

Approved: March 12, 1997
date

MINUTES OF THE SENATE COMMITTEE ON COMMERCE.

The meeting was called to order by Chairperson Alicia Salisbury at 8:00 a.m. on March 10, 1997 in Room 123-S of the Capitol.

Members present: Senators Salisbury, Barone, Brownlee, Gooch, Jordan, Ranson, Steffes, and Umbarger.

Committee staff present: Lynne Holt, Legislative Research Department
Jerry Donaldson, Legislative Research Department
Bob Nugent, Revisor of Statutes
Betty Bomar, Committee Secretary

Conferees appearing before the committee:
Charles R. Warren, Ph.D., President, Kansas Inc.
Mikel Miller, Policy Analyst, Kansas Inc.

Others attending: See attached list

Charles R. Warren, Ph.D., President, Kansas Inc., introduced Mikel Miller, Policy Analyst, Kansas Inc. Ms. Miller submitted an Annual Report, "Sales Tax Exemption and Kansas Income Tax Credits under Enterprise Zone Act." Attachment 1

Ms. Miller explained the 1994 Legislature passed legislation giving Kansas, Inc. the responsibility to prepare an annual report to evaluate the cost effectiveness of state and local sales tax exemptions granted under the Kansas Enterprise Zone Act and various state economic development income tax credits. In order to make this analysis, the Secretary of Revenue is directed to provide copies of all approved sales tax exemption certificates to Kansas, Inc. Inasmuch as the Department of Revenue is barred from revealing individual taxpayer records or identities, the 1994 legislation provided a method of obtaining the needed information by requiring the Secretary of Revenue to prepare a questionnaire that is included in the corporate tax booklet which requires all corporate taxpayers claiming economic development tax credits to acknowledge so by completing and filing the questionnaire along with their corporate income tax returns.

Ms. Miller stated an analysis of the data received reflects over 400 sales tax exemption certificates were approved by the Department of Revenue during FY 1996. Sales tax exemptions were granted to companies making a total of \$749.5 million in investment; eight-six percent (86%) were made by companies in the manufacturing sector. Investment approved for exemption in other sectors of the economy decreased during FY 1996 as a percentage of total exempt investment. In contrast, nearly \$13 million in investments were made in connection with corporate headquarters and another \$9.3 million in investment made by lessors as a direct result of changes made to the Kansas Enterprise Zone Act in 1994.

Ms. Miller testified that in FY 1996 fifty-four percent of exempt investment took place in the Northeast region of the State. The North Central region experienced the second largest exempt investment, unlike FY 1995 in which the majority of the exempt investment took place in metropolitan counties.

Ms. Miller explained that the 1988 Legislature exempted from Kansas Retailers' Sales Tax machinery and equipment used directly and primarily in manufacturing. Additionally, an approved sales tax exemption issued pursuant to the Kansas Enterprise Zone Act also exempts hand tools, machinery, equipment and tools used in maintaining and repairing machinery and equipment; transportation equipment not used in the manufacturing, assembling, processing, furnishing, storing, warehousing or distribution process at the plant or facility; office machines and equipment including computers and related peripheral equipment not directly and primarily used in controlling or measuring the manufacturing process; furniture and buildings; and machinery and equipment used in administrative, accounting, sales or other activities of the business. For non-manufacturing companies, corporate headquarters, back-office operations, and retailers in communities of 2,500 or less, an approved sales tax exemption certificate provides the same exemptions as for manufacturing firms.

Ms. Miller stated FY 1996 manufacturers' exemption certificates report a machinery and equipment

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON COMMERCE, Room 123-S Statehouse, at 8:00 a.m. on March 10, 1997.

investment of \$382,334,661 and a non-manufacturers' exemption of \$35,112,388. Ms. Miller stated if the Department of Revenue methodology of estimating forgone states sales tax is the same as it used in FY 1995, FY 1996 will reflect \$27,363,087 in forgone state sales tax for manufacturers of machinery and equipment already exempt. Kansas, Inc. contends it is impossible to determine the exact fiscal impact of the additional exemptions offered by the Enterprise Zone, but estimates \$14,987,519 is forgone sales tax for manufacturers machinery and equipment already exempt. Therefore, the state's fiscal impact, according to Kansas, Inc. is \$12,375,568, and at the local level, \$3.4 million.

Ms. Miller stated the second section of the Annual Report concentrates on economic development income tax credits relating to job creation and investment tax credits, tax credits for investment in Kansas Venture Capital, Inc., tax credits for investment in a certified Venture and Seed Capital Funds, Research and Development tax credit and High Performance firms workforce training and investment tax credit. The Kansas Department of Revenue reports that a total of \$5,637,566 in income and privilege tax credits were processed during calendar year 1995 in connection with economic development incentives. Seventy-three percent of the income and privilege tax credits claimed during calendar year 1995 were job expansion and investment tax credits.

Ms. Miller stated the 1994 legislation charged Kansas, Inc. with evaluating the cost effectiveness of the various income tax credits available to Kansas businesses. Due to the statutory confidentiality provisions, there has been no way to access the information needed to determine whether these tax credits achieved their intended purposes. The legislation required businesses receiving tax credits to acknowledge so by completing and filing a questionnaire along with their corporate income tax return. The Department of Revenue is then required to retrieve the completed questionnaire from the corporate tax return and provide them to Kansas, Inc. Kansas, Inc. uses the information from the questionnaires to contact those firms regarding the effect the incentives had on their company.

Ms. Miller stated the results from the questionnaire system cannot be used as intended due to: too few questionnaires submitted in each category of tax credits, impossible to determine whether the claim reported is a new claim or a carryover claim that originated several years ago, missing information, and duplication of information from sales tax exemption process. Although a revised questionnaire has been developed, the solution continues to be expensive and time consuming to both taxpayers and the Department of Revenue.

Ms. Miller testified another option is being discussed and that is Kansas, Inc. cooperating with the Corporate Tax Section on a survey of taxpayers through its office, eliminating the need for disclosure of taxpayer identities.

Ms. Miller concluded her report.

Upon motion by Senator Steffes, seconded by Senator Umbarger, the Minutes of the March 7, 1997 Meeting were unanimously approved.

The meeting adjourned at 9:00 a.m.

The next meeting is scheduled for March 11, 1997.

Annual Report

***Sales Tax Exemption
and
Kansas Income Tax Credits***

Presented to:

The Kansas Legislature

***Kansas, Inc.
January, 1997***

*Senate Commerce
Committee
March 10, 1997*

Attachment 1-1 thru 1-23

Introduction

In 1994, the Kansas Legislature passed H.B. 2556 which gave Kansas, Inc. the responsibility to prepare an annual report to evaluate the cost effectiveness of state and local sales tax exemptions granted under the Kansas Enterprise Zone Act and various state economic development income tax credits. The bill requires that the results of the analysis be submitted to the standing committees on Taxation and Economic Development of the House, and Assessment & Taxation and Commerce of the Senate.

To make this analysis possible, H.B. 2556 directed that the Secretary of Revenue provide copies of all approved sales tax exemption certificates to Kansas, Inc. Because the Department of Revenue is barred from revealing individual taxpayer records or identities, H.B. 2556 also provided a method to identify the firms that take advantage of economic development income tax credits. The bill required the Secretary of Revenue to prepare a questionnaire to be included in the corporate tax booklet and further required all corporate taxpayers claiming economic development tax credits to acknowledge so by completing and filing the questionnaire along with their corporate income tax returns. The Department of Revenue was made responsible for retrieving the completed questionnaires for Kansas, Inc. so the firms might then be contacted for information regarding the impact of those incentives.

The first section of this report presents an analysis of the data from the over 400 sales tax exemption certificates approved by the Department of Revenue during FY 1996.

The second section of this report concentrates on the following economic development income tax credits:

- Job Creation and Investment Tax Credits;
- tax credits for investment in Kansas Venture Capital, Inc.;
- tax credits for investment in a certified Venture and Seed Capital Funds;
- Research and Development Tax Credit; and
- workforce training and investment tax credits for High Performance Firms.

The Kansas Department of Revenue reports that a total of \$5,637,566 in income and privilege tax credits were processed during Calendar Year 1995 in connection with economic development incentives. The table below provides a breakdown of that total by individual economic development incentive. (The figures below include carryovers from previous years.)

Summary of Income Tax and Privilege Tax Credits Processed by Kansas Dept. of Revenue: Calendar Year 1995	
Job Creation and Investment Tax Credit (Enterprise Zone)	\$4,164,254
Certified Venture Capital Fund Investment Credit	\$569,312
Certified Seed Capital Fund Investment Credit	\$372,250
Research & Development Credit	\$439,651
High Performance Firms Workforce Training and Investment Tax Credit.	\$92,099
Total	\$5,637,566

Unlike state income tax credits, no figures exist which accurately report how much state sales tax is forgone in connection with exemptions provided by the Kansas Enterprise Zone. However, Kansas, Inc. estimates that during FY 1996, the state forfeited a total of \$12.4 million in state sales tax revenue in connection with the Kansas Enterprise Zone. A more complete explanation of sales tax exemptions granted under the Kansas Enterprise Zone and a characterization of the \$749.5 million in private sector investment associated with sales tax exemptions is provided beginning on page 4 of this report.

Key Findings

Sales Tax Exemptions

- In FY 1996, sales tax exemptions were granted to companies making a total of \$749.5 million in investment, a 6.5% increase in total investment over FY 1995.
- Eighty-six percent (86%) of the \$749.5 million in exempt investment was made by companies in the manufacturing sector.
- Manufacturing investment in FY 96 rose 21% over manufacturing investment in FY 95 from \$532.5 million to \$643.3 million. This was a smaller increase than took place between FY 94 and FY 95 when the state experienced a 27% increase in exempt manufacturing investment.
- Changes made to the Kansas Enterprise Zone Act in 1994 allowing sales tax exemption for lessors accounted for \$9.3 million in exempt investment in FY 1996.
- Changes made to the Kansas Enterprise Zone Act in 1994 allowing sales tax exemption for corporate headquarters accounted for \$13 million in exempt investment in FY 1996.
- The majority (54%) of exempt investment took place in the Northeast region of the state.
- In FY 1996, the Northeast region of the state experienced the most exempt investment, both in proportion to its population and the number of manufacturing employees.
- The North Central region experienced the second most exempt investment, representing the first time in five years the region ranked among the top two.
- Unlike FY 1995, the majority of exempt investment in FY 1996 took place in metropolitan counties.
- Twenty-nine (29) firms stated that their projects were the result of recruitment efforts. These 29 firms accounted for \$137.3 million in investment during FY 1996.
- Twelve (12) of the 29 firms stated that their projects were a result of recruitment efforts by the Kansas Department of Commerce & Housing. These 12 firms accounted for \$103.9 million in investment during FY 1996.
- Estimated forgone state sales tax in connection with the Kansas Enterprise Zone Act was \$12.4 million in FY 1996.

Income Tax Credits

- According to the Department of Revenue, taxpayers claimed economic development income or privilege tax credits totaling \$5.6 million during Calendar Year 1995. (This figure does not include carryover from economic development tax credits no longer available.)
- Seventy-three percent (73%) of the income and privilege tax credits claimed during Calendar Year 1995 were Job Expansion and Investment Tax Credits available through the Kansas Enterprise Zone Act.
- Revised Department of Revenue figures tell us that more Research & Development Tax Credits are being claimed than previously reported.

Sales Tax Exemption granted under the Kansas Enterprise Zone Act

FY 1996 Exempt Investment

Thanks to the cooperation of the Kansas Department of Revenue, Kansas, Inc. maintains a database of Kansas businesses issued sales tax exemption certificates between fiscal years 1992 and the present. This report is an analysis of that data with concentration on sales tax exemptions approved during FY 1996.

The Kansas Enterprise Zone Act offers qualified businesses state and local sales tax exemption for certain purchases made in connection with the creation of jobs. When a business in Kansas makes the decision to invest in such a project, the business must submit a *Request for Project Exemption Certificate* to the Kansas Department of Revenue. The firm must provide the Department with an estimate of the total amount of investment the firm plans to make in the project. The firm also indicates whether the investment will be in connection with original construction of a new facility; remodeling of, or reconstruction of an existing facility; an addition to an existing facility; or the purchase of additional machinery and equipment. That estimated investment is reported in this document and is referred to as "exempt investment."

While this document reports the total amount of exempt investment made in Kansas during the past fiscal year, it is important to keep several things in mind. Reference made to amounts of exempt investment are tabulations of estimated investment reported on exemption certificates and cannot be viewed as a precise measure of the investment that actually took place for the following reasons. The amount of exempt investment reported is only planned investment - it had not taken place at the time the exemption certificate was submitted and approved. In addition, Kansas, Inc. has no way of determining how many of these projects were canceled or postponed, or which projects ran over or under estimated costs. Tabulations of exempt investment reported by firms on their exemption certificates can, however, lend important insight into investment and growth trends in the state.

The total estimated exempt investment reported on sales tax exemption certificate applications approved in FY 1996 was the highest ever, totaling over \$749.5 million. Figure 1 shows the amount of exempt investment that was granted state and local sales tax exemption over the past five fiscal years. Exemptions in FY 1996 represent a 6 percent increase over FY 1995 investment, a smaller increase than took place between FY 1994 and 1995 when the increase was 20 percent.

Figure 1

Exempt Investment made in Connection with E-Zones
FY 92 to FY 96

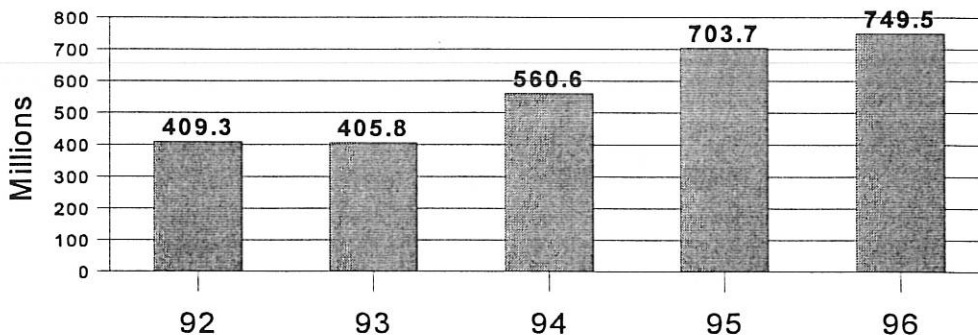
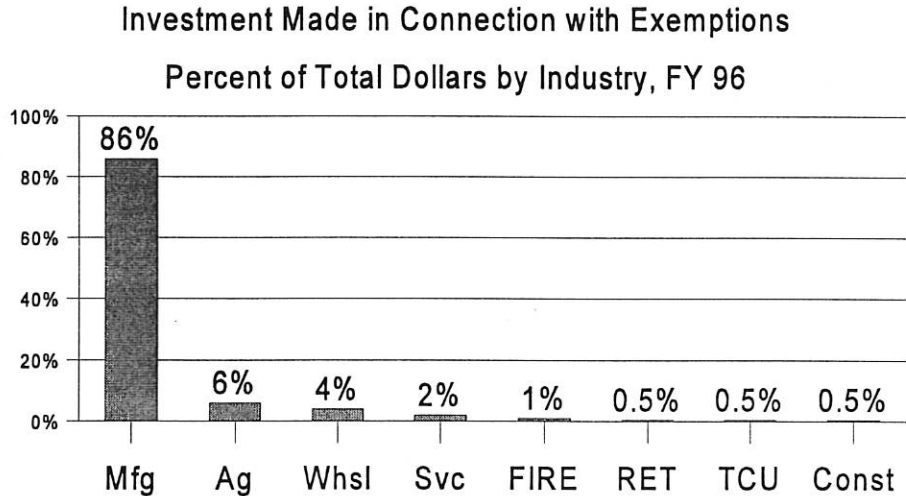


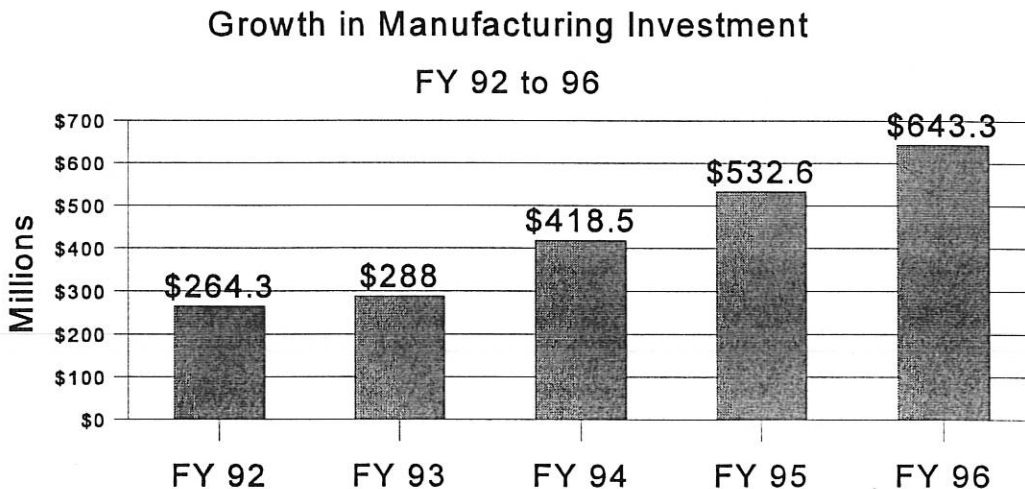
Figure 2 illustrates the distribution of exempt investment among the industrial sectors. The vast majority of investment eligible for sales tax exemption in FY 96 was made in the manufacturing sector. Investment approved for exemption in the other sectors of the economy decreased during FY 1996 as a percent of total exempt investment. In contrast, nearly \$13 million in investments made in connection with corporate headquarters was granted exemption and another \$9.3 million in investment made by lessors was also granted exemption. This was possible because of amendments to the Enterprise Zone statute made by the 1994 Legislature.

Figure 2



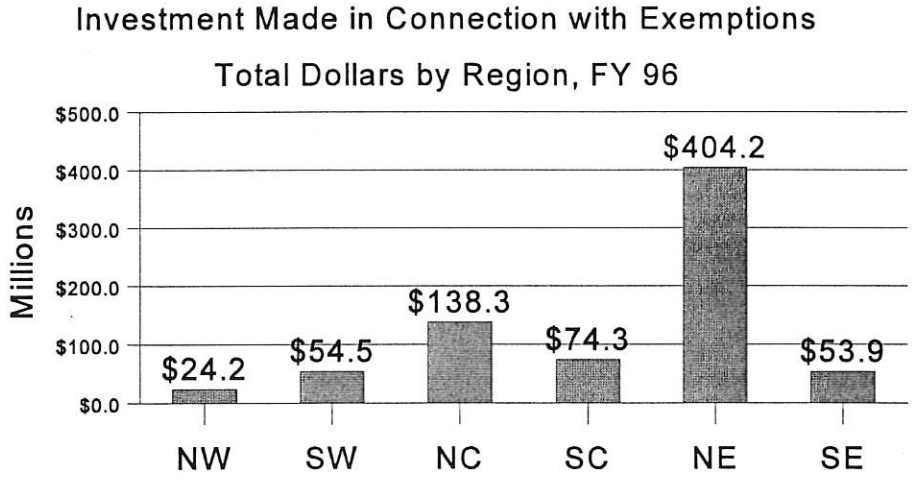
Manufacturing investment in FY 96 rose 21 percent over that of FY 95 rising from \$532.5 million to \$643.3 million (Figure 3). This was a smaller increase than took place between FY 94 and FY 95 when the state experienced a 27 percent increase in exempt manufacturing investment.

Figure 3



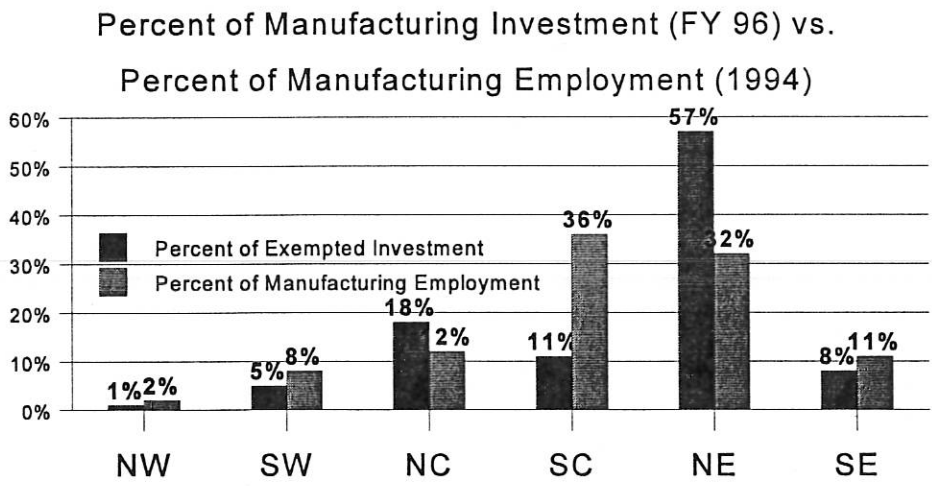
The regional distribution of exempt investment in FY 1996 is presented in Figure 4. As in FY 95, more than half the state's exempt investment (54%) took place in the Northeast region of the state. From FY 1992 through FY 1994, the South Central region experienced the most exempt investment. The second largest amount of exempt investment took place in the North Central region of the state. This represents the first time in five years that the North Central region ranked among the top two regions for investment. Much of that investment took place in Saline and Geary counties.

Figure 4



Additional analysis was conducted which compared the amount of exempt investment in manufacturing with the manufacturing employment in each region. Figure 5 compares the percentage (or share) of exempt investment made in each region to that region's share of the state's manufacturing employment. A region for which the exempted investment exceeded manufacturing employment, received more than its "proportional share" of exempt investment.

Figure 5

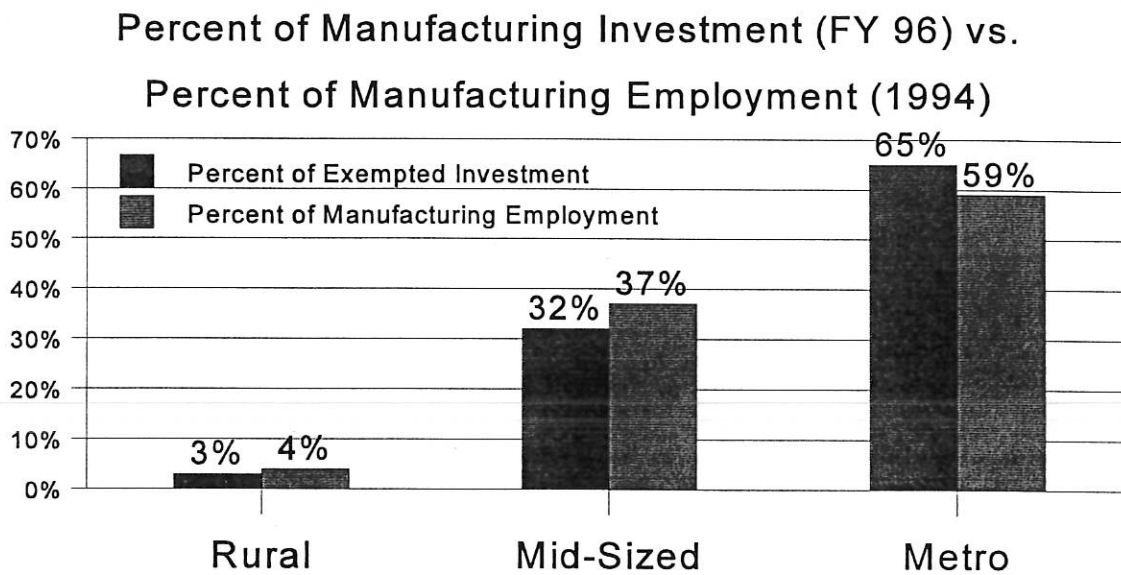


Using those percentages, a ratio can be established that provides a rough gauge by which to measure the vitality of the manufacturing sector within each region. The ratio is the percent of investment divided by the percent of manufacturing employment in the region. Table 1 reports the calculated ratio. The manufacturing sector in the Northeast region of the state ranks highest with a ratio of 1.81. The manufacturing sector in this region of the state is investing more per employee on equipment and facilities. This kind of investment pattern suggests a sizable portion of these firms are moving toward becoming more efficient and less labor intensive. It could also signal investment made by new-to-the-region businesses.

Table 1	
<u>Employment/Investment</u>	
Northeast	1.81
North Central	1.54
Southeast	0.74
Southwest	0.62
Northwest	0.41
South Central	0.30

Kansas, Inc. has recently documented significant growth in employment and population in rural and mid-sized counties of Kansas. This surge in economic vitality can also be seen through analysis of investment in rural, mid-sized, and metropolitan counties. Figure 6 shows that at least in the aggregate, rural and mid-sized counties of the state are holding their own in terms of manufacturing investment per employee. While investment in non-metropolitan counties of the state is not as strong as in the metropolitan counties, nonetheless, these figures suggest that investment in the less densely populated areas of the state is relatively healthy.

Figure 6



Twenty-nine (29) firms stated that their projects were the results of recruitment efforts. This investment totaled \$137.3 million. Twelve (12) of the 29 firms stated their projects were a result of recruitment efforts by the Kansas Department of Commerce & Housing. This investment totaled \$103.9 million.

What Does a Sales Tax Exemption Certificate Exempt?

Sales Tax on Machinery and Equipment Not Already Exempt. The 1988 Legislature amended the Kansas Retailers' Sales Tax Act to exempt machinery and equipment used directly and primarily in the manufacturing process. The following is an excerpt from the statute:

K.S.A. 79-3606(kk)

"... all sales of machinery and equipment used directly and primarily for the purposes of manufacturing, assembling, processing, finishing, storing, warehousing or distributing articles of tangible personal property where such machinery and equipment is used during a manufacturing, assembling, processing or finishing, string, warehousing or distributing operation:..."

The statute goes on to specifically exclude some types of machinery and equipment.

K.S.A. 79-3606(3)

" 'Machinery and equipment used directly and primarily' shall not include:

- (A) Hand tools;*
- (B) machinery, equipment and tools used in maintaining and repairing any type of machinery and equipment;*
- (C) transportation equipment not used in the manufacturing, assembling, processing, furnishing, storing, warehousing or distribution process at the plant or facility;*
- (D) office machines and equipment including computers and related peripheral equipment not directly and primarily used in controlling or measuring the manufacturing process;*
- (E) furniture and buildings; and*
- (F) machinery and equipment used in administrative, accounting, sales or other such activities of the business."*

In addition to the "machinery and equipment used directly and primarily" in the manufacturing process allowed under paragraph (kk) of the statute, an approved sales tax exemption certificate issued pursuant to the Kansas Enterprise Zone Act also makes items (A) through (F) exempt for the manufacturer (Motor vehicles retain their taxable status.) For non-manufacturing companies, corporate headquarters, back-office operations, and retailers in communities of 2,500 or less, an approved sales tax exemption certificate provides the same exemptions as for manufacturing firms. Local sales tax on these purchases is also exempt by this statute.

Sales Tax on Materials and Labor Purchased in Connection with a Construction or Remodeling Project. The state of Kansas no longer levies sales tax on labor used in original construction. There is, however, a 4.9% state sales tax on labor used in remodeling, reconstruction or enlarging an existing facility. In addition there is a 4.9% state sales tax on the materials used in all types of construction projects. An approved sales tax exemption certificate issued in accordance with the Kansas Enterprise Zone Act exempts a business from paying these taxes. An approved certificate would also exempt the business from paying these taxes at the local level.

What is the Fiscal Impact of Enterprise Zone Exemptions?

Estimating the state's fiscal impact of enterprise zone exemptions is relatively simple for that portion attributed to construction costs, however, estimating the fiscal impact of foregone sales tax on purchases of manufacturing machinery and equipment is more complicated.

As an example, in FY 1996, manufacturers' total project costs reported on exemption certificates totaled \$643,315,397. According to the estimated investment reported by firms, \$382.3 million was planned to go toward the purchase of machinery and equipment and \$261 million was planned to go toward construction costs (the purchase of material and labor.)

Because the business also indicates whether the project is "original construction of a new facility," "remodel or reconstruction of an existing facility," or an "addition to an existing facility" it is relatively simple to estimate the impact of forgone sales tax on labor and materials. Using the Department of Revenue's assumption that 60% of the construction costs are labor and 40% are for material, the forgone sales tax on the \$643.3 million in construction in FY 1996 would be \$5.11 million.¹

It is more difficult to estimate the amount of foregone sales tax on the \$382.3 million in purchases of machinery and equipment. From the information available to KDOR, it is impossible to determine what portion of total manufacturer's investment would have already been exempt under K.S.A. 79-3606(kk) even without the sales tax exemption certificate. Without this knowledge, it is impossible to determine the exact fiscal impact of the additional exemptions offered by the Enterprise Zone.

As recently as April 1996, the Department of Revenue has provided fiscal impact estimates which included 4.9% sales tax lost on the entire portion of the machinery and equipment purchased during FY 1995. In reality, in the case of manufacturers (which accounted for 86% of total reported investment in FY 1996), almost all of the machinery and equipment purchased in connection with a project would not already be exempted under K.S.A. 79-3606(kk).

¹Additional assumptions used: It is assumed that all information reported to KDOR was accurate and complete. It is recognized that some projects may run over or under the estimated amount. For some projects that run over the estimated amount, there are a number that may be canceled altogether. Whether these balance out or not is not factored into these figures. It is assumed all exempt purchases are made in the year the certificate was processed. While this is obviously unlikely, the rationale for this assumption is that what is carried over into the next year compensates for the amount from last year that is being carried over into this year.

Although KDOR did acknowledge the following, the resulting estimate was very much overstated and could mislead policy makers.

*"It should be pointed out that some of the machinery and equipment exempted by K.S.A. 79-3606(cc) would have been exempt under K.S.A. 79-3606(kk), even without the sales tax exemption certificate."*²

After speaking with several experts in the field, Kansas, Inc. believes that between 80 and 95 percent of the machinery and equipment purchased and used "primarily and directly" in the manufacturing process would be already exempt under 793606(kk). To be generous, our calculations used an 80/20 ratio of exempt and non-exempt manufacturing machinery and equipment.

For FY 1996, manufacturers' exemption certificates report machinery and equipment investment of \$382,334,661. If the Department of Revenue estimated the forgone state sales tax on manufacturer's machinery and equipment investment in the same way as for FY 1995, they would report a loss of \$18.7 million. Kansas, Inc. believes the more accurate estimate is \$3.7 million.

The following is the estimated state sales tax foregone in connection with the Kansas Enterprise Zone Act.

	<u>Project Costs Reported</u>		Total
	Construction	Machinery & Equipment	
Manufacturing	260,980,736	382,334,661	643,315,397
Non-manufacturing	71,040,289	35,112,388	106,152,677
Total	\$332,021,025	\$417,447,049	\$749,468,074

	<u>Estimated Forgone State Sales Tax</u>		Total
	Construction	Machinery & Equipment	
Manufacturing	5,117,350	3,746,880	8,864,230
Non-manufacturing	1,790,831	1,720,507	3,511,338
Total	\$6,908,181	\$5,467,387	\$12,375,568*

*KDOR's methodology would add an additional \$14,987,519 in forgone state sales tax for manufacturers machinery and equipment already exempt.

No attempt was made to measure the fiscal impact on specific local taxing authorities at the city and county level. However, the Kansas Department of Revenue reports that local sales tax collections are 27.7% as large as state tax collections. Therefore, the estimated sales tax forgone at the local level would be approximately 27.7% of the state's loss or approximately \$3.4 million.

²Department of Revenue letter to Governor Graves (cc Paul Bud Burke, Senate President and Tim Shallenburger, House Speaker) dated April 1, 1996 regarding the estimated fiscal impacts of incentives connected with the Kansas Enterprise Zone.

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Kansas Income Tax Credits

Results of Research Efforts

As described in the introduction to this report, the 1994 Legislature passed H.B. 2556 and charged Kansas, Inc. with evaluating the cost effectiveness of the various income tax credits available to Kansas businesses. Because of statutory confidentiality provisions, there has been no way to access the information needed to determine whether these tax credits achieved their intended purposes. Although the Department of Revenue is barred from revealing such information, H.B. 2556 offered a method to identify which firms received state income tax credits. The bill required businesses receiving tax credits to acknowledge so by completing and filing a questionnaire along with their corporate income tax return. The Department of Revenue is then required to harvest the completed questionnaire from the corporate tax return and provide them to Kansas, Inc. In-turn, Kansas, Inc. would use the information from the questionnaires to contact those firms regarding the effect those incentives had on their company. Following the Legislature's direction, the Secretary of Revenue developed a questionnaire with the cooperation of Kansas, Inc. The Secretary of Revenue made it a part of the 1994 Corporate Tax Booklet.

The Document Processing Bureau within the Department of Revenue was given the difficult task of retrieving the completed questionnaire from each corporate tax return. From the time the first completed questionnaires began to be received at document processing, the adequacy of the questionnaire method of collecting information was called into question. The following is a tabulation of the number of questionnaires received from taxpayers that had claimed a tax credit and completed the questionnaire to date.

<u>Questionnaires Retrieved from Tax Returns</u>	
Missing 2d Page (unusable)	28
Research and Development Tax Credit	16
Workforce Training Credit (HPIP)	1
E-Zone (Job Creation or Investment Credit)	171
Venture Capital/Seed Capital Tax Credit	0

Results from the questionnaire system are disappointing and cannot be used as intended. Too few questionnaires were submitted in each category of tax credits to allow for reliable survey results. In addition, it is impossible to tell whether the claim reported is a new claim or whether it was a carryover from a claim that originated several years ago. The chances are very good that the majority of questionnaires are reporting a carryover from a previous tax year. A good portion were missing the second page which told which credit was taken. The largest number of questionnaires reported claims for the job creation and investment tax credit; information already captured during the sales tax exemption certificate process. Only corporations are required to complete the questionnaire while a portion of the total tax credits claimed are reported on personal income tax returns. In addition, the questionnaire is an expensive proposition for both the taxpayer and the Department of Revenue which must harvest the questionnaires from the thousands of returns processed.

A revised questionnaire has been developed by the Department of Revenue and is part of the 1996 corporate tax return. The revised questionnaire asks the taxpayer whether they are reporting a new

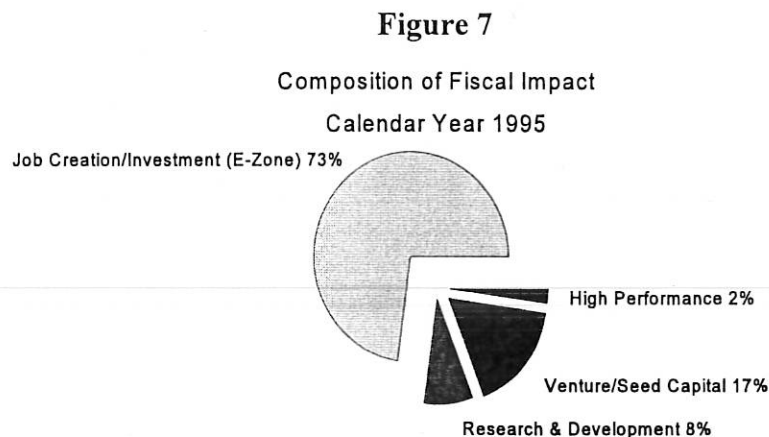
claim or carryover. The taxpayer is also requested to answer subjective questions as to the value of the credit and whether they feel the credit was an incentive to make the related investment, thus removing the burden of additional surveys conducted by Kansas, Inc. The questionnaire represents a significant improvement and we hope most of the problems have been solved and this new questionnaire will yield the expected results. There remains the problem of the expense involved to the taxpayer and that of the questionnaire harvesting process for KDOR. A copy of the new questionnaire is included in the Appendix to this report.

Another option exists that would eliminate the need for the questionnaire and relieve businesses of the burden of the questionnaire. The Corporate Tax Section within the Department of Revenue evaluates all corporate filings for tax credits. Presently, access to the names or records of taxpayers claiming credits is statutorily denied to those outside the Department of Revenue. There have been discussions with the Corporate Tax Section about the possibility of cooperating on a survey of taxpayers through their office, thus eliminating the need for disclosure of taxpayer identities.

What has been the Fiscal Impact of Economic Development Tax Credits?

This section describes a number of tax credits designed to encourage economic development in the state and present the most recent fiscal impact calculations. Numerical tabulations were gleaned from a recent report published by the Research and Revenue Analysis Office within the Department of Revenue.³

According to the Department of Revenue, taxpayers claimed economic development income or privilege tax credits totaling \$5.6 million during Calendar Year 1995. (This figure does not include carryover from economic development tax credits no longer available.) Figure 7 reflects data compiled by the Department of Revenue and provides a comparison of the fiscal impacts of each economic development tax credit. The figures represented include credits actually claimed during Calendar Year 1995. These figures also include any carryover that might be claimed from a previous year. Seventy-three percent (73%) of the total economic development credits claimed during Calendar Year 1995 were Job Creation and Investment Credits available through the Kansas Enterprise Zone. It is expected that the High Performance Firms Incentives Program, which is a relatively new program, will constitute a larger portion of the pie in the future as the number of certified firms continues to grow.



³Ibid

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Kansas Enterprise Zone Act - K.S.A. 74-50,113 et seq., as amended.

The basic *Job Creation Tax Credit* is \$1,500 per net new job. If a county has been designated as a nonmetropolitan business region, the credit is \$2,500 per net new job. The *Investment Tax Credit* is \$1000 per \$100,000 of qualified investment. This credit is the same for manufacturing or non-manufacturing businesses throughout the state, regardless of location. The 1996 Legislature revised the *Kansas Enterprise Zone Act* to provide eligibility for insurance companies and financial institutions by allowing the credits to be used against the privilege tax on net income. Both the Job Creation and the Investment Tax Credits are claimed by submitting a Schedule K-34 with the business' Kansas income tax filing (K.S.A. 79-32,160a). Both credits may be used to offset up to 100% of the business' annual tax liability and unused credits can be carried forward indefinitely. Retail businesses are not eligible for these credits.

Job Creation and Investment Tax Credit (E-Zone)

Current with Carryover, Post 1994 Revamping*

	Total Filers	Total Claimed
1994	39	\$1,864,511
1995	88	3,786,618
As of 8/31/96	72	3,157,566
Total	199	\$8,808,695

Dept. of Revenue report dated 11/15/96 reporting actual credits taken as of 8/31/96.

*See "Recent History of Sales Tax Exemption as it Applies to the Kansas Enterprise Zone Act" in the Appendix.

Job Creation and Investment Tax Credit Act of 1976 - K.S.A. 79-32,153 et seq. The *Job Creation and Investment Tax Credit Act of 1976* provides incentives for those businesses that may not qualify for the Enterprise Zone incentives, such as retail businesses, or non-manufacturing businesses that do not create at least 5 net new jobs. Eligibility for these credits requires the creation of at least two net new jobs.

This Act provides a job creation credit of \$100 per net new employee per year for a period of 10 years and an investment tax credit of \$100 per \$100,000 of qualified investment. Credits may be used to offset up to 50% of the business' Kansas income tax liability. Unused credits may not be carried forward.

Job Creation and Investment Tax Credit
 Current (No Carryover Allowed), Post 1994 Revamping*

	Total Filers	Total Claimed
1994	15	\$227,910
1995	16	377,636
As of 8/31/96	13	332,997
Total	44	\$938,543

Dept. of Revenue report dated 11/15/96 reporting actual credits taken as of 8/31/96.

*See "Recent History of Sales Tax Exemption as it Applies to the Kansas Enterprise Zone Act" in the Appendix.

Research and Development Tax Credit - K.S.A. 79-32,182 et seq. Created in 1986, this tax credit is designed to increase research and development activity by Kansas businesses. The income tax credit is equal to 6.5% of a company's investment in research and development above the average expenditure of the previous three-year period. Only 25% of the allowable annual credit may be claimed in any one year. Any remaining credit may be carried forward in 25% increments until exhausted.

Research and Development Tax Credit
 Current and Carryover

	Total Filers	Total Claimed
1988	8	\$ 4,954
1989	22	101,002
1990	33	124,439
1991	37	355,471
1992	57	233,913
1993	49	2,686,847
1994	84	3,192,242
1995	87	439,651
As of 8/31/96	21	138,524
Total	398	\$7,277,043

Dept. of Revenue report dated 11/15/96 reporting actual credits taken as of 8/31/96.

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Kansas Venture Capital, Inc. - K.S.A. 74-8304A, 74-8305 et seq. and Certified Venture and Seed Capital Credit - K.S.A. 74-8401. These credits are designed to encourage cash investment in venture capital and seed capital pools in Kansas. To that end, a credit equal to 25% of the taxpayer's cash investment in stock issued by Kansas Venture Capital, Inc., a certified Kansas venture capital company, or a certified local seed pool may be deducted from a taxpayer's income or privilege tax liability. The entire amount of the credit may be claimed in one year, or if the amount of the credit claimed exceeds the taxpayer's liability in any year, the amount may be carried forward until the credit is exhausted.

Certified Venture Capital Investment Credit

Current and Carryover

	Total Filers	Total Claimed
1986	7	\$ 6,846
1987	12	26,202
1988	168	391,433
1989	170	2,981,375
1990	74	533,859
1991	54	351,337
1992	10	146,526
1993	5	126,148
1994	11	826,078
1995	7	569,312
As of 8/31/96	0	0
Total	518	\$5,959,116

Dept. of Revenue report dated 11/15/96 reporting actual credits taken as of 8/31/96.

Certified Seed Capital Investment Tax Credit

Current and Carryover

	Total Filers	Total Claimed
1989	2	\$7,527
1990	2	10,179
1991-1994	0	0
1995	1	372,250
As of 8/31/96	0	0
Total	5	\$389,956

Dept. of Revenue report dated 11/15/96 reporting actual credits taken as of 8/31/96.

High Performance Firms Incentives Program (HPIP) Credit - K.S.A. 74-50,132. This incentives program was enacted in 1993 to retain Kansas' existing high-performance businesses, encourage investment in worker training and education, and spur the attraction of new, high quality firms to the state. The first firm was certified in late 1994. The incentives offered under the program are limited to manufacturers, export oriented service sector firms, and corporate headquarters and back-office operations of national or multi-national corporations. To qualify, the firms must pay above average wages for their industry in the county they are located, and either invest an amount equal to 2% of their total payroll on employee training or participate in either the Kansas Industrial Training (KIT) Program, the Kansas Industrial Retraining (KIR) Program, or the State of Kansas Investment in Lifelong Learning (SKILL) Program. Firms wishing to use this credit must become certified through the Kansas Department of Commerce & Housing (KDOC&H.)

Income Tax credits available through this program are:

- 10% Investment Tax Credit against corporate income tax on any investment exceeding \$50,000. The credit may be taken over a 10-year period subject to requalification by KDOC&H.
- Workforce Training Tax Credit on training expenditures above an amount equal to 2% of total payroll. The credit is limited to \$50,000 and no carryover provision exists.

**High Performance Firms Incentives Program (HPIP)
Investment Tax Credit and Workforce Training Tax Credit
Current with Carryover for Investment Credit Only**

	Total Filers	Total Claimed
1995	9	\$92,099
As of 8/31/96	0	0
Total	9	\$92,099

Dept. of Revenue report dated 11/15/96 reporting actual credits taken as of 8/31/96.

Appendix

Recent History of Sales Tax Exemption as it Applies to the Kansas Enterprise Zone Act:

1982: The Kansas Legislature established the Kansas Enterprise Zone Act, providing a city the ability to designate a portion of its area as an enterprise zone. Businesses which located within the zone would receive a sales tax refund on property and services associated with the construction, expansion, or rehabilitation of a business facility. In addition, job creation and investment tax credits were provided if a project created at least two net new jobs.

1986: Counties were given the authority to establish county enterprise zones.

1988: Sales tax on machinery and equipment used in manufacturing was made exempt. Prior to this, manufacturers had to be located in designated enterprise zone to receive this exemption. Kansas had been the only state in the region with this tax.

1992: The Legislature enacted a new Kansas Enterprise Zone Act, which reconfigured the original program established pursuant to K.S.A. 12-17,107 et seq. Enterprise zones established in the earlier program were eliminated and enterprises zone incentives were extended statewide with enhanced levels of benefits in certain rural areas. In contrast to the earlier program, the revamped enterprise zone laws linked eligibility for sales tax exemption, investment tax credits, and job creation tax credits to the type of business and their ability to meet certain job creation qualifications.

1994: The Enterprise Zone Act was amended again to add a definition of "corporate headquarters" and to clarify the existing definitions of "non-manufacturing business" and retail business." This amendment was proposed by Kansas, Inc. to correct misinterpretations of the law which had resulted in the denial of enterprise zone benefits to many companies. The amendment also permitted owners of leased property to receive sales tax exemptions when constructing, reconstructing, remodeling, or enlarging a facility which will be leased for a period of five years or more to a business which would be eligible for the exemption if it had constructed, reconstructed, remodeled, or enlarged the facility itself.

1995: The Legislature repealed the 2.5% sales tax imposed in 1992 on labor used in original construction. This law became effective April 15, 1995.

1996: The Legislature amended the law to allow businesses to offset 100 percent of their Kansas income tax liability with Enterprise Zone tax credits. It also included a definition for ancillary support facilities (back office operations), and headquarters which looks at the function the facility plays rather than the type of business the facility belongs to. The bill also amended the Act to allow insurance companies and financial institutions, which pay privilege tax, to be eligible for job expansion and investment tax credits.

Summary of Incentives

Eligibility for the various incentives and the value of the incentive depend on 1) the type of business, 2) the location of the business within the state, and 3) the number of net new jobs created. The *Kansas Enterprise Zone Act* defines the six counties of Douglas, Johnson, Leavenworth, Sedgwick, Shawnee, and Wyandotte as metropolitan counties. As such, they are ineligible to apply for the enhanced job credits available to designated non-metropolitan counties.

<i>Jobs Criteria/Definitions</i>	<i>Basic Incentives</i>	<i>Desig. Non-metropolitan Regions</i>
<p><u>Manufacturing</u> A manufacturing business is defined as any commercial enterprise identified under Standard Industrial Classification (SIC) codes, major groups 20-39 and must create a minimum of two (2) net new jobs.</p>	<p><u>Manufacturing</u> Sales Tax Exemption Job Creation Tax Credit - \$1,500 per net new job. Investment Tax Credit - \$1,000 per \$100,000 of qualified business facility investment.</p>	<p><u>Manufacturing</u> Sales Tax Exemption Job Creation Tax Credit - \$2,500 per net new job. Investment Tax Credit - \$1,000 per \$100,000 of qualified business facility investment.</p>
<p><u>Non-Manufacturing</u> A non-manufacturing business means any commercial enterprise other than a manufacturing or retail business that creates a minimum of five (5) net new jobs or the business headquarters of an enterprise or the ancillary support facility of an enterprise if the facility creates at least 20 new full-time positions.</p>	<p><u>Non-Manufacturing</u> Sales Tax Exemption Job Creation Tax Credit - \$1,500 per net new job. Investment Tax Credit - \$1,000 per \$100,000 of qualified business facility investment.</p>	<p><u>Non-Manufacturing</u> Sales Tax Exemption Job Creation Tax Credit - \$2,500 per net new job. Investment Tax Credit - \$1,000 per \$100,000 of qualified business facility investment.</p>
<p><u>Retail</u> A retail business is defined as any business providing goods or services taxable under the Kansas Retailers' Sales Tax Act; any professional service provider set forth in K.S.A. 17-2707, and amendments thereto; any bank, S&L, or other lending institution; any commercial enterprise whose primary business activity includes the sale of insurance; any commercial enterprise deriving its revenues directly from noncommercial customers in exchange for personal services such as, but not limited to barber shops, photographic studios, and funeral services. Retail businesses must create a minimum of two (2) net new jobs.</p>	<p><u>Retail</u> Sales Tax Exemption - Available for businesses in communities of less than 2,500 population Job Creation Tax Credit - \$100/year for 10 years for each net new job created (K.S.A. 1995 Supp. 79-32,153). Investment Tax Credit - \$100/year for 10 years for each \$100,000 in qualified business investment (K.S.A. 1995 Supp. 79-32,153).</p>	<p><u>Retail</u> Sales Tax Exemption - Available for businesses in communities of less than 2,500 population Job Creation Tax Credit - \$100/year for 10 years for each net new job created (K.S.A. 1995 Supp. 79-32,153). Investment Tax Credit - \$100/year for 10 years for each \$100,000 in qualified business investment (K.S.A. 1995 Supp. 79-32,153).</p>

**REQUEST FOR PROJECT EXEMPTION CERTIFICATE
PURSUANT TO K.S.A. 79-3606(cc)**

Kansas Department of Revenue
Director of Taxation
PO Box 12001
Topeka, Kansas 66625-0001

Date _____

Telephone: (913) 296-3498
FAX: (913) 296-2073

It is requested that a Certificate of Exemption be issued to the taxpayer for the following described project if it is determined by the Department of Revenue that the proposed project qualifies for exemption from sales tax under the provisions of K.S.A. 79-3606(cc).

(A) Name of taxpayer: _____
Business type: Corporation L.L.C. Limited Liability Partnership/Partnership Individual
Other _____

(B) 1. Name of business which will operate the business facility (if different from the name listed on Line (A)):

Business type: Corporation L.L.C. Limited Liability Partnership/Partnership Individual
Other _____

2. Location of business facility investment: _____
Street Number and Address
County _____ City _____ State _____ Zip _____

3. Mailing address of taxpayer (business) who will own and/or operate the business facility:

Box Number and/or Street Number and Name
City _____ State _____ Zip _____

(C) Are you relocating an existing business to another city or county that requires approval from the Secretary of Commerce? Yes No If yes, please attach said approval.

(D) Type of project: Original construction of a new facility Remodel or reconstruction of an existing facility
 Addition to an existing facility Additional machinery and equipment, not to include the purchase of a motor vehicle or trailer.

(E) Attach a detailed explanation or list of: Improvements to be constructed; repairs or remodeling to be done; machinery and equipment to be purchased and a justification of how these purchases relate to new employment.

(F) Describe specifically the type of business activity to be conducted by the taxpayer [name on Line (A)] at the business facility:

(G) Indicate the type of business conducted by the named taxpayer, by checking ONE of the following boxes and answering the corresponding question(s): **See instructions.**

Manufacturing:
Will the expansion of the manufacturing business involve the hiring and addition of at least two employees to your total Kansas employment?
Yes No

"Manufacturing business" means all enterprises with a manufacturing Standard Industrial Classification (SIC) major group code 201 through 399. Enter SIC _____ See attached listing of major group codes.

Nonmanufacturing:
Will the expansion of the nonmanufacturing business involve the hiring and addition of at least five employees to your total Kansas employment?
Yes No

Nonmanufacturing (Corporate Headquarters):
Will the expansion involve the hiring and addition of at least twenty new full time positions to your total Kansas employment?
Yes No

CONTINUE ON REVERSE SIDE

Will the expansion of the facility house principal officers of the corporation?
Yes No If yes, please enclose a list of principal officers of the corporation.

"Nonmanufacturing business" means any commercial enterprise other than a manufacturing business or a retail business. Nonmanufacturing business shall also include the Corporate Headquarters of an enterprise regardless of the firm classification as a retail business if that facility for which the sales tax exemption certificate is issued facilitates the creation of at least 20 new full time positions.

"Corporate headquarters" means a facility where the principal officers of the corporation are housed and from which direction management or administrative support for transactions is provided for a corporation or division of a corporation.

Retail:

Will the expansion of the retail business involve the hiring and addition of at least two employees to your total Kansas employment and be located or expanded in a city with a population of 2,500 or less?

Yes No

Lessor/Lessee:

Will the constructing, reconstructing or enlarging of the facility to be leased be for a period of 5 years or more?
Yes No If yes, please enclose a copy of the lease.

Would the lessee qualify for the sales tax exemption if the lessee requested the exemption directly with the department?

Yes No If yes, provide the following information:

Lessee's classification; The following will add to the lessee's total Kansas employment: Manufacturing: SIC _____ with hiring of two additional employees; Nonmanufacturing: Describe business _____ and business with hire five additional employees; Nonmanufacturing (corporate headquarters): creates the hiring of at least 20 additional full time employees; Certified Business: Certified by the Department of Commerce and Housing; Retail: Will the expansion of the retail business involve the hiring and addition of at least two employees to your total Kansas employment and be located or expanded in a city with a population of 2,500 or less? Yes No

Certified Business:

The business has been certified by the Department of Commerce and Housing. Attach copy of certificates.

(H) Is this project a result of recruitment efforts by officials of the state, county or city government? Yes No

If yes, please provide the name of the agency and/or official you were contacted by: _____

What will the average annual wage for new (non-managerial) employees be? _____

(I) List the name(s) and address(es) of the general contractor(s): _____

(J) Estimated project costs: Total _____ Construction costs _____

Machinery and equipment costs _____

(K) Contract date: _____

(L) Contract No. _____

(M) Estimated completion date (not to exceed two years): _____

Taxpayer

Name of Authorized Representative (please type or print)

Signature of Authorized Representative

Title

Phone Number

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STATE OF KANSAS ECONOMIC DEVELOPMENT INCENTIVE QUESTIONNAIRE

All Kansas corporate income taxpayers and/or their tax preparers are required, pursuant to K.S.A. 74-8017, to complete the following questionnaire regarding claims for income tax credits and sales tax exemptions. The information requested by the questionnaire is required to evaluate the utilization and effectiveness of these economic development and business tax credits and incentives provided by the state of Kansas.

The questionnaires will be collected by the Kansas Department of Revenue and submitted to Kansas, Inc., the economic development policy and planning agency created by the Kansas Legislature in 1986. Kansas, Inc., will conduct surveys of Kansas companies using the data provided on this form. It reports its findings annually to the Kansas Legislature.

If you have any questions regarding the questionnaire, call Kansas, Inc., at (913) 296-1460. If you have questions regarding the tax credits and their definitions, call the Department of Revenue at (913) 296-0222.

NOTE: The name and employer identification number of the corporate taxpayer will remain confidential. Results of this questionnaire will be reported to the legislature only in aggregate.

1.	_____	
	Company Name	
2.	_____	3. _____
	Federal Employer Identification Number	SIC Code
4.	_____	
	Mailing Address (PO Box or Street)	
5.	_____	_____
	City	State
		Zip Code
6.	_____	
	Name of Company Officer Filing this Questionnaire	

JOB EXPANSION AND INVESTMENT CREDIT ACT, K.S.A. 79-32,153, K.S.A. 79-32,160a

7. Will your tax year 1996 Kansas corporate income tax return include a "new" claim for this credit? Yes No
If yes, please provide the information and answer the questions on lines 8, 9 & 10.
8. Number of full-time employees (FTE) in tax year 1995 _____ Number of FTE during tax year 1996 _____
Total amount of expansion investment in tax year 1996 \$ _____
9. Did this credit provide an incentive for your company to expand employment or investment, or is it a way to off-set the cost of expansion? Incentive for Expansion Reduce Costs
10. Should Kansas retain this credit? Yes No

RESEARCH AND DEVELOPMENT CREDIT, K.S.A. 79-32,182

11. Will your tax year 1996 Kansas corporate income tax return include a "new" claim for this credit? Yes No
If yes, please answer the questions on lines 12 & 13.
12. Does this credit provide an incentive for your company to conduct research and development, or does this credit help reduce the cost of research and development your company must conduct regardless of any credit? Incentive Reduce Cost of Research
13. Should Kansas retain this credit? Yes No

KANSAS VENTURE CAPITAL AND SEED CAPITAL CREDITS, K.S.A. 74-8205, 74-8206, 74-8304, 74-8304a, 74-8401

14. Will your tax year 1996 Kansas corporate income tax return include a claim for these credits? Yes No
If yes, please answer the questions on lines 15 & 16.
15. Please indicate the credit(s) your company is claiming. Credit for investment in stock of Kansas Venture Capital, Inc.
 Credit for investment in a Kansas venture capital company Credit for investment in certified local seed capital pools
16. Should Kansas retain this credit? Yes No

WORKFORCE TRAINING AND FACILITY INVESTMENT CREDIT (HIGH PERFORMANCE FIRMS INCENTIVE PROGRAM HPIP), K.S.A. 74-50,132, 79-32,160a(e)

17. Will your tax year 1996 Kansas corporate income tax return include a claim for these credits? Yes No
If yes, please provide the information and answer the questions on lines 18, 19 & 20.
18. Please indicate the credit(s) your company is claiming. Credit for investment in training and education of employees
 Credit for investment in facilities and/or equipment
19. Number of employees receiving training and education _____
Amount invested in facilities and equipment during the last tax year \$ _____
20. Should Kansas retain this credit? Yes No

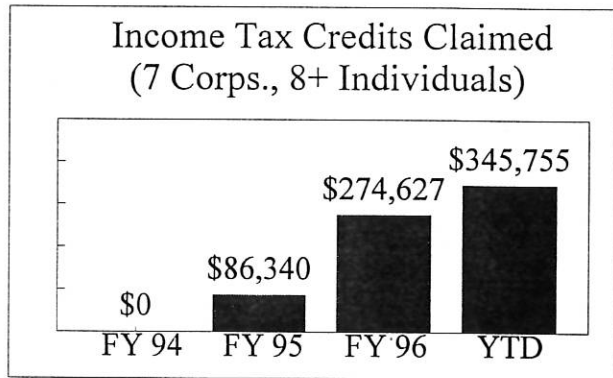
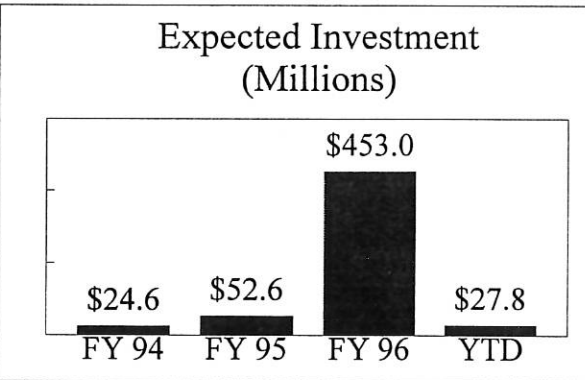
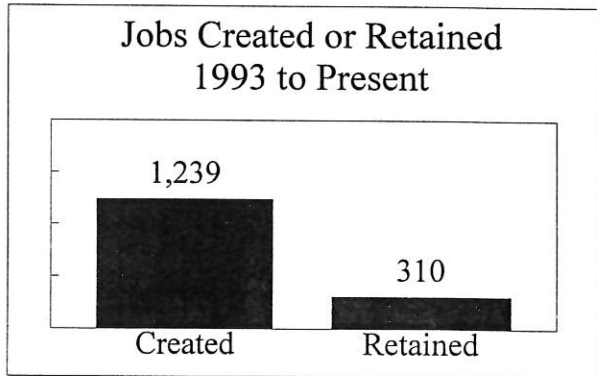
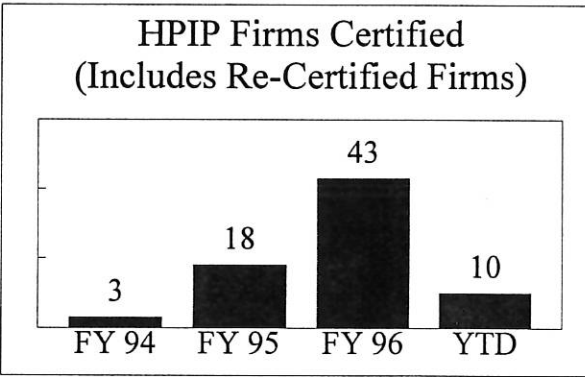
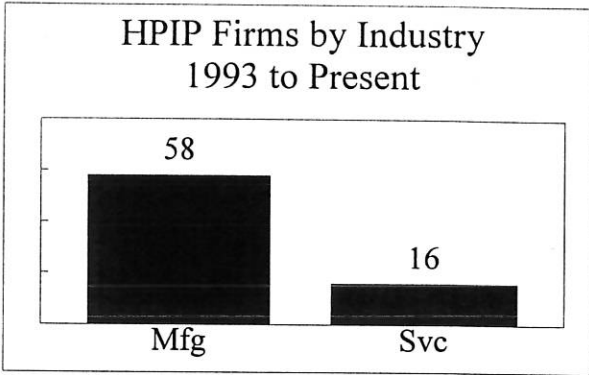
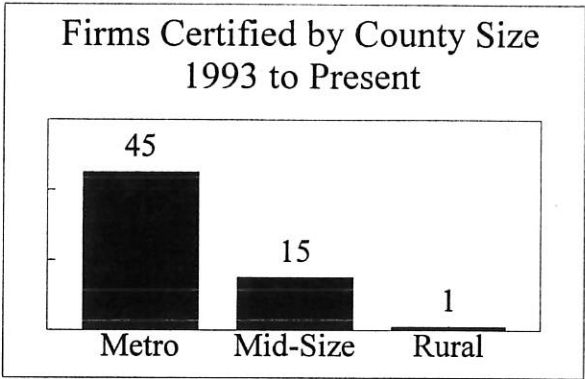
ENTERPRISE ZONE ACT SALES TAX EXEMPTION, K.S.A. 74-50,115

21. Did your company receive or use an enterprise zone exemption certificate during the state's fiscal year 1996 (7/95-6/96)?
 Yes No
If yes, please provide the information and answer the questions on lines 22 & 23.
22. Please provide the total amount of tax exempt purchases made under the exemption certificate \$ _____
Of total exempt purchases, indicate the amount paid for labor services and the amount paid for tangible personal property.
Labor Services \$ _____ Tangible Personal Property \$ _____
23. Should Kansas retain this sales tax exemption? Yes No

MANUFACTURING MACHINERY AND EQUIPMENT SALES TAX EXEMPTION, K.S.A. 79-3606(kk)

24. Did your company purchase any manufacturing machinery and equipment during the state's fiscal year 1996 (7/95-6/96)?
 Yes No
If yes, please provide the information and answer the questions on lines 25 & 26.
25. Please provide the amount paid for machinery and equipment purchased under this exemption \$ _____
26. Should Kansas retain this sales tax exemption? Yes No

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Based on job creation and business type, Kansas, Inc. has determined that only 4 HPIP firms would not have already been eligible for sales tax exemption under the E-Zone laws of Kansas. These 4 firms received sales tax exemption strictly as a result of the HPIP program. See adjacent table.

**Estimated
Sales Tax
Exemption**

Johnson Co. Manufacturer	\$588
Wyandotte Co. Manufacturer	\$1,116,251
Johnson Co. Manufacturer	\$35,133
Cowley Co. Manufacturer	\$9,800
Total	\$1,161,772