, county, State Board for Indigents' Defense Services or federal government.
 - a. Presumably exempt, but less than clear. (See Sec. 3(a) - "purchased directly by the state of Kansas . . ." (Emphasis added.)
- ii. Civil rights claims - can have claims involving only injunctive relief, with no monetary recovery, but the defendant required to pay the plaintiff's attorney fees. Frequently, such cases are against some branch of government. Who pays the sales tax? The plaintiff, who received no monetary recovery, but merely an injunction against discrimination, might have to pay sales tax on a \$100,000 or more fee.
- iii. Other statutes requiring a losing party to pay the other party's fees.

G. Advanced expenses - subject to tax?

- i. Sec. 2(b) assesses the tax on "gross receipts received . . ." The cost of a deposition, upon which we would pay tax to the court reporter, would be included in our final bill, and when that bill was paid would thus be included in "gross receipts." Would it not be taxed again? Since we would pass the sales tax on to our client, would there not be a tax on a tax?

IV. The consumer is the real victim.

A. Kansas law requires that we all pass on sales tax to the consumer. [K.S.A. 79-3604(a) and 79-3605.]

B. The net effect is to increase the cost of all services subject to tax, by 4.25% under present law, or more as the tax increases. (5.25% in Wichita, assuming that the city and county follow the state's lead, a virtual certainty.)

- i. The one who can least afford it is the needy person who can barely afford an attorney or other professional in the first place. Many of our clients, especially in criminal cases, are poor, and can barely afford to pay now, even at reduced rates.
- ii. Elderly persons are in general more prone to require certain services.
- iii. This Bill represents a "trouble" tax - it would tax a person whenever he or she was in trouble, or in time of personal grief and hardship.
- iv. This Bill would hurt the "little guy," whether business or otherwise, and the only person to benefit from supposed real property tax relief by this kind of bill is the owner of a big business or a \$700,000 house.

C. Probability that all who must collect this tax will have to increase their fees across the board to make up for the productive time they lose from administrative activities.

- i. "Domino" effect, since our business clients will have the same problem, plus our increased fees.

V. The concept is unworkable, and will surely be as unpopular with the consuming public as the current property tax situation.

- A. This bill doesn't hurt the lawyer, doctor, or other professional, other than perhaps to increase his headaches, and does not tax those with especially high incomes. It taxes the consumer.
- B. Envision, if you will, the survivors of a worker killed in a work-related accident. The law limits recovery from the employer to \$200,000, and provides for an attorney fee of not to exceed 25%, or \$50,000. Do those survivors also pay \$2,125 in sales tax? Under this Bill they would.
- C. This bill, or any other like it, should not be allowed to become law.



February 27, 1991

TO: Chairwoman Wagnon and Members of the House Taxation Committee

FROM: Trudy Aron

RE: **Opposition to House Bill 2113**

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Trudy Aron
Executive Director

Thank you for this opportunity to address you today. The American Institute of Architects in Kansas is **opposed** to House Bill 2113 which would tax professional services including those of architects.

SALES TAX ON ARCHITECTURAL SERVICES PLACES KANSAS ARCHITECTURAL FIRMS AT A COMPETITIVE DISADVANTAGE

Architecture is a highly competitive business. The addition of sales tax on an architect's fee will cause many Kansas clients to seek services from firms outside our state to avoid paying this added cost. In addition, it won't make economic sense for clients outside our State to hire Kansas firms if those firms must charge sales tax on their services.

SMALL, SINGLE DISCIPLINE FIRMS WILL SUFFER MOST

When designing a building, architects are the team leaders of a variety of consultants - architecture, structural, mechanical and electrical engineering, interior design, landscape architecture and other consultants as needed. Over 80% of all Kansas architectural firms have fewer than five (5) employees. Less than 5% of these firms will have the necessary consultants in-house to provide the services needed to design a project. Therefore, these firms must hire their consultants.

If the architectural firm must pay sales tax on the services they receive from their consultants, it will place small firms at an even greater disadvantage to large multi-discipline firms who can provide these services in-house by their employees.

SALES TAX ON SERVICES DISCOURAGES ECONOMIC DEVELOPMENT AND EXPANSION

Sales tax on services will impede business expansion and development by increasing the cost of doing business in Kansas. A sales tax on architectural and other professional services will increase significantly the front end costs of any business expansion plan. This will hurt Kansas now and into the future.

ENFORCING THE USE TAX STATUTES WON'T HELP; NEITHER WILL EXEMPTING SERVICE TO OUT-OF-STATE PURCHASERS

Many have said that enforcing the use tax statutes will make Kansas firms on a level playing field with those outside of Kansas. This just isn't so. Firms outside of Kansas will not have to pay sales tax on the services they buy - lawyers, accountants, and other business related services, insurance (a big expense for architects), banking, equipment rental and leasing, communications, and other overhead items. In fact, 75% of the licensed architects in Kansas live outside our State. These architects will be able to market their services for less than the services of resident firms because they will not have to collect the sales tax or pay for the services their firm purchases.

SALES TAX ON SERVICES WILL COST ALL BUSINESSES MORE AND THESE COSTS WILL HAVE TO BE PASSED ON TO ALL KANSANS

Most businesses, large and small, contract with a variety of service businesses. These include lawyers, accountants, advertising, marketing, insurance, etc. Each business will have to pay the sales tax on the services they purchase. These businesses will have to pass the cost of these increased taxes on to the public or go out of business. Therefore, every Kansan will pay.

SALES TAX ON SERVICES IS A NEW TAX

Kansas service business, like those in most states, have never been taxed. Imposing sales tax on services will create an administrative burden on all service business and the state as well.

The American Institute of Architects in Kansas has asked our members to try to determine the impact the imposition of sales tax on services will have on their architectural firm. Attached are the preliminary results of this survey.

We urge you to oppose House Bill 2113. In these economic times it is most urgent that Kansas remains economically competitive with our neighbors.

AIA Kansas

A Chapter of The American Institute of Architects



February 20, 1990

TO: Chairman Larkin and Members of the Tax Rollback Subcommittee

FROM: Trudy Aron

RE: Survey on Impact of Governor's Plan on Architectural Services

1991 Executive Committee

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Trudy Aron
Executive Director

IMPACT OF GOVERNOR FINNEY'S TAX PLAN ON ARCHITECTURAL FIRMS IN KANSAS

Assumptions: In reporting the statistics found here, we assumed that projects currently exempt from paying sales taxes on construction services would remain exempt from paying sales tax on those construction services, and that the consultant services would be exempt as well as the services of the architect. Therefore, the figures on exempt and non-exempt projects have been figured separately.

1. Number of firms sent survey 150.
2. Number of firms responding to survey by 2/19/91 27.
3. Percentage of firms responding to survey 18%.
4. Total number of employees represented in survey results 212.
Breakdown:

# employees	# firms reporting
1	5
2-3	5
4-6	7
7-10	6
11-20	2
21-55	2
5. Total annual billings reported \$17.3 Million.
6. Total annual billings for sales tax exempt clients \$10.8 Million (62%).
7. Total annual billings for non-exempt clients \$6.5 Million.
8. Total annual billings for consultant services for non-exempt clients \$2.3 Million.
9. Total other services/goods purchased currently not taxed which would be taxed under the Governor's plan \$2.3 Million.
10. Amount of tax on services/goods (item #9 above) taxed at 5.25% \$120,750 or .7% of total billings.*

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11. Amount of tax on consultant services (items #8) taxed at 5.25% \$120,750 or 1.9% of total non-exempt billings.*
12. Amount of tax on services/goods and consultant services taxed at 5.25% as related to the total billings is increased by 1.4%.*
13. Number of firms who indicate that some of their clients may seek services outside of Kansas 14 firms or 52%.
14. Number of firms who indicate they would have a strong incentive to move all or most of their operation outside Kansas 13 or 48%.
15. Number of persons employed by firms who may move 149 of 212 or 70%.

* The increased cost of taxing those goods and services purchased by the architectural firm (#10) and the affects of pyramiding of taxes on consultant services (#11) are compared to total billings. The increased costs for sales taxes on these services would be added to those of other overhead including employee compensation. No costs were added to reflect any increased cost to firms to administer the collection/remission of sales tax. This cost could be substantial. The profit margin of many architectural firms is already low, the added costs of sales taxes on these purchased services would significantly erode their profit.

The results of this survey will be updated as additional responses are received.

Kansas Life Association

Kansas Association of

PROPERTY & CASUALTY
INSURANCE COMPANIES, INC.

February 27, 1991

L. M. Cornish
Legislative Chairman
Merchants National Tower
P. O. Box 1280
Topeka, Kansas 66601

MEMBER COMPANIES

Armed Forces Ins. Exchange
Ft. Leavenworth

Bremen Farmers Mutual Ins. Co.
Bremen

Consolidated Farmers Mutual Ins. Co., Inc.
Colwich

Farm Bureau Mutual Ins. Co., Inc.
Manhattan

Farmers Alliance Mutual Ins. Co.
McPherson

Farmers Mutual Insurance Co.
Ellinwood

Great Plains Mutual Ins. Co., Inc.
Salina

Kansas Fire & Casualty Co.
Topeka

Kansas Mutual Insurance Co.
Topeka

Marysville Mutual Insurance Co., Inc.
Marysville

McPherson Hail Insurance Co.
Cimarron

Mutual Aid Assn. of the Church
of the Brethren
Abilene

Swedish American Mutual Insurance Co., Inc.
Lindsborg

Town and Country Fire and Casualty Ins. Co., Inc.
Hutchinson

Upland Mutual Insurance, Inc.
Chapman

Wheat Growers Mutual Hail Ins. Co.
Cimarron

Patrons Mutual Insurance Co.
Olathe

Cimarron Insurance Co.

Cimarron

Nordia Insurance Co.

Topeka

House Taxation Committee
Capitol Building
Topeka, Kansas

Re: House Bill 2113

On behalf of domestic insurance companies in the Kansas Life Association and the Kansas Association of Property and Casualty Insurance Companies, we would offer the following testimony and additional considerations in opposition to House Bill 2113.

Insurance companies, including both domestic and foreign companies authorized to do business in Kansas, already pay in excess of \$70 million in premium taxes and fees to the State of Kansas and we would oppose any additional tax burden. Service taxes on insurance would have a pyramiding effect due to the number of services involved in providing insurance coverage and would ultimately have to be passed on to the insureds in the form of higher premiums. This would have a regressive impact on lower income people due to the various mandatory coverages and minimum limits imposed by law. It would also unfairly tax small businesses that use insurance services and are not able to provide the same services and coverages internally.

Insurance affordability has been a major concern and the subject of extensive study by the Legislature. Increasing the cost of insurance protection with additional taxes will obviously hurt those who can now barely afford

The American Home Life Insurance Co.
Topeka

Employers Reassurance Corp.
Overland Park

Kansas Farm Bureau Insurance Co.
Manhattan

Security Benefit Life Insurance Co.
Topeka

American Investors Life Insurance Co.
Topeka

The Great American Life Ins. Co.
Hutchinson

Kansas Group Life Insurance Co.
Topeka

The Victory Life Insurance Co.
Topeka

The Centennial Life Insurance Co.
Mission

Great-West Life & Annuity Ins. Co.
Wichita

The Pyramid Life Insurance Co.
Shawnee Mission

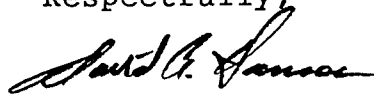
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insurance protection and will no doubt cause others to either reduce their coverages or go without insurance protection, including such basic coverages as life, health, accident, property and casualty insurance.

We therefore must oppose any additional taxes or fees.

Respectfully,

A handwritten signature in cursive script, appearing to read "David A. Hanson".

DAVID A. HANSON

DAH:kls



Kansas Engineering Society, Inc.

627 S. Topeka, P.O. Box 477, Topeka, Kansas 66601 (913) 233-1867

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Testimony in Opposition to Sales Tax on Professional Services before the House Committee on Taxation February 27, 1991

Members of the committee, I am Bill Henry, the executive vice president of the Kansas Engineering Society, an organization composed of more than 900 licensed professional engineers who practice their profession in private practice, government, education, industry and construction in our state.

The members of the Society oppose the imposition of the sales tax on professional business engineering services because it will deter economic development in our state and limit expansion in our state. Kansas is not a geographical island in terms of tax effects on business and the economy. Much of the state's economic growth, including professional services, has come in the northeast area of our state.

A few blocks mark the difference between taxation rates and in the case of professional services a total tax difference. In Missouri, Oklahoma, Nebraska and Colorado, professional services, including engineering services are not subject to state sales taxation.

In recent years the total membership of the Kansas Engineering Society has remained fairly stable. In some areas of the state we have lost engineers who belong to local chapters but in one area there has been a continued growth during the past ten years and that is in the Kansas Engineering Society's Eastern Chapter which is composed of the geographic areas of Johnson and Wyandotte counties.

A number of large Missouri firms now have Kansas offices in these counties and provide services to Kansas local units of government and private individuals through those offices. If those professional engineering companies had to face the imposition of sales tax on their services it would not be difficult to sever a lease and move across the state line.

Secondly, the amount of revenue that is estimated to be raised by the imposition of this tax may be over-estimated. Engineers in private practice provide most of their services to political subdivisions of the state and the

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state itself. Engineers design waterworks, sewer treatment systems and roads for cities and counties. If we're concerned with property tax relief it would seem ironic that we would place a tax on our local units of government to solve the tax problems caused by our property tax burdens. Indeed, in a brief survey of private consulting firms operating in our state it is estimated that 60-70% of the services that are provided by professional engineering firms are provided to the state of Kansas, and its political subdivisions.

For these reasons, the Kansas Engineering Society opposes the imposition of a sales tax on engineering services and would be most happy to provide further information in this area upon the committee's request.

Respectfully Submitted,
William M. Henry
Executive Vice President
Kansas Engineering Society

Testimony on HB 2113
Presented to the House Taxation Committee
By: Larry W. Magill, Jr., Executive Vice President
Independent Insurance Agents of Kansas
February 27, 1991

Thank you madam chairman and members of the committee for the opportunity to appear today in opposition to HB 2113, specifically the provisions on page 20 lines 35 to 38 taxing all services provided in Kansas at the rate of 4.25%. In the interest of keeping both my written and oral testimony as brief as possible, I would like to second the comments made by T. C. Anderson, Chairman of the Kansans for Tax Free Services Coalition and Bob Corkins, Director of Taxation, for the Kansas Chamber of Commerce and Industry.

They have explained many of the general reasons why we do not believe expansion of the present sales tax base to include services would be good public policy. I want to focus on the unique reasons why we are opposed to the concept. I have divided my testimony into the general criteria considered by the subcommittee on expansion of the sales tax base.

WHAT IS TO BE TAXED?

Since HB 2113 is extremely broad in scope, we must assume that as drafted, it will place a sales tax on insurance premiums. The history of the Department of Revenue's enforcement of the present sales tax is that they take as broad an interpretation of the law as possible in the absence of specific statutory language exempting a particular item.

The entire insurance premium is a fee for service. The basic service is the protection of the individual's or business's assets either from direct loss due to fire, tornado, etc. or indirect loss due to liability to a third party. The customer is paying for claims adjustment services, loss control services, defense attorney fees, and other similar

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services.

The insurance premium includes the agents commission. Commissions are the agents gross income and from that the agent pays for the services the agent provides. Attached to my testimony is a list of those services provided to public entities. The list would vary depending on the client being served, the services they need and the agents capabilities.

Larger business accounts may "unbundle" the insurance service and purchase specific services instead. This would be true for large businesses that self-insure. In addition, agents will occasionally quote premiums to large commercial accounts without commission. The agent then bills the account for their services on an hourly basis. Again, these service fees are in lieu of commissions.

Even more rarely, where commissions are inadequate to reimburse the agent for the services provided, the agent may charge a fee in addition to commissions. This requires a special brokers license and a written contract. According to the Insurance Department there are only a little over 400 brokers licensed in Kansas out of 35,000 insurance agents so it is not a widespread practice.

Since it is unclear exactly what is proposed to be taxed, premiums, commissions or fees, my comments will address all three.

EQUITY CONSIDERATIONS

The first and foremost reason we are opposed to a sales tax on insurance is that insurance premiums are already taxed. All foreign insurance companies, those domiciled outside of Kansas, pay a 2% premium tax on all insurance premiums collected in the state. Domestic insurance companies pay a 1% tax. In the fiscal year ending June 30, 1990, \$54,885,713 was paid into the state general fund by the insurance industry

in premium taxes. The premium tax is essentially identical to a sales tax. Thus, we would argue one is already being imposed. Furthermore, if you add other fees paid by insurance companies including assessments for the workers compensation fund (second injury fund), the industry pays a total of \$92,247,365 to the state of Kansas.

Secondly, we would argue that a service tax on insurance premiums or commissions would place Kansas independent agents at a serious competitive disadvantage with agents from other states - particularly on large business insurance accounts. There are presently 8,538 non resident agents licensed to do business in Kansas. These non resident agents do not simply operate in the border counties. They travel the entire state of Kansas. As we understand the sales tax law, they could not be required to collect a sales tax on insurance. We do not believe that the Department of Revenue will have the ability or the manpower to enforce collection of taxes from all the individuals and businesses of varying sizes that buy their coverage out of state.

Furthermore, the sales tax on insurance or commissions would be extremely inequitable in its application to independent agents verses employed agents. The definition of the standard industrial classification for "insurance agents, brokers and service," industry #6411, states the following, "Agents primarily representing one or more insurance carriers or brokers not representing any particular carriers primarily engaged as independent contractors in the sale and placement of insurance contracts with carriers, but not employees of the insurance carriers they represent." (emphasis added) A tax on independent agents would place our members at a severe competitive disadvantage to employed agents.

Finally, as with many other services, the large businesses would be

able to avoid the tax by self-insuring. Self-insurance, in effect, brings the service in-house. Only the very large firms with relatively predictable loss experience from year to year and sizeable net worth could afford to self-insure.

MOBILITY

The purchase of insurance is a highly mobile transaction. Mail order insurance companies have been quite successful in the personal insurance area. Companies like USAA, GEICO, and Hartford's AARP program are all examples of successful mail order insurance operations providing a full range of personal insurance coverages. Mail order operations are also common in the life and health area.

Plus, as mentioned above, insurance can easily be purchased from out of state agents. While the border counties would be most affected, there isn't a part of the state that would not be affected by non-resident agent sales activity. This would be particularly true when you consider that they would have anywhere from a 4.25% to a 6.25% price advantage.

In many cases in the personal insurance area, the insurance service is viewed by the consumer as somewhat of a "commodity". Because of that, even a small difference in cost can cause a consumer to change insurance carriers. In the area of business insurance, the cost difference may be significant depending on the size of the business and its insurance needs. Large businesses could pay into the hundreds of thousands or even millions of dollars per year in insurance premiums, particularly when you add the cost of group health insurance.

SITUS AND ADMINISTRATIVE COSTS

On a business account with multiple locations, the sales tax would have to be collected for each location separately taking into

consideration differences in local sales tax rates. Since the insurance for multiple location businesses is normally packaged into combined premiums, this entails significant administrative costs to break the premiums out by location. This would be a significant administrative burden for agents who generally bill business insurance accounts. If commissions are taxed, the administrative costs go up exponentially. Commission rates vary by line of coverage and by insurance companies. Agents would have to break out each location, each line of insurance and each commission level to calculate the sales tax for a given location. Agents may represent 20 or more different insurance companies with 20 or more different commission schedules compounding the problem.

Again, there are a tremendous number of Kansas franchise locations and branch offices owned by companies located out of state. We doubt that the sales tax will be collected on these businesses.

ECONOMIC IMPACT

None of the surrounding states tax insurance premiums, commissions or fees.

As a result, we feel the economic impact on our members, in relation to agents in surrounding states, would be severe. While independent agents in large areas of Kansas would not be able to do anything about it, we anticipate that agents in border counties could very easily move their operation across the state line.

PYRAMIDING

While the trucking industry estimates that goods are typically transported seven times before they are finally sold to the end user, we would estimate that insurance is involved in at least that many different businesses involved in a complex manufacturing operation. Each supplier

of component parts purchases insurance. The manufacturer of the final product purchases insurance. The wholesaler purchases insurance. The trucker purchases insurance. The retailer purchases insurance and all of the suppliers of services doing business with these entities in the chain purchase insurance. The pyramiding impact of placing a sales tax on insurance would be significant.

IMPACT ON TAX PAYER

In our view, the sales tax on services will be viewed by the consumer as a new tax - particularly where insurance is involved. While the proponents may talk in terms of an expansion of the tax base, this will be perceived by the consumers as a significant new tax. When you add the typical consumer's purchases of life, health, home and auto insurance they represent a significant and growing percentage of their total budget. Any sales tax on these purchases will be felt particularly by the low and moderate income individuals.

The state mandates the purchase of auto insurance, workers compensation and professional insurance for health care providers. In addition, lending institutions require borrowers to insure collateral such as homes and business property. Many low income individuals struggle now to purchase auto insurance. Any increase in cost due to a sales tax on the insurance could cause an increase in the number of uninsured drivers.

CONCLUSION

Our members, as service businesses, were among the hardest hit by property tax reclassification and reappraisal. We do not believe that any property tax relief through an expansion of the sales tax base will benefit our members in proportion to the added administrative cost and competitive disadvantages such a tax would place on them. For that reason

we are opposed to HB 2113. We would be happy to answer questions or provide any additional information.

Insurance Agents Services

By: Vern R. Pierson, CPCU, CLU CIAA of Arizona, Inc.

Why do business through an independent insurance agent or broker for your property, casualty, workers' compensation and fleet coverages? The following are some of the reasons why you should. Agents perform many tasks you probably are not aware of. (Please keep in mind that while this list is NOT exhaustive, neither do all agents perform everything listed.) Several items are applicable to more than one heading group, but for ease of reading, we have listed them just once.

Placement and Marketing

- * Monitors admitted insurance carriers, surplus lines carriers, and applicable pools, to be sure they are financially strong and capable of delivering contracted services.
- * There are special and unique coverages available that are not included in regular markets. Agents/brokers have access to these special and unique markets.
- * Independent agents/brokers are not one-company agents. They represent several insurance companies allowing a choice of the best markets for a given risk.
- * Agents know the various markets available for specialty coverages, as well as the reputation of those markets for service and claims.
- * The agent monitors new types of coverage available and presents a brief analysis to the client in order to discuss resulting benefits to the client of a market change or additional coverage.

Risk Management

- * Actively seeks coverage improvements to existing contracts for both existing and new risks.
- * Reviews Hold Harmless clauses to be sure public entities are properly protected.
- * Recommends deductibles to control insurance costs.
- * Recommends self-insurance where it's feasible - (This technique may lower cost to the client over a period of time).
- * Recommends adding coverage in areas that are unprotected that could be a financial drain.
- * Constantly uses the risk management techniques of eliminating, reducing or transferring risks.
- * Visits all locations periodically for a physical review of exposures.
- * Provides guidelines for amounts of insurance. (The final decision, however, must be yours.)
- * Reviews coverage exclusions to be sure they are not unreasonable and suggests alternative solutions.
- * Reviews lease agreements for insurance requirements. May develop alternative for insurance if in on the negotiation side of the lease.
- * Review of construction agreements. Same comments as for lease agreements.
- * Assists public entities in working out (pre-loss) reciprocal agreements with other facilities that could be used to house temporary operations in the event of a major loss. (Reduces need of extra expense insurance and helps plan for a crisis situation.)
- * Requests and participates in special claim reviews with the carrier and public entity.
- * Requests the carrier to conduct risk control and/or claims seminars for a special need that develops within a public entity.
- * Negotiates with the carrier/program administrator on behalf of the public entity on any items of concern that develop.
- * Available to consult with on new projects; to attend planning/strategy sessions; to advise regarding potential exposures and offer possible solutions.
- * Provides basic risk management consulting services.

Loss Control

- * Reviews losses for trends and makes appropriate recommendations. (Depending on available information.)
- * Reviews risk control recommendations and assists with implementation as necessary.
- * Involves the carrier's loss control unit as needed to assist with loss reductions, thereby possibly lowering future insurance costs.

Account Servicing

- * Assists in developing premium estimates for budget purposes.
- * Assists with difficult losses as needed.
- * Requests Certificates of Insurance on behalf of the public entity.
- * Reviews all Certificates of Insurance received from others to be sure they are in compliance with the request and are with valid insurance carriers.
- * May provide follow-up for Certificates of Insurance as they expire.
- * Provides proof of insurance on vehicles to comply with the State Statute.
- * Supplies information to the public entity for bid specifications when it's time for rebidding.
- * Available to answer all questions regarding insurance and to provide a second opinion when it's needed.
- * Handles all requests for changes to existing insurance contracts and follows up with the carrier to be sure they are issued promptly.
- * Assists the public entity in organizing their portfolio of policies so that needed information can be obtained easily.
- * If you fail to make a timely premium payment, they are there to remind you and help coordinate communication with the insurance company.
- * Agents/brokers are professional individuals, expected to perform at a level of high expertise. They carry errors and omissions insurance coverage in the event they don't live up to their responsibilities.

Underwriting

- * Makes use of the carrier's building cost estimates as needed in establishing proper values.
- * Determines and classifies building construction types for lowest possible rates.

New and Renewal Application Information Gathering

- * Assists in developing Statement of Values, building construction, information, fire protection class and plot plan.
- * Completes or assists in completing the new or renewal survey (application) for insurance proposals.

Pricing Considerations

- * Reviews losses and outstanding reserves prior to annual experience calculations to obtain maximum pricing benefit.
- * For those carriers who provide premium audit billings, the agent reviews them to be sure they are justified and comply with the contracts.
- * Involves the carrier's loss control representative in new building plans for recommendations involving lower insurance costs.
- * Determines the correct exposures for rating purposes and provides input for credits where justified.
- * Remuneration is generally on a commission or fee basis versus an hourly wage.
- * The services provided usually do not increase your cost, therefore it is in your interest to obtain maximum available services from your insurance professional.

Risk Analysis

- * Reviews requests for Certificates of Insurance received by a public entity.
- * Reviews contractual requests involving insurance.
- * Reviews all insurable exposures and makes recommendations for suitable coverage.
- * The agent monitors applicable case-law in his state and is willing to describe to his client how these ever-changing complexities of case law can affect the client, and modifies his insurance program accordingly.

Presentation Assistance

- * Available to attend meetings to assist the administrator when necessary with presentations, answering questions, etc.
- * Reviews with the public entity all insurance quotations received. Points out the differences that often the inexperienced eye does not see.

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27 February 1991

TO THE MEMBERS OF THE TAXATION COMMITTEE:

In 1988 this committee completed a careful and detailed study of the nature of interest to be taxed as "computer software" and "computer services". That consideration included the study of taxing all matters of computer software and computer programming services. This committee considered the issues of interstate competition and the effect upon Kansas based employment, the economic sense, the equities and inequities, compliance and administration matters, among the many other aspects.

The result of that deliberation and the subsequent action by the legislature is shown in K.S.A.79-3602(f), 79-3603(e) & (g). [References are to paragraphs in HB-2113, not prior section numbers.]

The issue of imposition of sales and use tax upon custom computer software and custom software modifications was evaluated fully and carefully. The intent of this committee at that time was to clearly define that which was taxable and that which was not. **Custom computer software and services related thereto and custom modification services should not be subject to sales or use taxes, while the prewritten, canned software was taxable.**

In order to clarify that intent of the legislature, and in light of the changes now being considered in this body, and to assist the administrative agency personnel in understanding their responsibility, we submit that the following language be added to K.S.A.79-3606 to clarify legislative intent.

"() the creation of any custom computer program which is originally developed for the exclusive use of a single end user, and those services rendered in the modification of computer software when the modification is developed or performed exclusively for a single end user only to the extent of the modification and only to the extent that the actual amount charged for the modification is separately

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stated on invoices, statements and other billing documents provided to the end user."

If you compare the language with that of K.S.A.79-3603(g), you will note that it parallels that language. It is needed here for the reason that its use in K.S.A.79-3603(g) is for the purpose of clearly defining that which is taxable as "tangible personal property" or as "services" to tangible personal property. Since K.S.A. 79-3603 (b) taxes services generally under HB-2113, a conflict could arise between the exemption of tangible personal property and taxation as a service.

We now ask that you make that technical correction by adding the above suggest language to complete the process.

Respectfully submitted,



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