

Approved: Jan 16, 1996  
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 January 10, 1996 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  
Elizabeth Carlson, Secretary to the Committee

Conferees appearing before the committee: Gary Haulmark  
Mark Beck, Director, Property Valuation Division  
Chris Courtwright, Legislative Research Department  
Tom Severn, Legislative Research Department

Others attending: See attached list

### APPROVAL OF MINUTES

Senator Bond made a motion to approve the minutes of January 9, 1996. The motion was seconded by Senator Corbin. The motion carried.

### REQUESTS FOR INTRODUCTION OF BILLS

Gary Haulmark requested the introduction of a bill to amend KSA 79-201j allowing for nursery machinery and equipment to be exempt from property tax.

Senator Corbin made a motion to introduce this bill. The motion was seconded by Senator Sallee. The motion carried.

Mark Beck, Director, Property Valuation Division, requested the introduction of a bill for some clarification and clean-up and to alter the ratio study process for more efficiency. (Attachment 1)

Senator Ranson made a motion to introduce this bill. The motion was seconded by Senator Hardenburger. The motion carried.

### STAFF REVIEW--GOVERNOR'S TAX EQUITY TASK FORCE

Chris Courtwright, Legislative Research Department, reviewed the report of the 1996 Governor's Tax Equity Task Force. (This book is on file in the Legislative Research Department.) Mr. Courtwright read the Executive Order which established the Task Force and reviewed the background regarding taxes and the state and local tax structure. He called the attention of the committee to the charts on page 3 and 4 of the book. There was discussion in the committee about the decrease in property taxes in 1992 because of the School Finance Act and the increase in the property taxes back to the same high figures in 1994. Mr. Courtwright then reviewed the Conclusions and Recommendations of the Task Force on page 17.

Senator Ranson called to the committee's attention the fact that although the Task Force did not recommend the elimination of the 35 mill levy over a 7 year period that was proposed by Representative Phill Kline, the Task Force did make a motion to reduce the reliance on property taxes over a period of time without specifying a certain time frame.

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION, Room 519-S  
Statehouse, at 11:00 a.m. on January 10, 1996.

Senator Sallee said there was a decrease in the property taxes in 1992 but since that time the property taxes have increased to the same high figure.

Senator Lee said the 35 mill levy has been good for the area which she represents and the mill levy has not gone back up to the original amount.

Senator Martin reviewed the minority report of the Task Force which is printed on page 19.

**STAFF REVIEW--INTERIM SPECIAL COMMITTEE ON ASSESSMENT AND TAXATION**

Chris Courtwright reviewed Proposals #6, #7, #8, #10, #11, #12, #14 of the Special Committee on Assessment and Taxation giving the Conclusions and Recommendations concerning each proposal. Senator Langworthy announced Proposal #13 has been assigned to the Senate Commerce Committee. (Attachment 2)

Tom Severn, Legislative Research Department, reviewed Proposals #5 and #9 including the conclusions and recommendations.

The meeting adjourned at 12:05 p.m.

The next meeting is scheduled for January 11, 1996.



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### Division of Property Valuation

TO: Senate Committee on Assessment & Taxation  
FROM: Mark S. Beck, Director of Property Valuation  
DATE: January 10, 1996  
SUBJECT: Summary of Proposed Legislation for 1996

The Division of Property Valuation respectfully request that the Senate Committee on Assessment & Taxation introduce legislation which will amend the following statutes:

Section 1. K.S.A. 32-1104. Presently, K.S.A. 32-1104 requires the Secretary of Wildlife and Parks to annually, on or before February 1, provide the county appraiser with a list of motorboats. This amendment would replace the reference to motorboats with *vessels* that are numbered by the Department of Wildlife and Parks. The Department of Wildlife and Parks presently requires vessels, including motorboats, jet skis, etc., to be numbered. The vessels required to be numbered are taxable personal property required to be listed for taxation by the taxpayer with the county appraiser. The amendment would require the Secretary's list to be more inclusive and would, therefore, help prevent tax evasion and lead to a more uniform and equal taxation.

Section 2. K.S.A. 45-221. This amendment to the open records act adds an exception to protect the confidentiality of a taxpayer's financial information when requested or required by the director of property valuation. Presently, taxpayer financial information is required to be kept confidential when requested or required by the county appraiser for appraisal purposes. However, when the director of property valuation requests or requires financial information of a taxpayer there is no law that makes it confidential. This problem becomes more serious as the Division of Property Valuation works with the counties to build a state wide data base on properties to assist the county appraisers in the valuation of property.

Section 3. K.S.A. 75-5105a. This is a housekeeping amendment that updates the director's duties to devise and prescribe personal property guides and to conduct the appraisal ratio study.

The amendment to K.S.A. 75-5105a (b) recognizes that not all personal property is valued on the basis of its fair market value since the classification amendment to the constitution became effective January 1, 1989 (thus, the reference to "fair market value" is removed); and

Also, K.S.A. 75-5105a (e) is amended to conform with the Kansas real estate ratio study act that was adopted in 1992 (presently, the reference is to the old Kansas real estate ratio study act that was repealed in 1992).

Section 4. K.S.A. 1995 Supp. 79-1439. This is a housekeeping amendment that updates the assessment rates and descriptions set forth in K.S.A. 1995 Supp. 79-1439. Although K.S.A. 79-1439 was amended as recently as 1992, it has not kept pace with constitutional amendments to Article 11, Section 1 of the Kansas Constitution, e.g., K.S.A. 1995 Supp. 79-1439 presently states that residential property is assessed at 12%, when the Constitution provides that it is assessed at 11.5%,

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attach 1-1*

public utility property is assessed at 30%, when the Constitution provides that it is assessed at 33% etc.

Section 5. K.S.A. 79-1445. This is a housekeeping amendment that updates the substantial compliance statute, which was last revised in 1985. Presently, county commissioners are allowed to appeal any finding of non-compliance; however, the statute does not set forth the procedures for such appeals. The amendment specifies that county commissioners may appeal the director of property valuation's finding of non-compliance within 30 days and that a hearing shall be held in accordance with the Kansas administrative procedure act.

Section 6. K.S.A. 1995 Supp. 1467b. The due date for the county clerk's certification of the exempt real and personal property tax rolls to the director of property valuation is changed from July 1st to July 15th in order to coincide with the date prescribed for the county clerk to forward the abstract of the assessment rolls to the director of property valuation. The abstract date was changed from July 1 to July 15 in 1992; however, the date for the certification of the exempt rolls was left unchanged causing confusion.

Section 7. K.S.A. 1995 Supp. 79-1479. The quarterly progress reports that county appraisers must file with the director are reduced to annual progress reports, preserving the director's right to require more frequent filings if a county is not in substantial compliance. This change is designed to eliminate unnecessary reports from counties that are in substantial compliance so that greater assistance and attention can be given to counties that are not in substantial compliance.

Section 8. K.S.A. 1995 Supp. 79-1488. The real estate ratio study act is amended to allow the director the discretion to select random samples of residential sales from counties having a total parcel count exceeding 10,000 rather than 15,000. This amendment would authorize, but not mandate, sampling of residential sales in 16 additional counties. In 1992 the International Association of Assessing Officers (IAAO) made a comprehensive review of PVD ratio study procedures. They recommended that we take additional steps to insure that ratio study samples would be good representations of all property in the county. In 1994 PVD developed some new sampling methods, with assistance from the professors on our Technical Advisory Committee. These new methods have been tested in the 18 largest counties over the last two years. The results have been very successful and PVD is ready to proceed with the next phase. A change in the legislation will permit similar methods to be utilized in smaller counties. The sampling process can also be more cost effective in addition to improving statistical accuracy and reliability of our performance measures.

Section 9. K.S.A. 79-1806. This amendment provides the county clerks 10 additional days to report the amount of taxes levied upon tax and tag motor vehicles. The due date is changed from January 15 to January 25, beginning in 1997.

## Proposal No. 5

### ***STUDY TOPIC: Tax Relief for the Elderly\****

### **BACKGROUND**

In response to requests for property tax relief for the elderly, the Legislative Coordinating Council assigned Proposal No. 5 – Tax Relief for the Elderly, to the Committee for study.

### **COMMITTEE ACTIVITIES**

The Committee devoted part of three meetings to this proposal. At its August meeting staff presented a memorandum on tax relief, and Paul Welcome, Johnson County Appraiser, proposed a partial (school) property tax freeze for elderly Kansans.

#### **Staff Memorandum**

After outlining tax relief for the elderly in the income and sales tax laws, and giving some detail on the food sales tax refund program, the staff memorandum concentrated on property tax relief. Forms of property tax relief featured were homestead exemptions, circuit breakers, tax freezes, tax deferrals, and "work off" measures. The inheritance tax was the subject of another proposal being studied by the Committee.

Homestead property tax exemptions exempt a portion of the value of a residence (homestead) property for qualified homeowners. Most such programs employ age as a condition for receiving the exemption. If viewed as a partial exemption, a homestead property tax exemption could conflict with the uniform and equal requirements of the *Kansas Constitution*.

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\* One bill was recommended. A number had not been assigned to it by the time this report went to press.

The Kansas program, despite the term "Homestead" in its title, is a "circuit breaker." In 1970, Kansas became the sixth state to enact a circuit breaker. During the 1970s, half the states enacted such programs. Currently, 33 states have a circuit breaker program, two allow local option programs, and Nebraska has a graduated homestead exemption program which operates similarly to a circuit breaker.

The memorandum also reviewed the history of the homestead property tax refund program in Kansas and compared the circuit breaker programs in the neighboring states.

#### **School Tax Freeze Proposal**

Paul Welcome, Johnson County Appraiser, proposed a school property tax freeze for older Kansans. The program would freeze school taxes in the year that taxpayers first qualified. That portion of their tax bill then would not increase as a result of either an increase in the appraised value of their home or an increase in the levy rate for schools. Such a program currently is in effect in Texas. Copies of the Texas law and constitution also were reviewed by the Committee.

At its October meeting, the Committee reviewed the policy options prepared by staff.

At its November meeting, the Committee reviewed data illustrating the indexing of features of the Homestead Property Tax Refund Program.

### **CONCLUSIONS AND RECOMMENDATIONS**

#### **POLICY OPTION CHECKLIST**

Should changes be recommended in the income or sales tax? The Committee recommends no changes.

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Attach 2-1*

Should changes be recommended in the food sales tax refund program? The Committee recommends no change.

Should a school property tax freeze be recommended? In light of probable constitutional constraints, the Committee does not recommend further consideration of a school property tax freeze.

Should a tax deferral or "work-off" program be considered? The Committee does not recommend such a program at this time.

### **POSSIBLE CHANGES TO THE HOMESTEAD PROPERTY TAX REFUND PROGRAM**

Should the maximum amount of tax (currently \$600) be changed? The Committee recommends that the maximum amount of property tax eligible for the refund be indexed. This will cause the maximum income qualifying for a refund to increase, because the refund is calculated by deducting an amount determined by income from the actual tax paid.

Should the "co-insurance" tables be modified as to increase the maximum allowable income? With the changes recommended in the maximum tax, the maximum allowable income will increase, so the Committee does not recommend changes to this table.

Should the definition of household income be made more restrictive by excluding some kinds of income? The Committee recommends no change.

Should business losses be excluded from the calculation of household income? The Committee recommends no change.

Should an assets test be used to deny benefits to those well-off but with low incomes? The Committee recommends no change.

Should a program be established (or strengthened) to enhance public awareness of the program? The Committee encourages the Department of Revenue to continue to publicize the program, but recommends no further changes at this time.

**Summary.** The Committee recommends that the maximum amount of property tax eligible for the homestead property tax refund be indexed. This change also will cause the maximum household income eligible for the refund to increase. (Legislation to implement this recommendation is being submitted.)

## Proposal No. 6

**STUDY TOPIC: *The Chief Industries case and its application to resident and nonresident corporations.*\***

### BACKGROUND

Proposal No. 6 directed the Special Committee to review the 1994 *Chief Industries* decision (255 Kan. 640) and study its implications for domiciliary and nondomiciliary corporations. The charge to the Committee contemplated making any legislative recommendations deemed appropriate, including in particular the proposal to allow corporations to elect to have all income arising from the acquisition, management, use, or disposition of tangible or intangible property treated as business income. If such an election is to be authorized, the Committee was to consider whether:

1. such election should be retroactive indefinitely or only to a date certain;
2. such election should be binding prospectively for ten years on all members of a unitary group of corporations; and
3. the Secretary of Revenue should have authority to release corporations from such election within the ten-year period and, if so, under what circumstances that authority should be exercised.

In *Chief*, the Kansas Supreme Court held that the only test to be applied in determining whether the proceeds from the sale of stock by the nondomiciliary corporation was business income under K.S.A. 79-3271(a), and thus apportionable to Kansas, is the transactional test set forth in the 1968 Kansas Supreme Court case, *Western Natural Gas* (202 Kan. 98). In *Western Natural Gas*, the court noted that:

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\* S. B. 394 accompanies this report.

"... business income... must arise from transactions and activity in the regular course of a trade or business. Business income includes income from intangible property if the acquisition, management and disposition giving rise to the income constitute integral parts of the regular trade or business operations. It is not the use of the property in the business which is the determining factor under the statute. The controlling factor by which the statute identifies business income is the nature of the particular transaction giving rise to the income. To be business income the transaction and activity must have been in the regular course of taxpayer's business operations."

The Board of Tax Appeals (BOTA) had held that while the sale of stock at issue in the *Chief* case did not satisfy this statutory construction from *Western Natural Gas*, an additional separate and independent functional test existed pursuant to the adoption of a regulation by the Department of Revenue. This functional test enabled the Department to attempt to treat the sale of stock as business income apportionable to Kansas.

But the Kansas Supreme Court in *Chief* ruled that BOTA erred in holding that an independent functional test had been added by virtue of a regulation adopted by the Department of Revenue in 1979, KAR 92-12-73(b). (That regulation states that the "gain or loss from the sale, exchange or other disposition of real or tangible or intangible personal property constitutes business income if the property while owned by the taxpayer was used in the taxpayer's trade or business.")

The court noted that while duly adopted administrative regulations have the force of law, they do not supplant statutory law nor do they preempt judicial statutory construction. "Neither BOTA nor the Department can change the test this court established in *Western Natural Gas* by reliance on a regulation," the court stated in *Chief*. "The legislature can modify this court's statutory construction, but it has not done so."

BOTA also had ruled that a more "broadly defined" transactional test such as set forth in *Welded Tube*, a 1986 Pennsylvania case, would



determine the sale of the stock to be business income and thus apportionable to Kansas. But the Kansas Supreme Court again noted in *Chief* that the fatal flaw inherent in the argument was that the "holding in *Western Natural Gas* has not been modified nor has the statute it construed been subsequently amended by the legislature although over 25 years have passed since the date of the decision."

So because the sale of stock did not satisfy the transactional test set forth in *Western Natural Gas* and no valid functional test (or broader transactional test) existed, the income ultimately was treated as nonbusiness income pursuant to K.S.A. 79-3271(e).

To the extent that nondomiciliary corporations will no longer have any Kansas income tax liability on nonrecurring capital gains, the question has arisen as to whether Kansas-domiciled corporations – who would have nonrecurring capital gains allocated entirely to Kansas – are at a competitive disadvantage under the transactional test set forth in *Western Natural Gas*.

## COMMITTEE ACTIVITIES

At the August meeting, Secretary LaFaver discussed the tax treatment of business and nonbusiness income and outlined the ramifications of the *Chief* case.

At the September meeting, a number of conferees testified in support of the election concept contained in the Senate Assessment and Taxation Committee's amendment to H.B. 2008.

Secretary LaFaver reminded the Committee that the Department had attempted to resolve the inequity for in-state firms with an administrative solution. He said that the Governor had reiterated concerns that the proposed legislation could create major new opportunities for tax avoidance. The Secretary said that the Governor had asked that new legislation be developed to cure the inequity for in-state firms without encouraging tax avoidance.

The Committee asked the Secretary to present the proposed new legislation at the November meeting. The Secretary proposed statutorily certifying the functional test and triple-weighting the sales factor in the corporation income tax apportionment formula.

## CONCLUSIONS AND RECOMMENDATIONS

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The Committee recommends that legislation be enacted similar to the Senate Assessment and Taxation Committee version of H.B. 2008, except that: (1) corporations could no longer request a release from the ten-year election; and (2) the bill would not have a retroactive application. Enactment of S. B. 394 would accomplish this recommendation.

# Proposal No. 7

## **STUDY TOPIC: Inheritance Tax Repeal.**

### **BACKGROUND**

The inheritance tax proposal required the Committee to study the policy and fiscal implications of replacing the inheritance tax with an estate "pick-up" tax as proposed in H.B. 2150 as passed by the House Committee of the Whole and in H.B. 2171 as introduced. The Committee also considered a plan to increase the exemption amounts within the existing inheritance tax structure, as proposed in H.B. 2150 as introduced.

### **Estate "Pick-Up" Tax Plan**

#### **House-Passed Version**

H.B. 2150, as amended by the House Committee of the Whole, would enact the Kansas Estate Tax Act and repeal the Kansas Inheritance Tax Act. The estate tax would be an amount equal to the maximum credit allowed by Section 2011 of the Internal Revenue Code against the tax that otherwise would be imposed on the transfer of the taxable estate of the decedent, multiplied by a fraction, the numerator of which is the Kansas gross estate value and the denominator of which is the total gross estate value. This type of estate tax is known as a "pick-up" tax.

Under a pick-up tax, estates with a value of \$600,000 or less would incur no liability. The bill references the Internal Revenue Code in effect on December 31, 1994, so any subsequent federal change in the exemption threshold would not change the \$600,000 level in Kansas law.

#### **Inheritance Tax Exemption Amounts**

Under the current inheritance tax, surviving spouses are totally exempt; Class A distributees –

defined to include lineal ancestors, lineal descendants, step-parents, step-children, adopted children, lineal descendants of any adopted child or step-child, the spouse or surviving spouse of a son or daughter, and the spouse or surviving spouse of an adopted child or step-child of the decedent – receive a \$30,000 exemption; and Class B distributees – brothers and sisters of the decedent – receive a \$5,000 exemption.

#### **Effective Date and Fiscal Impact**

The new estate tax law contained in the House-passed version of H.B. 2150 would have been applicable to the estates of all decedents dying after December 31, 1995. The Inheritance Tax Act would have continued to apply to the estates of all decedents dying before January 1, 1996.

A fiscal note from the Department of Revenue said that receipts would decrease by about 67 percent under the estate pick-up tax relative to collections under the inheritance tax law. Based on collections in tax years 1992 through 1994, that percentage reduction in receipts would have represented a drop of about \$35 million annually in SGF receipts. The impact on FY 1996 receipts would have been unclear because of the January 1 changeover date and the fact that estates sometimes take many months to be settled. Once the impact of the new law would be fully phased-in, a 67 percent drop in receipts would mean an annual reduction in SGF receipts of at least \$40 million (based on the April, 1995 consensus estimate of \$60 million for inheritance tax receipts).

#### **Resident Trust Amendment**

A House floor amendment also would redefine "resident trust" for income tax purposes to mean:

1. trusts created in Kansas by wills of decedents who were domiciled in Kansas at the time of death and which provide for distributions to at least one beneficiary domiciled in Kansas; and

2. trusts created by or consisting of property of persons domiciled in Kansas on the date the trusts become irrevocable, provided at least one beneficiary is domiciled in Kansas. This income tax provision would have a positive, but indeterminate, impact on SGF receipts.

### **Alternative Plan to Increase Inheritance Tax Exemptions**

#### **H.B. 2150 as Introduced**

The original H.B. 2150, which was introduced by Representative Carmody and others, would have simply increased the exemption amounts for Class A and B distributees within the existing inheritance tax structure. The exemption for Class A distributees would have been increased from \$30,000 to \$100,000, and the exemption for Class B distributees would have been increased from \$5,000 to \$25,000.

The Department of Revenue said that based on data from tax years 1992 through 1994, such increases would have meant an annual reduction in SGF receipts of approximately \$11.6 million. Given the fact that the current consensus estimate is somewhat higher than the average amount of receipts in tax process years 1992 through 1994, the actual fiscal impact would be expected to be slightly more than the \$11.6 million figure.

#### **COMMITTEE ACTIVITIES**

At the July meeting, staff briefed the Committee on a number of the inheritance and estate tax issues raised in H.B. 2150 and H.B. 2171. The Committee asked the Department of Revenue to provide information on the size of estates.

At the August meeting, the Department provided data on the size of estates subject to the Kansas inheritance tax in tax years 1992 through 1994. During the public hearing, John Wachter, Kansas Bar Association, and Representative Tim Carmody told the Committee that a pure pick-up estate tax would be much simpler administratively. Jack Ovel, Boatmen's Bank and Trust Company, expressed opposition to the resident trust provision.

At the October meeting, the Committee discussed the desirability of moving to an estate tax but also expressed concern over the fiscal impact of a pure pick-up tax as envisioned in H.B. 2150. The Committee asked staff from the Department of Revenue to return in November to explain 1991 S.B. 188, an estate tax proposal thought to be closer to revenue-neutral.

#### **CONCLUSIONS AND RECOMMENDATIONS**

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The Committee requests that the Department of Revenue provide the 1996 Legislature with data regarding the fiscal impacts and tax shifts associated with a number of different estate tax exemption thresholds.

The Committee notes that if the 1996 Legislature is to consider any sort of "revenue-neutral" estate tax system, the tax shifts involved with such a change would need to be carefully studied.

## Proposal No. 8

### **STUDY TOPIC: Tax Court**

### **BACKGROUND**

The tax court proposal required the Committee to study the proposal embodied in 1995 S.B. 40 and recommend whether the State Board of Tax Appeals (SBOTA) should be abolished and replaced by a Kansas Tax Court. The Committee analyzed the issues raised during the debate on S.B. 40, including qualifications of Tax Court members, the proposal to establish a special Small Claims Division, and the duties and functions of the Property Tax Appeals Board. Additional policy issues concerned a provision which would prevent interest from accruing on assessments for more than one year after the requests for hearing have been received by the Director of Taxation.

### **Replacing SBOTA with Kansas Tax Court**

S.B. 40 as amended by the Senate Committee on Assessment and Taxation would have abolished SBOTA as of July 1, 1995 and transferred all of its powers, duties, functions, property, and personnel to a new Kansas Tax Court. Sections 1 through 6 and 9 through 12 of the bill provide for the transition and the establishment of the Tax Court. The Tax Court would be an independent agency within the executive branch. According to a 1994 study by the Federation of Tax Administrators, two states – Maryland and Minnesota – have actual tax courts established as independent agencies within the executive branch to hear tax appeals. Seventeen states, including Kansas, have independent boards or commissions within the executive branch dedicated exclusively or primarily to reviewing tax appeals.

### **Qualifications of Tax Court Judges**

Section 7 of the bill provides that the Tax Court would consist of three judges appointed by the

Governor from a list submitted by the Supreme Court Nominating Commission. Judges would normally serve eight-year terms, but the first three judges appointed would be named to an eight-year term, a six-year term, and a four-year term, respectively. All judges would be eligible to be appointed for an additional eight-year term.

Two of the judges would be required to:

1. have been regularly admitted to practice law in Kansas;
2. be a resident of Kansas at the time of taking the oath of office and maintain residency while holding office; and
3. have been engaged for at least five years in the active practice of law as a lawyer, judge, full-time teacher of law in an accredited law school, or as a certified public accountant who has maintained active registration as an attorney, or any combination thereof.

The third judge would be required to be classified as a certified general real property appraiser pursuant to the State Certified and Licensed Real Property Appraisers Act.

Pursuant to New Section 10, Tax Court judges would be paid salaries similar to those currently paid to SBOTA members. The annual salary of the chief judge would be an amount equal to the annual salary paid to a district judge designated as an administrative judge, and the annual salary of the other judges would be equal to the amount paid to district judges.

### **Qualifications of SBOTA Members**

Under current law, SBOTA members are required by K.S.A. 74-2433 to be selected with special reference to training and experience for duties imposed by the SBOTA statutes. New language added by 1995 H. Sub. S.B. 19 requires members appointed after July 1, 1995 to have "legal, ac-

counting, or appraisal training and experience." SBOTA members are selected by the Governor to serve four-year terms, subject to confirmation by the Kansas Senate. SBOTA members are required to be residents of Kansas, and not more than three members are to be from the same political party. One member is to be appointed from each congressional district, with one at-large member.

### **Small Claims Division**

One specific division of the Tax Court, as established by S.B. 40, would be the Small Claims Division (SCD). Taxpayers could elect to appeal decisions, findings, orders, or rulings of the Director of Taxation to the SCD when the amount of tax in controversy does not exceed \$15,000, or – in the case of multiple year assessments or denials of refunds – when the amount of tax does not exceed \$15,000 for any given year. Taxpayers could appeal to the SCD in lieu of a formal hearing before the Director but would not be precluded from seeking resolution in an informal procedure established by the Department of Revenue.

Taxpayers appealing to the SCD would be precluded from appealing to the regular division of the Tax Court. Judgments in the SCD would be conclusive upon all parties and could not be further appealed. Hearings in the SCD would be informal in nature. All testimony would be given under oath, but no transcript of the proceedings would be kept. Parties could appear in person or be represented by an attorney or other representative.

Kansas Tax Court judges could sit as judges of the SCD or could designate hearing officers to hear the SCD cases. Determinations made by hearing officers so appointed would be binding and have the same force and effect as if they had been made by a judge.

### **Property Tax Appeals Board**

Another division of the Tax Court would be the Property Tax Appeals Board (PTAB). The PTAB, which would consist of five members, would be appointed by and serve at the pleasure of the Tax

Court. All PTAB members would have to be Kansas residents, and at least two of the members would have to be classified as certified general real property appraisers. The remaining PTAB members would be required to have been:

1. actively engaged as a licensed real estate salesperson or broker for the five years immediately preceding their appointment;
2. actively engaged as a licensed real estate appraiser for the four years immediately preceding their appointment; or
3. performing real estate appraisals as an occupation for at least five years preceding their appointment.

Not more than three members of the PTAB could be of the same political party. Subject to the provisions of K.S.A. 1994 Supp. 75-4315c, one PTAB member would have to be appointed from each of the state's four congressional districts, and one individual would be designated as the at-large member. PTAB members would be in the unclassified service of the Kansas Civil Service Act. The Governor would have specific authority to remove a PTAB member for cause, after a public hearing has been conducted in accordance with the Kansas Administrative Procedures Act (KAPA). Members of PTAB would receive an annual salary equal to that paid to magistrate judges.

Hearings before the PTAB would be conducted by one member, and records of the proceedings would not be maintained. In cases involving the valuation of property, the board member would be required to issue a summary disposition within ten working days stating the value of the property. Orders of the PTAB in which the value of property is in issue would not be required to contain specific findings of fact and conclusions of law.

## The PTAB Option

Taxpayers paying property taxes under protest pursuant to K.S.A. 1994 Supp. 79-2005 or appealing decisions rendered by a hearing officer or hearing panel pursuant to K.S.A. 1994 Supp. 79-1606 would have a choice of appealing EITHER to the PTAB or to the regular division of the Tax Court, whereas under current law such cases go to SBOTA. Moreover, taxpayers going to the PTAB could subsequently appeal to the regular division of the Tax Court if they were aggrieved of the finding of the board.

## The Regular Tax Court Division

Proceedings before the regular division of the Tax Court would be governed by the provisions of KAPA to the extent that the provisions of S.B. 40 do not provide differently. Taxpayers could be represented by an attorney, any person enrolled to practice before the United States Tax Court, or could appear *pro se*. Hearings would be conducted by one judge, unless the Chief Judge makes a determination that a case should be heard *en banc*. Hearings would be *de novo*, as provided in Section 20.

The Tax Court would have the power to summon witnesses from any part of the state to appear and give testimony and to compel such witnesses to produce materials relating to any subject matter before the court. The Tax Court also would have the power to direct depositions of witnesses residing in Kansas or elsewhere, to be taken in a like manner as civil depositions in district court.

All final actions of the Tax Court, including final actions on non-state-assessed property tax cases, could be appealed to the Court of Appeals. Under current law, property tax valuation cases not involving state-assessed property are appealed from SBOTA to district court before being eligible for appeal to the Court of Appeals.

## Interest on Tax Assessments

New Section 22 of the bill provides that interest would no longer accrue on tax assessments subject to hearing by the Director of Taxation

after one year subsequent to the date on which a request for hearing is received by the Director.

The Department of Revenue has indicated that this provision could have a negative impact on SGF receipts to the extent that some complicated corporation income tax assessments often take longer than a year at the Director's level.

## COMMITTEE ACTIVITIES

At the July meeting, staff briefed the Committee on the tax court proposal. Secretary LaFaver said that the Department of Revenue was looking into setting up a mediation process in response to concerns about hearings bogging down at the Director of Taxation level. Representatives of the Kansas Bar Association and KCCI testified in support of the tax court concept. The Rural Kansas Taxpayers Association and two members of SBOTA spoke in opposition.

Also at the July meeting, SBOTA was asked to provide information on the average time a "normal" residential appeal takes from beginning until final resolution and on the number of times SBOTA decisions ultimately are overturned at the district court level.

At the September meeting, Secretary LaFaver provided a draft of the proposed mediation process and said it would be implemented in a matter of weeks. SBOTA responded to the data requests made in July, and new Chairman Gus Bogina spoke to the Committee in opposition to the tax court proposal.

In October, the Committee voted to recommend the Tax Court proposal adversely and asked SBOTA Chairman Gus Bogina to appear in November to discuss efforts to streamline and modernize procedures at SBOTA.

**CONCLUSIONS AND  
RECOMMENDATIONS**

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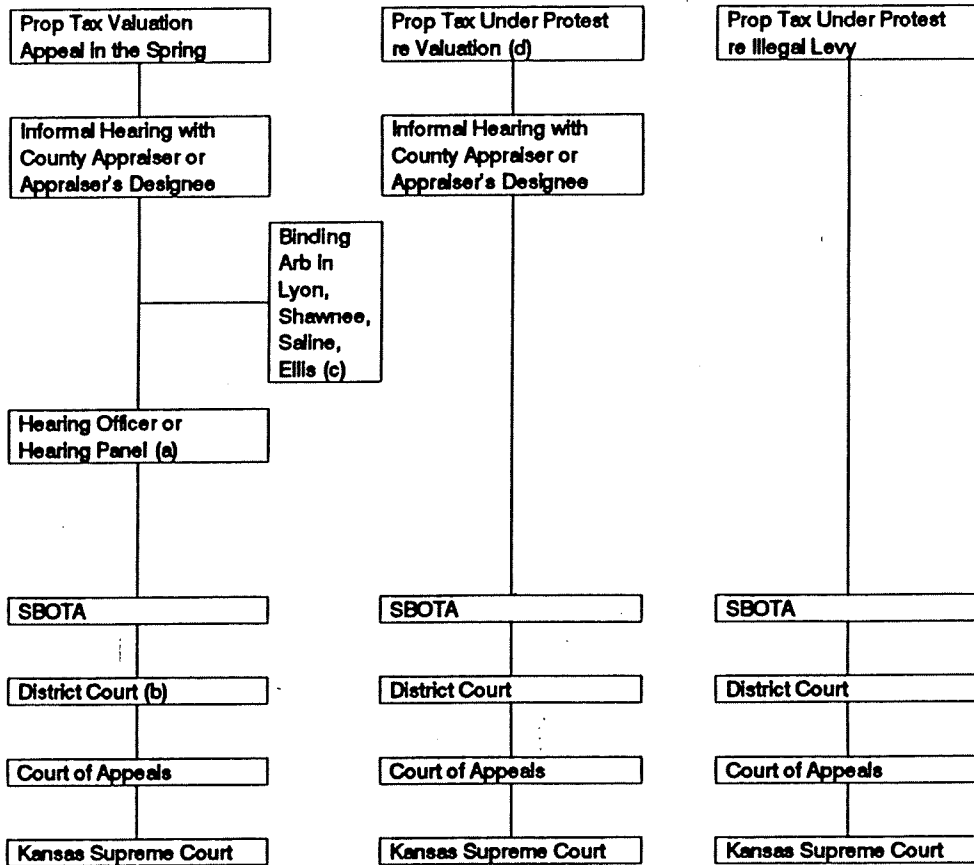
The Committee recommends the Tax Court proposal adversely.

The Committee approves of Chairman Bogina's efforts to streamline and modernize procedures at SBOTA and recommends that SBOTA submit any proposed statutory changes necessary to both standing tax committees during the 1996 Session. The Committee also requests that SBOTA articulate positions on:

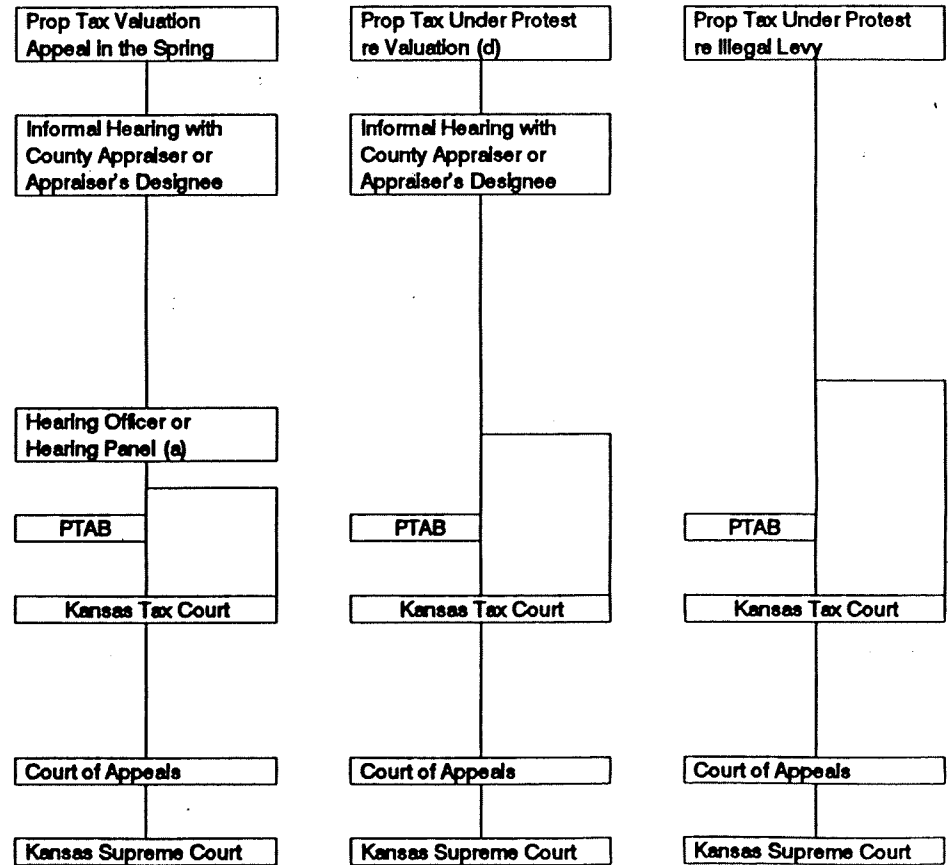
1. any further changes necessary in the qualifications of SBOTA members; and
2. whether the Legislature should consider renewing the binding arbitration option which was previously available to taxpayers in four counties.

# Property Tax Cases

## Current Law



## 1995 SB 40



(a) Hearing officers or hearing panels are mandatory in all counties with 10,000 or more parcels of real property. County commissioners in counties with fewer than 10,000 parcels of real property have the option of appointing such officers or panels.

(b) Valuation—appeal cases involving state—assessed valuation bypass the District Court and go directly to the Court of Appeals.

Binding arbitration "pilot program" available in Shawnee, Saline, Lyon, and Ellis counties expires with tax year 1995 cases.

(c) Taxpayers may not initiate a property—tax—under—protest case on valuation grounds if they have initiated a valuation case for the same tax year during the Spring appeals process.

2-11



## Proposal No. 9

**STUDY TOPIC:** *Proposal No. 9 directed the Special Committee to consider whether the original subject matter of S.B. 41, providing for payment of interest on refunds of property tax, should be enacted.\**

### **BACKGROUND**

During the 1995 Session, S.B. 41, which provided for interest on certain refunds of property tax, was significantly amended on the floor of the House and subsequently failed to pass. Several requests were made for an interim study of the matter and Proposal No. 9 was assigned by the Legislative Coordinating Council.

S.B. 41, as amended by the House Committee on Taxation, would have required county treasurers to pay interest at the rate of 12 percent on refunds of property taxes paid pursuant to an order of the State Board of Tax Appeals or a court, or pursuant to a change made by the county appraiser following the informal meeting required when the taxes were paid under protest. The refunds would have been required to be made within 30 days.

### **COMMITTEE ACTIVITIES**

The Committee devoted parts of three meetings to this proposal. In July, conferees expressed their views on the matter. In September, conferees reported on their efforts to reach an agreement on a bill, and in October the Committee deliberated on the issue.

In July the following conferees spoke in support of requiring interest on refunds of property taxes: Shelby Smith, Rural Kansas Taxpayers Association; and Bernard Hentzen, Hentzen Contractors, Inc., and former Sedgwick County Commissioner. Speaking in opposition were the following: Don

\* H. B. 2596 accompanies this report.

Cooper, Shawnee County Commissioner; Paul Welcome, Johnson County Appraiser; and Jerry McCoy, Sedgwick County Treasurer. Larry Clark, Kansas County Appraisers Association, also submitted testimony which suggested alternatives to the specific measures in S.B. 41. At the conclusion of the testimony, the conferees were requested to get together and work out a compromise for the September meeting.

At the September meeting, the conferees reported that they had met on September 7 and followed up with additional discussions, but were unable to arrive at a compromise. The opponents remained opposed to any legislation which required interest on refunds of taxes paid under protest, and proponents continued to demand a uniform policy with respect to the payment of interest. Also at its September meeting, the Committee received testimony from the Chairman of the State Board of Tax Appeals (SBOTA) on its backlog of property tax cases and the typical timetable for resolving cases.

At its October meeting the Committee deliberated, employing the policy options checklist prepared by staff.

### **CONCLUSIONS AND RECOMMENDATIONS**

#### **POLICY OPTIONS CHECKLIST**

Should interest be paid on property taxes refunded following successful appeals of valuation to SBOTA or the courts?

Should interest be allowed on property taxes refunded following successful protests of taxes on the basis of valuation?

If so, should a reasonable period be allowed the county for hearing and processing the protest prior to the commencement of interest?

Should the bill be made prospective?

Should the rate be the same as the delinquency rate?

Should the rate be tied to the delinquency rate, (K.S.A. 79-2004)?

## RECOMMENDATIONS

The Special Committee decided against paying interest on refunds. Instead, a procedure would be established whereby a taxpayer who was paying the tax under protest on the basis of valuation or illegal levy would pay the tax on the uncontested part of the value of the property, or the prior year's taxes, whichever are greater. If the case is resolved in favor of the taxpayer, there usually would be no further tax due. If the case is resolved entirely or partly in favor of the county, then the taxpayer would be billed for the unpaid tax along with interest at the rate of 10 percent. This same procedure could be followed by a taxpayer who had appealed the valuation in the spring if the case had not been resolved by the time for payment of the property tax.

Enactment of H. B. 2596, attached to this report, will implement these recommendations.

## Proposal No. 10

***STUDY TOPIC: Proposal No. 10 directed the Special Committee to analyze the county land bank proposal and recommend whether counties should be authorized to establish such entities. The proposal also involved a determination as to whether a land bank authorization should be statewide or limited to Wyandotte County.***

### **BACKGROUND**

The original House-passed version of 1995 S.B. 165 would have authorized boards of county commissioners in any county to establish a county land bank. A conference committee later removed this provision from the bill and recommended that the land bank issue be recommended for interim study.

Under the proposal in S.B. 165, any property located in the county and owned by the county, a city, or any other taxing subdivision could be transferred to the county land bank. The land bank would have the authority to acquire, hold, use, and convey real estate. Proceeds of any sale would be retained for use by the land bank. Any property acquired by the bank would be exempt from payment of ad valorem taxes but would remain subject to special assessments, unless such assessments were abated by the political subdivision imposing them.

A county land bank would be governed by a board of trustees consisting of up to seven members, as established by a resolution adopted by the county commissioners. The board of trustees could establish separate neighborhood advisory committees to review the operations and activities of the bank. Counties would be authorized to advance operating funds to their land banks. County commissioners could by resolution abolish a land bank they previously had established, in which case all of the property in the bank would revert to the county.

The proposal in S.B. 165 is a slightly modified version of the original land bank proposal, which

was embodied in H.B. 2513. H.B. 2513 would have authorized only Wyandotte County to establish a land bank. H.B. 2513 was studied during the 1995 Session by a subcommittee of the House Taxation Committee.

The origin of H.B. 2513 was a recommendation made by the 1994 Blue Highway Committee on Urban Revitalization. Conferees from Wyandotte County representing the Liveable Neighborhood Task Force requested authority for that county to establish a land bank on a pilot-project basis. Proponents said that the proposal was based on a municipal land bank established in Cleveland, Ohio, and would enable the sale of blocks of land to redevelopers with clear title and without delinquent taxes.

A current statute relating to judicial foreclosure and the sale of real estate by counties, K.S.A. 79-2803a, authorizes counties to request that the court order two or more lots or tracts to be sold together as a single unit, provided a finding is made that the lots or tracts constitute a single unit for "usual uses" and will sell for a higher price if sold together.

### **COMMITTEE ACTIVITIES**

At the August meeting, staff briefed the Committee on the land bank proposals in S.B. 165 and H.B. 2513. Former Representative Mary Jane Johnson, Kansas City Mayor Carol Marinovich, Willie Martin (Sedgwick County), and Don Moler (League of Kansas Municipalities) appeared in support of the proposal.

The Committee requested that the proponents form a "working group" and get together with staff before reporting back with a revised proposal at the October meeting.

At the October meeting, Wyandotte County Commission Chair Nancy Burns informed the Committee that the county commission had voted to oppose the land bank bill because of fears of

Additional bureaucracy and added expense to taxpayers.

## **CONCLUSIONS AND RECOMMENDATIONS**

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The Committee shares the concern of the Wyandotte County Commission that the land bank concept, if not implemented properly, could lead to additional bureaucratic expense.

But the Committee also recognizes that delinquent properties are a growing problem in a number of areas of the state.

The Committee therefore encourages the proponents of the landbank concept to keep holding working group meetings until the 1996 Legislature convenes, with an eye toward fine-tuning the proposal embodied in the original House-passed version of S.B. 165.

The Committee notes that if such legislation is to be reconsidered, it must contain safeguards to prevent potential conflicts-of-interest for members of land bank boards of trustees. The Committee further recommends that if the proposal is to be reconsidered, the Legislature consider a sunset clause for the land bank authorization.

# Proposal No. 11

## **STUDY TOPIC: Sales Tax Exemptions.\***

### **BACKGROUND**

Proposal No. 11 directed the Special Committee to review existing sales tax exemptions and determine whether additional exemptions are necessary for the sales and purchases of not-for-profit religious and charitable groups. The Committee further was asked to determine whether the application of the sales tax to labor services associated with remodeling is equitable – given the enactment of 1995 S.B. 14 – and to determine whether the exemption should be extended to remodeling labor services.

A number of changes in the sales tax base were enacted in 1995:

The 2.5 percent sales taxes on original construction labor services and on utilities consumed in the production or manufacture of tangible personal property were repealed by S.B. 14. In addition, S.B. 88 exempted:

1. fumigants used in the processing and storing of grain;
2. the treating of by-products or wastes derived from a production process;
3. sales of utilities to property which is exempt from property taxation pursuant to K.S.A. 79-201b Second through Sixth;
4. certain sales of motor vehicles between family members;
5. sales of accessories to be attached to motor vehicles to assist disabled persons; and

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\* Five bills were recommended. One bill, S.B. 395 accompanies this report. Numbers had not been assigned to the other four bills by the time this report went to press.

6. sales of certain machinery and equipment to nurseries.

Both standing committees also received requests from not-for-profit groups seeking new sales tax exemptions. Moreover, the repeal of the 2.5 percent tax on original construction labor services caused a number of conferees to call for the repeal of the 4.9 percent tax on remodeling labor services. Accordingly, the Legislative Coordinating Council directed the Special Committee to analyze both issues.

The fiscal impact for exempting residential remodeling services is estimated to be about \$13 million annually. The fiscal impact for exempting all remodeling services, commercial and residential, is estimated to be about twice as large – about \$26 million.

The fiscal impact for exempting purchases and sales made by parent teacher associations and organizations was estimated to be about \$0.5 million annually.

The fiscal impact of exempting purchases of 501(c)(3) religious organizations when such property is to be used exclusively for religious purposes is indeterminate, according to a February 14, 1995 fiscal note from the Department of Revenue.

The fiscal note for exempting Girl Scout cookies from the sales tax is about \$250,000, according to the Kansas Council of Girl Scouts.

Another sales tax issue included a Senate Assessment and Taxation Committee amendment to H.B. 2114 that would add language to K.S.A. 1994 Supp. 79-3609 to provide that retailers would be presumed to have taken sales tax exemption certificates in good faith in the absence of evidence to the contrary. Another amendment to the same bill would have provided that the federal government, its agencies or instrumentalities, certain nonprofit hospitals, schools, and educational institutions would no longer need to furnish specific project exemption certificates for projects with a total cost of \$10,000 or less.

## COMMITTEE ACTIVITIES

At the July meeting, staff briefed the Committee on the fiscal note for exempting remodeling labor services. A number of conferees appeared in support of the exemption and said that the remodeling services exemption would make things much simpler administratively now that original construction labor services have been exempted.

In August, conferees appeared in support of the exemptions for certain religious organization purchases, sales and purchases of PTAs and PTOs, and Girl Scout cookies.

Staff in September reviewed the Department of Revenue's rule and regulation authority. Secretary LaFaver explained the informal hearing process and also discussed the implementation of a new mediation process. A number of conferees relayed concerns about the current audit procedures and also encouraged the Committee to recommend favorably the provision that would presume that retailers took exemption certificates in good faith in the absence of evidence to the contrary. The Committee asked Secretary LaFaver to provide additional information in November about audit procedures and the cost of audits.

## CONCLUSIONS AND RECOMMENDATIONS

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The Committee recommends that the sales tax be repealed on labor services associated with both residential and commercial remodeling. A bill to accomplish this recommendation is being submitted.

The Committee also recommends that purchases and sales made by PTAs and PTOs be exempt. A bill to accomplish this recommendation is being submitted.

The Committee further recommends that purchases of 501(c)(3) religious organizations be exempt when such property is used exclusively for religious purposes. A bill to accomplish this recommendation is being submitted.

The Committee recommends that sales of Girl Scout cookies be exempt from the tax. A bill to accomplish this recommendation is being submitted.

The Committee recommends that government agencies and instrumentalities, nonprofit hospitals, schools, and educational institutions be removed from requirements to furnish specific project exemption certificates for projects with a total cost of \$10,000 or less. Enactment of S.B. 395 would implement this recommendation.

The Committee also asks that the Department of Revenue promulgate additional sales tax rules and regulations as part of an effort to improve dialogue between taxpayers and auditors during the audit process. Specifically, the Committee recommends new rules and regulations that would:

1. allow taxpayers access to the working papers of auditors;
2. provide for "exit interviews" with a representative of the taxpayer present to review the working papers and any preliminary findings;
3. set limits on the maximum percent of a small business' man-hours that can be tied up during the audit process; and
4. clarify that flexibility be provided in allowing taxpayers to meet with auditors outside of normal business hours.

The Committee also asks that these proposed rules and regulations be available for review by the standing tax committees early in the 1996 Session.

Finally, the Committee notes that the Multistate Tax Compact (K.S.A. 79-4301) contains a provision that vendors accepting exemption certificates in good faith be relieved of liability for sales or use tax with respect to the transactions. The Committee requests that the Department of Revenue modify its rules and regulations (again to be submitted to both tax committees early in the 1996 Session) to define "good faith" as "lacking in intent to evade or defeat the tax."

## Proposal No. 12

### ***STUDY TOPIC: Local Use Tax.***

Proposal No. 12 directed the Special Committee to study the application of the local compensating (use) tax, determine whether Kansas-based businesses are sometimes placed at a competitive disadvantage, and, if so, recommend whether the local use tax base should be expanded.

### **BACKGROUND**

The authority for cities and counties to levy local sales taxes was enacted in 1970. A local use tax for motor vehicles purchased outside the state was enacted in 1982 and was expanded in 1987 to include watercraft purchased outside the state.

Under the current local sales tax structure, cities and counties may levy taxes in 0.25 percent increments up to a normal maximum of 2.0 percent, subject to several exceptions. Sales taxes of up to 1.0 percent may be used for general purposes, but the additional authority (up to 1.0 percent) normally must be used only for the financing of health care services. Cities may impose a tax earmarked for health care only if the county has no such tax. Moreover, any such city tax expires immediately upon the imposition of a county health care sales tax.

As of July 1, 1995, 142 cities and 70 counties were imposing local sales taxes. Delphos featured the highest combined local sales tax rate at 3.0 percent (2.0 percent, Ottawa County; 1.0 percent, Delphos). The combined local rate was at least 1.75 percent in 54 cities, in the part of Manhattan in Riley County, and in the entirety of Jefferson and Ottawa counties. There were no local sales taxes (county or city) imposed anywhere within ten counties (Clark, Coffey, Comanche, Hodgeman, Marshall, Phillips, Rush, Sheridan, Smith, and Wallace).

### **COMMITTEE ACTIVITIES**

At the July meeting, staff briefed the Committee on the history and utilization of Kansas local sales tax rates. At the August meeting, several conferees addressed the committee about Missouri's attempts to impose a use tax on behalf of its local units. The conferees also said that Kansas-based businesses were sometimes placed at a competitive disadvantage relative to Missouri-based businesses for certain goods delivered into Kansas – since the Kansas-based businesses were required to collect local sales taxes, but the Missouri-based businesses were NOT required to collect local use taxes.

At the October meeting, the League of Kansas Municipalities asked the Committee to introduce legislation making the local use tax base identical to the state use tax base. The Committee then requested the Department of Revenue to provide data in November on who pays state use taxes and on how much is attributable to motor vehicles and watercraft.

At the November meeting, the Department provided data which suggested that the League's proposal would increase local use tax collections by about \$24 million.

### **CONCLUSIONS AND RECOMMENDATIONS**

The Committee concludes that expanding the local use tax base to make it the same as the state base is a wise policy to pursue, but is not recommending specific legislation at this time.

The Committee recommends that future proposals contain a uniform local use tax rate for all sales other than those involving motor vehicles and watercraft.

## Proposal No. 13

**STUDY TOPIC: Liberalization of tax increment financing provisions, especially broadening application of the law to include "conservation areas" or "economic development areas."\***

### BACKGROUND

Many Kansas communities are faced with the problems of finding methods to address aging commercial districts and housing stocks. Among these available methods is tax increment financing (TIF), but Kansas cities attempting to use TIF have encountered difficulties. Proposal No. 13 charges the Committee to recommend whether the TIF laws should be amended to allow a certain portion of new economic activity to be dedicated to the financing of TIF projects and whether TIF should be allowed for the financing of certain private buildings or structures and whether TIF projects should be authorized in "economic development" or "conservation areas" as well as "blighted areas."

### COMMITTEE ACTIVITIES

The Committee devoted parts of three meetings to this topic. At the September meeting several conferees outlined their desires for expanded authority to utilize tax increment financing, including authority for use in "conservation areas," pledging of increases in utility (franchise) and local sales taxes, extension of the time period for tax increment collection to 20 years, and authority to use tax increments to pay for projects without the necessity to issue bonds.

At the October meeting conferees clarified their position, narrowing their request to five areas:

1. Allowing "conservation areas" which are not yet blighted to be eligible for TIF, up

to 15 percent of the land area of the city, and undeveloped areas in connection only with the construction of low or moderate income housing, industrial facilities, or manufacturing facilities.

2. Allow TIF proceeds to be used for improvements and structures necessary to meet building code, access requirements, asbestos abatement, or other requirements of law.
3. Permit less than 100 percent of the tax increment to be allocated to the project if other revenues are available.
4. Permit local franchise and sales taxes to be pledged for financing of the project;
5. Prohibit use of eminent domain for acquisition of property for conservation districts and undeveloped areas.

At the November meeting the Committee heard a report from Bill Caton, a member of the Governor's Commission on Housing and Homelessness, supporting expansion of the eligibility criteria for TIF projects. Don Moler, General Counsel, League of Kansas Municipalities, supported expansion of the TIF eligibility but did not support use of TIF for housing in newly developing areas. Mr. Randy Speaker, Director of Housing, Department of Commerce and Housing, submitted material relating to the Department's activities and objectives, and supporting expanded eligibility for TIF projects.

The Committee deliberated in November utilizing the policy requests made by the Development and Retention Council in October.

### CONCLUSIONS AND RECOMMENDATIONS

The Committee recommends that TIF financing be permitted for "conservation areas" which would

\* S. B. 405 accompanies this report.



include up to 15 percent of the land area of a city which is not yet blighted but within which at least half of the structures are at least 35 years old and may become blighted from identified factors.

The Committee recommends that increased revenue received by a city from franchise fees collected from utilities and other businesses within the redevelopment district, and from local sales taxes collected within the redevelopment district, may be pledged for the TIF project.

The Committee recommends that the period for tax increment collection be extended from 15 to 20 years.

The Committee recommends that a city be permitted to pledge less than 100 percent of the property tax increment if other revenues are available and pledged by the city.

The Committee recommends that the use of eminent domain for acquisition of property for "conservation areas" be prohibited.

The Committee also recommends that any state-wide levy for education not be considered part of the increment available to pledge for TIF projects.

Enactment of S. B. 405, attached to this report, will implement these recommendations.

# Proposal No. 14

**STUDY TOPIC: Indexing of personal exemption for income tax purposes.**

## **BACKGROUND**

The income tax indexation proposal required the Committee to consider whether Kansas personal exemption or standard deduction amounts should be indexed based on a "cost-of-living" adjustment to provide additional tax relief. Two bills considered by the 1995 Legislature dealt with indexation. S.B. 58 sought to index the Kansas standard deduction amounts prospectively beginning in tax year 1995. H.B. 2314 would begin indexing the Kansas personal exemption after first "catching up" with the last six years of indexation in the federal personal exemption amount.

### **Federal Indexation**

As an example of the indexation process, here is how the Internal Revenue Code's indexation mechanism worked to increase the federal personal exemption and standard deduction amounts from tax year 1994 to tax year 1995:

	1994	1995
Personal Exemption	\$2,450	\$ 2,500
St Ded – Married Joint	6,350	6,550
St Ded – Married Separate	3,175	3,275
St Ded – Head of Household	5,600	5,750
St Ded – Single	3,800	3,900

### **S.B. 58 – Kansas Standard Deduction Indexation Plan**

S.B. 58 would have indexed Kansas standard deduction amounts annually beginning in tax year 1995 by utilizing the same "cost-of-living" adjustment determined under Section 1(f)(3) of the Internal Revenue Code. (Section 1(f) reads as follows: (f) Adjustments in tax tables so that inflation will not result in tax increases – (1) In General – Not later than December 15 of 1990, and each subsequent calendar year, the Secretary

shall prescribe tables which shall apply in lieu of the tables contained in subsections (a), (b), (c), (d), and (e) with respect to taxable years beginning in the succeeding calendar year. (2) Method of Prescribing Tables – The table which under paragraph (1) is to apply in lieu of the table contained in subsection (a) (b), (c), (d), or (e), as the case may be, with respect to taxable years beginning in any calendar year shall be prescribed – (A) by increasing the minimum and maximum dollar amounts for each rate bracket for which a tax is imposed under such table by the cost-of-living adjustment for such calendar year, (B) by not changing the rate applicable to any rate bracket as adjusted under subparagraph (A), and (C) by adjusting the amounts setting forth the tax to the extent necessary to reflect the adjustments in the rate brackets. (3) Cost-of-Living Adjustment – For purposes of paragraph (2), the cost-of-living adjustment for any calendar year is the percentage (if any) by which – (A) the CPI for the preceding calendar year, exceeds (B) the CPI for calendar year 1989. (4) CPI for Any Calendar Year – For purposes of paragraph (3), the CPI for any calendar year is the average of the Consumer Price Index as of the close of the 12-month period ending on August 31 of such calendar year. (5) Consumer Price Index – For purposes of paragraph (4), the term "Consumer Price Index" means the last Consumer Price Index for all urban consumers published by the Department of Labor. For purposes of the preceding sentence, the revision of the Consumer Price Index which is most consistent with the Consumer Price Index for calendar year 1986 shall be used. (6) Rounding – (A) In General – If any increase determined under paragraph (2)(A), section 63(c)(4), section 68(b)(2) or section 151(d)(4) is not a multiple of \$50, such increase shall be rounded to the next lowest multiple of \$50. (B) Table for Married Individuals Filing Separately – In the case of a married individual filing a separate return, subparagraph (A) (other than with respect to subsection (c)(4) of section 63 (as it applies to subsections (c)(5)(A) and (f) of such section) and section 151(d)(4)) shall be applied by substituting "\$25" for "\$50" each place it appears.)

According to the fiscal note provided by the Department of Revenue, S.B. 58 would have

changed the Kansas standard deductions as follows:

	Current Law (TY 1995)	S.B. 58 (TY 1995)
Married Joint	\$ 5,000	\$ 5,150
Married Separate	2,500	2,575
Head of Household <sup>a</sup>	4,400	4,500
Single	3,000	3,100

a) NOTE: Head of household filers in Kansas are also entitled to take an extra personal exemption (\$2,000 under current law).

The Department of Revenue's income tax simulation model (the Department's model, last updated in November of 1994, contains approximately 10,000 tax year 1993 individual income tax returns and represents a sample size of about 1 percent of the returns filed in that year. The 1993 data were adjusted to a tax year 1995 base using estimated growth in Kansas Personal Income) estimates that S.B. 58 would have reduced FY 1996 SGF receipts by about \$3.4 million (attributable to the first year of indexation in tax year 1995). Assuming the "cost-of-living" adjustment remained constant for future years, the fiscal note would have been expected to grow by slightly more than \$3.4 million per year in all future years (given the elasticity of the income tax). In other words, if S.B. 58 had been enacted in 1995, the actual fiscal impact might have ended up at \$3.4 million in FY 1996, \$7.0 million in FY 1997, \$10.8 million in FY 1998, etc.

### Standard Deductions vs Itemized Deductions

The Department's model also estimates that about 64 percent of all individual income tax returns claim the Kansas standard deduction. Individuals may NOT itemize deductions on their Kansas returns in lieu of claiming the Kansas standard deduction unless they have itemized deductions on their federal returns – see K.S.A. 1994 Supp. 79-32,120.

### Personal Exemption Indexation

The model estimates that indexing the \$2,000 current Kansas personal exemption amount in a similar fashion as proposed for the indexation of standard deductions in S.B. 58 would have raised the amount in the first year to \$2,050 and would reduce SGF receipts by about \$5.5 million. The fiscal impact would be expected to snowball in future years, as explained in the earlier discussion relating to standard deduction indexation.

### H.B. 2314 – The "Catch-Up" Indexation Plan

Kansas' current \$2,000 amount is the same amount as the federal personal exemption was in 1989. Indexation since 1989 will have increased the federal personal exemption amount to \$2,500 for tax year 1995. Another policy option the Committee may wish to consider is to "catch up" to the federal personal exemption amount prior to beginning state indexation. This proposal was embodied in H.B. 2314. The Department's model estimated that the initial increase in the personal exemption amount from \$2,000 to \$2,500 for tax year 1995 would have decreased FY 1996 receipts by about \$52.3 million.

### H.B. 2149 – Kansas Personal Exemptions Above Federal

Though not an indexation plan, another bill worthy of mention dealing with personal exemptions is H.B. 2149. That bill would have increased the Kansas personal exemption to an amount well above the federal level. The personal exemption would have been increased from \$2,000 to \$2,800 in tax year 1995; to \$3,000 in tax year 1996; to \$3,200 in tax year 1997; to \$3,400 in tax year 1998; and to \$3,600 in tax year 1999 and thereafter.

The Revenue Department's model suggested fiscal notes of \$83.3 million for FY 1996; \$106.5 million for FY 1997; \$130.6 million for FY 1998; \$155.5 million for FY 1999; and \$181.1 million for FY 2000.

## COMMITTEE ACTIVITIES

At the August meeting, staff briefed the Committee on the indexation proposal and on how to interpret data presented from the Department of Revenue's simulation model. Conferees representing Senator Jerry Karr, Kansas Family Research, and the Kansas Taxpayers Network spoke in favor of indexation as a way of providing additional tax relief.

### ***CONCLUSIONS AND RECOMMENDATIONS***

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The Committee finds that the failure to index Kansas personal exemption and standard deduction amounts since they were brought into conformity with the federal amounts in the late 1980s has represented a hidden tax increase.

The Committee believes that increases in incomes as a result of inflation should not represent a benefit that accrues to the government.

The Committee recommends that if the resources are available, the 1996 Legislature should seriously consider protecting taxpayers from future inflation-driven tax increases by indexing prospectively personal exemption and standard deduction amounts beginning in tax year 1996.

Although not recommending the introduction of legislation at this time, the Committee further recommends that future indexation proposals consider annual increases of a fixed dollar amount along with other alternatives, including increases based on the CPI-U.