

Approved: Feb. 13, 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 February 8, 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: Shirley Sicilian, Research & Analysis, Dept. of Revenue
Art Brown, Mid-America Lumbermens Association
Mark Lanzrath, Morgan Distribution Co., Shawnee
Pat Shelley, Teague Electric, Lenexa
Chris McKenzie, League of Kansas Municipalities

Others attending: See attached list

APPROVAL OF MINUTES

Senator Martin made a motion to approve the minutes of February 6, 1996. The motion was seconded by Senator Bond. The motion passed.

SB 453--APPLICATION OF LOCAL COMPENSATING USE TAX

The hearing was opened on **SB 453** and Senator Langworthy called the attention of the committee to a copy of Proposal #12 by the Special Committee on Assessment and Taxation (Attachment 1) This issue was studied during the interim and this is the report. Also passed to the committee was a copy of the fiscal note prepared by the Division of the Budget. (Attachment 2) Senator Langworthy asked Shirley Sicilian, Research and Analysis, Department of Revenue, to explain to the committee how the figure of \$23.7 million increase in tax collections to local governments was figured.

Ms. Sicilian passed to the committee a copy of the report which was sent to the Division of the Budget. Senator Martin said he was interested in how the figure of approximately \$24 million was arrived at and she went through the five points on page 1. (Attachment 3) Senator Martin also asked if this included the mail order sales. Ms. Sicilian said they captured an amount that is currently being collected by the state. It could be much more because Kansas is not collecting on all catalog sales. Senator Martin said he thought the figure was somewhat inflated.

Staff said a case could be made that the figure of \$23.7 million may be too low rather than too high.

PROPOSERS

Art Brown, representing Mid-America Lumbermens Association, said he wanted to address what this issue is and what it is not. (Attachment 4) He said it is not a tax increase to Kansas citizens. This issue relates to business tax policy, not individual tax policy, and he gave some examples. Mr. Brown also spoke of the newspaper clippings with his attachment which tells about the money which the city of Kansas City has collected. He said the state of Missouri can apply this tax on any out-of-state business doing business in Missouri, but because there is no such tax policy in Kansas, Missouri businesses escape paying any tax to Kansas when they do business in Kansas. He said the next two proponents will explain how it affects their business. Mr. Brown did not feel that the Department of Revenue would audit individuals, because they do not have the manpower to do so, but the Department could audit businesses to see that they comply with this tax.

There were questions from the committee about how the Kansas businesses could pay this amount of tax.

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION, Room 519-S
Statehouse, at 11:00 a.m. on February 8, 1996.

Senator Lee said she has received calls from some constituents stating they have purchased ATV's in Nebraska and are now being charged state sales tax and interest by Kansas. This shows the Department of Revenue does do audits and individuals are charged tax. She asked how **SB 453** would effect these citizens. Staff said citizens would have to pay not only the state sales tax but also the local compensating use tax. Senator Feleciano asked how the local compensating use tax would effect Boeing in Wichita with their large dollar amount of purchases. Staff said machinery and equipment are exempt from sales tax, but the exemption does not include supplies nor personal computers.

Mark Lanzrath, Morgan Distribution, Shawnee, spoke in support of **SB 453**. (Attachment 5) He gave an example how a sale in Kansas would cost more than a sale made by a Missouri company delivering to the same job site. He said this puts the Kansas company at a disadvantage if the same price is charged for the items. He said if a Kansas company does less business this will result in less employees and less income tax revenues for the state. Missouri implemented a local option use tax in 1992.

There was a question for Mr. Lanzrath if a Wichita company like Boeing purchased computers from an out-of-state company they would not pay any local Wichita sales tax, but if they purchased from a firm in Wichita, they would have to pay the local tax, which puts the local firm at a disadvantage. Mr. Lanzrath said "Yes, a Kansas business would be at a disadvantage."

Senator Martin said someone in Kansas is going to pay this tax, and if it is an individual, they would pay the tax.

Pat Shelley, Teague Electric, Lenexa, offered his perspective on the local option use tax. (Attachment 6) Mr. Teague used an example of how it costs less to buy from a Missouri company than a Kansas business right down the street. He said last year they were advocating repeal of the sales tax on new construction because of the inequities it created in the construction business in their area and he felt the tax differential being discussed was a similar situation. Mr. Shelley said this bill will benefit everyone by helping keep Kansas businesses strong.

Chris McKenzie, League of Kansas Municipalities, spoke in support of **SB 453**. (Attachment 7) He said in 1982, a local compensating use tax was enacted on vehicles and vessels that are registered under state law. This statute is working in a satisfactory manner. The Department of Revenue has administered this law in a fair and effective manner and **SB 453** should be identical in application. This law would ensure that Kansas businesses are not put at a competitive disadvantage. Mr. McKenzie said **SB 453** would provide alternative revenue sources for cities and would be a step in lessening the state's reliance on the property tax. He said in answer to some of the discussion of the committee, that yes, there would be people or businesses who would have to pay the tax who don't pay the tax today.

Senator Langworthy asked Shirley Sicilian to come back to the podium to answer some more questions. Senator Ranson said it would be helpful if the committee could be given an idea of how this bill would affect individual counties and what the increase in taxes would be to each county. Ms. Sicilian said she could do that.

Senator Martin asked about the estimated figure of sales upon which the local compensating use tax was calculated. He said it was not reality that the total figure of sales are going to be able to be used.

Senator Langworthy asked if any auditors were added when they figured FTEs in the fiscal note? Senator Langworthy said she has problems with how the Department of Revenue would be able to administer this tax and provide oversight. She said obviously Missouri has figured this out but she was concerned that this was not figured into the fiscal note. Ms. Sicilian said there were no auditors included, there was a tax examiner III figured in, but they thought the Department would continue to audit as has been done in the past.

There were no more questions and the meeting was adjourned at 12:00 noon.

The next meeting is scheduled for Tuesday, February 13, 1996.

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.

*Sen. Assess + Tax
Feb 8, 1996
attach 1-1*



DIVISION OF THE BUDGET

Room 152-E

State Capitol Building

Topeka, Kansas 66612-1504

(913) 296-2436

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Bill Graves
GovernorGloria M. Timmer
Director

February 8, 1996

The Honorable Audrey Langworthy, Chairperson
Senate Committee on Assessment and Taxation
Statehouse, Room 143-N
Topeka, Kansas 66612

Dear Senator Langworthy:

SUBJECT: Fiscal Note for SB 453 by Senate Committee on Assessment and Taxation

In accordance with KSA 75-3715a, the following fiscal note concerning SB 453 is respectfully submitted to your committee.

SB 453 would amend current law relating to local compensating use taxes. The bill would expand the base on which the local compensating use tax is levied so that it is the same as the base on which the state compensating use tax is levied. Under current law, the local compensating use base applies only to motor vehicles, including boats, purchased outside the state. The bill would require any applicable local compensating use tax to be collected along with the state compensating use tax. Monies collected by the Director of Taxation in the Department of Revenue would be credited to the County and City Compensating Use Tax Fund.

Estimated State Fiscal Impact				
	FY 1996 SGF	FY 1996 All Funds	FY 1997 SGF	FY 1997 All Funds
Revenue	--	--	--	--
Expenditure	--	--	\$278,963- \$919,333	\$278,963- \$919,333
FTE Pos.	--	--	--	7.0 - 31.0

SB 453 would not create any additional state tax revenue. According to the Department of Revenue, the bill could increase local compensating use tax collections by as much as \$23.7 million in FY 1997. However, because of several assumptions that had to be made, the Department indicates

Sen. Assess + Jay
Feb 6, 1996
attach 2-1

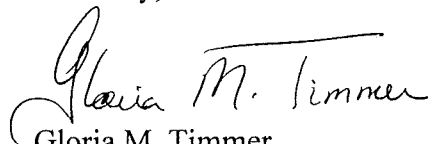
that this represents the high-end of the estimate. One of the Department's assumptions is that all out-of-state purchases will occur in the same local taxing jurisdictions as motor vehicles and boats, which the agency acknowledges is probably not the case. Second, the Department assumes that all motor vehicles and boats that are subject to the state compensating use tax are subject to the local use tax. Currently, 70 counties have a local sales tax, leaving 35 that do not. The Department also assumes that this tax would be collected only when the state compensating use tax was collected.

SB 453 would likely result in additional expenditures from the State General Fund by the Department of Revenue in FY 1997 above the amount contained in *The FY 1997 Governor's Budget Report*. According to the Department of Revenue, the bill could require additional expenditures of \$278,963 (and 7.0 FTE positions) to \$919,333 (and 31.0 FTE positions) from the State General Fund. If only currently registered retailer and consumer compensating use taxpayers are required to collect and remit local Kansas taxes, then the lower amount could be incurred. If every retailer is required to collect and remit these taxes, then the higher amount could be incurred.

Under the first scenario, the Department indicates that it would need \$106,841 for 5.0 FTE positions and \$24,880 for other operating expenses in the Record Services Bureau to handle additional batch entry and deposit entry functions; additional checker, validation, and cashier functions; additional distribution and correction functions and additional data entry responsibilities. The Business Tax Bureau may need \$57,542 for 2.0 FTE positions for responsibilities associated with locating, notifying, and registering taxpayers. There are approximately 15,000 taxpayers who would need to be notified, but the Department is uncertain how many would need to be registered. An additional \$83,500 would be required in the Information Systems Bureau because every computer program would need to be examined to decide whether implementation of this bill would impact taxation procedures. Finally, the Taxpayer Assistance Bureau could require \$6,200 for additional printing and postage costs.

Under the second scenario, the Department indicates that the Record Services Bureau would need an additional \$470,732 over the first scenario amount from the State General Fund for 22.0 FTE positions and an additional \$109,472 for other operating expenses. The additional resources would be needed to assist the mail receiving, checkers, and validation functions; mail opening and assembly functions; deposit entry functions; cashier, edit, data entry, and corrections functions; distribution functions; and supervisory functions. The Business Tax Bureau could need an additional \$60,166 for 2.0 FTE positions for increased location, notification, and registration responsibilities. The \$83,500 for the Information Systems Bureau and the \$6,200 in printing costs included in the first scenario would also be funded under this scenario.

Sincerely,



Gloria M. Timmer
Director of the Budget

cc: Kansas Association of Counties
Shirley Sicilian, Revenue

Jay

M E M O R A N D U M

TO: Ms. Gloria M. Timmer, Director
Division of Budget

DATE: February 6, 1996

FROM: Kansas Department of Revenue

RE: Senate Bill 453
as Introduced

BRIEF OF BILL:

Senate Bill 453, as Introduced, would amend local sales tax statute K.S.A. 12-198, to impose a compensating use tax for every city or county imposing a retailer's sales tax. The local compensating use tax would be for the privilege of using, storing or consuming, within a city or county, any article of tangible personal property. The tax rate would be fixed at the same rate as the city's or county's retailer sales tax.

Under current law the Local Compensating Use Tax applies only to motor vehicles and boats. This amendment would require any applicable local compensating use tax to be collected along with the State Compensating Use Tax. Monies collected by the Director of Taxation would be credited to the city and county compensating use tax fund.

This act would take effect July 1, 1996.

FISCAL IMPACT:

This bill could increase local compensating use tax collections by a crude estimate of \$23.7 million annually, effective with FY 1997.

There is no accurate way of determining exactly how much revenue to local governments would increase if this proposal were enacted. For the purpose of this estimate, it was assumed that this tax would be collected only when state compensating tax was collected. Therefore, the computational methodology was as follows:

1. First, under current law, local compensating use tax applies only on purchases of motor vehicles and boats. This tax is relatively easy to monitor and enforce as there is a central clearing point through which all of these transactions must pass before they can be titled or registered in Kansas. It can then be assumed that the \$6.8 million in local use tax collected in FY 1995 represented all such vehicles which were purchased out-of-state and registered in a jurisdiction which was subject to a local sales tax.
2. Second, to estimate the total purchase price of the vehicles involved, a weighted average local tax rate was calculated. This rate for FY 1995 was determined to be .89%. Dividing total collections by the average tax rate produces an estimated \$764 million total out-of-state sales amount.
3. Third in a similar manner, total state compensating use tax collections for FY 1995 of \$168 million was divided by the state rate of 4.9%. This converts the tax collections on estimated sales of \$3.429 billion.
4. Forth, the estimated local sales figure of \$764 million was subtracted from the estimated state sales figure of \$3.429 billion to provide an estimate of \$2.665 billion as an estimate of the out-of-state sales upon which state compensating use tax is being paid which are not currently subject to a Kansas local use tax.
5. Finally, applying the local weighted average tax rate of 0.89% to the untaxed sales estimate of \$2.665 billion produces an annual estimate of a \$23.7 million increase in local compensating use tax collections, effective with FY 1996.

Sen. Assess + Jay
Feb 8, 1996
Attach 3-1

This estimate carries several major caveats: First, it was assumed that all motor vehicles and boats which are subject to the state use tax are subject to local use tax. This is not correct. At the present time 70 counties have a local sales tax, leaving 35 who do not. Therefore, the quoted estimate is too high--actual local collections could be several million dollars less than the \$23.7 million.

Further, it was assumed that all out of state purchases will occur in the same local taxing jurisdictions as motor vehicles and boats which is not likely to be true.

Finally, it is important to point out that the provisions of this bill would create no additional State tax revenue. To the contrary, it is conceivable that the increased complexity of the accounting and reporting procedures that would be necessitated by this bill would reduce the level of voluntary compliance by out-of-state retailers that we currently enjoy. If this were to occur, State revenue collections could decrease.

ADMINISTRATIVE IMPACT:

The Department's administrative costs are contingent on two possible scenarios:

Scenario I - Only currently registered retailer and consumer compensating use taxpayers would now be required to collect and remit to the KDOR local Kansas entity taxes.

Scenario II - Every retailer has the potential of becoming a compensating use taxpayer collecting local Kansas taxes. In addition, all currently registered retailer and consumer compensating use taxpayers would be collecting local Kansas taxes. This would have the potential of doubling taxpayer filing requirements and KDOR's processing requirements.

Costs under Scenario I:

Record Services Bureau - One additional Keyboard Operator II @ \$20,961 would be required to handle the additional batch entry and deposit entry functions. One additional OA-III @ \$20,961 to handle the additional Checker, Validation and Cashier functions. One additional Bookkeeper, @ \$22,948 would be required to handle the additional distribution and correction functions. Two additional Office Assistant III's @ \$20,961 (\$41,922) would be required to handle: a) the additional keystrokes in Data Entry from the returns and the 16A local report and b) the additional edit corrections created from the confusion of the taxpayers.

These five positions would also require fiscal year 1997 One-Time Operating Expense expenditures of \$23,500 (\$4,700 x 5) and fiscal year 1997 Annual Other Operating Expenditures of \$1,380 (\$276 x 5). Note: the one-time expenses include microcomputer system, Herman Miller workstation, chair, electrical outlets, telephone and installation of cables. The annual expense includes the annual fee for a telephone line.

Business Tax Bureau - These costs relate to locating, notifying, and registering taxpayers. There are approximately 15,000 taxpayers who will need to be notified. We have no estimate on how many will need to be registered. One Accountant Specialist @ \$27,459 will be needed to work the distribution of local taxes. A Tax Examiner III @ \$30,083 will be required to work correspondence generated by refund requests, error corrections, amended returns, waiver requests, and answer general questions regarding this tax.

Information Systems Bureau - There would be a significant cost impact on I.S. There are currently over 300 programs used to maintain the Sales Taxation Files; this includes the S2 (legacy) file and ARMS. These programs support the following systems:

- Registration and the issuing of returns
- DCP (Batch Control, Fiscal, and Deposits)
- Data entry
- Daily Posting
- Distribution
- Statistics
- Informational reports and special requests

Every program would need to be examined to decide if this taxation change will impact the process. Because the majority of these programs were written in the 1960's and are very unstructured, they will require a great deal of analysis to determine the implications of these additions to the programs. The necessary coding will need to be inserted into the existing processes or in some cases, cloned from similar sections which deal with Local Consumers Compensating Use Tax. Assuming 2/3 of the programs require enhancements to carry out the mandates of this taxation change, using an average of 20 hours of time required for each program, there would be approximately 4000 hours of programming time involved for analysis and design, coding, testing, implementation and follow-up.

200 programs changed X 20 hours per program = 4000 hours or 500 man days.

1 FTE @ \$167.00 per day X 500 days = \$83,500 one-time salaries.

New forms would have to be designed for the returns which would incorporate spaces for the correct reporting of the Local Retailers Compensating Use Tax.

Taxpayer Assistance Bureau - Implementation of the proposed legislation will require more printing of returns and instructions and it also may require notification of the changes. Costs will vary as the determination is made of additional taxpayers needing to file returns as a result of this legislation.

<u>Contractual Services</u>	
Additional printing	\$ 1,200
Postage	<u>5,000</u>
Total	\$ 6,200

Costs Under Scenario II:

Record Services Bureau - The following resources for this bureau would be required to handle the additional returns, 16A's and all processing responsibilities that go with them:

Four additional OA-II's @ \$19,196 (\$76,784) to assist in Mail Receiving, Checkers and Validation Units functions. One additional OA-I @ \$17,578 to assist in Mail Opening and Assembly functions. Two additional Keyboard Operator II's @ \$20,961 (\$41,922) to complete Deposit Entry functions. Seventeen additional Office Assistant III's @ \$20,961 (\$356,337), to complete cashier, edit, data key entry and corrections functions. One Accountant II @ \$34,545 to complete distribution functions. One Accountant Specialist @ \$27,459 to provide entry, correction and supervisory functions. One bookkeeper @ \$22,948 to assist in distribution functions.

These twenty-seven positions would also require fiscal year 1997 One-Time Operating Expense expenditures of \$126,900 (\$4,700 x 27) and fiscal year 1997 Annual Other Operating Expenditures of \$7,452 (\$276 x 27). Note: the one-time expenses include microcomputer system, Herman Miller workstation, chair, electrical outlets, telephone and installation of cables. The annual expense includes the annual fee for a telephone line.

Business Tax Bureau - Again, these costs are for locating, notifying, and registering taxpayers. There are approximately 9,000 retailers and 6,000 consumers compensating use taxpayers who will have to be notified. We have no estimate on how many will need to be registered. If every retailer would be subject to this tax, we would need to notify approximately 100,000 taxpayers. There would be a significant impact to the taxpayers and a significant amount of education of taxpayers to help them file their returns properly. One Accountant Specialist @ \$27,459 would be needed to work the distribution of local taxes. Three Tax Examiner III's @ \$30,083 (\$90,249) would be needed to work correspondence generated by refund requests, error correction, amended returns, waiver request, and to answer general questions regarding this tax.

ADMINISTRATIVE PROBLEMS AND COMMENTS:

Record Services Bureau - In either scenario, this legislation would create great confusion for consumers and retailers selling or purchasing tangible personal property and using, storing or consuming property within a city or county. The DCP system would require changes that would allow for the batching, entry and deposit of compensating returns with local tax. The document entry system would need similar revisions. Additional batch, deposit entry, document entry and corrections would be required. Additional pre-edit requirements would occur to handle the many errors sent in by the taxpayers by being confused on the local tax issues.

Business Tax Bureau - This bill will have to be interpreted as imposing either a retailers compensating use tax or a consumers compensating use tax or both. We will need to determine if discounts for surrounding states will apply to local taxes collected. It will be difficult for retailers to determine what local taxes apply because mailing addresses are not sufficient to determine taxing authority. This tax would be a significant administrative burden to the taxpayers to report properly. The amount of record keeping forced on them would be monumental.

Information Systems Bureau - The costs and problems outlined above for Information Systems are personnel costs and related computer processing costs to implement the required changes through development, design/coding, and testing (unit and support of customer for user testing). The administrative impact for user involvement in the project, user testing and training, as well as on-going user involvement in supporting the new system change (s) is not included but is believed to be quite significant..

General Comments - Many of the Department's administrative problems associated with this bill are also legal concerns and are contained in the legal impact section. Does this proposed tax apply between and among cities and counties as stated? If an item is mail-ordered, where does situs attach; from the place where the order was called in? the mailing address where the item was sent? or the place where the item was finally taken for "using, storing, or consuming?"

It is also unclear if the authors of this bill intend for the retailer discounts allowed by K.S.A. 79-3707 to apply to local collections as well.

Administrative problems from the taxpayers perspective are varied and complex. It is impossible for anyone to determine with any degree of certainty the precise geographical location of a customer from address, zip-code or telephone prefix.

Each quarter, the Department implements new local taxes, rate changes, as well as additions and deletions of taxing jurisdictions. It would be extremely difficult for out-of-state retailers to keep current on all of these changes. In addition it would require the retailers who do voluntarily register and collect the Kansas compensating use tax to move from a post card size return with four or five lines to a six page return with lines for every city and county. It may also result in the other states with which we maintain reciprocal agreements, requiring Kansas retailers to collect and report their local use tax.

LEGAL IMPACT:

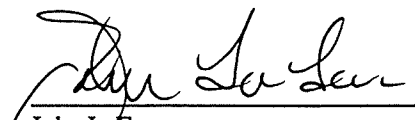
The proposed legislation seeks to impose a city or county local compensating tax. Only those jurisdictions which have a local sales tax would be allowed to have a local compensating tax. The way the bill is drafted, the compensating tax comes into existence automatically when the local unit of government imposes a local sales tax. This may violate the Kansas Constitution.

Currently, Kansas law (K.S.A. §12-187) provides the constitutional methodology for a local unit of government to impose a local sales tax. There is no similar provision for imposition of a local compensating tax. To insure that this tax withstands constitutional challenge, K.S.A. §12-187 should be amended to provide for the imposition of a local compensating tax.

The question of nexus becomes the next issue to be addressed. There is neither time nor space to provide a detailed analysis of Due Process and Commerce Clause nexus cases. Suffice it to say that if this tax is intended to be on the consumer and it is the consumer who will be required to report and pay this tax, nexus is not an issue. If, on the other hand, the legislation is intended to impose a burden on a non-city or non-county retailer to collect and remit a retailers' compensating tax for a jurisdiction in which that retailer is not located, then, on a local level, the national question of nexus appears. The question of establishing nexus for thousands of Kansas retailers for scores upon scores of local tax jurisdictions is problematic. Litigation will be lengthy and expensive. In large metropolitan counties such as Johnson County, the lines of demarcation will be particularly difficult.

As to the consumer portion of the compensating tax, when property is mobile (for example construction equipment), which local unit of government gets the tax? This provision is silent as to situs of the tax for use in a local jurisdiction. It is recommended that, at a minimum, situs be established somewhat parallel with the logic behind K.S.A. §12-191. Establish some threshold presumption. Without this issue being addressed, situs litigation can be anticipated similar to the litigation undertaken when local sales taxes were first introduced. The loss of that case (Capital Electric Line Builders) then resulted in the current K.S.A. §12-191. It is recommended that language be adopted to avoid this type of situs based litigation in the future.

APPROVED BY:



John LaFaver
Secretary of Revenue

MARCUM/PARKS



MID-AMERICA LUMBERMENS ASSOCIATION

TESTIMONY FOR THE SENATE ASSESSMENT AND TAXATION COMMITTEE

Senate Bill # 453

February 8, 1996

Madam Chair, members of the Committee. My name is Art Brown. I represent the retail lumber and building material dealers in this State through the Mid-America Lumbermens Association. It is my pleasure to address you today as a proponent for Senate Bill # 453, which would allow for the implementation of a local-option compensating use tax to be applied by the local units of Government in the State of Kansas.

My role today is more that of a facilitator than anything else. Other proponents will identify how this tax, currently being administered by Missouri is impacting business owners and operators in our State. They are the ones who are "in the field" and give you the hands - on look at what has been occurring since Missouri initiated this tax policy in October of 1994. (note: notice to taxpayer is attached to my testimony)

What I want to address is what this issue is and what it is not. It is not a tax increase to Kansas citizens. This issue relates to Business tax policy, not individual tax policy. I will give a couple of examples to illustrate my point.

The second item attached to my testimony is a voucher from our headquarters office in Kansas City, MO. You will notice the line item USE TAX FOR APRIL-MAY-JUNE 1995. The amount is \$209.10. What I want the committee to note is the 3 items listed on the bottom of this page. You will see a #408-032 which is our



*Senate Assess + Tax
Feb 8, 1996*

interoffice code for our annual golf tournament in Salina. As you notice in the body of this voucher this tax is on caps, shirts and other items I purchase for this Salina KS., golf tournament, purchases from a company in New Jersey, and paid for by our home office in Missouri. You will note that the State of Missouri got a \$107.20 bite for this by applying their local option use tax. In its simplest form, this tax can be applied by the Missouri Dept. of Revenue on any out of State business doing business in Missouri, but because there is no such tax policy in Kansas, they escape paying any tax to Kansas when they do business in Kansas. This point will be more graphically pointed out by future conferees.

How does implementation of this policy impact individuals? I wish to use an example that was brought out in the interum tax committee hearings this last year. One of the members of that committee gave the example of purchasing a baseball bat at Coors Field in Colorado and bringing it back to their home in Kansas. Did they owe a use tax on that baseball bat? In a technical sense, they do. Use tax paid by individuals on the State level currently is done on a voluntary basis. Therefore, if the citizen in question voluntarily paid a use tax to the State on the baseball bat in question, then they would also pay the local option use tax on the same baseball bat if this bill was inacted. If they did not voluntarily pay the State use tax, then there would be no collection of the local option use tax made. All this bill would do is add the local-option rate to that sale. I would leave it to the wisdom of the committee as to how many citizens you know fill out such a form under these circumstances. The point is: The Department of Revenue simply does not have the manpower to audit individuals in this manner, but they do have the manpower to audit businesses'.

No citizen would see an extra bracket on their income tax, there would be no sales tax paid at the counter for items purchased, and no property tax statements sent out, yet, both that local unit and the business located in that locale get the benefit out of implementation of this policy without any harm to the average Kansas Citizen.

Is this tax legal? That is a very good question. In *Associated Industries of Missouri vs. Lohman*, the U.S. Supreme Court struck down the way that Missouri administered their use tax because in some cases the rate of their use tax exceeded their local sales tax. What Missouri came back with is what I pointed out to you earlier in my testimony which is the letter sent to all taxpayers. It is a system that must be working. I have also included for the committee articles from the *Kansas City Star* about the windfall of money the city of Kansas City has realized from inactment of such a tax. The way this bill is written, we believe, is Constitutional but would much prefer you ask an attorney that question rather than myself.

The impact on local units- - what it would do and what it would not do- - will be addressed by those who understand the impact on such entities far better than I, and I would defer to their testimony.

In closing: many of you are looking at this issue and saying to yourself, "this really doesn't impact me at all." Actually, outside of the first 3 tiers of eastern counties in the State, there is not near as much impact as there is those aforementioned counties. However, there is no DOWNSIDE to the counties outside of that area. Strictly speaking, the local units in these areas would be receiving funds they have never received before, and would not have to raise any taxes, or go through any additional administrative steps other than what they are currently utilizing.

As for administration of this policy and the monies realized to the local units, I again would defer to the Dept. of Revenue for their analysis of this measure.

I feel I have laid some of the groundwork to explain what this issue is and what it does and does not do. I appreciate the time you have given me to bring this matter to your attention, and would stand for questions or comments from the committee.

Tax Administration Bureau
P. O. Box 840
Jefferson City, MO 65105-0840

STATE OF MISSOURI
Department of Revenue



(314) 751-2836

September 1994

Dear Taxpayer:

The United States Supreme Court rendered a decision in the case of *Associated Industries of Missouri, et al v. Director of Revenue, No. 93-397*, which affects the collection and remittance of Missouri use tax. Effective October 1, 1994, you will no longer be required to collect and remit Missouri use tax of 5.725% on all transactions subject to use tax.

Beginning October 1, 1994, there will be two different use tax rates. A sale will be subject to a use tax rate of either 4.225% or 5.725%. The location of the purchaser and the sales tax rate in effect at the purchaser's location will determine which tax rate to use for that sale. If the purchaser's location has a combined state and local sales tax rate of 5.725% or higher, sales to that purchaser by out-of-state vendors will be subject to the 5.725% use tax rate. If the purchaser's location has a combined state and local sales tax rate less than 5.725%, sales to that purchaser by out-of-state vendors will be subject to the 4.225% use tax rate.

If you are a purchaser liable for consumer's use tax, and you have more than one location, you may be required to report use tax at both rates. Some purchases may be at the 5.725% rate while others are at 4.225%. The Missouri use tax returns have been changed to allow filing at one or both use tax rates. Enclosed are rate cards at the rate of 4.225% and 5.725%.

Should you require additional information or should you have any questions about the use tax or the change in the use tax rates, please contact the Tax Administration Bureau, Post Office Box 840, Jefferson City, MO 65105-0840 (Phone 314-751-2836).

Sincerely,

A handwritten signature in black ink, appearing to read "Kenneth M. Pearson".

Kenneth M. Pearson
Administrator

KMP:DP:dp

VOUCHER

MID-AMERICA LUMBERMENS ASSOCIATION
GENERAL FUND - SPECIAL ACCOUNT

to

MISSOURI DEPARTMENT OF REVENUE

Date: JULY 10, 1995

\$209.10

USE TAX DUE FOR APRIL-MAY-JUNE 1995

AT FYI.

Tax Due on 1995
Shootout caps, straw hats & shirts

APPROVED BY: _____

DEBIT ACCOUNT: #135 ~ 60.36
#408-032 ~ 107.20
408-042 ~ 41.54

computer software
Sun-Flower Shootout
Show-Me Scramble

THE KANSAS CITY STAR.

Vol. 115, Monday, February 20, 1995, No. 156
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Spend use tax wisely

Kansas City government has a new source of revenue, worth almost \$5 million a year. Those funds ought to be spent on projects that are important to the entire city. Above all, the use tax revenue should not be automatically split into six equal parts and then distributed to City Council districts, as some politicians want.

Fortunately, City Manager Larry Brown has proposed a good way to spend use tax funds in the 1995-96 budget, which the council has to approve in April.

The biggest allocations would be \$1.54 million for beautification along Bruce Watkins Drive and \$1 million for continued construction of Ilus W. Davis Park north of City Hall. Brown also wants the tax receipts to enhance street preservation (\$871,000), bridge repairs (\$572,000) and boulevard maintenance (\$500,000) around the city, among other worthwhile projects.

Some current City Council members may not want to adopt Brown's suggestions because they don't automatically divide tax revenue into six equal parts to be spent as council members wish.

But Brown is absolutely correct to push the idea that the tax should be funneled into the general fund, then used for the good of the entire city.

This tax, which is collected on catalog sales in Missouri, got plenty of attention last year when a court said cities could begin spending their portion of use tax receipts. Kansas City had accumulated \$12 million waiting for a final court ruling.

Brown and Mayor Emanuel Cleaver properly tried to get the City Council to approve targeting the funds for large, unfunded projects such as road construction.

But Brown and Cleaver failed to include any large project from north of the river on the list, setting off understandable protests from that part of the city. Meanwhile, other council members, grabbing for new revenue wanted to divide the money to be spent on smaller projects in their districts.

In a compromise, about half the money was dedicated to worthwhile projects of citywide importance, such as knocking down dangerous buildings. The other half was allocated to City Council districts, to be spent in a myriad of ways, regardless of citywide priorities.

The new City Council, elected on March 28, will have the final say on how the use tax is spent in the 1995-96 fiscal year. Those members will have very good reasons to support allocating the revenue for large projects that are important to many Kansas City residents.

4-8

\$12 million up for grabs: Let the division begin

Mayor, City Council members have own views on use of funds.

JAMES C. FITZPATRICK
Staff Writer

Kansas City Mayor Emanuel Cleaver sounded a shark alert Wednesday as City Council members began circling \$12 million in appropriated funds.

Councilwoman Carol Coe has opposed dividing the money into seven \$1.7 million pots — one for projects in each of the six council districts and one for “citywide” projects.

Councilman Ronald E. Finley suggested a flat \$2 million for each district. That would eliminate any argument over how to fine citywide projects, he said. Much of the money has built up over the last two years during a legal challenge to a state law authorizing collection of a tax on

out-of-state purchases — catalog sales, for the most part. Earlier this year, the legality of the 1.5 percent “use tax” was upheld.

Cleaver wants to see most of the money spent on projects he thinks will benefit the entire city, such as a civic mall north of City Hall and improvements along Bruce R. Watkins Drive. In an interview Wednesday afternoon, he denounced Coe’s proposal as shortsighted.

“If that’s going to be the philosophy, the city will never be able to do anything,” he said. “If we divide everything by six (districts), we’ll never reach the greatness many of us envision.”

But Cleaver is now in the position of counterpuncher because of a deft jab from Coe last week.

At an Aug. 31 meeting with the editorial board of *The Kansas City Star*, Cleaver said he would introduce at last Thursday’s council meeting an ordinance to appropriate \$4 million for the civic mall,

\$4 million for reconstruction of a Blue Parkway section, \$3 million to plant trees and beautify bridges along Watkins Drive and \$1 million to tear down 10 dangerous Midtown apartment buildings.

But the council meeting came and went Thursday without Cleaver introducing his ordinance. He said Wednesday he decided to wait a week because the meeting last week was so contentious. Heated discussion of the Hilton Hotels Corp.’s new riverboat gambling proposal dominated that meeting.

But dissension on the Hilton proposal, which the council approved on a bare majority vote, didn’t stop Coe from introducing her ordinance. As a result, Coe’s ordinance to divide the money seven ways was before the council’s Rules and Audit Committee on Wednesday.

Cleaver’s, meanwhile, is to be introduced today and will arrive

at the Rules and Audit Committee next week.

Among those speaking in support of Coe’s proposal were several Northland leaders, one of whom said he felt “betrayed” because Cleaver’s proposal did not include any funds for Northland projects.

Even Committee Chairwoman Judy Swope, a close ally of the

mayor, said she felt her 6th District in south Kansas City wasn’t benefiting sufficiently.

Cleaver said later he probably would modify his proposal, once it is before the committee, to include funds for the Northland and to replace a bridge in Swope’s south Kansas City district.

And his ordinance would be introduced today, he promised.

Monday,
September 26,
1994

Council to consider ways to divide fund

Legal review clears \$12 million in 'use' taxes for KC projects.

By JAMES C. FITZPATRICK
Staff Writer

Kansas City Council members soon will rejoin the battle over how to spend \$12 million in "use" taxes that recently became available.

At a business session Thursday, acting City Attorney Kathleen Hauser told the council there was no reason the council could not spend the money. It has been accumulating for two years during a legal challenge to a state-levied use tax on out-of-state purchases.

On the heels of Hauser's comments, council members Michael B. Hernandez and Ronald E. Finley introduced separate proposals for spending the money. That brought to four the number of competing plans. Mayor Emanuel Cleaver and Councilwoman Carol Coe introduced proposals earlier.

The council's Rules and Audit Committee is scheduled to discuss the proposals Wednesday.

For a few days recently it appeared the money might not be available soon. More than a week ago, Hauser told the council a new legal question had come up.

After researching the issue, Hauser concluded that a U.S. Supreme Court ruling earlier this

See **COUNCIL, B-2, Col. 2**

Council gets OK to spend tax fund

Continued from B-1

year in the state's favor probably would stand. She told the council Thursday that several other Missouri cities have been spending their shares of the tax revenue.

Councilman George Blackwood said he was encouraged by Hauser's report.

"It's better to argue over \$12 million than to argue over nothing," he said.

Blackwood said that whatever else happened he wanted \$4 million of the \$12 million to go toward development of a proposed civic mall north of City Hall.

Cleaver's plan includes \$4 mil-

"It's better to argue over \$12 million than to argue over nothing."

Councilman George Blackwood

lion for the civic mall, \$4 million for reconstruction of part of Blue Parkway, \$3 million for improvements along Bruce R. Watkins Drive and \$1 million for demolition of dangerous buildings in the Midtown area. The mayor has indicated, however, that he plans to amend his proposal to include money for some Northland and

south Kansas City projects.

Coe's proposal would divide the money into seven equal shares, with one share going to each of the six council districts and one share for "citywide" improvements.

Finley's proposal includes \$4 million for the civic mall, \$1 million for razing dangerous buildings and \$3.4 million for Northland projects.

Hernandez's list includes \$4 million for Blue Parkway, \$3 million for Watkins Drive, \$1 million for demolition of dangerous buildings and \$1.2 million for improvements along Avenida Cesar Chavez, formerly 23rd Street Trafficway.

Morgan Distribution



A Morgan Products Ltd. Company

Testimony for the Senate Tax Committee on Implementation of Local Option Use Tax.

February 8, 1996

Madame Chair, members of the Tax Committee, thank you for the opportunity to address you regarding the adoption of a local option use tax. My name is Mark Lanzrath, and I am the Credit Manager for Morgan Distribution, a wholesale millwork company located in Shawnee, Kansas, whom I have been with for 20 years.

Briefly, let me describe the present situation a Kansas company encounters when competing with a Missouri company. When we sell a builder a house job of windows, where the job site is located in Olathe, Kansas, we charge sales tax at the rate of 6.75%. This consists of the base 4.9% Kansas sales tax and 1.85% local option tax. When a Missouri company delivers to the same job site, only 4.9% Kansas use tax is charged. Assuming both companies charge the same price for the items, this gives the Missouri company a pricing advantage, at the expense of the local taxing unit.

There are opportunity costs that the State of Kansas incurs, as well. If a Kansas company is doing less business as a result of the unlevel playing field, numbers of individuals employed, as well as income will be down. This results in lower state income tax revenues, both personal and business.

Let me inform you of what Missouri has done to level the playing field within their state. In the summer of 1992 they implemented a local option use tax. Thus, they have closed the tax rate gap and effectively eliminated the advantage a Missouri company would have by purchasing from a Kansas company.

In closing, I again thank the Chair and its members for taking time to listen to our concerns on this issue.

Sen. Arns + Jay
Feb 8, 1996
attach 5-1



Testimony for the Senate Tax Committee on Implementation of Local Option Use Tax

February 8, 1996

Madame Chairperson, members of the Tax Committee, thank you for allowing me to appear before you today to offer my perspective on the local option use tax. My name is Pat Shelley, I am General Manager of Teague Electric Construction in Lenexa. We are an electrical construction company and we deal in residential, commercial and industrial electrical construction.

The construction business in the Kansas City area is extremely competitive - we work on very tight profit margins. Consequently, most of our buying decisions are based on price. We purchase material from both Kansas and Missouri electrical wholesale companies. Generally speaking, we prefer to buy material from the supplier that's just down the street, but if we can get a total price from a Missouri supplier that is almost 2 % less because of the local option sales tax - for the exact same material - competitive pressures dictate that we do so. In 1995, we bought approximately \$ 4,000,000.00 worth of electrical construction materials. Of that, about 75% came from Missouri based distributors.

Last year, we were advocating repeal of the sales tax on new construction because of the inequities it created in the construction business in our area. It is our feeling that the tax differential we are discussing today creates a similar situation for the material suppliers. We don't think it is fair for anyone to have a competitive advantage because of our tax laws. In the long run, we all benefit by helping to keep Kansas businesses strong.

Thank you for your time and I encourage you to do whatever you can to rectify this situation.



**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
DATE: February 8, 1995
RE: SB 453--Local Option Use Tax

During 1995 the League's Finance and Taxation Policy Committee and Convention of Voting Delegates formally considered and endorsed extending the local compensating use tax act (K.S.A. 12-198) to be **identical in application to the state compensating use tax** imposed under K.S.A. 1995 Supp. 79-3703, and amendments thereto.

K.S.A. 12-198 currently provides for a local compensating use tax on vehicles and vessels that are registered under state law. This statute was enacted in 1982 and has been working in a satisfactory manner. Moreover, based on all information we have the state's compensating use tax has been administered in a fair and effective manner by the Department of Revenue. The policy question raised by this proposal is whether the playing field for the local compensating use tax should be identical in application to the state's compensating use tax. We would respectfully suggest the answer to that question is "yes" in order to ensure that Kansas businesses are not put at a competitive disadvantage.

We believe the approach used in drafting this bill which relies on the city's or county's actual local sales tax rate would comply with the constitutional standards set forth by the Missouri Supreme Court in the 1994 decision of *Associated Industries of Missouri v. Lohman*. In that case the court held a uniform state tax rate for the local compensating use tax discriminated in violation of the commerce clause.

Finally, as I have attempted to demonstrate to this committee, the success of cities in recent years in keeping the rate of growth in city property taxes under control has been tied directly to the availability of alternative revenue sources. SB 453 would provide some valuable revenue to cities--particularly those in border areas--that would otherwise have to come from the property tax. This would be just one more step in the direction of lessening our reliance on the property tax.

Please let me know if you have any questions about this matter. Thank you.

Sen. Cassens + Jay
Feb 8, 1996
attch 7-1