

Approved: Jan 30, 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 25, 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: Chris McKenzie, Kansas League of Municipalities
John LaFaver, Secretary, Department of Revenue
Jim Maag, Kansas Bankers Association
Matthew Goddard, Heartland Community Bankers
John Peterson, Fourth Financial Corporation

Others attending: See attached list

APPROVAL OF MINUTES

Senator Bond made a motion to approve the minutes of January 24, 1996. The motion was seconded by Senator Hardenburger. The motion passed.

REQUESTS FOR BILL INTRODUCTIONS

Chris McKenzie, Kansas League of Municipalities, requested the introduction of two alternative bills concerning the property valuation process. (Attachment 1)

Senator Bond made a motion to introduce these two bills. The motion was seconded by Senator Martin. The motion passed

SB 448--TAXATION OF FINANCIAL INSTITUTIONS

Secretary John LaFaver, Department of Revenue, presented this bill, giving the committee members an insight into the legislation. He said the bill is to apportion the income for multi-state institutions. This bill would help the Department of Revenue to determine which fraction of income is taxable in each state since the financial institutions cross state lines. Secretary LaFaver said the old law was in effect when banks did not operate out of state and there was not the need for apportionment at that time. This bill would probably not effect community banks who do not do branch banking and cross state lines. This bill is necessary to establish what the rules will be for apportioning the income for financial institutions which do operate across state lines. Presently, the Department has been doing this on a case-by-case basis and this would make the rule the same for everyone. **SB 448** is basically one that was adopted by the multi-state tax commission after a lengthy study process. It is necessary to have a standard because some financial institutions will be taxed by more than one state and some institutions will not be taxed by any state. He said this bill would also resolve a controversy of whether a bank which merges with another bank pays taxes on the last year of operation before the merger. Secretary LaFaver said it a complicated bill but it was carefully drafted.

Senator Martin stated that if these entities have always been taxed on an individual basis then there should be no fiscal impact to show there will be an increase in money. Secretary LaFaver said they had tried to make this a revenue neutral bill. There was also discussion of how this proposal differs from the *Chief* case. Secretary LaFaver said the whole apportionment scheme is unique for banks so that is not a part of the *Chief* case. The only part that would be similar to the *Chief* case would be the determination of what is business income. All income that is earned is subject to tax. The bill is written so that all income that is apportionable is taxable.

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION, Room 519-S
Statehouse, at 11:00 a.m. on January 25, 1996.

Jim Maag, Kansas Bankers Association, said since several banks and savings banks already have interstate branching operations in Kansas and no home offices here in Kansas, he believed it is appropriate for the Legislature to address this issue. (Attachment 2) The staff of the KBA has met with Secretary LaFaver and his staff in drafting this legislation. Mr. Maag expressed several concerns for new Section 1 and new Section 2. He also said the definition of "Financial institutions" does not include savings banks and he believed they must be added. The apportionment formula is very complex and includes property, payroll and receipts to be used in determining how to allocate the net income of a bank involved in interstate operations. The state Affairs Committee of the KBA believes the payroll factor should be dropped from the apportionment formula. The Committee from KBA believes Kansas should encourage the growth of payroll and jobs rather than discourage personnel operations in the state. Mr. Maag expressed concern regarding new Section 6 which he thinks addresses an issue unrelated to the rest of the bill. This is the section which sets forth a procedure for the merger of financial institutions. He thought this section should be removed from **SB 448**.

Senator Feleciano asked if the merger between Bank IV and Boatmens was what he was talking about. Mr. Maag said that was not a good example but he did give an example of a merger and how this would work. He said there needs to be a solution for this, but he did not believe it should be in this bill.

Secretary LaFaver said it is not their intent to subject income to tax more than once.

Senator Lee asked if there could be a time when banks can acquire another bank that was losing money and the larger bank then would not owe any tax. Tom Hintz, C.P.A., Manhattan, stood to answer this question. He stated that if the business was continued they can accept the loss and he thought federal law was similar for banks. Senator Lee said losses need to be discussed as well as profits.

Matthew S. Goddard, Heartland Community Bankers Association, agreed that action needs to be taken regarding the allocation and apportionment of income for financial institutions doing business outside of Kansas. (Attachment 3) He said, however, Section 6 is a concern for Kansas savings institutions. An increase in costs in mergers might affect the number of employees being retained by the acquiring thrift. He said of even greater concern is the retroactive nature of the privilege tax collection. He asked the committee to examine **SB 448** and some of the unwanted impacts it could have on financial institutions.

John Peterson, representing Fourth Financial Corporation, said they supported **SB 448**. He said they supported the Department of Revenue's effort to draft a method of allocating income. In regard to Section 6, he said he thought there was a consensus that there should not be zero tax, but they also should not be doubly taxed. It is important to put this into effect so that Kansas would have the same allocation formula and same factors that other states have. If the language needs to be clarified, that should be done. This would allow the state to get a fair share of the tax that is due them.

Senator Langworthy announced a sub-committee would be appointed to work on **SB 448**. She appointed Senator Bond as chairman and Senator Martin and Senator Langworthy as members.

The meeting was adjourned at 11:55 a.m.

The next meeting is scheduled for January 30, 1996.

SENATE ASSESSMENT AND TAXATION COMMITTEE GUEST LIST

DATE: Jan 25, 1996

NAME	REPRESENTING
Matthew Goddard	Heartland Community Bankers
Jim May	KBA
MARK BURGHAUT	ALDERSON et al.
Kathy Oufor	CBA
Chuck Stokes	cl
Kristin Animari	KS CU ASSOCIATIONS
Janice Lee	KCHA
M. Maitlin	Sedg. Cozenty
Jul Maria	First Bank Kansas
Bill Jancee	BOEING
J.P. Small	KOCH INDUSTRIES, INC
Michael J. Smith	KMHA
John Peterson	Fourth Financial Corp
JOHN LAFAYER	EDOR
Anne Spiess	KS. Assoc of Counties
Suzie Hoffmann	CBA



League of Kansas Municipalities

PUBLISHERS OF KANSAS GOVERNMENT JOURNAL 300 S.W. 8TH TOPEKA, KS 66603-3896 (913) 354-9565 FAX (913) 354-4186

TO: Senate Assessment and Taxation Committee
FROM: Chris McKenzie, Executive Director *CM*
DATE: January 25, 1996
RE: Request for Bill Introduction Concerning Property Valuation

Despite its unpopularity and continued criticism of its administration, the property tax is vital to the continued operation of local government in Kansas. Cities statewide accounted for sixteen percent of the property taxes collected in Kansas in 1994. For many smaller cities, however, the property tax is the single most important source of revenue in their budgets. In other words, cities have a stake in the continuation of this important revenue source, and the public's perceptions of its fairness is critical to the future of our property tax system.

County officials and the state Division of Property Valuation have worked diligently in recent years to develop a fair and efficient property tax system. Unfortunately there continues to be a wide gap between the public's perceptions of the system's fairness and the reality of these accomplishments.

While cities are not responsible for the administration of the property tax system, city officials are aware of the continued dissatisfaction with the system and have asked if there are ways in which we as a state can improve the system. In a desire to be responsible partners with the public, counties and the state in improving this vital tax system, I appear today on behalf of the League of Kansas Municipalities to respectfully request the introduction of two alternative bills concerning the property valuation process. In principle the two bills would contain the following elements:

Bill 1

This bill would include two amendments:

- ➔ an amendment to K.S.A. 1995 Supp. 79-1439 to insert a proviso that if the appraised market value of the property has increased less than 5% over the prior year, the appraised market value for purposes of assessment under this section shall not be adjusted by the county appraiser; and
- ➔ an amendment to K.S.A. Supp. 79-1460 to provide that the county appraiser shall notify each taxpayer in the county annually only if the valuation or classification of the property has changed from the prior year.

President: John Divine, Mayor, Salina * **Vice President:** Ralph T. Goodnight, Mayor, Lakin * **Past President:** Harry L. Felker, Mayor, Topeka *
Directors: Donald L. Anderson, Mayor, Lindsborg * Chris Cherches, City Manager, Wichita * Yvonne Coon, City Administrator, Clearwater * Ed Eilert, Mayor, Overland Park * Rod Franz, Finance Director, Salina * John Golden, Commissioner, Goodland * Richard Jackson, Commissioner, Ottawa * Carol Marinovich, Mayor, Kansas City * Tom Martin, Mayor, Dodge City * Marguerite Strange, Commissioner, Leavenworth * Melvin Williams, Councilmember, Mission * John Zutavern, Commissioner, Abilene * **Executive Director:** Christopher K. McKenzie

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Bill 2

This bill would amend K.S.A. Supp. 79-1411b, Supp. 79-1439, Supp. 79-1460, and perhaps other provisions of Article 14 of Chapter 79 to provide for a staggered system of valuing property at its market value within each county every three years. The basic provisions would be as follows:

- ➔ Each county (i.e., assessment district) would be divided into three assessment subdistricts.
- ➔ The real property in each subdistrict would be physically inspected and appraised at its fair market value every third year.
- ➔ After valuation every three years, any increase in assessed value would be phased-in over the subsequent three year period.
- ➔ Any decrease in assessed value would be given full effect immediately.
- ➔ All new improvements would be brought on to the tax roll immediately, but adjusted for purposes of the phase-in within the subdistrict in which it is located.
- ➔ Notices would only be sent every three years, but taxpayers would have the right to appeal valuations in conjunction with their property tax payments (i.e., tax protest).

The system described above is currently in place in the state of Maryland.

Thank you very much for your consideration of this request. We are prepared to offer additional information in support of your consideration of each of these requests.



The KANSAS BANKERS ASSOCIATION
A Full Service Banking Association

January 25, 1996

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

Madam Chair and Members of the Committee:

Thank you for the opportunity to appear before the committee on the provisions of **SB 448**. This bill attempts to resolve the difficult issue of how to equitably tax the interstate operations of banks, s&ls, and savings banks. 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. The staff of the KBA has met on two occasions with Secretary LaFaver and his staff in an attempt to draft the necessary amendments to the Kansas privilege tax law for financial institutions.

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

In New Section 1 in subsection (a) the additional phrase "and its apportionment factors shall include the part of its property, payroll and sales that is related to its apportionable income" has been inserted. Why the term "sales" is used here needs to be discussed since in all other parts of the bill the term "receipts" is used to describe that factor in the apportionment formula.

In New Section 2 on page 2 of the bill a subsection (c) which defines "business income" and a subsection (n) which defines "nonbusiness income" have been inserted. Neither of these subsections appears in the model act and we believe both subsections are unnecessary for the purposes of this bill and should be removed.

On page 3 of the bill there is a definition of "Financial institution" which does not include savings banks. We believe such institutions must be added to this definition since it is the federally-chartered savings banks which currently have the largest interstate branching operations in Kansas.

*Sen. Assess + Tax
Jan 25, 1996
attach 2-1*

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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. The State Affairs Committee of the KBA has reviewed the apportionment factors set forth in the bill and recommends that the Legislature may want to consider changing these factors and their weighting.

The committee believes the payroll factor should be dropped from the apportionment formula. They believe Kansas should encourage, rather than discourage, the growth of payroll and jobs and do not believe it is appropriate for Kansas to be using a factor which has the effect of discouraging financial institutions from locating personnel-intensive operations in our state.

They further suggest that the Legislature consider replacing the "receipts" factor in the apportionment formula with a "deposits" factor. A brief scanning of Section 3 of **SB 448** reveals how complicated the "receipts" factor is and how difficult it would be for the Department of Revenue to review and enforce. Conversely, deposit numbers for branch operations of financial institutions involved in interstate operations are readily available.

Our neighboring state of Missouri has adopted a "deposits" factor in the apportionment formula for their financial institutions tax. A copy of the apportionment provisions of the Missouri law is attached to this testimony.

It is difficult to know what percentages should be used in weighting the apportionment factors and it may take one or more years of actual privilege tax receipts to determine whether the appropriate factors and factor weighting has been achieved. The KBA is quite willing to work with this committee and the department in an attempt to resolve this complex problem.

The KBA also has serious concerns about New Section 6 of the bill addresses an issue unrelated to the rest of the bill. The section sets forth a procedure for collecting the privilege tax when a financial institution ceases to do business due to merger or other reasons. It would apply to all taxable years after 1994.

Kansas banks pay a privilege tax in lieu of the state corporate income tax. It is a tax for the "privilege" of doing business in any current year.

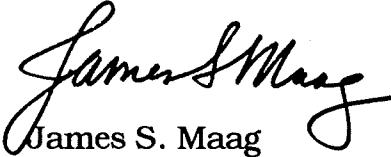
Thus in 1996 banks will pay a tax for the right to do business in 1996 and this tax will be based on their 1995 net income.

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 financial institution 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.

We believe the provisions of Section 6 raise serious constitutional problems for the privilege tax because it is attempting to impose an additional tax on institutions which have already paid the appropriate amount of tax for the "privilege" of doing business. We, therefore, believe this section should be removed from the bill because it is not an appropriate place to address this issue and could jeopardize the constitutionality of the remainder of the bill.

The KBA stands ready to work with this committee in amending **SB 448** to make it a bill which speaks only to the issue of applying the privilege tax to interstate banking operations. We do not believe this bill should be used as a vehicle to resolve other taxation issues whether they relate to financial institutions or other types of corporations.


James S. Maag
Senior Vice President

1-2

31

MISSOURI BANKERS ASSOC.

AUG-31-1995 14:56

148.097. 1. A taxpayer is taxable in another state if, by reason of business activity in another state, it is subject to and did pay one of the types of taxes specified: a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax. The taxpayer must carry on business activities in another state. If the taxpayer voluntarily files and pays one or more of such taxes when not required to do so by the laws of that state or pays a minimal fee for qualification, organization or for the privilege of doing business in that state, but does not actually engage in business activities in that state, and does not have business facilities in that state or does actually engage in some activity, not sufficient for nexus, and the minimum tax bears no relation to the taxpayer's activities with such state, the taxpayer is not taxable in another state.

2. When the income of a taxpayer is derived from business activity conducted within and without this state and the business activity is taxable in another state, then income shall be apportioned to this state by multiplying the gross income minus the deduction in section 148.040 by a fraction, the numerator of which is the sum of the property factor, the payroll factor, and the deposits factor, and the denominator of which is

Section 148.097 reaffirms the physical presence requirements as necessary to tax Missouri banks and trust companies. This section is the beginning of the process for considering various factors to determine the bank tax owed, and is a first recognition in the bank tax that some banking is conducted across state lines.

An organization with many banks should be able to fully and fairly allocate the financial institution tax, while the same law should not complicate the community bank's tax return.

NOTE! Section 148.097 includes several terms of act, such as "nexus". Before a bank seeks to allocate taxes under this section, the bank should carefully review the law and its impact with the bank's attorneys, CPAs or other tax advisors. It is believed this law will be revenue neutral.

Section 148.097.1 provides that a commercial bank (e.g. taxpayer) is taxable under this law in another state when it pays one of the taxes specified, has a physical presence in the state, or engages in business activity in that state sufficient for nexus.

Section 148.097.2 provides an apportionment formula as follows:

$$\text{gross income} - \text{deductions} \times \left[\frac{\text{property factor}}{\text{total property}} + \frac{\text{payroll factor}}{\text{total payroll}} + \frac{\text{deposit factor}}{\text{total deposits}} \right]$$

When there is no property, payroll or deposits outside the state, that factor is eliminated.

28 three reduced by the number of factors which have
29 a denominator of zero.

30 3. For purposes of subsection 2 of this section,
31 the property factor is a fraction, the numerator of
32 which is the average value of the taxpayer's real
33 and tangible personal property owned or rented
34 and used in this state during the income year, and
35 the denominator is the average value of all the
36 taxpayer's real and tangible personal property
37 owned or rented and used during the income year,
38 except under this subsection, any property that the
39 bank acquired in settlement of debts and is held
40 for sale under section 362.165, RSMo, or section
41 29 Title 12 United States Code. Property owned
42 by the taxpayer shall be valued at its original cost.
43 Property rented by the taxpayer is valued at eight
44 times the net annual rental rate. The net annual
45 rental rate is the total rental rate paid by the
46 taxpayer, less total annual rental rates received
47 by the taxpayer from subrentals. The average
48 value of property owned by the taxpayer shall be
49 determined by averaging the values at the begin-
50 ning and ending of the income year, but the director
51 of revenue may require averaging by monthly
52 values if reasonably required to reflect the average
53 value of the taxpayer's property for the income
54 year.

55 4. For purposes of subsection 2 of this section,
56 the payroll factor is a fraction, the numerator of
57 which is the total amount paid in this state during
58 the income year by the taxpayer for compensation,
59 and the denominator of which is the total compen-
60 sation paid everywhere during the income year by

Section 148.097.3 defines the property factor.

$$\text{Property factor} = \frac{\text{Value of bank's qualified property in Missouri}}{\text{Value of all bank's qualified property}}$$

NOTE! Property must meet the definitions in this subsection to be included as qualified property. There are also various rules for calculating the qualified property values.

2-5

314 634 8451 P.09

MISSOURI BANKERS ASSOC.

AUG-31-1995 14:57

61 the taxpayer. Compensation is paid in this state
62 if:

63 (1) The employee's service is performed
64 entirely within this state;

65 (2) The employee's service is performed both
66 within and without this state, but the service
67 performed without this state is incidental to the
68 employee's service within this state; or

69 (3) The employee's services are performed both
70 within and without this state, and:

71 (a) The employee's base of operations is in this
72 state; or

73 (b) There is no base of operations in any state
74 in which some part of the service is performed, but
75 the place from which the service is directed or
76 controlled is in this state; or

77 (c) The base of operations or the place from
78 which the service is directed or controlled is not
79 in any state in which some part of the service is
80 performed but the employee's residence is in this
81 state.

82 5. For purposes of subsection 2 of this section,
83 the deposits factor is a fraction, the numerator of
84 which is the average of deposits recorded on the
85 books at the main banking house and branches of
86 the taxpayer within this state during the income
87 year, and the denominator of which is the average
88 deposits recorded on the books everywhere by the
89 taxpayer during the income year. Such average
90 shall be determined by averaging deposits as of
91 the first of the year with deposit as of the last day
92 of the year.

148.610. For the purposes of sections 148.610 to

Section 148.097.4 defines the payroll factor.

$$\text{Payroll factor} = \frac{\text{Total bank qualified compensation paid in Missouri}}{\text{Total bank compensation paid}}$$

NOTE! The rules for apportioning compensation under this subsection makes Missouri the origin of almost all bank compensation paid to an employee of a Missouri bank.

Section 148.097.5 defines the deposit factor.

$$\text{Deposit factor} = \frac{\text{Average of bank's qualified deposits in Missouri}}{\text{Average of all of bank deposits}}$$

Generally, bank deposits are only recorded on the books of the bank or bank facility.

NOTE: For certain bank groups, the Chapter 148 tax will be largely eliminated if SB 380 becomes law.



Matthew S. Goddard, Vice President

700 S. Kansas Ave., Suite 512
Topeka, Kansas 66603
(913) 232-8215

To: Senate Assessment and Taxation Committee

From: Matthew Goddard
Heartland Community Bankers Association

Date: January 25, 1996

Re: Senate Bill No. 448

The Heartland Community Bankers Association appreciates the opportunity to appear before the Senate Committee on Financial Institutions and Insurance to express our concerns relating to SB 448.

We agree that action needs to be taken regarding the allocation and apportionment of income for financial institutions doing business outside of Kansas. However, Section 6 of the legislation is a source of concern for Kansas savings institutions. The provision offers the legislature two choices: increasing revenues or increasing the costs of financial institution mergers and acquisitions. An increase in such costs, while unlikely to prevent a merger, could play a role in subsequent decisions concerning the number of employees and branches retained by the acquiring thrift. The greater the cost associated with the transaction, the greater the cost-cutting measures the purchaser must pursue in order to offset expenses.

Of even greater concern is the retroactive nature of the privilege tax collection. Several of our members have made acquisitions since Dec. 31, 1994, the bill's retroactive date. They played by the rules as they were written at the time, following the advice of their accountants and legal counsel. After spending up to a year on the acquisition process, the legal formalities were completed and the deals were done. Now, months later, SB 448 would require financial institutions to pay taxes on a transaction everyone thought was already completed. These thrifts operated in good faith and in compliance with the law. Now, after the fact, that law might be changed.

It is for these reasons that we would request this committee to examine SB 448 and the unwanted impacts it could have on financial institutions.

Thank you.

*Sen. Assess + Tax
Jan 25, 1996
attach 3-1*