

MINUTES OF THE HOUSE COMMITTEE ON UTILITIES.

The meeting was called to order by Chairperson Don Myers at 9:00 a.m. on January 30, 1997 in Room 514-S of the Capitol.

All members were present.

Committee staff present: Lynne Holt, Legislative Research Department
Mary Shaw, Committee Secretary

Conferees appearing before the committee: Bob Uehling, Senior Manager, Deloitte & Touche Consulting Group

Others attending: See attached list

Chairperson Myers mentioned that the Committee was going to hear a briefing about a very important element of any retail wheeling, which is the federal, state and local tax implications of electric utility restructuring or retail wheeling. The Chair also mentioned that next week on Wednesday, February 5, 1997, the Committee will hear a briefing on one of the most important issues on retail wheeling and that is stranded cost, or uneconomic cost, or transition cost, it goes by several names and is one of the most contentious issues when the deregulation of electricity begins.

The Chair introduced Mr. Bob Uehling, Senior Manager, of Deloitte and Touche Consulting Group of Dallas, Texas. Mr. Uehling provided an outline of his slide presentation, Electric Utility Industry Restructuring: Kansas Taxation Issues (Attachment #1). Questions and discussion followed.

The Chair acknowledged Representative McKinney and he mentioned that he thought, in 1994, the Legislature passed a bill relating to use of underground natural gas storage and procedures used to protect land owners and surrounding land owners. He mentioned that there was some litigation on that issue this past Fall and some confusion over types of procedures and types of condemnation procedures with facilities located on county lines. He said sets of appraisers had to be used on one side of the county line and another set on the other side of the county line. Representative McKinney made a motion to introduce a Committee bill related to underground gas storage aimed at clarifying some of these problems. The motion was seconded by Representative Sloan. Motion passed.

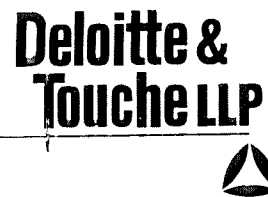
Representative McClure made a motion for the drafting of a Committee bill on natural gas gathering that the Committee will dispense later. The motion was seconded by Representative Sloan. Motion passed.

The Chair acknowledged Representative Alldritt and he mentioned that currently under Kansas law railroads are required to maintain railroad crossings, however, if they don't, local governments really do not have much recourse. Representative Alldritt made a motion that the Committee consider that a bill be drafted that would give local government, a city or a county, the ability to fix, repair, maintain that crossing and assess that railroad for the cost within a reasonable period of time. The motion was seconded by Representative Samuelson. Motion passed.

The Chair announced that the Committee will be meeting in Room 313-S tomorrow, January 31, 1997, for questions and answers to the Kansas Corporation Commission.

The meeting was adjourned at 10:00 a.m.

The next meeting is scheduled for January 31, 1997.



***State of Kansas
House Utilities Committee***

Thursday, January 30, 1997

House Utilities
1-30-97
Attachment 1

**ELECTRIC UTILITY INDUSTRY RESTRUCTURING:
KANSAS TAXATION ISSUES**

Robert H. Uehling Senior Manager

AGENDA

- **Background**
- **State and Local Taxation of Electric Utilities**
- **State and Local Tax Issues Arising From Competition/Deregulation**
- **Kansas Electric Utility Taxation: Issues and Analysis**
- **State and Local Tax Policy Considerations**

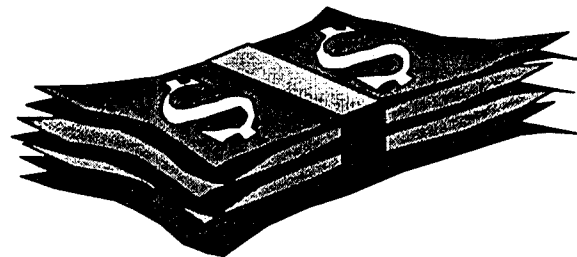
BACKGROUND

Electric Utilities Are Major

- **Taxpayers**

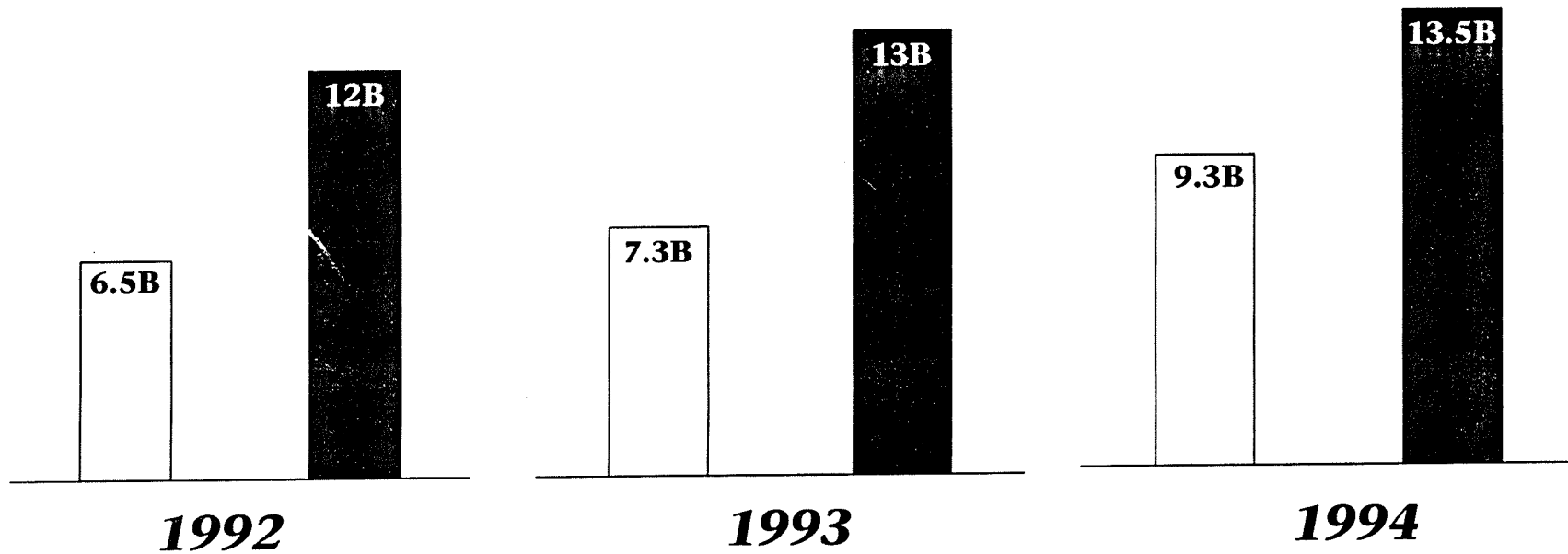
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

- **Tax collectors**



BACKGROUND

Taxes Paid by Investor-Owned Utilities

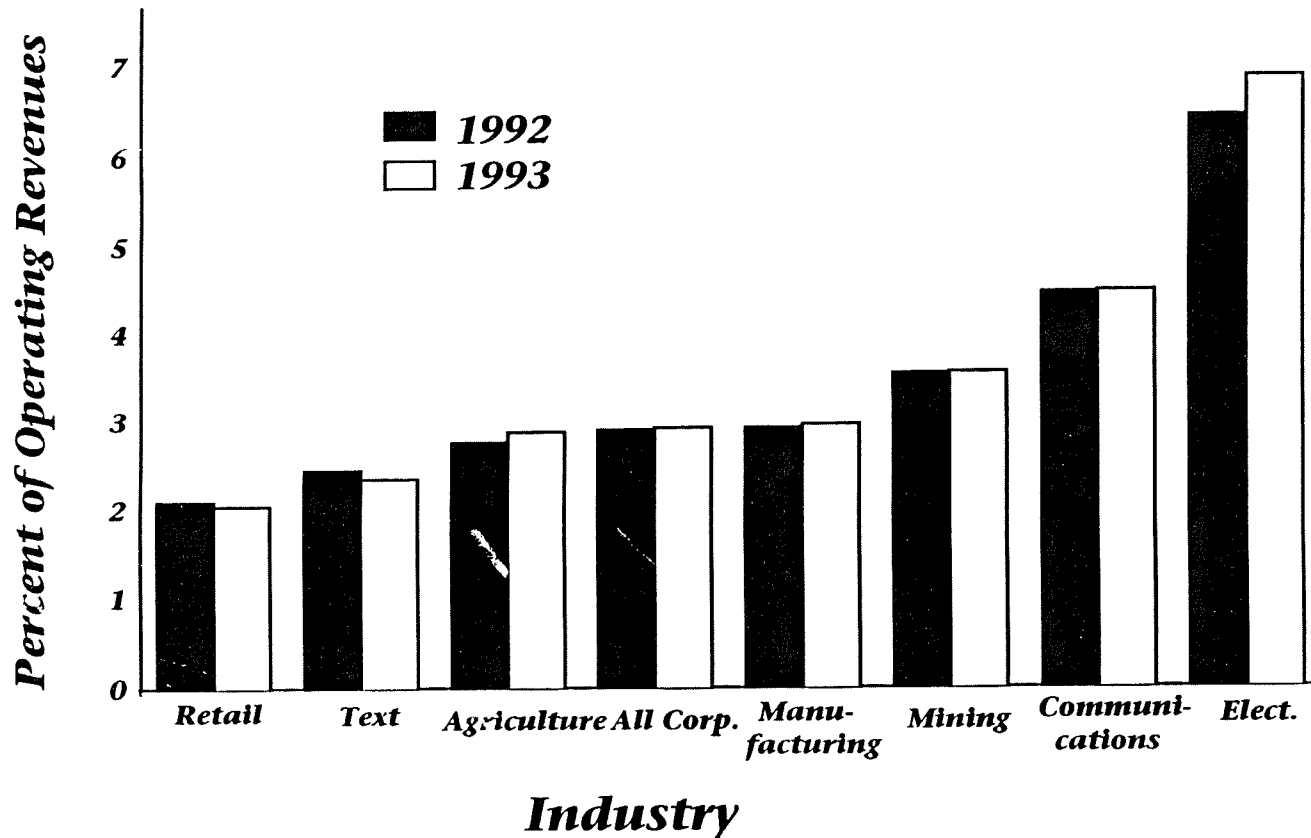


 *Federal income taxes*
 *State and local taxes*

Source: FERC Form No.1

PROJECT OVERVIEW AND BACKGROUND

Industry Comparison of State and Local Taxes Paid



Source: Compiled by Edison Electric Institute ("EEI") from the *Source Book 1992, Statistics of Income, Corporation Income Tax Returns* and *Source Book 1993, Statistics of Income, Corporation Income Tax Returns*. Internal Revenue Service, Publication 1053, (Rev. 3-96)



BACKGROUND

Taxation Is a Major Issue in Industry Transition

- **Competition increases incentive to reduce all costs, including taxes.**
- **Increased interstate activity presents new complexities.**
- **Evolution of electricity market raises tax policy issues and revenue implications.**

STATE AND LOCAL TAXATION OF ELECTRIC UTILITIES

State and Local Taxes Paid by Electric Utilities

- **Property taxes**
- **Gross receipts taxes**
- **Sales and use taxes**
- **State income and franchise taxes**
- **Utility user taxes**
- **Regulator assessment fees**
- **Miscellaneous taxes and fees**

STATE AND LOCAL TAX ISSUES ARISING FROM COMPETITION/DEREGULATION

Major Issues

- **Possible electricity price reduction**
- **Declining property tax assessments**
- **Market share of tax advantaged providers**



STATE AND LOCAL TAX ISSUES ARISING FROM COMPETITION/DEREGULATION

Possible Electricity Price Reduction

- **A decrease in electricity prices may cause reduction in tax revenues.**
- **Economic theory suggests, however, that lower prices may increase demand; therefore, tax revenue impact over long term may not be significant.**

STATE AND LOCAL TAX ISSUES ARISING FROM COMPETITION/DEREGULATION

Declining Property Tax Assessments

- **Competition may reduce value of high-cost generation property.**
- **Some high-cost generation property may be retired.**
- **Significant property tax revenue ramifications, particularly for local jurisdictions.**
- **Value of transmission and distribution property could increase in certain cases.**

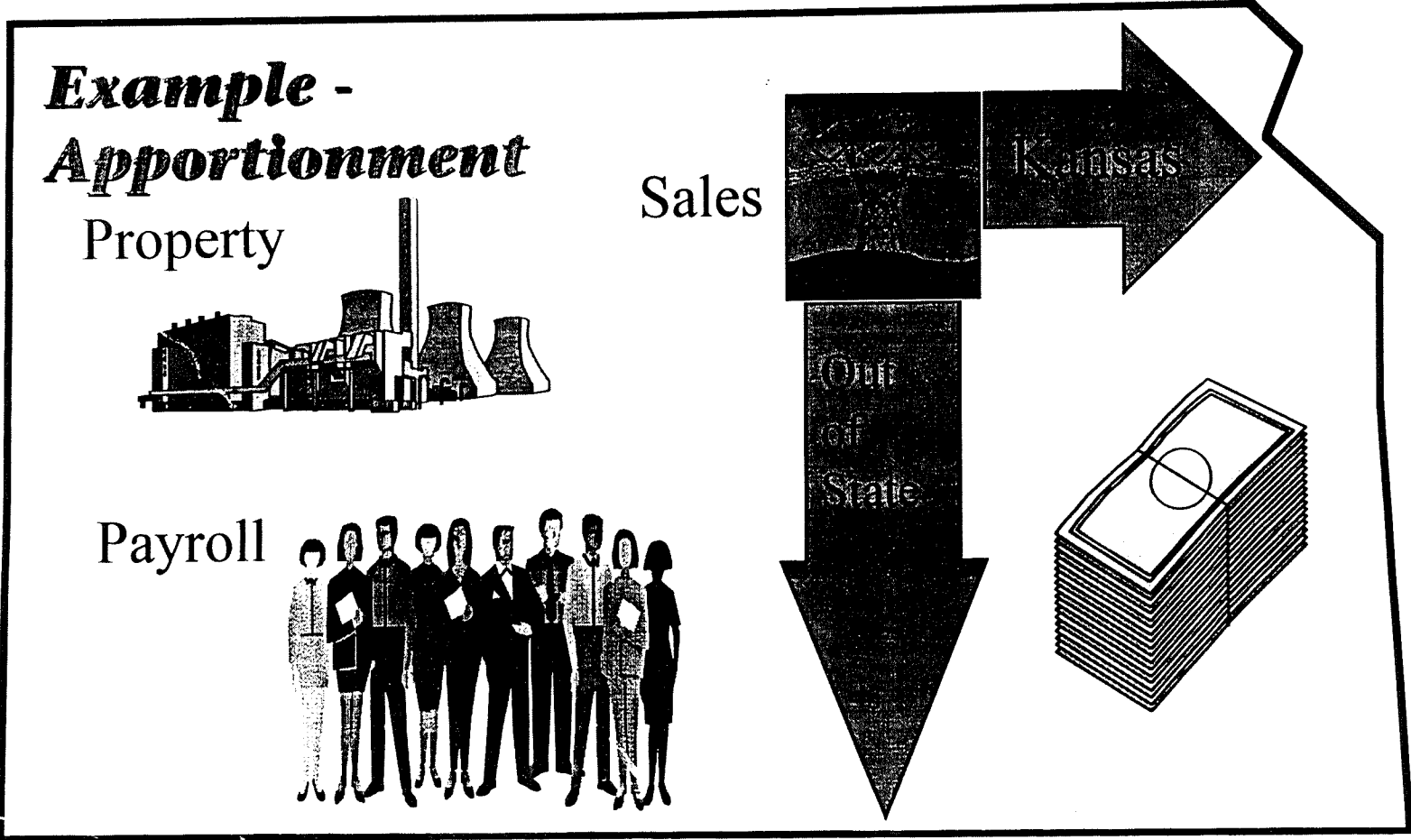
STATE AND LOCAL TAX ISSUES ARISING FROM COMPETITION/DEREGULATION

Market Share of Tax Advantaged Providers

- **Regulated vs. Non-Regulated**
- **In-State vs. Out-of-State Providers**
- **Taxable vs. Non-taxable Providers**



STATE AND LOCAL TAX ISSUES ARISING FROM COMPETITION/DEREGULATION



STATE AND LOCAL TAX ISSUES ARISING FROM COMPETITION/DEREGULATION

Sales + Property + Payroll in Kansas =
Income Taxed in Kansas



Sales into
Kansas



Sales into
Kansas



HOW DOES KANSAS TAX BURDEN COMPARE?

- **Major Kansas Taxes Paid by Utilities:**
 - **Property Taxes**
 - **Sales and Use Taxes**
 - **Corporate Income Taxes**
 - **City Franchise**



HOW DOES KANSAS TAX BURDEN COMPARE?

CURRENT KANSAS BUSINESS TAX ENVIRONMENT

- **Kansas Governor's Tax Equity Task Force Issued its report in December 1995 - Key Findings Include:**
 - **"Under the current tax structure, Kansas stands out as the state in the region with the highest taxes on mature business. The sources of the high overall tax level on Kansas businesses are the property tax and the corporate income tax."**
(Charles Krider and Pat Oslund, University of Kansas. Emphasis added.)

HOW DOES KANSAS TAX BURDEN COMPARE?

CURRENT KANSAS BUSINESS TAX ENVIRONMENT

- **“The property tax on business machinery and equipment is the highest in the region, with Iowa recently eliminating its tax.”**
- **“While new and expanding firms can receive tax incentives, mature firms face not only the full tax burden but the highest taxes in this region. Tax incentives, such as the business and job development credits, are not available to utilities.”**
- **“The Kansas business tax structure is not as favorable a climate for the state’s export industries as exists in many other states.”**

Source: Governors’ Tax Equity Tax Force, December 1995



HOW DOES KANSAS TAX BURDEN COMPARE?

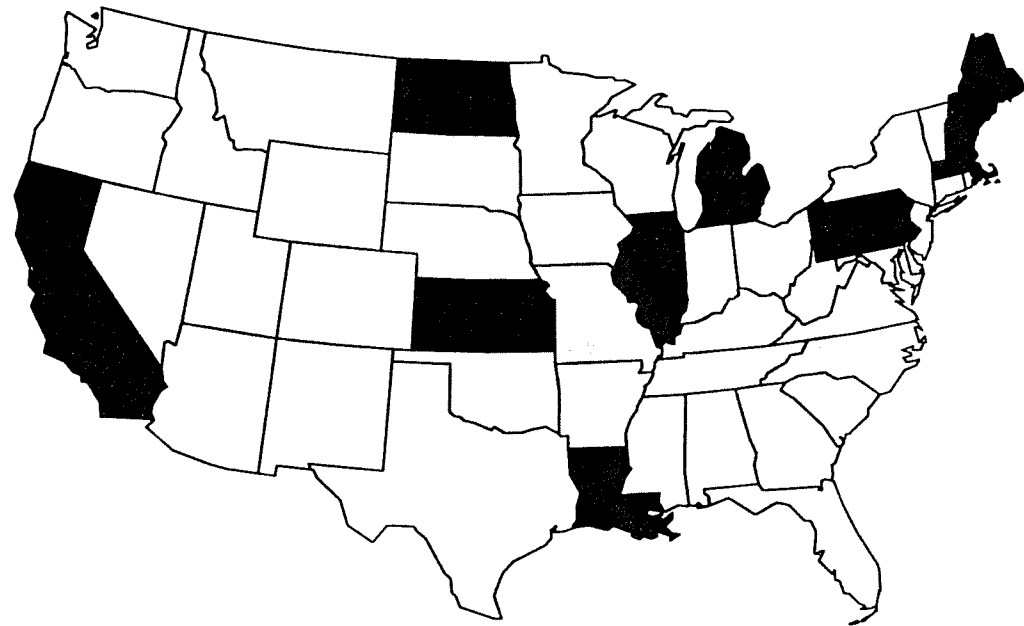
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CURRENT KANSAS BUSINESS ENVIRONMENT

- CFO STATE TAX SURVEY

Where to avoid:

The survey rated state tax policy influence on business decisions on a scale of 1 (very positive) to 5 (very negative). Kansas made the "Top Ten" list of states to avoid based on tax policy.

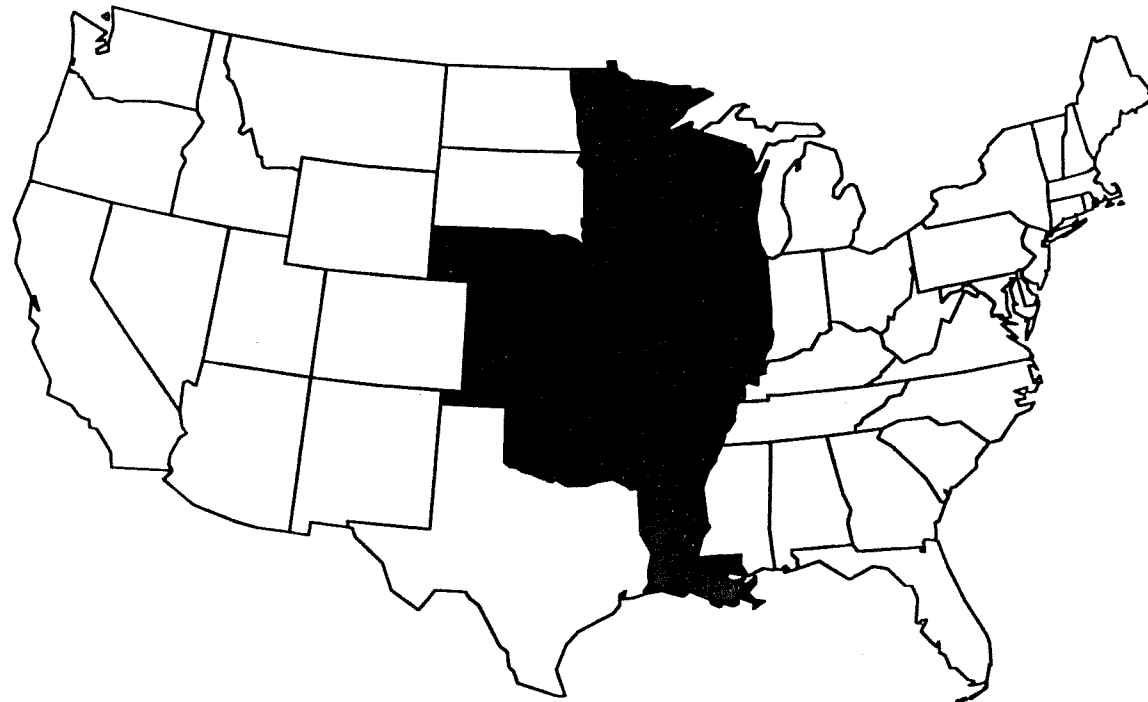


HOW DOES KANSAS TAX BURDEN COMPARE?

ANALYSIS OF IN-STATE VS. OUT-OF-STATE ELECTRIC UTILITIES

I.O.U.'s state tax burden in a region comprised of the following states:

- **Kansas**
- **Nebraska**
- **Missouri**
- **Oklahoma**
- **Illinois**
- **Minnesota**
- **Wisconsin**
- **Iowa**
- **Arkansas**
- **Louisiana**



HOW DOES KANSAS TAX BURDEN ON I.O.U.'S (COMPARE TO OTHER STATES?)

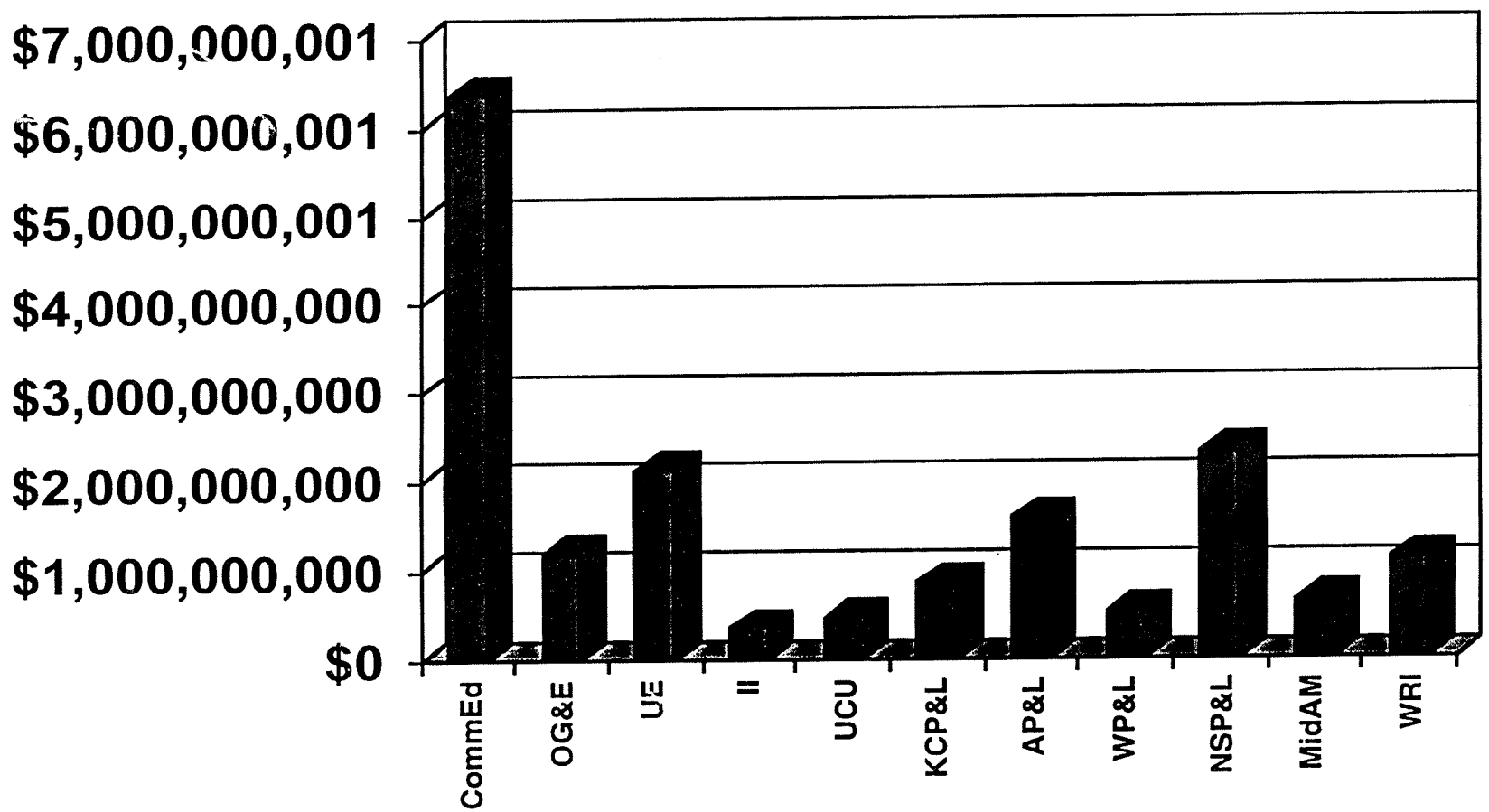
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- **Methodology for Comparison:**
 - **Obtained FERC Form No. 1 for 1994 for the major investor-owned utilities in the defined region**
 - **Did not audit data contained in FERC Form 1's**
 - **Utilized analysis of FERC Form 1 data to test previously documented studies citing Kansas as having the highest tax burden in the region related to property and income taxes on mature businesses**
 - **Since the "product" sold is electricity or megawatts, the analysis focused on the state tax burden on electric operating revenues and megawatts sold**



HOW DOES KANSAS TAX BURDEN COMPARE?

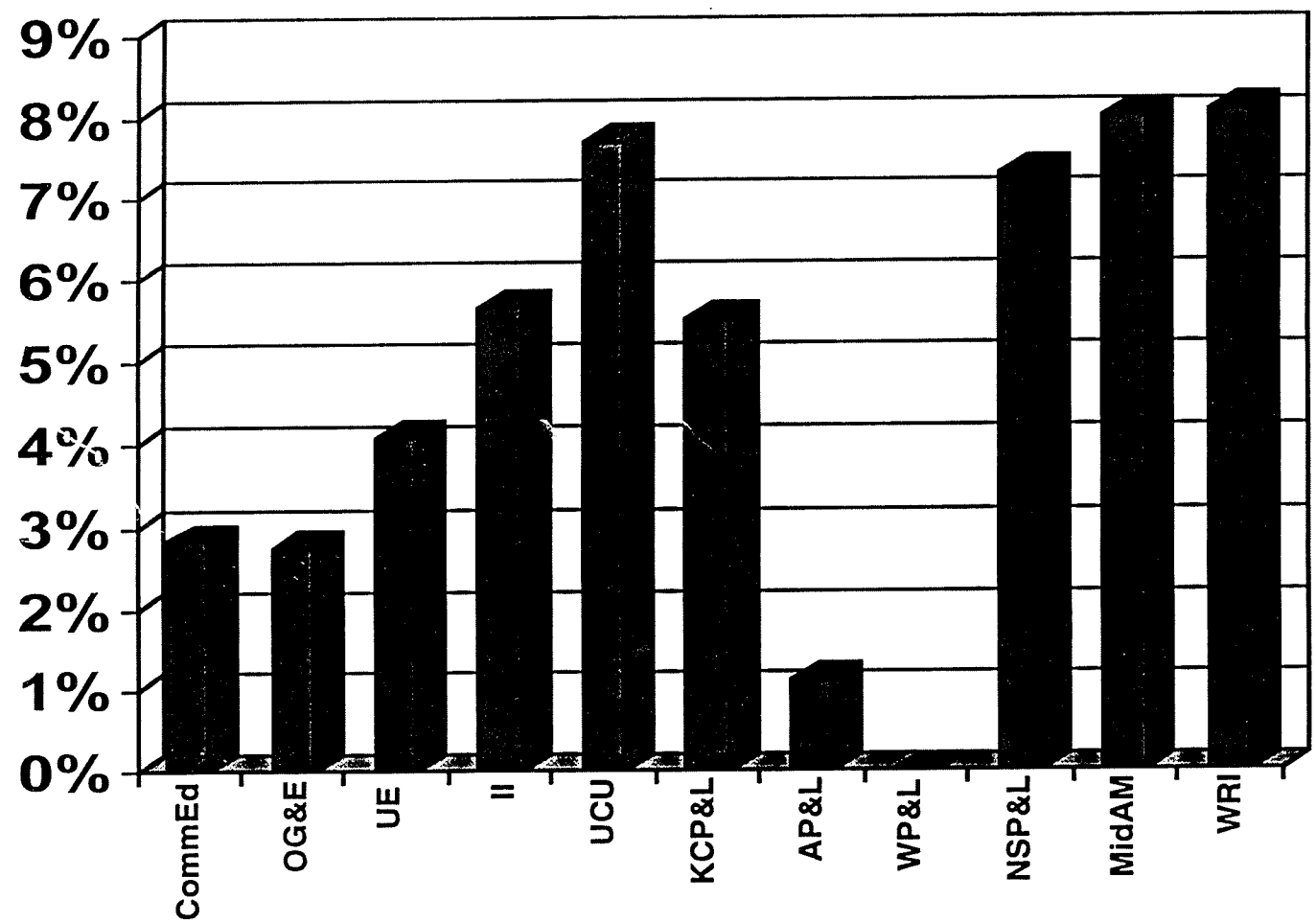
RANKING ELECTRIC OPERATING REVENUES BY ENTITY



Source: FERC No.1 1994

HOW DOES KANSAS TAX BURDEN COMPARE?

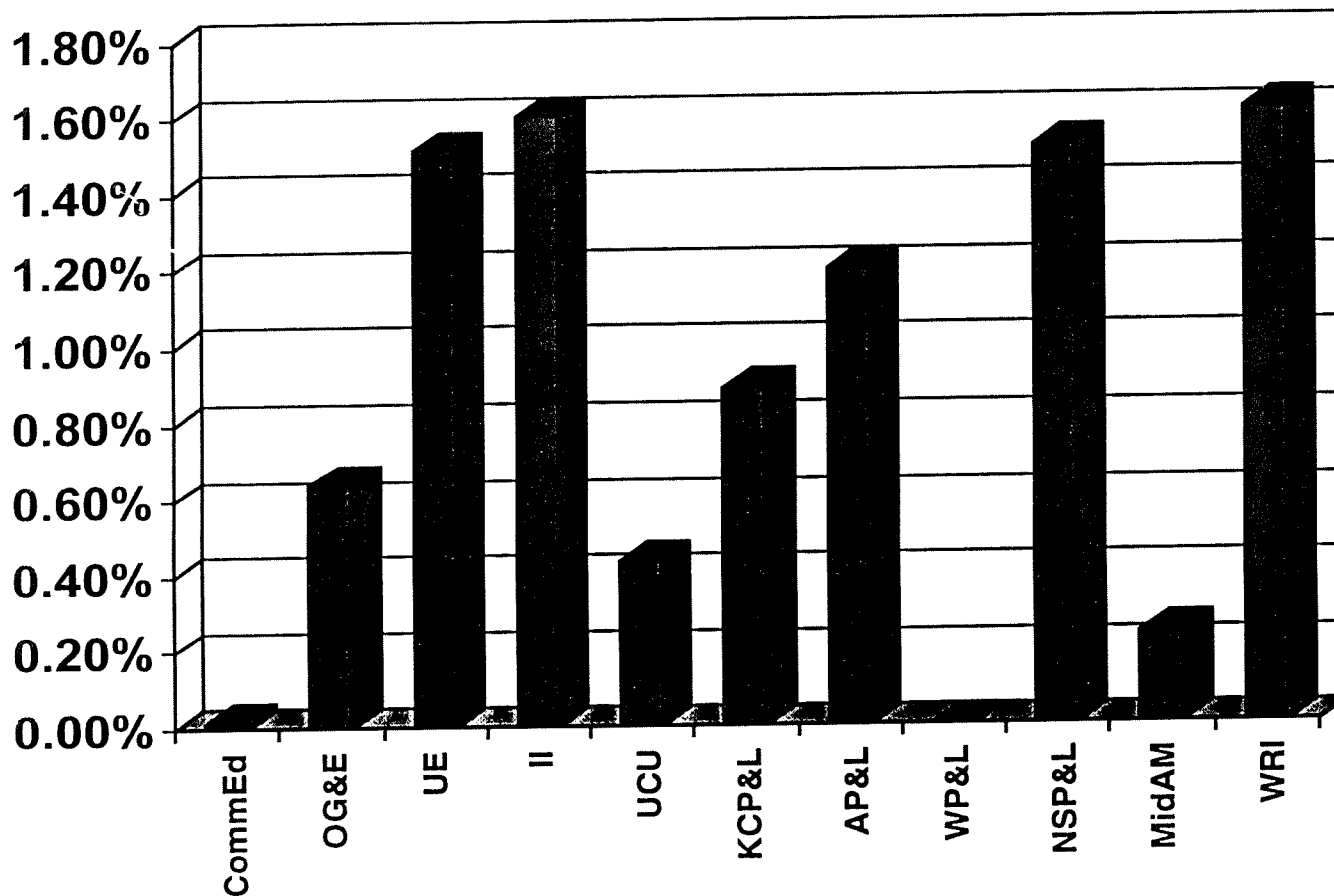
COMPARISON OF PROPERTY TAX COSTS AS PERCENT OF ELECTRIC OPERATING REVENUES



Source: FERC No.1 1994

HOW DOES KANSAS TAX BURDEN COMPARE?

COMPARISON OF INCOME TAXES AS A PERCENT OF ELECTRIC OPERATING REVENUES

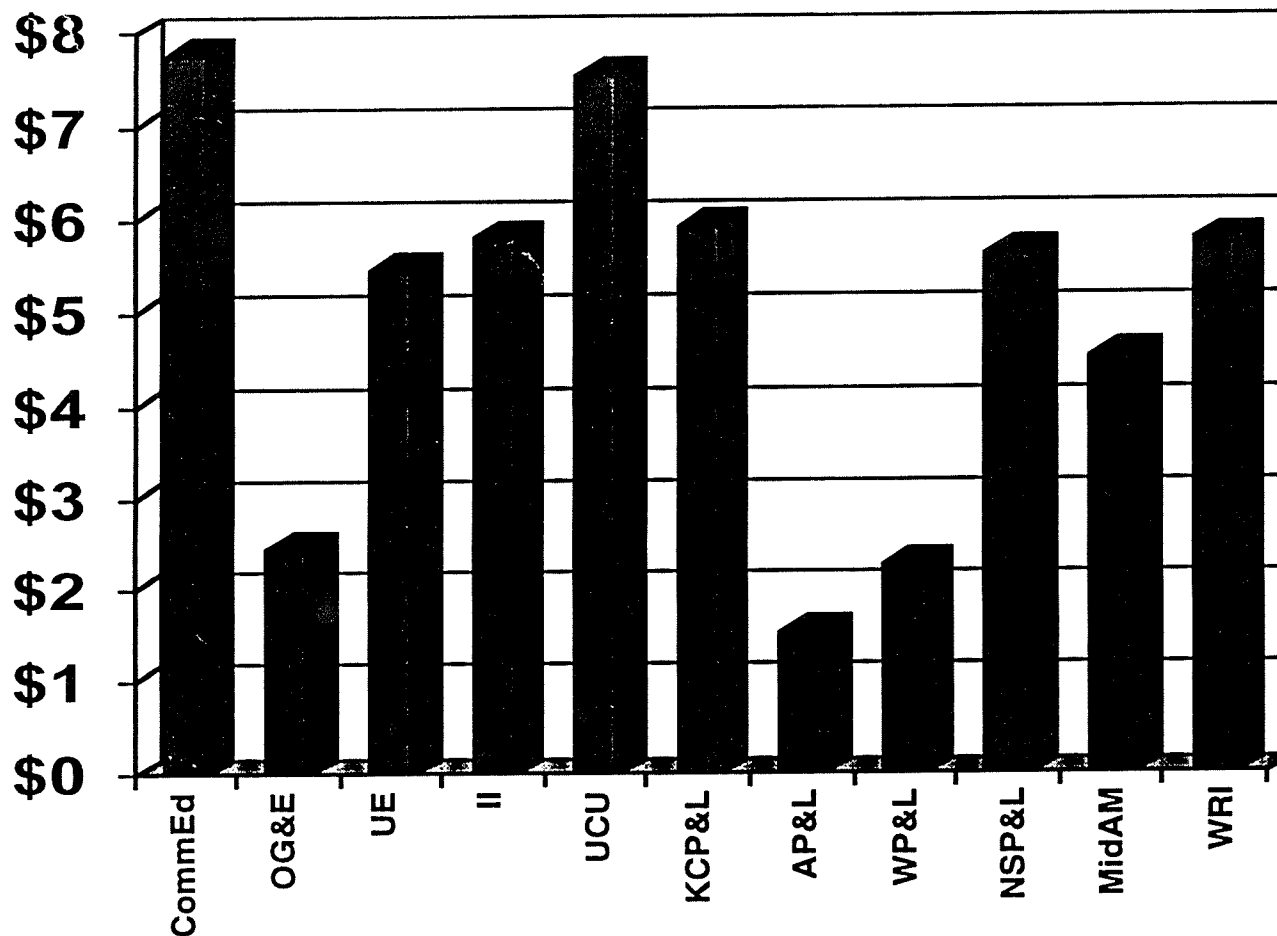


Source: FERC No.1 1994



HOW DOES KANSAS TAX BURDEN COMPARE?

COMPARISON OF TOTAL STATE & LOCAL TAX BURDEN OVER MEGAWATT HOURS SOLD

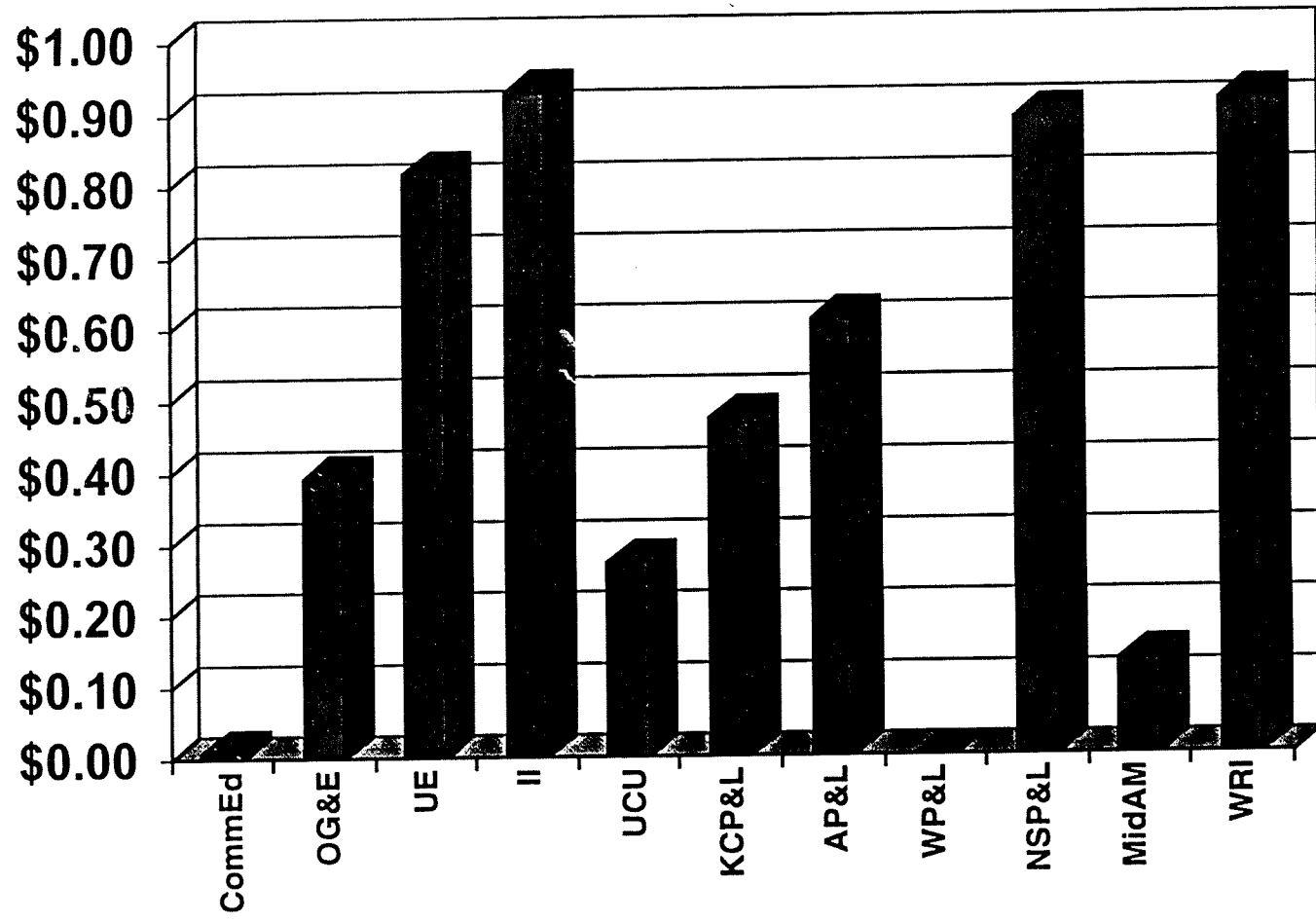


Source: FERC No.1 1994



HOW DOES KANSAS TAX BURDEN COMPARE?

STATE INCOME TAX COSTS PER MEGAWATT HOURS SOLD



Source: FERC No.1 1994

HOW DOES KANSAS TAX BURDEN COMPARE?

UTILITIES AS COMPARED TO OTHER INDUSTRIES

- **Kansas taxes utilities differently than it taxes other industries.**
- **Differences exist in property taxation - utilities are taxed significantly higher.**
- **Differences exist in sales/use taxation - businesses and other industries can lower their sales/use tax costs through qualification for credits and incentives which are not available to utilities**
- **Differences exist in income taxation - businesses and other industries can reduce their income tax liability through qualification for incentives and credits.**

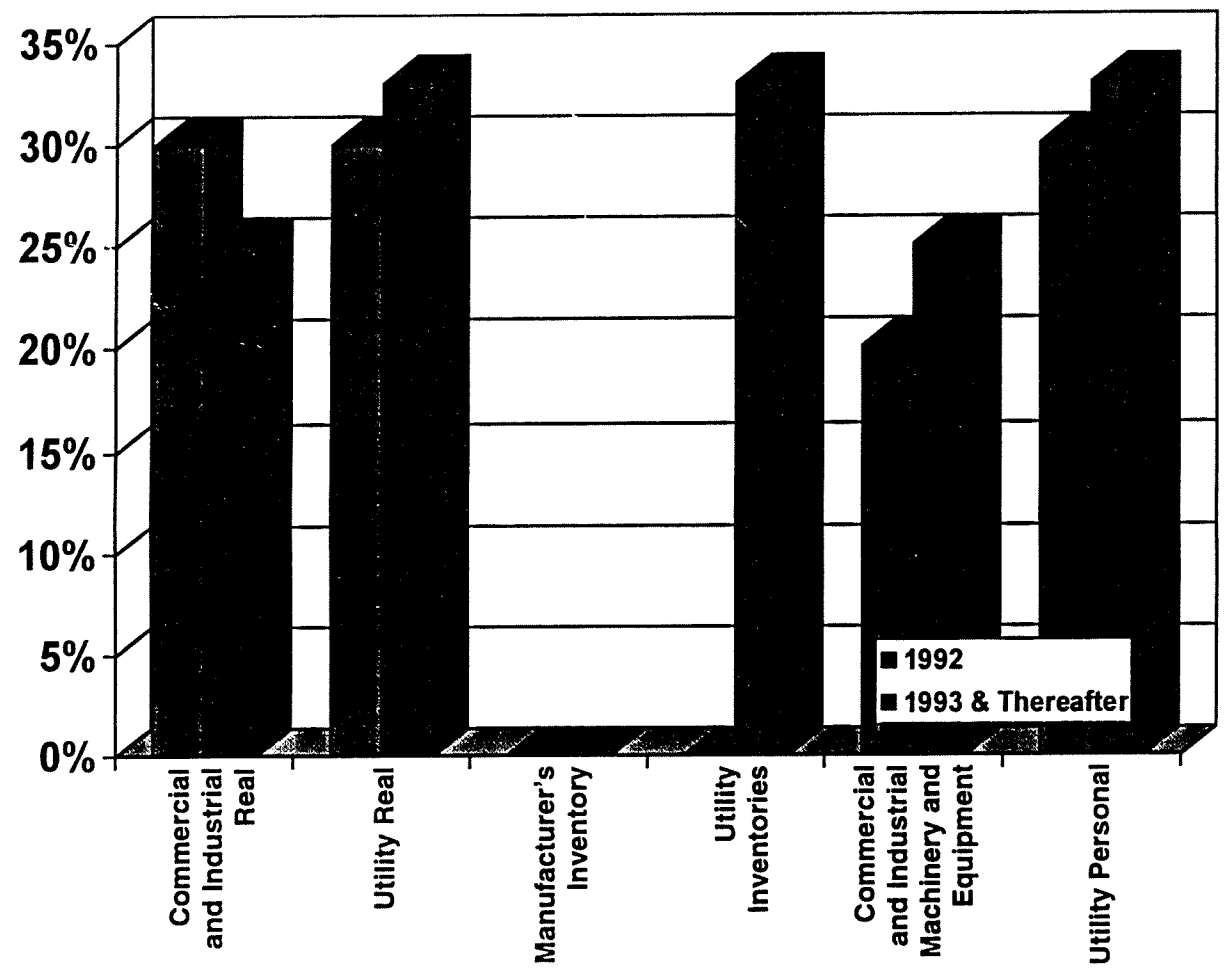
HOW DOES KANSAS TAX BURDEN COMPARE?

UTILITIES AS COMPARED TO OTHER INDUSTRIES

- **Kansas made changes in the way utility property is taxed in 1992 (See chart on following slide)**
- **Utility property is taxed at rates much higher than commercial and industrial property**
- **The Kansas property tax rates for commercial property are the highest in the region; with Kansas utility property taxed higher than commercial, Kansas utilities bear the highest property tax burden in the region.**

HOW DOES KANSAS TAX BURDEN COMPARE?

COMPARISON UTILITY PROPERTY TO COMMERCIAL AND INDUSTRIAL PROPERTY



SOURCE: 1995 GOVERNOR'S TAX EQUITY TASK FORCE REPORT

WHAT DOES THIS MEAN TO KANSAS BASED UTILITIES ENTERING COMPETITION?

- **Our analysis indicates that Kansas produced electricity may bear a greater state tax burden than electricity produced outside the state, within the region of comparison. (Region defined as the following states: Oklahoma, Nebraska, Missouri, Iowa, Minnesota, Illinois, Louisiana, Wisconsin and Arkansas)**
- **Non-Kansas produced electricity in a retail wheeling environment may be available to Kansas customers at costs which reflect lower state taxes.**
- **Kansas produced electricity in a retail wheeling environment, when sold into other states may bear a greater state tax cost, thereby, placing the Kansas producer at a possible competitive disadvantage.**



STATE AND LOCAL TAX POLICY CONSIDERATIONS

Proposals by Various Parties

- **Property tax reform**
- **Broad-based energy taxes**
- **Electricity consumption taxes**
- **Repeal of sales tax exemption**
- **Use taxes on imported electricity**
- **Repeal of gross receipts taxes**



STATE AND LOCAL TAX POLICY CONSIDERATIONS

Proposals by Various Parties: Property Tax Reform

- **Remove distinction between the treatment of public utility property versus non-public utility property**
- **Targeted state aid for local jurisdictions severely impacted by declining local tax base**



STATE AND LOCAL TAX POLICY CONSIDERATIONS

Proposals by Various Parties: Broad-Based Energy Taxes

- **Based on percentage of selling price or fixed amount per British thermal unit (Btu)**
- **May create fewer distortions among competing sources of energy**
- **May produce adverse reaction from public, particularly regarding motor fuels, heating oil and natural gas**
- **May adversely affect business competitiveness**

STATE AND LOCAL TAX POLICY CONSIDERATIONS

Proposals by Various Parties: Electricity Consumption Taxes

- **Equal tax on all electricity consumed in the taxing jurisdiction**
- **Tax could be a percentage of selling price or fixed amount per KWH**
- **Apply regardless of who generates the power**
- **Would discourage electricity consumption in favor of untaxed energy forms**



STATE AND LOCAL TAX POLICY CONSIDERATIONS

Proposals by Various Parties: Repeal of Sales Tax Exemptions

- **Broadens the tax base**
- **Essentially produces the same economic result as a consumption tax equal to a percentage of price**
- **May produce adverse reaction from public and discourage new business investment**

STATE AND LOCAL TAX POLICY CONSIDERATIONS

Proposals by Various Parties: Use Taxes on Imported Electricity

- **Eliminates incentive to buy from out-of-state providers not subject to gross receipts tax**
- **Constitutional concerns**
- ***General Motors Corporation v. Tracy* case (natural gas)**

STATE AND LOCAL TAX POLICY CONSIDERATIONS

Proposals by Various Parties: Repeal of Gross Receipts Tax

- **Eliminate disparities in existing gross receipts tax regimes**
- **Replacement by net income tax would raise less revenue**
- **Replacement by income tax may cause charge to company book earnings**

CONCLUSION

- **Industry competition will have a dramatic impact on tax revenues.**
- **Existing tax regimes will affect the competitive balance in the industry.**
- **Tax issues will be an important part of restructuring discussions.**
- **Examination of these issues in greater detail is required, particularly at state and local levels.**

