

Approved: March 13, 1995
Date

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION.

The meeting was called to order by Chairperson Audrey Langworthy at 11:00 a.m. on February 21, 1995 in Room 519--S of the Capitol.

Members present: Senator Langworthy, Senator Corbin, Senator Martin, Senator Bond, Senator Clark, Senator Feleciano, Jr., Senator Hardenburger, Senator Lee, Senator Ranson, Senator Sallee and Senator Wisdom.

Committee staff present: Tom Severn, Legislative Research Department
Chris Courtwright, Legislative Research Department
Don Hayward, Revisor of Statutes
Gayle Addington, Acting Secretary to the Committee

Conferees appearing before the committee: David Craig, David Craig and Associates, Topeka
Paul Welcome, John County Appraiser
Janet Stubbs, Kansas Building Industry Association
Bob Corkins, KCCI
Sue Danker, Danker Roofing, Manhattan
Dave Gregory, Star Lumber, Wichita
John Hefley, Lumber Yard, Hillsboro
Bob Sjogren, CPA, Newton
Art Brown, Mid-America Lumbermens Assn.

Others attending: See attached list

SB 275--FAIRMARKET VALUE FOR PROPERTY TAX PURPOSES; CONSIDERATIONS IN DETERMINING

Gordon Garrett, Legal Counsel, Commercial Property Association of Kansas presented written testimony only. (Attachment 1)

David Craig, David Craig & Associates, Topeka, spoke in support of **SB 275**. Mr. Craig said he was here as an appraiser and he did testify in the Montara Housing court case when the case was overturned. The bill deals with the appraisal of lots in subdivisions. The technique used in these cases is these lots are not sold in one day so in valuing the property, it is taken into consideration the expense of holding the lots until they are sold. It is felt they should be taxed as a rental project for loan purposes. The Board of Tax Appeals agreed. The court held that once it is platted, each lot is valued at its retail value even though you could not sell all those lots in one day. Historically, appraisers have always taken into consideration the lots are going to be sold over a period of time and have taken into consideration the expenses the developer incurs during that time. That is the reason for the addition of this language. As an appraiser, they appraise subdivisions as though owned by one owner and they are going to be developed over a period of time and also sold over a period of time. The retail value of the individual lots is not added up which is what this court decision, without this additional language, would require.

Senator Bond asked if this also applies to commercial and industrial development? Mr. Craig said it does apply to all types of real estate. He also said this issue is at the supreme court level.

Paul Welcome, Johnson County Appraiser, said he appears in support of **SB 275**. He said he thinks these sales have been excluded from the ratio study by the policy of the PVD, and he thinks they are using the "absorption" type method.

Janet Stubbs, Kansas Building Industry Association, presented the written testimony of Grant Gardner, an appraiser from Wichita. (Attachment 2) He, too, was an expert witness for the Wichita builders in the court case before the Board of Tax Appeals. Mr. Gardner wrote that he hoped the committee would recognize the validity of these techniques by including the change in language proposed in **SB 275**. He said he wanted the committee to insure that Administrative and Judicial bodies do not have the latitude to misconstrue statutory language in a manner that leads to a precedent for ad valorem valuation on any basis other than "fair market

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value". The "fair market value" of individual lots within a larger aggregate are less than the total of the "market prices." This fact has been recognized by the Federal Government. He gave information concerning developers beginning developments based on historic absorption trends and expenses and they suddenly found themselves faced with an expense from real estate taxes that rendered many projects uneconomical. Without a "fair market value" standard, "just" taxation becomes arbitrary and capricious. He concluded by saying the doctrine of equal treatment under the law is in jeopardy without further statutory clarification.

SB 294--SALES TAX EXEMPTION CERTIFICATES

Bob Corkins, KCCI, said he also speaks for the Kansas Retail Council. (Attachment 3) He said Kansas retailers are performing an uncompensated sales tax collection service for the state and local governments and this task is becoming an onerous burden. This tax is not a privilege tax for the seller but is a consumption tax upon the consumers. Some states compensate the retailers for this collection of sales tax. Kansas does not. The Department of Revenue routinely rejects many sales tax exemption certificates even though the customers at issue are the parties who provide the applicable certificates to the retailer. As you hear the comments of the other conferees they will explain reasons why the certificates have been rejected. **SB 294** would clear up many of the problems which have occurred. Mr. Corkins presented a couple of balloon amendments for the bill. One is an element which is in **HB 2500**, a similar proposal. The other would clarify the intent of **SB 294** in order to help avoid future misapplication by the Department of Revenue. He strongly urged the committee to recommend the bill favorably with these two changes.

There was discussion among the committee members of problems some of their constituents have had with the sales certificates. Senator Hardenburger said she introduced this bill and she felt the heavy liability placed on the retailer is unfair. Senator Martin asked if this has just come to light within the past year and Mr. Corkins said it has been over the past 18 months.

Sue Danker, Danker Roofing, Manhattan, said she was here to testify regarding the cap on the \$10,000 on project exemption certificates. The major part of the work they do is on schools, hospitals and government entities. If there is damage from a storm, they can accept the blanket exemption certificate on the labor. But almost always it is both labor and materials, and regardless if it a \$10.00 job or a \$10,000 job, they have to have the project exemption certificate for the project to be exempt, or they have to charge tax. Ms. Danker presented a letter from USD #383 (Attachment 4) which states the school had applied for 93 tax exemption certificates and only 19 of them were over \$10,000. The school supports **SB 294** which would require the exemption certificate for only those projects in excess of \$10,000.

Dave Gregory, Star Lumber and Supply Co., Inc. said the Department of Revenue initiated a sales tax audit of his company last year. (Attachment 5) The division found examples where sales tax exemption certificates had been collected from customers but they thought sales tax should have been collected. He said it is too hard to understand the law and to comply with the interpretation of the Department. He listed five points; (1) the retailers are not accountants; (2) they should be able to accept in good faith the exemption certificates from the sales tax; (3) they should not be responsible for interpreting the intention of the customers for the use of the purchase; (4) the retailer should not be expected to know the business of all the customers; (5) and they feel it is a burden to question the ethics of their customers. The existing law places a tremendous burden upon the retailer. He urged the committee to pass **SB 294** favorably.

Senator Martin asked if there was a special assessment made against Star Lumber and Supply Co., from the audit by the Department of Revenue. Mr. Gregory said they are still going through the audit.

John Hefley, Lumber Yard, Hillsboro, said their company has just been audited. The Department looked at a couple of the sales tax exemption certificates and thought they looked fine. They also said they had a credit due them from April of 1994 to December of 1994. However, there are a bunch of exemption certificates that are no good and the Department said the company is responsible for them. Mr. Hefley asked if a sales tax exemption certificate is issued by the state, are they not supposed to accept them? The auditor said "no, and you are going to be held liable." They asked the auditor how to do this correctly and he told them to continue doing as they have been doing. If a customer brings a sales tax exemption certificate to their business, it should be good. It is a very heavy burden on their business. Mr. Hefley supplied a large number of certificates, some of which were approved and others that were not. He asked if the committee could decipher them. He urged passage of **SB 294**.

Senator Langworthy asked if they knew how much sales tax they owe, and Mr. Hefley said if they have to pay all the Department of Revenue wants, it would be over \$26,000.

Bob Sjogren, CPA, Knudsen, Monroe & Company, Newton, Kansas, said he was here to concur with what Mr. Hefley has just told the committee. (Attachment 6) He said if this company has to pay the large amount

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mentioned, it would have a very adverse effect on their financial position. He said he did not understand why the retailer was ever designated as the responsible party to determine tax usage by the customer. He urged support of **SB 294** so that situations like the Hefley case would not occur in the future.

Senator Lee asked how does a business get an exemption certificate? Mr. Sjogren said it was his understanding that public works and educational institutions have to go through a procedure for the issuing of the sales tax exemption certificate by the Department of Revenue.

Art Brown, Mid-American Lumbermens Association, said he appeared today in support of **SB 294**. (Attachment 7) He said this is a big issue with lumber dealers. He attached the KAR regulations that deal with the subject matter of the bill. These rules and regulations put a great deal of pressure on a business who has no idea what the end use of an item he sells to a customer is going to be. He said they heartily encourage favorable passage of **SB 294**.

Mark Carduillo, Department of Revenue, said they are mixing two kinds of exemption certificates in the bill. What they are talking about here is a project exemption certificate that is issued for labor and materials on projects. One aspect of the bill would omit projects under \$10,000. He was asked what would be a project under \$10,000 if they had several subcontractors with whom they are dealing. If the Department is forced to go against the purchasers, it would be difficult to track down a lot of the customers. Currently, under the law, it is a requirement of the retailer to insure that the exemption is valid. Mr. Carduillo said the retailer is given a 60 day window to insure a proper exemption.

Questions were asked from the committee about the process of a business to qualify for a project exemption and Mr. Carduillo said a project exemption would be a not-for-profit business or agency. He said from listening to the conferees, he thinks what they are talking about are resale exemption certificates. That would require the retailer to claim they are exempt, they must put down their exemption number and the reason for the exemption. Senator Feleciano asked Mr. Carduillo to look over the large packet of sales certificates from Mr. Hefley and he said the Boy Scouts are not exempt for project sales because they buy items, resell them and charge tax.

Tom Sheridan, Department of Revenue, chief of the audit department, says he did not come to testify but had an interest in the bill. Senator Martin said the Department is not treating people over the state fair and right. He said the Department has told people if they get a Representative or Senator involved their feet will be held to the fire.

The hearing was closed on **SB 294**.

The meeting adjourned at 12:00 noon.

The next meeting is scheduled for February 22, 1995.

**SENATE ASSESSMENT AND TAXATION COMMITTEE
GUEST LIST**

DATE: 2/21/95

| NAME | REPRESENTING |
|-------------------|------------------------|
| RICHARD ROPEWALCZ | TAXPAYERS |
| Dennis Marten | |
| JANET STURBS | KBIA |
| DAVID CRAIG | SELF |
| Trudy Perkins | CPAK |
| Gordon T. Ganett | CPAK |
| David Payer | Dept. of Res. |
| Mark Ciannullo | KDOR- |
| Steve Stoff | " |
| Peggy Gagan | Atchison County |
| Red Broberg | Saline Co. |
| Paul Wolcott | Johnson Co. APPRAISER |
| Joyce Hayes | KU |
| WED GRANT | KCCI |
| Tom Slattera | ABC/Ks |
| Bill Anderson | Water DIST#1 of Jo Co |
| Anne Spiess | Ks. Assoc. of Counties |
| Sherry Ray | Johnson Co Comm |
| Karen Penney | City of Ourland Park |
| | KASB |

CPAK

Commercial Property
Association of Kansas

Gordon T. Garrett
Vice President -
Legal Counsel

Trudy L. Perkins
Associate Director

Board of Directors

Randy Austin
Fairlawn Plaza
Topeka

Steve Caffey
Developer & Realtor
Block & Company
Kansas City

Arlin Meats
Melvin Simon Co.
Mgr.-West Ridge Mall
Topeka

Jack Fox
J.C. Nichols Co.
Overland Park

Mike Loveland, CCIM
Commercial Real Estate
J.P. Weigand & Sons
Wichita

Tom Moses, CCIM
Griffith & Blair Commercial
Topeka

Cal Roberts
Mortgage Banker
Overland Park

Colby Sandlian
Developer
Wichita

Cindy Sherwood
Dentist
Independence

Bob Shmalberg
Scotch Industries
Lawrence

Ross Stiner
Realtor & Developer
Olathe

Steve Struebing
Attorney-Developer
Junction City

Patty Stull
Realtor
Hays

Dan Tucker
Banker-Businessman
Kansas City, KS

Larry Winn, III
Attorney
Overland Park

Date: February 22, 1995

To: Senate Tax Committee

From: Gordon T. Garrett Legal Counsel, Commercial
Property Association of Kansas

Subject: Senate Bill #275

Madam Chair, Members of the Committee, I am Gordon
T. Garrett, representing the Commercial Property
Association of Kansas.

We would like to support Senate Bill No. 275
because it legislatively deals with a troublesome
court decision that creates major problems in the
commercial development community.

Last June the Kansas Court of Appeals ruled that
the appraisal method known as the Developers
Discount was unconstitutional essentially because
it benefitted the holders of multiple lots as
opposed to the holder of a single lot, therefore
violating the Kansas constitution on uniform and
equal taxation.

The appraisal method of taking into account the
future income of a property or properties, because
not all commercial lots will be sold at the same
time, is a legitimate appraisal method and should
be made part of K.S.A. 79-503(a).

K.S.A. 79-503(a) list the factors to be considered
in arriving at fair market value and the
"absorption period and sell out period" for valuing
vacant commercial lots should be one of the
factors.

I have attached several pages from the manual of
the American Appraisal Institute which lays out the
policy for considering future income of a property
to be relative to it's valuation.

Thank you for considering the testimony on this
bill.

penses in dollars just as they are expected to occur, not to convert the amounts to constant-dollar equivalents. Unadjusted discount rates rather than real rates of return are used so that these rates can be compared with other rates quoted in the open market—e.g., mortgage interest rates and bond yield rates. Fixed income securities like bonds do not respond to unexpected inflation in the same way as real estate because the interest rate and face value are fixed at the time the bond is issued.

Thus, projecting income from real estate in nominal terms allows the analyst to consider whether or not the income potential of the property and the resale price will increase with inflation. If the income and resale price are expected to increase with inflation, the present value of the projected cash flows will be affected. Any projected increases in income and property value due to inflation must be realistic. Furthermore, the appraiser must be consistent and not discount inflated dollars at real, uninflated rates. When inflated nominal dollars are projected, the discount rate must also be a nominal discount rate that reflects the anticipated inflation.

Unexpected Inflation

A distinction must be made between expected inflation and unexpected inflation. Expected inflation refers to changes in price levels that are expected at the time the investment is made or the property is being appraised. As discussed above, anticipated inflation should be reflected in expected rates of return. However, actual inflation may differ from what was anticipated at the time the investment was made. Depending on how the investment responds to the actual change in price levels, its value may increase or decrease over time at a different rate than originally anticipated. If the return on the investment does not increase with unexpected inflation, the investor's real rate of return will be less than originally projected. Investors often include an additional risk premium in the rate of return required on investments that do not respond well to unexpected inflation. As indicated, the net operating income and resale value of income-producing real estate may increase with unexpected inflation. Thus, investors may not require as great a premium for the risk due to unexpected inflation in discount rates for real estate as they would for fixed income investments like corporate bonds.

INCOME CAPITALIZATION APPROACH METHODS

Two capitalization methods—direct capitalization and yield capitalization—are described below. These methods are based on different measures of expected earnings and include different assumptions concerning the relationship between expected earnings and value.

Direct Capitalization

Direct capitalization is a method used to convert an estimate of a single year's income expectancy into an indication of value in one direct step—either by dividing the income estimate by an appropriate income rate or by multiplying the income estimate by an appropriate factor. The income expectancy considered is frequently the anticipated income for the following year. The rate or factor selected represents the relationship between income and value observed in the mar-

ket and is derived through comparable sales analysis. The income from a property, usually annual net operating income or pre-tax cash flow, is divided by its sale or equity price to obtain the income rate. A factor or multiplier can be derived by dividing a property's sale price by its annual potential or effective gross income.

Direct capitalization is market-oriented; an appraiser analyzes market evidence and values property by inferring the assumptions of typical investors. Direct capitalization does not explicitly differentiate between the return on and return of capital because investor assumptions are not specified. However, it is implied that the selected multiplier or rate will satisfy a typical investor and that the prospects for future monetary benefits, over and above the amount originally invested, are sufficiently attractive.

Direct capitalization may be applied to potential gross income, effective gross income, net operating income, or pre-tax cash flow (equity dividend). The income selected for capitalization depends on the purpose of the analysis and the data available.

Yield Capitalization

Yield capitalization is a method used to convert future benefits into present value by discounting each future benefit at an appropriate yield rate or by developing an overall rate that explicitly reflects the investment's income pattern, value change, and yield rate. Like direct capitalization, yield capitalization should reflect market behavior. The method is profit- or yield-oriented, simulating typical investor assumptions with formulas that calculate the present value of expected benefits assuming specified profit or yield requirements.

The procedure used to convert periodic income and reversion into present value is called *discounting*; the required yield rate of return is called the *discount rate*. The discounting procedure presumes that the investor will receive a satisfactory return on the investment and complete recovery of the capital invested. The method is referred to as *yield capitalization* because it analyzes whether an investment property will produce the particular level of profit or yield required. Yield capitalization is also called *discounted cash flow analysis* because a discount rate is used to calculate the present value of anticipated future cash flows.

Appraisers distinguish between contract rent and market rent in analyzing income. Market rent is used to value a fee simple estate. If a leased fee estate is being valued, the appraiser considers contract rent for the existing leases and market rent for lease renewals.

A number of analytical techniques and procedures can be used to value an entire property, specific property benefits, or partial interests in property. Present value can be calculated with or without considering the impact of financing and income taxes as long as the specific rights being appraised are clearly identified. The techniques and procedures selected are determined by the purpose of the analysis, the availability of data, and the practices common in the marketplace.

Direct Capitalization, Yield Capitalization, and Discounting Compared

Direct capitalization is simple and easily understood. The capitalization rate or factor is derived directly from the market. Direct capitalization does not require

explicit estimates of future income as long as the capitalization rate is extracted from comparable sales that reflect similar expectations for changes in income and property value.

Yield capitalization, on the other hand, is based on assumptions about expected changes in income and property value. To select a market-oriented discount rate, market attitudes and expectations must be interpreted. In yield capitalization specific investment goals for the return on and of invested capital are considered. The property's projected income stream and reversion are capitalized into a present value by applying the investor's anticipated yield rate in the discounting procedure. Discounting can be performed with formulas and factors that are obtained from financial tables or calculated and applied with hand-held financial calculators or programmable computers. There are also a variety of software programs for personal computers that can be used for discounting cash flows.

The income capitalization approach need not be limited to a single capitalization method. With adequate information and proper use, direct and yield capitalization methods should produce similar value indications. Both methods are market-derived and, therefore, should reflect a typical investor's view of market value.

Residual Techniques

Residual techniques are employed in the income capitalization approach so that physical value components (land and building), financial value components (mortgage and equity), or legal estates (leased fees and leaseholds) can be considered separately. Residual techniques presume that the value of a component or portion of the property is known or can be estimated. The income attributed to this component is then deducted from total property income to reveal the residual income, which is capitalized to ascertain the value of the unknown portion of the property. Residual techniques can be used in both direct and yield capitalization. In Chapter 12 (Highest and Best Use Analysis), the land residual technique was introduced as a means to determine which land use maximizes the residual value of the land. In Chapter 20 (Direct Capitalization), the land residual technique will be explored in greater depth.

HISTORY OF THE APPROACH

To understand the development of the various methods, techniques, and procedures used in the income capitalization approach, it may be helpful to examine its history. The following discussion is divided into two time periods: the early years, when the theoretical bases for direct and yield capitalization were established, and the modern era, when specific techniques and procedures were developed and refined.³

³ See James H. Burton, *The Evolution of the Income Approach* (Chicago: American Institute of Real Estate Appraisers, 1982).

Early Writings

The mathematical foundation for discounting can be traced to John Newton, who was among the first to provide a theory of compound interest, and Edmund Halley, the noted astronomer who published the first present value tables in 1693. John Smart is credited with providing the first comprehensive set of tables and the first partial payment table in 1726. His book, *Tables of Interest and Annuities*, included tables identical to the present value and compound interest tables found in modern appraisal texts.

In 1811 William Inwood published tables that had originally appeared in the works of others, such as John Smart. Of particular significance to appraisers, Inwood used real estate valuation examples to illustrate the use of Smart's tables. Inwood's example postulated that the present value of an annuity was based on a single discount rate. Inwood's book also contained a table for calculating the present value of an income in perpetuity, which seems to mark the first time an author converted an interest rate into a coefficient. Inwood multiplied the coefficient by the investment's annual income, which was assumed to be perpetual, to calculate the current value of the investment. The Inwood premise has been used by real estate appraisers ever since.

In 1890 Alfred Marshall became the first economist to address valuation techniques specifically. He identified the interest rate as the link between income and value and offered the formula

$$\text{Value} = \frac{\text{Income}}{\text{Interest rate}}$$

In the early 1900s Irving Fisher contributed to capitalization theory by analyzing the proposition that value is the present worth of future benefits. This concept is fundamental to modern appraisal theory and is recognized directly in discounted cash flow analysis. Thus, by the early 1900s the mathematical and conceptual foundations of direct and yield capitalization were established. In the years that followed, these concepts were applied in a manner consistent with prevailing investor attitudes and behavior.

Modern Era

Pre-1959

In the history of the income capitalization approach, two characteristics distinguish the years before 1959 from the periods that followed. First, prior to 1959 property was usually valued by dividing it into its land and improvement components. During this period the land and building residual techniques dominated appraisal practice. Their use reflected investors' concern with the physical components of property and the need to recapture the cost of depreciating improvements.

Second, before 1959 property value was estimated without considering financing. An all cash market value transaction was assumed without recognizing that a purchaser might use borrowed funds. Although band-of-investment techniques were available to synthesize an overall capitalization rate from the required returns

of debt and equity investors, capitalization was dominated by physical residual techniques.

Real estate investors at this time were concerned with the productive economic life of the improvements, not with investment attributes such as financing. Prices were relatively stable and the effects of physical deterioration were not obscured by inflation. Capital gains were not seen as a significant source of equity return. Loan-to-value ratios and interest rates were relatively low, and creative financing, variable interest rates, and lender participation were not common. Because real estate financing was predictably regular, its effect on value was of little concern.

1959 to Mid-1970s

The year 1959 is especially significant to the income capitalization approach and serves as a transitional point in appraisal history. With the publication of *The Ellwood Tables*, L. W. Ellwood signaled the shift from reliance on physical residual techniques to techniques based on the debt and equity components of real estate investment.

Ellwood's contribution to the income capitalization approach was monumental because his system allowed for the capitalization of a stream of cash flows and provided a basis for analyzing specific investment assumptions in the valuation process. Ellwood popularized the notion that the total value of a property should reflect both the value of the mortgage and the value of the equity and he included financing in his formula. He recognized that the property appreciation or depreciation reflected in the proceeds of resale or reversion was a potentially important benefit of real property investment. Ellwood's formula explicitly considered reversion and the effects of mortgage amortization. Ellwood also recognized that a finite, relatively short holding period was the proper framework for analysis and valuation. Although the Ellwood formula is essentially a way to solve a discounted cash flow problem, Ellwood simplified the discounting procedure by publishing tables of precalculated rates that could be combined into a representative overall capitalization rate. These tables were particularly useful before electronic calculators and personal computers became available.

In the 1960s many appraisers began to use investment component, or band-of-investment, techniques to synthesize overall capitalization rates. (For further discussion of band-of-investment techniques, see Chapter 20.) Soon many appraisers applied a band-of-investment technique that employed the loan constant and the equity capitalization rate as the appropriate returns to the lender and the equity investor. This technique, which is similar to one introduced by S. Edwin Kazdin in 1944, was especially significant during the 1970s and 1980s.

Ellwood techniques were popular at this time for several reasons. First, stable income streams became less common because inflation and real increases in property values began to overtake the effects of physical depreciation. Thus, capital gains became more significant. Second, investors were becoming increasingly sophisticated. They began to think in terms of leveraging and shorter holding periods rather than the economic lives of properties, recapture rates, and long-term investments. During this period major appraisal organizations first recognized the effect of financing in their definitions of market value.

Mid-1970s to the Present

Since the mid-1970s capitalization theory and practice have been influenced by inflation and recurring national recessions. Recent developments in the real estate market include .

- The marketing of partial interests such as limited partnerships and joint ventures
- Rapid increases in market rent levels until the mid-1980s, followed by declining rent levels in many metropolitan areas
- Use of complex participation mortgages, creative financing, and seller financing
- Fluctuating mortgage interest rates, which resulted in a preponderance of all-cash transactions in periods of high interest rates
- More foreign investment in U.S. real estate
- Numerous changes in tax laws which have drastically changed the treatment of real estate relative to other investments
- Cycles of overbuilding, underbuilding, excess demand, and a lack of sufficient demand

In recent years appraisers have focused on market participants' reactions to the dynamics of the market and relied on capitalization methods, techniques, and procedures to simulate investor decision making.

The methods that are most useful today include direct capitalization based on equity capitalization rates derived from comparable sales and yield capitalization that employs DCF analysis. In many circumstances these methods best reflect the behavior of market participants. The availability of computers has also had a major effect on investment analysis and valuation. Computers process data quickly and can be used for statistical analysis, DCF analysis, and business accounting, as well as the storage of comparable sales data.

Appraisers do not always agree on which income valuation techniques are appropriate. There is ongoing debate on the relevance of traditional capitalization techniques and the validity of DCF analysis. However, market participants use both traditional techniques and DCF analysis, so both are valid and relevant tools for real property appraisers.

SUMMARY

From an investor's perspective, the earning power of a real estate investment is the critical element affecting its value. The fundamental investment premise is the higher the earnings, the higher the value. Investment in an income-producing property represents the exchange of present dollars for the right to receive future dollars.

In the income capitalization approach to value, an appraiser analyzes a property's capacity to generate benefits and converts these benefits into an indication of present value. The income capitalization approach is an integral part of the valuation process. Income capitalization techniques and procedures are employed to analyze and adjust sales data in the sales comparison approach and to measure functional and external obsolescence by capitalizing an estimated income loss in the cost approach.

The three main components of real property rights are ownership entities, financial interests, and legal estates. A market value appraisal of income-

producing property most often involves 100% ownership of equity interests (either free of debt or subject to specified financing) in a leased fee estate.

Appraisers may be called on to value complex property rights such as minority shareholder or partnership interests; equity interests subject to various layers of debt; participation mortgages; and master leasehold, sandwich leasehold, and subleasehold estates. Clients may also ask an appraiser to value property rights subject to anticipated rezoning, rehabilitation, or project completion. When a business enterprise is associated with a property, the value of the property may reflect a premium for the *business value* created by profitable management, operations, or franchises. *Going concern value* refers to the value of the realty plus business value.

The income capitalization approach is typically applied to derive an indication of market value, but it can also be employed to estimate investment value, which is the value of a property to a particular investor. Although the criteria of the investor and the market may coincide and the numerical estimates may be equivalent, market value and investment value are not interchangeable.

In the income capitalization approach, future benefits are commonly measured as *potential gross income (PGI)*, the total potential income attributable to the real property at full occupancy before operating expenses are deducted; *effective gross income (EGI)*, the anticipated income from all real property operations adjusted for vacancy and collection losses; *net operating income (NOI)*, the actual or anticipated net income remaining after all operating expenses are deducted from effective gross income, but before mortgage debt service and book depreciation are deducted; *pre-tax cash flow*, the portion of net operating income that remains after debt service is paid, but before ordinary income tax on operations is deducted; *after-tax cash flow*, the portion of pre-tax cash flow that remains after ordinary income tax on operations is deducted; and *reversion*, the lump-sum benefit that an investor receives at the termination of an investment.

An investor's total expected return includes full recovery of the amount invested, the *return of capital*, and a profit, the *return on capital*. Rates of return can be categorized as either *income rates* or *yield rates*. An income rate is the ratio of one year's income to value; it may be used as a capitalization rate to convert income into value. A yield rate is applied to a series of individual incomes to obtain the present value of each. Both income and yield rates can be used to analyze components of real property rights and the physical real estate by applying residual techniques in the capitalization procedure.

Overall capitalization and equity capitalization rates are income rates. They are not rates of return on capital and do not reflect the eventual equity yield rate. An *overall capitalization rate (R_o)* is an income rate for a total property that reflects the relationship between its annual net income expectancy and total property value; it is used to convert net operating income into an indication of overall property value. An *equity capitalization rate (R_e)* is an income rate that reflects the relationship between the annual pre-tax cash flow expectancy and the equity investment. It is also referred to as a *cash on cash rate*, *cash flow rate*, or *equity dividend rate*.

A *yield rate* is a rate of return on capital. It is usually expressed as a compound annual percentage rate. The yield rate considers all expected benefits, including the proceeds from sale at the termination of the investment. An *interest*

rate is a yield rate for debt capital. A *discount rate* is a yield rate used to convert future payments into present value.

An *internal rate of return (IRR)* refers to the yield rate that is earned or expected for a given capital investment over the period of ownership. The *IRR* equates the present value of the future benefits of the investment to the amount of capital invested. The *overall yield rate* (Y_o) is a rate of return on the total capital. It represents a weighted average of the equity yield rate and the mortgage yield rate. An *equity yield rate* (Y_e) is the rate of return on equity capital, as distinguished from the rate of return on debt capital.

Return of capital refers to the recovery of invested capital; *return on capital* refers to the additional amount received as compensation for use of the investor's capital until it is recaptured. In real estate investments, capital may be recaptured in many ways (e.g., through annual income or resale of the property).

If property value does not change over the period of the investment, the investor can recapture all the capital at the sale of the property and the indicated income rate (R_o) will equal the return on capital. If the investor does not expect to recapture all of the original investment, some of the income must be used to repay the capital, and the return on capital will be less than the income rate (R_o). If the investor expects to receive more than the original investment, the rate of return on capital will exceed the income rate (R_o).

In yield capitalization, the distinction between return on and return of capital is always explicit, and a discount rate is selected to provide a specified return on capital. In direct capitalization the income rates used must allow for both a return on and return of capital. An estimate of value derived by applying an overall capitalization rate to property income reflects both the return on and recapture of the capital invested.

The capitalization rate selected for valuation may be an income rate or a yield rate, but it should represent the annual rate of return necessary to attract investment capital. Because rates of return are prospective, market perceptions of risk and changes in purchasing power due to inflation or deflation are important considerations. The capitalization rates chosen should simulate market expectations.

All investments are predicated on the expectation of receiving a return on capital that represents the time value of money plus an appropriate adjustment for risk. Risk reflects the chance of incurring financial loss and the uncertainty of realizing future benefits. Investors expect a reward for assuming risk. The rate of return on capital thus combines a safe, riskless rate with a premium to compensate the investor for risk, the burden of management, and the illiquidity of invested capital.

Inflation erodes purchasing power and jeopardizes the rate of return that an investor anticipates. Because lease terms often allow for inflationary adjustments, appraisers usually project income and expenses in inflated, unadjusted dollars and express the discount rate as a nominal, apparent rate of return on capital that includes an allowance for inflation. The use of unadjusted discount rates allows for comparison with other rates quoted in the open market (e.g., mortgage interest and bond yield rates).

Appreciation in real value results from an excess of demand over supply and increases property values. Inflation and appreciation have a similar effect on future dollars, but different effects on discount rates. Inflation tends to increase

discount rates because investors require a higher nominal rate of return to offset any loss in value due to inflation. Appreciation does not affect the discount rate unless the risk of the property changes. Inflation tends to lower capitalization rates. Actual inflation may differ from the inflation anticipated at the time the investment was made. *Unexpected inflation* is reflected in the rate of return on capital used to value the property.

Direct capitalization is a method used to convert an estimate of a single year's income expectancy into an indication of value in one direct step—either by dividing the income estimate by an appropriate income rate or by multiplying the income estimate by an appropriate income factor.

Yield capitalization is a method used to convert future benefits into present value by discounting each future benefit at an appropriate yield rate or by developing an overall rate that explicitly reflects the investment's income pattern, value change, and yield rate. Yield capitalization is also called *discounted cash flow analysis* because a discount rate is applied to calculate the present value of anticipated future cash flows.

Appraisers distinguish between contract rent and market rent in analyzing income. Market rent is used to value a fee simple estate. In valuing a leased fee estate, the appraiser considers contract rent for existing leases and market rent for lease renewals.

Direct capitalization does not require explicit estimates of future income because the capitalization rate is extracted from comparable sales that reflect similar expectations as to changes in income and property value.

Yield capitalization is based on assumptions about expected changes in income and property value. The property's projected income stream and reversion are capitalized into present value by applying the investor's anticipated yield rate in the discounting procedure. With adequate data and proper use, direct and yield capitalization should provide similar value indications.

Since the mid-1970s the income capitalization approach has been influenced by macroeconomic conditions and specific developments within the real estate market. Current valuation methods draw on equity capitalization using rates derived from comparable sales and yield capitalization with computer-assisted DCF analysis.

February 20, 1995

Re: Senate Bill No. 275

Senate Taxation Committee
State Capitol, Room 519-S
Topeka, Kansas 66612

This bill will provide important instruction with regard to consideration of appraisal techniques that currently are at risk of being ignored by the Courts. The mass appraisal programs purchased by the State for reappraisal were not designed to accommodate the standard appraisal techniques applied to holdings of multiple lots, nor were all of the County Appraisers skilled in this area of valuation. As a result, many vacant lots were appraised at 5 to 10 times their market value leading directly to the bankruptcy of several developers. It is my hope that this committee recognize the validity of these techniques by including the change in language at issue, and consider further measures to insure that Administrative and Judicial bodies do not have the latitude to misconstrue statutory language in a manner that leads to a precedent for ad valorem valuation on any basis other than "fair market value".

The "fair market value" of individual lots within a larger aggregate are less than the total of the "market prices", because future dollars are worth less than present dollars, and these returns are subject to holding expenses such as taxes, sales commissions or salaries, advertising and infrastructure costs, debt service, etc. This fact has been recognized by the Federal Government and under banking guidelines, appraiser's were required to do discounted cash flow analysis in appraisal of such multiple holdings. This was to protect taxpayers and depositors against defaults that might otherwise arise from inflated opinions of value.

Without familiarity of these techniques, many County Appraisers assigned values to individual lots within larger aggregates, that reflected present "market prices" for individual lots, without deducting expenses, or anticipating the period required to market the whole, or discounting those returns to net present values. This resulted in inflated "fair market values" for the individual lots. The problem was exacerbated in some cases, when the "cost" of infrastructure still outstanding as special assessments was added to the present "market price" of each lot.

As a result, developers who had begun developments based on historic absorption trends and expenses, suddenly found themselves faced with an expense from real estate taxes that rendered many projects uneconomic, or in the best case, economic only if the absorption period could be shortened by factors that the market demand would not sustain. The options available were to appeal the valuations and hope that reason would prevail before bankruptcy was forced, or to default on the loans on the developments.

*Senate Assess + Tax
2-21-95
Attach 2-1*

I was involved as an expert witness before the Kansas State Board of Tax Appeals, on a case where the methodology being used to appraise vacant lots was brought to question. The final order on the case can be found in a Board Order issued June 17, 1992, on Docket No. 89-7592-EQ, et al. On page 12, part 41. reads, "The Board concludes that the developer's discount or subdivision appraisal is an accepted mode of appraisal practice. We also conclude that the information necessary for its calculation was obtainable or was already gathered by the County Appraiser." and part 42. "The most important conclusion is whether to accept or reject the appraisal method requested...The Board concludes that the subdivision appraisal method is reasonable for subdivisions owned in common or so much of them as remains in the developer's hands."

This conclusion does little more than reaffirm the Department of Property Valuation's position that is included in a memorandum to all County Appraisers dated February 16, 1990, that reads in part, "The Vacant Lot Subcommittee of the Property Valuation Advisory Committee has spent the last few months examining the issue of subdivision development valuation. They have reached the consensus that the concept of subdivision analysis is applicable to the mass appraisal of vacant lots found in tract developments."

Though both bodies empowered with the responsibility of establishing the methodology to insure that the mandate established in KSA 79-503a to appraise all property for ad valorem purposes at "fair market value", agree that this methodology is appropriate and applicable, a case resides before the State Supreme Court that has the potential to undermine their conclusions. The seat of authority is not nearly as important in this issue as the doctrine of equalization and the essential role that "fair market value" holds in delivering that just distribution of tax burden. Without a "fair market value" standard, "just" taxation becomes subjective, and subject to arbitrary and capricious application.

In the Court of Appeals of the State of Kansas, No. 70,346, Shawnee County Appraiser, Appellant v. Lario Enterprises, Inc., Appellee, the Court states on page 1, part 3. "The developer's discount method of valuation is based upon ownership and is not based upon the value of each parcel of property as mandated by K.S.A. 1993 Supp. 79-501." The court goes on to conclude that this method leads to something other than equal treatment, and impugns the use of this method of valuation. A critical error is committed by the Court in confusing the terms "parcel" and "lot". Whereas a "lot" is a single unit within a plat, and a "parcel" as defined by the Division of Property Valuation can consist of multiple lots under common ownership, and whereas K.S.A. 79-501 establishes that Appraisers are to consider each parcel, the Court errs in concluding that each "lot" must be appraised separately under the law. They compound their error by substituting "market price" for "market value".

It is not clear whether the Court does not understand real estate appraisal, or whether they disagree that "fair market valuation" yields equal treatment in taxation and this is a studied error. In either case the doctrine of equal treatment under the law is in jeopardy without further statutory clarification.

In practice, an aggregate of lots under common holding, must be appraised using a discounted cash flow analysis. That value can then be apportioned among the lots comprising the aggregate. This practice is generally provided for through the K.S.A. 79-501 requirement that the appraiser consider each "parcel", and the definitions of "parcel" set forth by the State Division of Property Valuation in their bidder instructions to appraisal contractors. However, the DPV's definitions fall short of assuring this application to all aggregates of lots for which the method should be used. "Parcel Identification Numbers" do not cross streets, so although a developer may hold lots in several blocks within a subdivision a County Appraiser might construe that this method of valuation should be applied block by block instead of for the entire holding. In subdivisions where the developer still holds multiple lots and some lots have been isolated by improved lots, the County Appraiser may construe that the isolated lots in the active block should be treated individually instead as a part of the aggregate. In some cases an aggregate of lots are sold to a second party that is not the "developer of record", and the County Appraiser may construe that these lots should be appraised individually because they are not in the "hands of the developer". In this case the second party should be afforded the same principals of appraisal practice that the developer has, although if it is a much smaller aggregate of lots, the discounting period is likely to be shorter yielding a higher "fair market value" per lot. These are circumstances in which the discounted cash flow analysis is appropriate, but may not be understood by the County Appraisers, or specifically stated by DPV or BOTA.

If language were crafted that allowed for the appraisal of vacant lots within a subdivision under common ownership, by a discounted cash flow analysis, many of these potential problem would be eliminated. In the mean time, inclusion of the "or by absorption or sell-out period:" language proposed for K.S.A. 79-503a, would strengthen the case for "fair market value" appraisal and equal treatment in taxation.

A more detailed discussion of the particulars regarding the Appeals Court's decision with regard to "lots" and "parcel" is attached.

Sincerely,

Grant B. Gardner
Kansas State Certified Appraiser, # G-424
2305 North Richmond
Wichita, Kansas 67204

Here are my arguments against the Court of Appeals decision. I believe that the Appeals Court has raised a constitutional mandate and a statutory provision as existing in opposition to each other.

The Appeal Courts decision places the provision that mandates a "uniform and equal basis of valuation" in opposition to the requirement to appraise at "market value," when in fact if all property is appraised at "market value," the "uniform and equal basis of valuation" mandate is satisfied.

In fact the only way to insure that the mandate of a "uniform and equal basis of valuation" is to appraise all property at its "market value," or a derivative thereof, for any other valuation basis would bring in subjective elements that were not demonstrable in the real estate market and would lack a tangible benchmark that would support their uniform application.

The intent of the mandate is the fair distribution of the tax burden, and the statutory requirement to appraise at market value is the seminal genius of legislation to achieve that end.

This requirement forces that "each parcel" be taxed in proportion to a value that would be acceptable to both well informed buyer and seller acting without undue compulsion as of a common date in terms of money; and provides for a host of methods to reach this determination, and the means to test these results against actual market activities.

If this requirement is satisfied, then all have been treated in a "uniform and equal" manner. No where in the Court's decision was the valuation of the subject property found or represented to be anything other than "market value," and in this manner the property has been treated on a "uniform and equal" basis with all other property for which the requirement to appraise at "market value" has been met.

Among the many methods of valuations that have been statutorially required for consideration in deriving "market value" is the income approach. This approach recognizes that the market places a value upon a net income stream and that for certain types of properties, the market net operating income is the principle factor in consideration of its "market value."

Because there are a variety of types of properties for which this approach is the strongest indicator of market value, and because the characteristics of these properties vary widely, the income approach also takes different forms. In all cases this approach yields a value indication that is predicated upon the current value of future net returns.

The most common form of this approach establishes a probable annual market net income, and derives a value as though the property were capable of sustaining this income into perpetuity, through the application of a capitalization rate extracted from the market for similar "investment" type properties. In function, each successive annual net income is discounted at the capitalization rate contributing a smaller percentage to current value, with the cumulative value of all returns representing the total "market value."

In other instances the income is projected for a specified period of time with the sale of the property at the end of the term. In this case the capitalization rate is translated into a "discount rate" that diminishes each year, just like in the previous case. For the final year of the term, the sale price is reduced to a current value based on the appropriate "discount factor" for that year. By example, the future returns in the 20th year using a 12% capitalization rate or "discount rate" would have a current value equal to 10.37% of its actual amount.

The income approach for development parcels, whether they be raw ground, an aggregate of lots in an active subdivision, commercial, or residential, is essentially the same as the previous case, where a capitalization rate has been converted, to discount each annual net return. Though this case involves annual returns that are not necessarily constant, the valuation technique is identical. In appraisal parlance the terms "developer discount method" or "subdivision analysis method" or "discounted cash flow analysis", speak to the application of an income approach to a particular type of property, and the term "discount" is in no way different than the reduction of future returns to current value found in any other form of the income approach.

The Appeals Court error is threefold; first they have confused "each parcel" with "each lot", second they have confused "market price" with "market value", and third they have presumed that different values constitute favoritism and hold this as antithesis to "uniform and equal basis of valuation."

The court argues that each lot should be appraised separately when the requirement is "each parcel". The definition established for "each parcel" under statutory authority of the DPV, in their bidder instructions clearly states that a parcel is a collection of lots within a subdivision held under common ownership.

In the latter case, a market value is derived for the aggregate and then allocated among the individual lots. The court has confused this allocation of the market value of the aggregate to an individual lot with the "market price" of an individual lot. The principle acting upon what the court sees as an apparent "disparity" is the size of the parcel in question and whether the market value will reflect a return over a short or long period of time.

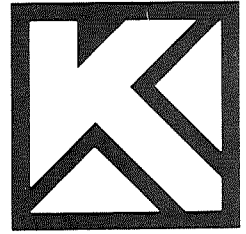
The court has presumed that this "disparity" reflects favoritism in antithesis to "uniform and equal" treatment, when in fact if a single lot were plugged into the same analysis that was used for an aggregate of lots, the result would be a higher "market value" per lot due to fewer expenses and a quicker return, even though all were calculated using a constant market price.

All other things being equal this is "uniform and equal" treatment, with the analysis reflecting that the value per lot of a larger parcel is less than the value per lot of smaller parcel with the same density, due to increased expenses, and smaller current values associated with returns from further in the future.

These elements are reflected in real market activities conducted by informed buyers and sellers, such that two parcels varying in size, all other elements being equal including density, the smaller parcel would yield a higher price per lot sold in aggregate. Finally, there is no evidence that an investor holding multiple lots throughout the taxing district would be subject to any less equal treatment. For each lot, the anticipated marketing time should influence its market value, and if it was not treated fairly in this fashion resulting in something other than "market value" for taxation, the owner would have cause for appeal, just as in the instant case.

LEGISLATIVE TESTIMONY

Kansas Chamber of Commerce and Industry



835 SW Topeka Blvd. Topeka, Kansas 66612-1671 (913) 357-6321 FAX (913) 357-4732

SB 294

February 21, 1995

KANSAS CHAMBER OF COMMERCE AND INDUSTRY

Testimony Before the

Senate Committee on Assessment and Taxation

by

Bob Corkins
Director of Taxation

Madam Chair and members of the Committee:

My name is Bob Corkins, director of taxation for the Kansas Chamber of Commerce and Industry, and I thank you for the opportunity to advance our arguments in support of SB 294. I also speak on behalf of the Kansas Retail council whose members have made this issue a high priority for 1995. Kansas retailers are performing an uncompensated sales tax collection service for state and local governments and this measure would help keep that responsibility from becoming an even more onerous burden.

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

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

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

*Senate Assess + Tax
2-21-95
attach 3-1*

With increasing frequency, the state Department of Revenue is requiring retailers to move beyond their role of mere tax collector and into the role of tax auditor. As other conferees will explain today, retailers are forced to either strictly police the validity of sales tax exemption certificates or bear the cost of the applicable sales tax themselves.

Only a legal fiction authorizes the state to exert this sort of pressure against retail businesses. The relevant section of Kansas' sales tax code specifies that our sales tax is imposed "for the privilege of engaging in the business of selling tangible personal property at retail in this state". (KSA 79-3603) How many people do you know that consider the sales tax to be a privilege tax upon retailers *rather* than a consumption tax upon consumers? For all intents and purposes it is truly a tax upon consumers. In fact, the statutes later specify that the tax "shall be paid by the consumer or user to the retailer" and that it "shall be a debt from the consumer or user to the retailer". (KSA 79-3604)

The Department of Revenue (KDOR) has very deftly manipulated this retailer responsibility into a means of simplifying the agency's own enforcement obligations. Department auditors routinely reject many sales tax exemption certificates which are presented by retailers as evidence that they were not required to collect sales tax on given purchases by given customers. The customers at issue are the parties who provide the applicable certificates to the retailers.

Other conferees on today's bill will also explain the various reasons for which certificates have been rejected. As you hear their comments and judge the reasonableness of state auditors for yourselves, keep in mind that nearly three years ago this legislature acceded to the Department's wishes by enacting stricter paperwork requirements for retailers regarding these certificates. That measure, 1992 SB213, explicitly requires retailers to either produce valid exemption certificates within 60 days from the time requested by the agency, or the retailer is liable for the tax. Consequently, KDOR now has much more paperwork within which to find new technical flaws.

In simplest terms, SB 294 would say that retailers who have documented sales tax exemption certificates are off the hook. If KDOR suspects that a given certificate is invalid, inapplicable, or even fraudulent, the Department is free to pursue the party truly responsible: the buyer.

This bill addresses a separate exemption certificate problem which in which KDOR displays a strained application of the sales tax code. State auditors are acting on a literal interpretation of the sales tax exemption for public works and other construction projects pertaining to educational institutions. KSA 79-3606(d) and (e) exempts sales of materials or labor for such projects. KDOR has assumed that this means any project including both materials and labor is eligible for exemption only after the Department has issued a specific project exemption certificate -- an application process which typically takes two weeks or more. If the project is purely for services or purely for materials, then KDOR has honored the exemption without a formal project certificate.

We believe a faster, more reasonable, and equally reliable way of handling this matter is proposed in SB 294. Many schools, for example, could find themselves in immediate need for new roofing following a severe storm. If the project cost is below the \$10,000 threshold, there would be no cause to delay the project while waiting for KDOR approval. Again, the bill would inject a dose of common sense into the enforcement of sales taxes.

Finally, I have a couple of balloon amendments to suggest for this bill. One is an element of a similar proposal -- HB 2500 -- which was introduced this session through the House Committee on Local Government. The other would clarify the intent of SB 294 in order to help avoid future misapplication by KDOR.

Again, thank you for your time and consideration. We urge you to recommend the bill favorably for passage together with the improvements indicated in this testimony.

1 unless the director in writing previously authorizes their disposal. Any
 2 person selling tangible personal property or furnishing taxable services
 3 shall be prohibited from asserting that any sales are exempt from taxation
 4 unless the retailer has in the retailer's possession a properly executed
 5 exemption certificate provided by the consumer claiming the exemption.
 6 Any retailer asserting a claim that certain sales are exempt who does not
 7 have the required exemption certificates in possession shall acquire such
 8 certificates within 60 days after receiving notice from the director that
 9 such certificates are required. If such certificates are not obtained within
 10 the period set forth herein, the sales shall be deemed to be taxable sales
 11 under this act.

12 *A retailer shall be presumed to have taken an exemption certificate in*
 13 *good faith in the absence of evidence to the contrary. The only evidence*
 14 *that would overcome the presumption would be the repeated failure of*
 15 *the retailer to obtain exemption certificates when warranted, an active*
 16 *solicitation of exemption certificates which are improper, and the hon-*
 17 *oring of exemption certificates that do not contain a Kansas sales or com-*
 18 *pensating retail registration number. A retailer is entitled to rely on the*
 19 *validity of a presented exemption certificate claiming the applicability of*
 20 *any provision of K.S.A. 79-3606, and amendments thereto, to the trans-*
 21 *action in question and no retailer shall be responsible for ascertaining the*
 22 *validity of the contents of an exemption certificate other than the identity*
 23 *of the person or entity who presents it.*

sales tax exemption pursuant any provision of K.S.A. 79-3601 et seq

24 The amount of tax imposed by this act is to be assessed within three
 25 years after the return is filed, and no proceedings in court for the collec-
 26 tion of such taxes shall be begun after the expiration of such period. In
 27 the case of a false or fraudulent return with intent to evade tax, the tax
 28 may be assessed or a proceeding in court for collection of such tax may
 29 be begun at any time, within two years from the discovery of such fraud.
 30 No assessment shall be made for any period preceding the date of reg-
 31 istration of the retailer by more than three years except in cases of fraud.
 32 No refund or credit shall be allowed by the director after three years from
 33 the date of payment of the tax as provided in this act unless before the
 34 expiration of such period a claim therefor is filed by the taxpayer, and no
 35 suit or action to recover on any claim for refund shall be commenced
 36 until after the expiration of six months from the date of filing a claim
 37 therefor with the director.

38 Before the expiration of time prescribed in this section for the assess-
 39 ment of additional tax or the filing of a claim for refund, the director is
 40 hereby authorized to enter into an agreement in writing with the taxpayer
 41 consenting to the extension of the periods of limitations for the assess-
 42 ment of tax or for the filing of a claim for refund, at any time prior to the
 43 expiration of the period of limitations. The period so agreed upon may

3-4

1 be extended by subsequent agreements in writing made before the ex-
2 piration of the period previously agreed upon. In consideration of such
3 agreement or agreements, interest due in excess of 48 months on any
4 additional tax shall be waived.

5 Sec. ~~4~~ K.S.A. 1994 Supp. 79-3606 and 79-3609 are hereby repealed.

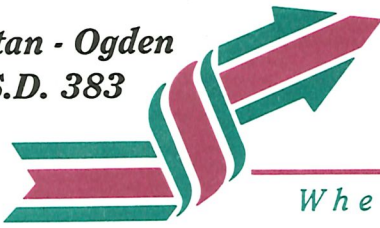
6 Sec. ~~5~~ This act shall take effect and be in force from and after its
7 publication in the statute book.

New Sec. 3. (a) Upon application therefor, the director of taxation shall issue a blanket sales tax exemption certificate to a political subdivision of the state. Any contractor, subcontractor or repair person may purchase material or service, or any combination thereof, for use in a qualifying contract the total cost of which is \$10,000 or less and may use such blanket certificate number when making purchases from suppliers under such contract.

(b) The political subdivision shall attach a suffix number to the blanket certificate number for each project of \$10,000 or less as such projects are authorized. Such suffix number shall be reported to the director of taxation by the political subdivision.

3-5

Manhattan - Ogden
U.S.D. 383



Where all can learn

February 20, 1995

Senate Assessment and Taxation Committee:

Manhattan Unified School District #383 supports the passage of Senate Bill No. 294. Under the current provisions of the law the district must obtain a tax exemption certificate for all projects requiring vendors to provide both materials and labor regardless of the nature and magnitude of the project. In one year, U.S.D. #383 has requested 93 tax exemption certificates with only 19 of those projects having contracts in excess of \$10,000.

The majority of the tax exemption certificates are requested for small individual site repairs such as glass replacement, roof and plumbing leaks, and HVAC work. The nature of the circumstances surrounding these small emergency projects does cause the district some hardship because of a backlog at the Kansas Department of Revenue- Division of Taxation in actually assigning the certificate numbers before work can begin.

We make a concerted effort to comply and have assumed the burden of paperwork required to manage the unlimited scope of the current law. However, we have experienced a marked increase in the response time at the state level. Initially, we were able to call and immediately obtain a verbal assignment of the number. Now, we fax in the request and wait for up to one (1) day for the number assignment. Normal planned projects processed through the mail now take up to one (1) week. This delay plus the paperwork seems a undue burden for public school entities and will only continue to increase in volume as our physical plants age.

We support the proposed provision in Senate Bill No. 294 requiring a project tax exemption certificate for those contracts issued in excess of \$10,000. This change to the law will allow us to take care of our weekly repair needs, maintain our buildings and protect the quality of our educational environment for our students.

Sincerely,

Jackie L. Walter
Director of Business Services

Senate Assess + Tax
2-21-95
attach 4-1

Blanket
Certificate

KANSAS DEPARTMENT OF REVENUE
EXEMPTION CERTIFICATE
FOR
SCHOOLS OR EDUCATIONAL INSTITUTIONS

The undersigned purchaser certifies that the purchase of tangible personal property or service from _____ of _____, Kansas, is exempt from the tax levied by the Kansas retailers' sales and compensating tax act for the following reason:

Per K.S.A. 79-3606(c) all sales of tangible personal property or services, including the renting and leasing of tangible personal property, purchased directly by a public or private elementary or secondary school or public or private nonprofit educational institution and used primarily by such school or institution for nonsectarian programs and activities provided or sponsored by such school or institution or in the erection, repair or enlargement of buildings to be used for such purposes. The exemption herein provided shall not apply to erection, construction, repair, enlargement or equipment of buildings used primarily for human habitation.

THIS CERTIFICATE IS NOT VALID UNLESS COMPLETED IN ENTIRETY.

The undersigned understands and agrees that if the property or service is used other than as stated above or for any purpose which would not exempt the sale under the act, the undersigned becomes liable for the tax.

Purchaser (School name)

Street Address

City, State, Zip

Authorized Signature

Date

REQUEST FOR PROJECT EXEMPTION CERTIFICATE

Kansas Department of Revenue
Division of Taxation
Business Tax Bureau
Robert B. Docking State Office Building
Topeka, Kansas 66625-0001
(913) 296-2461

Date _____

Tax exempt # _____

It is requested that a Certificate of Exemption be issued to the Petitioning Authority for the following described project if it is determined by the Department of Revenue that the proposed project qualifies for exemption from sales tax under the provisions of K.S.A. 79-3606(d) or (e).

(A) Type of Project: _____
Describe Work to be Done

A. Present Use of Facility: _____

B. Proposed Use of Facility After Project: _____

(B) Project Location: _____
Building Number, Street Address, City, State

(C) Is this project being constructed as part of a business enterprise whose sales are subject to sales tax (e.g., municipal water, electric or gas companies)? Yes No

(D) Is the Petitioning Authority authorized to levy ad valorem taxes on tangible property? Yes No
If so, under what statute? _____

(E) A. Is this project being totally financed by industrial revenue bonds? Yes No

B. Is this project being partially financed by industrial revenue bonds? Yes No

Amount of bonds being issued for project: _____

If yes, A or B above, you must have the agreement on the back of this form completed and attach a copy of the letter of intent or resolution of intent to issue bonds.

If no, how is project being financed (show type of tax, bonds, etc.)? _____

(F) Name of Claimant Owner of Project: _____

(G) Estimated Project Cost: _____ (H) Contract Date: _____

(I) Contract No. _____ (J) Project No. _____

(K) Starting Date: _____ (L) List Names and Addresses of Prime Contractors Below:

Petitioning Authority

Mailing Address

Signature of Authorized Representative

City, State & Zip Code

Type or Print Name

Title

Phone Number

Project Exemption Certificate

KANSAS DEPARTMENT OF REVENUE
DIVISION OF TAXATION

EXEMPTION CERTIFICATE

PERMIT TO PURCHASE TANGIBLE PERSONAL PROPERTY OR SERVICES WITHOUT
PAYMENT OF SALES TAX, LOCAL SALES TAX, OR COMPENSATING TAX

The undersigned purchaser certifies that the sale of tangible personal property by

_____ of _____
(name of vendor) (City, State)

is exempt from the Kansas Sales and Compensating (Use) Tax pursuant to K.S.A. 79-3606(d) or (e) of the Retailers' Sales Tax Act.

Pursuant to the above section, the exemption certificate number below must appear on the invoice covering such sale.

Date _____ Purchaser _____
(Contractor/Subcontractor)

Address _____

City, State _____

Authorized Signature

NOT VALID ON PURCHASES MADE PRIOR TO: _____

Exemption Certificate No. _____

Name of political subdivision of the state, instrumentality or agency of the United States government or nonprofit hospital or educational institution with whom contract has been signed:

Project number (if used) _____

Location of project (city or coun., _____

Description of project _____

INSTRUCTIONS

EXEMPT ORGANIZATION-A copy of this certificate (as completed by the Department of Revenue) should be furnished to each contractor or subcontractor who will be purchasing tangible personal property for use on the project.

CONTRACTOR/SUBCONTRACTOR-A completed copy of this exemption certificate must be furnished to each retailer from which the contractor/subcontractor is making purchases of tangible personal property for use on the project.

RETAILER-A completed copy of this exemption certificate must be retained by the retailer from each contractor/subcontractor making purchases of tangible personal property for use on the project.



STAR LUMBER & SUPPLY CO., INC.

325 SOUTH WEST STREET

P.O. BOX 7712

PHONE: (316) 942-2221

WICHITA, KANSAS 67277

Kansas Senate Committee On Assessment And Taxation
Senate Bill #294
February 21, 1995

I appreciate the opportunity to come before you. My name is Dave Gregory. I am the Vice President of Merchandising at STAR LUMBER & SUPPLY of Wichita. Last year, my position was Director of Information Systems where I worked very closely with sales tax collection.

In June of last year, the Department of Revenue initiated a sales tax audit of STAR. In the audit sampling the Division of Revenue found examples where they believe we should have collected sales tax on customers who had provided us with sales tax exemption certificates.

We were shocked! So will every retailer when they go through the experience we went through. It is our position that retailers do not have a remote chance to comply with the law. Not any possibility whatsoever. The law is so sophisticated... nobody can comply. The law is too hard to understand, extremely complex, and based upon the Department of Revenue's interpretation does not allow for common sense.

I have five points which I would like to relate today:

1. The people who are at the other end of this law are not accountants or tax experts, they are cashiers and sales people. The people you meet everyday while shopping and paying for your goods.
2. If any contractor, remodeler, manufacturer, or retailer submits to us an exemption certificate, we should in good faith honor their request to be exempt from paying sales tax.
3. In addition if any of these customers purchase tools or supplies the retailer should not be responsible for interpreting their intentions, for the use of such items.
4. We cannot be expected to know all of the business our customers are involved in as well as the tax auditors, but we are.
5. If our customer provides us with a Sales Tax Certificate, we should honor it in good faith. We feel the

burden to question the ethics of our customers should be placed upon the state, not on the retailers of Kansas.

At STAR, like many of our retail counterparts, we are utilizing the information highway to electronically build tickets for customers. Gone is the back room where a handful of data entry clerks keyed in tickets and invoiced orders. 450 of our 600 employees are authorized to invoice customers instantly, as the customer leaves the store. Many of our cashiers and sales clerks are young people still in their teens. They are today's back room.

Existing law places an enormous burden on our sales and cashier staffs to know and correctly execute the state's complex sales tax exemptions:

1. Cashiers and sales clerks are expected to know when a customer is a contractor or remodeler as opposed to a retailer. In reality this is impossible or very difficult at best.
2. Cashiers and sales clerks are expected to distinguish when a customer is purchasing a tool or supplies in violation of their particular exemption certificate. We believe that all of our products could easily be tax exempt under one end use and may not under another. How are we responsible for each end use.
3. They are expected to be able to change the taxable or non taxable lines within one order. This is an accountant's nightmare for retailers.
4. Most importantly, from our perspective the cashier or sales clerk is expected to question the ethics of every customer who has a exemption certificate and tell them they are not entitled to a sales tax exemption.

This policy places the burden of proof on the retailer in an undue fashion. This law pits the customer against the store. It is our core belief that all retail tax collection systems should be fair and easy to administer and not put the retailer in an adversarial relationship with their customers. If our customer provides us with a Sales Tax Certificate, we should honor it in good faith. We feel the burden to question the ethics of our customers should be placed upon the state, not on the retailers of Kansas.

It is our position that if we have a copy of a tax exemption certificate, a sales tax registration certificate, or even a signed document from our customer providing us with his retail sales tax I.D. number and a request to be exempt, we should be free from any tax liability.

Our cashiers and sales clerks could literally see thirteen types of Kansas exemption certificates. On top of that some customers provide us with Kansas Sales Tax Registration Certificates which the state does not recognize.

In addition, the state asks customers to write a "General description of products to be purchased from the seller:". In a memo from the State's tax auditor to one of our employees the auditor wrote: "For example, if Payless Cashways gives you an exemption certificate listing lumber and lumber products and purchases a pair of gloves, the gloves will be held taxable." We, like most companies charge our employees for extra gloves, tape measures, and personal tools. Some cashiers would have assumed that they were going to retail the gloves. Some of them would have agreed with the auditor. Most of them wouldn't have distinguished the difference between the gloves and the lumber.

In one particular case, one of our customers has been issued a sales tax certificate by the state, however we did not have the certificate on file. The customer had sent us a signed letter explaining they had changed their sales tax number. The auditor noted that she personally knew they had a valid certificate, but disallowed their exemption because we did not have the exemption certificate on file. In another case they disallowed a exemption because the customer had provided us a certificate after we had invoiced the order. In these two cases, as in many more, the Department of Revenue is double dipping. The Department of Revenue is fully aware that they are:

1. Collecting sales tax from our customers
2. Attempting to collect the sales tax, interest, and penalties from us.

In a memo to us, the auditor wrote to us, and I quote, "Now to muddy things up more regarding contractors, there is a classification of contractors called 'Contractors/Retailers'. They are contractors who have a store front retail side as well... Be careful not to accept a contractor/retailer exemption from a contractor who does not have a store front."

I ask you, how does that cashier or even a backroom office clerk know if our customer has a store front. Most of them have never seen the customer's building. To be honest, most of our employees haven't seen all of our stores in Wichita and we are one of the largest retailers in the city.

I ask you to remember these five things:

1. The people who are at the other end of this law are not accountants or tax experts, they are cashiers and sales people.
2. If any contractor, remodeler, business, manufacturer, or retailer submits to us an exemption certificate we should

in good faith honor their request to be exempt from sales tax.

3. In addition if any of these customers purchase tools or supplies we should not have to judge their intentions for the use of such items.

4. We should not be expected to know all of the businesses our customers are involved with.

5. If our customer provides us with a Sales Tax Certificate, we should honor it in good faith. Cashiers and sales clerks should not act as the tax police - the state should act in that role. The burden to question the ethics of our customers should be placed upon the state, not on the retailers of Kansas.

The bill before you today will answer many of the inequities and go a long way towards placing the burden of ethics investigations on the state rather than a cashier or sales clerk. I urge you to pass this bill.

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Newton, Kansas 67114-0425
316 283-5366 • FAX 316 283-8379

Knudsen Monroe & Company LLC

Certified Public Accountants
Ivan D. Knudsen, CPA • Leslie R. Monroe, CPA
Everett J. Moeder, CPA Cht'd • Robert D. Sjogren, CPA
Jack R. Blazer, CPA • Dale L. Clark, CPA

February 21, 1995

Senate Assessment and Taxation Committee
State Capitol Building
Topeka, Kansas 66612

RE: Senate Bill No. 294

Dear Committee Members:

I am present here today to concur with what Jon Hefley has already explained to you about the dire consequences that can result from a current audit being conducted by the Kansas Department of Revenue.

In this case, Mr. Hefley and his company thought they were complying with the law. They accepted exemption certificates from customers in good faith. Now they are told that they must provide verification that their customers did in fact pay sales tax on the purchases - or Mr. Hefley's company must pay the tax.

Mr. Hefley and his company have been clients of mine for the past ten years, so I have access to the financial condition of this business. If this company has to make payment of approximately 6 per cent of "exemption certificate" sales for the last three years, the company will probably not be put out of business. However, it would have a significant adverse effect on its financial position, and with current low margins and tough competition, it would take a long time to recover.


I realize the Department of Revenue is performing its duties as required. I just do not believe the intent of the law was to create a financial hardship on individuals and businesses who in good faith thought they were complying with the law. I do not understand why the retailer was ever designated as the responsible party to determine tax usage by the customer.

In what I see here and what I believe to be good policy, I support Senate Bill No. 294 so that situations like you have heard about with Jon Hefley will not occur in the future.

I thank you for your time.

Yours truly,

KNUDSEN, MONROE & COMPANY, L.L.C.


Robert D. Sjogren

Senate Assess + Tax
2-21-95
attach 6



800 WESTPORT ROAD • KANSAS CITY, MISSOURI 64111-3198
816/931-2102 FAX 816/931-4617

MID-AMERICA LUMBERMENS ASSOCIATION

**TESTIMONY FOR THE SENATE TAXATION COMMITTEE
SENATE BILL NO. 294 February 21, 1994**

Madame chair, members of the Senate Taxation committee, my name is Art Brown, and I appear before you today representing the retail lumber dealers as a proponent of Senate Bill No. 294. I know the scheduled time for this bill is very short, so my comments will be very brief.

These other business folks have taken time out of their day to lend support to this bill. That speaks better than anything I could say.

Obviously with the lumber dealers here, this is a big issue for us for the reasons they have stated. Speaking for the dealers who are not here, we echo the sentiments these conferees have presented to you today.

I have attached the K.A.R. regulations that deal with the subject matter in this bill. Because of the current law in this regulation and as you have heard, Mr. Hefley is going through a great deal of effort to substantiate tax validity for his customers, which enactment of this bill would alleviate him from. Statements such as the outlined statement on the front page of this K.A.R. which states :



*Senate Assess + Tax
2-21-95
attach 7-1*

that if a retailer honors a blanket exemption certificate, the retailer can be held responsible for the tax if the director determines the retailer knew OR SHOULD HAVE KNOWN the sale was tax exempt; in our opinion put a great deal of pressure on a business person who has no real idea what the end use of an item he sells to a customer is going to be.

We are also very supportive of the language which allows a project exemption for materials and services over \$10,000.00 in costs. This is a great asset to us and we heartily encourage the incorporation of this language into this bill. It will certainly cut down in administrative duties on projects of this nature.

I would close by stating that if this is a big issue to us, it is also a big issue to many other businesses who could not appear before you today. Speaking for them, as well as ourselves, you would be doing all of us a great and beneficial service, by passage of Senate Bill No. 294. It may be too late to help Mr. Hefley in his situation, but it certainly will help dealers like him in the future from having to endure what he is having to go through.

I can answer any questions or address any comments at this time, or I can be available to the committee at a convenient time in the future. Thank You.

108; K.S.A. 1986 Supp. 79-3606 as amended by L. 1987, Ch. 64, Sec. 1 as further amended by Ch. 292, Sec. 32; effective, E-70-33, July 1, 1970; effective, E-71-8, Jan. 1, 1971; effective Jan. 1, 1972; amended May 1, 1987; amended May 1, 1988.)

92-19-25. (Authorized by K.S.A. 79-3609, 79-3610, 79-3611, 79-3618, K.S.A. 1971 Supp. 79-3602, 79-3603; effective, E-70-33, July 1, 1970; effective, E-71-8, Jan. 1, 1971; effective Jan. 1, 1972; revoked May 1, 1987.)

92-19-25a. Exemption certificates. (a) All retail sales are presumed taxable unless specifically exempt. Each retailer shall be responsible for determining the validity of a purchaser's claim for exemption. In determining the validity of any claim for exemption, the retailer shall have a duty to make a reasonable and prudent inquiry of the purchaser regarding the item purchased and the basis for the exemption claimed. If the retailer determines the sale is not subject to tax, the retailer shall secure a completed exemption certificate from the purchaser. The certificate shall set out in detail the reason for the claim to exemption. Each retailer shall attempt to secure the exemption certificate either prior to billing the purchaser or prior to delivering the property. However, the retailer's responsibility for securing a certificate continues even though the purchaser may strike the tax from the billing or otherwise raises an exemption claim for the first time after receiving delivery or billing for the property. If the retailer does not obtain a proper exemption certification, the retailer shall have the burden of proving the sale was exempt.

(b) The sale of services enumerated within the sales tax act are presumed to be taxable unless specifically exempt. When an enumerated service is claimed to be exempt, the person furnishing the service is required to obtain and maintain an exemption certificate in the same manner as a retailer of tangible personal property. If the retailer does not obtain a proper exemption certificate, the retailer shall have the burden of proving the sale was exempt.

(c) Each retailer shall keep a record of each exempt sale of property and services made during each calendar month, showing the date, amount, customer's name and address, item or service sold, and other pertinent information to support a claim for deduction taken on the monthly return. Each retailer shall make all

exemption certificates available to the director of taxation for inspection. An exemption certificate shall be retained by the retailer for a period of not less than three years.

The director of taxation shall recognize an exemption certificate when in substantially the following form:

EXEMPTION CERTIFICATE

The undersigned purchaser certifies that the sale to him of tangible personal property or service by _____

_____ of _____, Kansas, is exempt from the tax levied by the Kansas retailers' sales and compensating tax act for the following reasons: _____

The undersigned understands and agrees that if he uses the property or service other than as stated above or for any purpose which would not exempt the sale under the act, he becomes liable for the tax.

Date: _____ Purchaser _____ (Signature)
Address _____

A retailer making recurring exempt sales of the same type to the same purchaser need not secure a separate exemption certificate for each transaction but may accept, at the retailer's own risk, a blanket exemption certificate covering future sales. If the retailer honors a blanket exemption certificate on a taxable sale, the retailer may be held responsible for the tax if the director determines the retailer knew or should have known the sale was not exempt. (Authorized by K.S.A. 79-3618; implementing K.S.A. 79-3609, 79-3610, 79-3611, K.S.A. 1985 Supp. 79-3602, 79-3603 as amended by L. 1986, Ch. 386, Sec. 1; effective May 1, 1987.)

92-19-26. (Authorized by K.S.A. 79-3618, K.S.A. 1971 Supp. 79-3606; effective, E-70-33, July 1, 1970; effective, E-71-8, Jan. 1, 1971; effective Jan. 1, 1972; revoked May 1, 1987.)

92-19-27. (Authorized by K.S.A. 79-3608, K.S.A. 1973 Supp. 79-3602, 79-3618; effective, E-70-33, July 1, 1970; effective, E-71-8, Jan. 1, 1971; effective Jan. 1, 1972; amended Jan. 1, 1974; revoked May 1, 1987.)

92-19-27a. Sales for resale; Kansas resale exemption certificates. (a) Kansas sales tax is imposed upon retail sales only. Retail sales are sales to final users or consumers. If the retailer timely accepts a properly completed Kansas resale exemption certificate in good faith, the retailer shall be relieved of liability for sales tax or the duty to collect use tax. The

retailer may accept a resale exemption certificate only from another retailer or a person who holds a valid personal property who holds a valid sales or compensating (use) tax number.

(b) The director of taxation shall recognize a Kansas resale exemption certificate when in substantially the following form:

KANSAS RESELLER EXEMPTION CERTIFICATE

_____ (Name of purchaser)

_____ (Address of purchaser)

Hereby Certify: That I hold valid resale exemption certificate issued pursuant to the Kansas sales and compensating tax law; that I am engaged in the business of _____

The tangible personal property to be resold by me is _____ and I shall purchase from: _____

_____ (Signature) or auth

resold by me in the form of tax-exempt property. Provided, however, That in the event the property is used for any purpose other than the resale, or display while holding it in the course of business, it is understood that the purchaser shall be liable for the Kansas sales and compensating tax, measured by the purchase price of the property. Description of property to be resold: _____

_____ 19 _____ (Signature) or auth

_____ (Signature) or auth

description of property to be resold: _____

there may appear an item of particular property to be purchased for resale. Each purchaser shall be required to obtain a resale exemption certificate from the retailer at the retailer's own risk and shall be liable for tax on sales when a sale is not of the type normally made in the purchaser's business. If a purchaser purchases property for resale which is not of the type normally made in the purchaser's business, the purchaser shall require the purchaser to obtain a resale exemption certificate from the retailer at the time of purchase and to make a statement that the particular property is for resale in the normal course of the purchaser's business.

The retailer shall be presumed to have a resale exemption certificate in good faith unless the retailer can overcome the presumption by evidence to the contrary.

The retailer's ongoing exemption certificate shall not be of the type normally made in the purchaser's business;

_____ (Signature) or auth

_____ (Signature) or auth

_____ (Signature) or auth

_____ (Signature) or auth

_____ (Signature) or auth

_____ (Signature) or auth

_____ (Signature) or auth

icates available to the inspection. An exemption retained by the retailer less than three years of taxation shall require a certificate when in substantial...

EXEMPTION CERTIFICATE

The purchaser certifies that the property or service by...

Tax levied by the Kansas retailer act for the following reasons...

The purchaser understands and agrees that the certificate is not valid unless the retailer would not exempt the sale...

Purchaser

When the same purchaser receives the same exemption certificate, the retailer may accept, at the retailer's option, a resale exemption certificate...

If the retailer honors the certificate on a taxable sale, the retailer is held responsible for the tax. The retailer determines the retailer's liability. If the retailer determines the sale was not exempt, K.S.A. 79-3618; implementing rules 79-3610, 79-3611, K.S.A. 79-3603 as amended by E-71-8, Sec. 1; effective May 1, 1987.

(Authorized by K.S.A. 79-3606; effective E-71-8, Jan. 1, 1972; revoked May 1, 1987.)

(Authorized by K.S.A. 79-3602, 79-3618; effective July 1, 1970; effective, E-71-8, Jan. 1, 1972; amended and revoked May 1, 1987.)

Sales for resale; Kansas resale exemption certificates. (a) Kansas sales tax applies to retail sales only. Retail sales to users or consumers. If the retailer accepts a properly completed exemption certificate in good faith, the retailer shall be relieved of liability for the duty to collect use tax. The...

The retailer may accept a resale exemption certificate only from another retailer of tangible personal property who holds a valid Kansas retail sales or compensating (use) tax registration number.

(b) The director of taxation shall recognize a Kansas resale exemption certificate when in substantial compliance with the following form:

KANSAS RESELLER EXEMPTION CERTIFICATE

(Name of purchaser)

(Address of purchaser)

I hereby certify: That I hold valid retailer registration number _____ issued pursuant to the Kansas sales and compensating tax law; that I am engaged in the business of selling _____

That the tangible personal property described herein which I shall purchase from: _____

will be resold by me in the form of tangible personal property: Provided, however, That in the event any of such property is used for any purpose other than retention, demonstration, or display while holding it for sale in the regular course of business, it is understood that I am required by the Kansas sales and compensating tax law to report and pay tax, measured by the purchase price of such property. Description of property to be purchased: _____

Date: _____ 19 _____

(Signature of purchaser or authorized agent)

Under "description of property to be purchased" there may appear an itemized list of the particular property to be purchased for resale, or a general description of the property to be purchased for resale. Each retailer accepting a resale exemption certificate containing a general description of resale property does so at the retailer's own risk and may be held liable for tax on sales when a particular item sold is not of the type normally resold in the purchaser's business. If a purchaser buys property for resale which is not of the type normally resold in the purchaser's business, the retailer shall require the purchaser to issue a specific resale exemption certificate containing a statement that the particular property is being purchased for resale in the normal course of the purchaser's business.

(c) A retailer shall be presumed to have taken a resale certificate in good faith in the absence of evidence to the contrary. Evidence that would overcome the presumption include:

(1) A retailer's ongoing exemption of items that are not of the type normally resold in the course of the purchaser's business;

(2) repeated failure of the retailer to obtain specific exemption certificates when warranted;

(3) an active solicitation of resale exemption certificates which are improper; and

(4) the honoring of certificates that do not contain a Kansas sales or compensating (use) retail registration number.

(d) Rules and regulations governing exemption certificates concerning bookkeeping duties, the timeliness of the retailer's request for a certificate, and the risks to the retailer in honoring a blanket exemption certificate for non-exempt taxable sales, shall also apply to Kansas resale exemption certificates. (Authorized by K.S.A. 79-3618; implementing K.S.A. 79-3608, K.S.A. 1985 Supp. 79-3602; effective May 1, 1987.)

92-19-28. Motor carriers. Sales of tangible personal property or services to any motor carrier engaged in the transportation of persons or property in interstate common-carrier transportation are subject to the Kansas retailers' sales tax in the same manner as are sales to other firms, persons or corporations except as follows:

a) Sales of rolling stock, including busses and trailers to each motor carrier qualifying as a public utility and engaged in either interstate commerce exclusively or interstate commerce and intrastate commerce, and the rolling stock are immediately and directly used in interstate commerce are exempt. The rolling stock may be temporarily stored within the state until it is directly and immediately consumed in interstate commerce. However, charges for labor services rendered to common carriers authorized to engage in interstate commerce by the interstate commerce commission for the servicing, maintenance, or repair of rolling stock including busses and trailers are taxable.

b) Sales of all repair parts and replacement materials or parts to each motor carrier qualifying as a public utility, engaged in either interstate commerce exclusively or interstate commerce and intrastate commerce, when the repair parts and replacement material or parts are immediately and directly used in interstate commerce are exempt. The repair parts and replacement materials or parts may be temporarily stored within the state until they are directly or immediately consumed exclusively in interstate commerce.

c) Sales of gasoline, distillate and other motor fuels to each motor carrier qualifying as a public utility, engaged in either interstate com-

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