

Approved: 3-26-96  
Date

MINUTES OF THE HOUSE COMMITTEE ON TAXATION..

The meeting was called to order by Chairperson Phill Kline at 9:00 a.m. on March 11, 1996 in Room 519-S of the Capitol.

All members were present except: Rep. Graeber  
Rep. Ott  
Rep. Lawrence

Committee staff present: Chris Courtwright, Legislative Research Department  
Tom Severn, Legislative Research Department  
Don Hayward, Revisor of Statutes  
Shirley Sicilian, Dept. of Revenue  
Ann McMorris, Committee Secretary

Conferees appearing before the committee:  
John Federico, Pete McGill & Associates  
Sr. Elizabeth Ney, Villa St. Joseph, Overland Park  
John Grace, Kansas Assn. of Homes for the Aging  
Secretary John LaFaver, Dept. of Revenue  
James A. Maag, Kansas Bankers Association

Others attending: See attached list

Chair opened hearing on:

**SB 447 - Adult care home property tax exemption**

Proponents:  
John Federico, Pete McGill & Associates  
St. Elizabeth Ney, Villa St. Joseph, Overland Park (Attachment 1)  
John Grace, Kansas Assn. of Homes for the Aging (Attachment 2)

Don Hayward indicated this bill needs amending - on page 2, line 11 after the word 'actual' add "cost of". and also recommended this bill be made prospective rather than retroactive.

Chair closed hearing on **SB 447**.

Chair opened hearing on:

**SB 448 - Taxation of financial institutions.**

Proponent:  
Secretary John LaFaver, Department of Revenue (Attachment 3)

Opponent  
James Maag, Kansas Bankers Association (Attachment 4)

Chair closed hearing on **SB 448**.

Moved by Rep. Hayzlett, seconded by Aurand, committee introduce a bill concerning collection of delinquent oil and gas property taxes. Motion carried.

The next meeting is scheduled for March 12, 1996.

Adjournment at 10:28 a.m.

Attachments - 4



**TESTIMONY PRESENTED**

**TO THE**

**HOUSE TAXATION  
COMMITTEE**

**BY**

**SISTER ELIZABETH NEY**

**ON BEHALF OF**

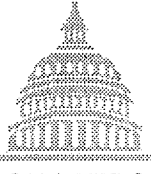
**VILLA SAINT JOSEPH**

**IN SUPPORT OF**

**SB 447**

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**MARCH 11, 1996**



Testimony In Support of SB 447

Sister Elizabeth Ney - The Sisters of Saint Joseph

House Committee on Taxation

March 11, 1996

My name is Sister Elizabeth Ney and I appear here today on behalf of Villa Saint Joseph.

Villa Saint Joseph is a 120-bed skilled nursing facility located at 11901 Rosewood, in Overland Park, Kansas, founded in 1988. Villa Saint Joseph is owned by the Carondelet Health Corporation and is operated by Carondelet Long Term Care Facilities, Inc. Both are sponsored institutions of the Sisters of St. Joseph of Carondelet. The Sisters of Saint Joseph of Carondelet is a Catholic charity that has sponsored health care institutions in the greater-Kansas City area since 1877 and continue to provide high quality care to the residents they serve.

Please make note of the fact that both the owner of Villa Saint Joseph, the Carondelet Health Corporation, and the operator, Carondelet Long Term Care Facilities, Inc, are not-for-profit corporations and meet all requirements as a corporate designate 501(c)-3. Nonetheless, because of a quirk in Kansas law which forced an unfavorable ruling from the Kansas Board of Tax Appeals, Villa Saint Joseph does not enjoy tax-exempt status as do essentially all other not-for-profit adult care homes in Kansas.

It is for that very reason that we stand before you today. It is our hope that the passage of SB 447 would clarify the original intent of K.S.A. 79-201b and allow tax exempt status in situations where one charity assists in funding another for the purposes of operating a not-for-profit nursing home that is otherwise operated so as to meet all the guidelines for full tax exemption.

The particulars are these;

1. Because of a serious shortage of skilled nursing home beds in the Overland Park area, the Sisters of Saint Joseph in 1988, decided to open a skilled nursing facility to care for the aged population.
2. Conventional financing was not possible so Carondelet Health Corporation, a 501(c)-3 corporation, paid for the land, construction and the contents, and leased it back to Carondelet Long Term Care Facilities, Inc., another 501(c)-3 corporation.
3. In 1992, the Kansas Board of Tax Appeals denied Villa Saint Joseph's application for ad valorem tax exemption. BOTA denied the application in part because of the structure of the loan between one charity and another.
4. It is our opinion that it is common financial practice in religiously-sponsored health care systems, that one not-for-profit would lend to another not-for-profit at the market rate or lower, as is the case of the Carondelet Health Corporation and Carondelet Long Term Care Facilities, Inc.
5. We suggest that it was not the intention of the Kansas legislature to deny tax exempt status to not-for-profit, 501(c)-3 corporations that operate exclusively as an adult care home and utilize this type of funding mechanism.
6. SB 447 merely seeks to clarify the language and correct the discrepancy in the law.

In conclusion we respectfully ask that you support SB 447. I will be happy to respond to any questions you may have.

# KAHSA

KANSAS ASSOCIATION OF  
HOMES AND SERVICES FOR THE AGING

## TESTIMONY

TO: The Honorable Phill Kline, Chair  
House Taxation Committee

FROM: John R. Grace, President

DATE: March 11, 1996

=====  
Thank you, Mr. Chairman, and members of the committee.

Kansas Association of Homes and Services for the Aging is a not-for-profit trade association representing over 150 not-for-profit retirement, nursing, and community service providers throughout Kansas.

We support Senate Bill 447.

Villa St. Joseph is a member of our association. The Villa has an excellent reputation for providing high quality care and services for older adults and their families in the greater Kansas City area.

Senate Bill 447 would clarify that an arrangement in which a not-for-profit adult care home that leases its facility from another not-for-profit corporation would not jeopardize the tax exempt status of the adult care home. The capital financing markets are extremely difficult for not-for-profit organizations to access and this type of leasing arrangement is a viable way to ensure that Villa St. Joseph can continue to meet the needs of the growing elderly population in the greater Kansas City community. It is our view that this would have extremely limited application. We would ask for the Committee's favorable endorsement of this bill.

I would be glad to answer any questions.

Thank you very much.

OR THE AGING  
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House Taxation  
3-11-96  
Attachment 2

TESTIMONY OF  
JOHN D. LaFAVER, SECRETARY OF REVENUE

IN SUPPORT OF

SB 448

March 11, 1996

- I. Kansas supports a statutory rule for the apportionment of income from
- a. Old law developed in an era when a financial institution operated in only one state.
  - b. But branching now exists. Regardless of "opt in" or "opt out", the need for apportionment exists.
  - c. Need for objective standard to determine where its income can be taxed.
  - d. Same issue that has been addressed for many years for corporate taxation.

II. Vehicle that we present to apportion income is one adopted by the multi-state tax commission after lengthy study and work with the banking industry and both head office and market states. It is the standard for states in developing a uniform approach to bank income apportionment.

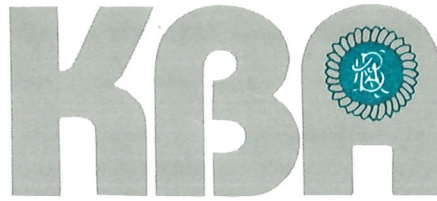
a. It uses a three factor formula similar to the corporate formula, consisting of property, payroll and receipts. Each is defined in the bill and each has factors that alternatively vector income to the market and h headquarters states.

For example, income from loans is sourced to KS when income from those loans is secured b property in KS. Likewise, the property represented by loans is sourced to KS when the loan is serviced by a KS office.

b Since only business income can be apportioned, the bill defines what business income is for banks (that is, any income operationally related to the bank: consistent with the Allied Signal case).

III. The bill also resolves a potential controversy over whether a bank that merges with another escapes taxation in its final year or more of operation. Presently the bank privilege tax is a tax on the privilege of doing business based on the previous year's income. Under this structure a bank's first year of operation is taxed the second year.

When a bank merges, the original bank does not exist at the end of the last year, and arguably is not obligated to pay tax on its next to last year's income. The amendment we offer in section six assures that a bank would pay tax on all income up to the date of merger. State revenue estimates are based on this assumption.



The KANSAS BANKERS ASSOCIATION  
A Full Service Banking Association

March 11, 1996

TO: House Taxation Committee  
RE: **SB 448** - Apportionment and allocation of income of financial institutions

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to appear before the committee on the provisions of **SB 448**. This bill, in part, attempts to resolve the difficult issue of how to equitably tax the interstate operations of banks, s&ls, and savings banks - a problem facing this state as well as all other states. Because several banks and savings banks already have interstate branching operations in Kansas and no home offices here we believe it is appropriate for the Legislature to address this issue at this time.

Sections 1 through 5 of **SB 448** are based on the model legislation for interstate operations proposed by the Multi-State Tax Commission (MTC). In fact, the language of the first five sections of **SB 448** matches the MTC model act word-for-word with these exceptions:

In New Section 1, on page 2, subsection (e) relating to the filing of combined reports has been added;

In New Section 2, on page 2, a subsection (c) which defines "business income" has been inserted and in that same section, on page 4, a subsection (n) defining "nonbusiness income" has been added. Neither of these subsections appears in the model act.

The MTC model act recommends that the apportionment factors of property, payroll, and receipts be used in determining how to allocate, for state tax purposes, the net income of a bank involved in interstate operations. The MTC further recommends that each of the three factors be weighted equally.

To date, the MTC model act has been adopted in its entirety by only three states (Arkansas, Massachusetts, and California) although it is the intent that all states ultimately adopt it in order to assure that no more than 100% of a bank's income would be subject to taxation by one or more states.

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Attachment 4-1



As indicated above, the KBA can support those provisions of **SB 448** relating to the implementation of the MTC model act for interstate operations. However, the KBA cannot support the bill in its present form because of **New Section 6** of the bill. That section sets forth the department's recommended procedure for calculating the financial institutions privilege tax when a financial institution ceases to do business due to merger or other reasons. The provisions of **New Section 6** would apply to all taxable years after 1995.

Kansas banks and s&ls pay a privilege tax in lieu of the state corporate income tax. The state has chosen this method of taxation in order to be able to tax the income generated from the holding of U. S. government obligations by such institutions.

The financial institutions privilege tax is actually a franchise tax for the "privilege" of doing business in the current year. Thus in 1996 a bank will pay the tax for the right to do business in 1996 and the tax will be based on its 1995 net income.

Therefore, if a bank ceased to exist on December 31, 1995, it owes no privilege tax in 1996 because it no longer needs to pay for the "privilege" of doing business and it has already paid for the "privilege" of doing business in 1995 when it filed its 1995 return based on its 1994 taxable income.

In addition, if a bank were to cease operation sometime in 1996 it will have already paid for the "privilege" of doing business in 1996 based on its 1995 income so there would be no additional privilege tax liability for the institution in 1997 since it obviously would not be doing business in that year.

Under the provisions of **New Section 6** a bank which is the "surviving" bank in a merger involving two or more banks would be required to pay additional privilege taxes for the "privilege" of doing business in 1996 even though they have already paid for that privilege and this additional tax would be based on the 1995 income generated by the "merged" bank or banks prior to the merger - income over which the surviving bank had no control!

It is important to understand that banks which were involved in mergers in 1995 were not attempting to avoid tax liability when they filed their 1996 privilege tax return. They were simply following the law as it is presently written. We believe the provisions of Section 6 raise serious

constitutional problems for the privilege tax because it is attempting to impose an income tax on institutions which have already paid the appropriate amount of tax for the "privilege" of doing business in 1996 and which had no control over the income on which the state is now attempting to levy a tax.


In the "General Instructions" for the 1996 privilege tax forms the Department of Revenue has included, for the first time, a paragraph which states that banks involved in mergers must follow a procedure like that set forth in **New Section 6** in calculating their 1996 privilege tax. (see attachment) There is obviously no statutory authorization to include such a paragraph in the General Instructions and past attempts by the Department of Revenue to impose this interpretation of the privilege tax law have always been successfully challenged.

The provisions of **New Section 6** are based on the erroneous assumption that taxation of the income of the bank merged out of existence does not create constitutional problems. In fact, such language creates the very constitutional problem which the privilege tax is designed to avoid. If the income of a bank which ceases to exist is taxed as part of another bank's net income in the following tax year then the tax is not a privilege tax at all, but has become an income tax.

Kansas cannot constitutionally have a half-privilege, half-income tax for financial institutions. Any attempt to implement the provisions of Section 6 will very likely result in litigation which could get the Kansas privilege tax declared unconstitutional.

We, therefore, believe that **New Section 6** should be removed from **SB 448** because it is not an appropriate place to address this issue and could jeopardize the constitutionality of the remainder of the bill.

We appreciate your willingness to read and listen to our concerns about this bill and we would respectfully request that no further action be taken on **SB 448** unless **New Section 6** is removed.

  
James S. Maag  
Senior Vice President

# 1996 PRIVILEGE TAX GENERAL INSTRUCTIONS

4-4

**IMPORTANT:** Senate Bill 354, passed by the 1995 Legislature, excludes the taxes on or measured by income as an add back modification for all privilege taxpayers for privilege tax year 1995 and all years thereafter.

## MERGERS

The Kansas privilege tax is a tax paid for the privilege of doing business in Kansas as a financial institution based on the income of the next preceding taxable year. Therefore, if a merger, consolidation or similar event, has taken place and the tax attributes of the merged bank are assumed by the acquiring bank for federal income tax purposes, the pre-merger taxable income of the merged bank must be included with the acquiring bank's preceding year's taxable income for purposes of computing the acquiring bank's privilege taxes.

## ESTIMATED TAX

For all federal taxable years commencing after December 31, 1992, every national banking association, bank, trust company, and savings and loan institution whose liability can reasonably be expected

## EXTENSION TO FILE

The Director of Taxation will grant a reasonable extension of time corporations to file a Kansas privilege tax return. Taxpayers who file 7004 with the Internal Revenue Service seeking an automatic six-month extension of time to file federal tax returns will automatically receive a month extension of time to file their Kansas privilege tax return. Note there is no extension of time to pay the amount of Kansas tax due. amount due is not paid by the original due date, interest will be and penalty may be charged. Interest will be computed at the rate of 1% per month on the balance of tax due. If paid after the due date but within 6 months of the due date, penalty will be computed at 10% on the balance of tax due. If paid more than 6 months beyond the due date, the penalty will be calculated at 25% on the balance of tax due. Payments should be accompanied by Kansas extension Form E-2. A copy of the federal Kansas extension must be attached to the Kansas return when it is filed. The application for Kansas extension must be submitted prior to the original due date.

**79-1107.** National banking associations and state banks; tax imposed; rate. Every national banking association and state bank located or doing business within the state shall pay to the state for the privilege of doing business within the state a tax according to or measured by its net income for the next preceding taxable year to be computed as provided in this act. Such tax shall consist of a normal tax and a surtax and shall be computed as follows:

- (a) The normal tax shall be an amount equal to 4 1/4% of such net income; and
- (b) the surtax shall be an amount equal to 2 1/8% of such net income in excess of \$25,000.