Approved:________________________
Date

MINUTES OF THE HOUSE COMMITTEE ON TAXATION..

The meeting was called to order by Chairperson Phill Kline at 9:00 a.m. on March 24, 1998 in Room 519-S of the Capitol.

All members were present except: Rep. Terry Presta

Committee staff present: Chris Courtwright, Legislative Research Department
Tom Severn, Legislative Research Department
Don Hayward, Revisor of Statutes
Shirley Sicilian, Department of Revenue
Ann McMorris, Committee Secretary

Conferees appearing before the committee:
Shirley Sicilian, Department of Revenue

Others attending: See attached list

Chair opened for introduction of bills

Moved by Representative Powell, seconded by Representative Larkin, committee introduce a bill requested by cable industry to put additional restrictions on ability of delinquent payment fees to be imposed on consumers. Motion carried.

Moved by Representative Garner, seconded by Representative Findley, committee introduce a bill to change law which would allow the taxpayer if audited by a neighboring state and payment of income tax determined, request refund from Kansas for overpayment. Motion carried.

Chair opened for staff briefing on:

SB 541 - Privilege tax on financial institutions, consolidated returns

Staffer Shirley Sicilan briefed the committee on **Senate Bill 541** on the history of the privilege tax, the estimated privilege tax receipts, and the effect of investment subsidiaries on privilege tax. The purpose of **S B 541** is to eliminate a financial institution's ability to avoid tax through the use of investment subsidiaries. (Attachment 1)

Following questions and discussion, Chair Kline announced appointment of a **Subcommittee On SB 541** and named Rep. Doug Mays as Chair, and members Vickery, Shultz, Larkin and Krehbiel.

Chair opened for committee action, amendments and motion on bills previously heard.

SB 44 - Sales tax exemption for remodeling services
HB 2755 - Income tax credit for teaching aids and certain education expenses
HB 2481 - Income tax credit for investment in certain agricultural cooperatives

Moved by Representative Gregory, seconded by Representative Cook, to eliminate the current language of **SB 44** and insert the language from **HB 2755** - income tax credit for teaching aids and certain education expenses and amend New Section 1, Line 28 to reduce the amount from $500 to $125 and New Section 2, p.2, line 2, reduce the amount to $300 and exclude tuition. Motion carried.

Moved by Representative Vickery, seconded by Representative Howell, amend **HB 2481** - Income tax credit for investment in certain agricultural cooperatives with amendment (Attachment 2) into **SB 44**. Motion carried. Yes 11, No 8

Moved by Representative Larkin, seconded by Representative Ruff, amend **HB 2755**, line 37 to insert the language "accredited" elementary.....Motion failed. Yes 9, No 12

Some question on whether amending **HB 2755** and **HB 2481** into **SB 44** was germane. Chair explained his ruling on germane is that the titles both carried the language "income tax credit".

Moved by Representative Krehbiel, seconded by Representative Ruff, amend **HB 2755** to include on line 37 "post secondary school" and include instructors as well as students. Motion failed. Yes 10, No 11

Moved by Representative Krehbiel, seconded by Representative Ruff, amend **HB 2755** to include on line 37 "post secondary school" but would not apply to instructors nor cover tuition. (post secondary school would apply to vocational and private Kansas colleges). Motion failed. Yes 11 No 11

Moved by Representative Krehbiel, seconded by Representative Ruff, amend **HB 2755** to include tuition only for post secondary schools. Motion failed Yes 11 No 11

Moved by Representative Powell, seconded by Representative Cook, **SB 44** as amended be passed favorably. Motion carried.

SB 602 - County severance tax prohibited

Moved by Representative Cook, seconded by Representative Vickery, move **SB 602** out favorably. Motion carried.

Vickery introduced for attachment to the minutes a letter from Dickinson County Commission dated March 23, 1988. (Attachment 3)

HCR 5037 - Memoralizing Congress to sunset IRS Code

Moved by Representative Larkin, seconded by Representative Shriver, **HCR 5037** be tabled. Motion failed. Yes 8 No 13

Moved by Representative Powell, seconded by Representative Cook, **HCR 5037** be recommended favorably for passage.

Substitute motion by Representative Larkin, seconded by Representative Ruff, to amend **HCR 5037** by adding language that would indicate non support of national sales tax or flat income tax that would shift tax burden to average taxpayers.

Representative Mays requested split of Substitute amendment.

Substitute Motion #1 - Amend **HCR 5037** to exclude inclusion of national sales tax that would shift tax burden to average taxpayers. Motion carried.

Substitute Motion #2 - Amend **HCR 5037** to exclude flat income tax that would shift tax burden to average taxpayers. Motion carried.

Moved by Representative Powell, seconded by Representative Tanner, move **HCR 5037** as amended out favorably for passage. Motion carried.

The next meeting will be held on call of the chair.

Adjournment.

Attachments - 3

TAXATION COMMITTEE GUEST LIST

DATE: **MARCH 24, 1998**

NAME	REPRESENTING
George Petersen	Ks Taxpayers Network
Kelly Kultala	City of Overland Park
Amy Johnson	Off St Bank Commissioner
Don Moler	League of KS Mun.
Judy Moler	Ks. Assn of Counties
Wendy Adams	KS Aggregate Producers' Assn
Woody Moses	KS Aggregate Producers' Assn.
Bob Totten	Ks Contractors Association
John Federico	KCUA
Dave Holthaus	Western Resources
Matt Goddard	HCBA
Mike Taylor	City of Wichita

S… OF KANSAS
Bill Graves, Governor

DEPARTMENT OF REVE…
John D. LaFaver, Secretary

Shirley K. Sicilian, Director
Office of Policy & Research
Kansas Department of Revenue
915 SW Harrison St.
Topeka, KS 66612-1588

(913) 296-3081
FAX (913) 296-7928

Office of Policy & Research

MEMORANDUM

TO:	Chairman Phill Kline House Taxation Committee
FROM:	Shirley Klenda Sicilian Director, Policy & Research
RE:	**Staff Briefing on Senate Bill 541 - Requiring consolidated filing of banks and investment subsidiaries.**
DATE:	March 24, 1998

Chairman Kline and members of the Committee, thank you for asking me to provide a staff briefing on Senate Bill 541 regarding the privilege tax and investment subsidiaries.

I. Privilege Tax Basics.

On January 1, 1964, the Kansas privilege tax was imposed on national banking associations, banks, trust companies, and savings and loan associations "for the privilege of doing business within the state." (K.S.A. 79-1106 and 1107). Institutions subject to the privilege tax are exempt from paying corporate income tax. (K.S.A. 79-32,113). Unlike the corporate income tax, the privilege tax is not a *direct* tax on income. Rather, it is a franchise tax *measured* by net income. (K.S.A. 79-1107). This distinction may not sound like much, but one important result is that income earned from federal securities can figure into the measurement of the privilege tax base, while it can not be taxed directly under an income tax. (K.S.A. 79-32,117(c)(I)). In fact, federal statute and U.S. Supreme Court case law specifically allow states to include federal obligations held by corporations - banks and non-banks alike - in the measurement of a franchise tax.[1] (31 USCA 3124(a)(1)). Another point of comparison between corporate income and privilege tax is the rate: the marginal privilege tax rate is 6.3~~5~~% 75 compared to a higher 7.35% for other corporations.

II. Estimated Privilege Tax Receipts - Effect of Investment Subsidiaries.

In April 1997, the consensus revenue estimating group forecasted Kansas privilege tax revenue would reach $38 million in FY 1998. In November 1997, the consensus group met again, and revised its forecast downward to $20 million, an $18 million decrease. The basis for this revision was the banks' increasing use of "investment subsidiaries" to hold their U.S. securities. If a bank moves U.S. securities to a subsidiary, the interest earned escapes state taxation. Because the bank does not hold the U.S. obligations, the bank does not pay privilege tax on the earned interest. And, because the interest on U.S. obligations is not subject to corporate income tax, the subsidiary does not pay tax on the earned interest either.

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[1] Werner Machinery Co. v. Director of Taxation, Dept. of Treasury, State of N.J., 7… Co. v. Bowers, 76 S.Ct. 777, 351 U.S. 928; Monroe County Sav. Bank v. City of F…

To estimate the impact this issue could have on revenues, the department did two studies. Both studies measured what would have happened in prior years had all privilege tax filers made full use of investment subsidiaries. The difference is in the data sources. For the first study, we examined FY 94 through FY 97 returns for 69 of the 100 largest privilege taxpayers. Income from U.S. obligations was determined and the tax base was recalculated without it. Tax returns were then recalculated and the change in taxpayer liability was dramatic. The analysis indicated that even if privilege taxpayers do not alter their asset portfolios while making use of investment subsidiaries, a decline of approximately 70 percent in privilege tax revenues can be expected. These average declines were consistent across all 4 years of data. Our second study used historic data from the FDIC for all banks through June 30 of 1997. The conclusion of that study more than supports the first. Results showed that, in the aggregate, subtracting income from U.S. assets could completely offset net income.

The department feels the use of investment subsidiaries will increase over time and the full impact may not be felt immediately. The consensus estimates reflect that position. Fiscal year 1998 does not reflect a full 70% decrease. However, by 1999, receipts are expected to drop to $10 million. This movement will necessarily take place as banks, initially reluctant to utilize this procedure, may feel compelled to reduce their tax bill if possible. For FY 1998 to date, privilege tax receipts are running 19.2% below our revised estimate. In February, receipts were negative with $1.6 million of the reduction due to refund filings related to investment subsidiary activity.

III. S541 Neutralizes the Effect of Investment Subsidiaries on Privilege Tax Receipts.

In light of these developments, the Senate Financial Institutions and Insurance Committee requested the department provide statutory language which would eliminate a financial institution's ability to avoid tax through the use of investment subsidiaries. We believe senate bill 541 accomplishes that request. We worked with the Kansas Banking Commission, who were very helpful, in drafting the language. The approach is similar to that taken in other states. It does not change the structure of the privilege tax in any way. It simply establishes explicit authority to prevent banks from omitting previously taxed income from their tax base. Essentially, the language would require a bank and its investment subsidiary to file a consolidated return. There are four sub-sections:

- **Section (a)** gives the secretary authority to require a bank to file a consolidated return or combined report with any affiliate which owns, holds or manages all or part of the taxpayer's securities portfolio.
- **Section (b)** ensures the receipts apportionment factor applied to multi-state banks or banks with subsidiary operations out of state cannot be manipulated by transactions between a bank and its subsidiary.
- **Section (c)** allows the secretary of revenue to allocate income or expenses between a bank and its subsidiary where full combination would not accurately reflect the bank's tax base. This language is similar to language found in the Kansas corporate income tax law.
- **Section (d)** makes these changes applicable to all taxable years commencing after December 31, 1997.

There is no statute, constitutional prohibition, or case law decision that would stand in the way of this approach. One case to be aware of is First National Bank of Manhattan v. Kansas Department of Revenue, which held that a bank could not file a consolidated return with its holding company. (First National Bank of Manhattan v. Kansas Department of Revenue, 13 Kan. App.2nd 706). However, this case is not on point when it comes to a bank consolidation with its investment subsidiary. The fiscal note is $28.8 million for fiscal year 1999 and $29.5 million for fiscal year 2000.

KANSAS ASSOCIATION of WHEAT GROWERS

P.O. Box 1266 • Manhattan, KS 66505–1266 • (785) 587–0007 • FAX (785) 587–0003

DATE: February 19, 1998

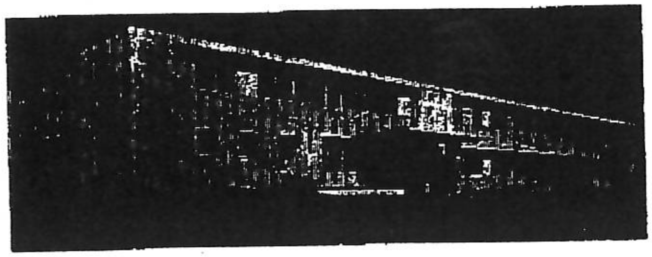
TO: House Committee on Taxation

FROM: Michael Doane, Executive Vice-President
Kansas Association of Wheat Growers

RE: Proposed Amendments to H.B. 2481

On behalf of the Kansas Association of Wheat Growers, I would like to the submit the following amendments the committee pertaining the the Producer Investment Act (H.B. 2481):

Lines 23-26: (2)(b) For all taxable years commencing after December 31, ~~1996~~ 1997, there shall be allowed a credit against the tax liability of ~~an individual or family farm corporation~~ <u>a member</u> imposed under the Kansas income tax act in an amount equal to <u>10% of the</u> ~~a~~ direct investment in an agricultural cooperative.



DICKINSON COUNTY COURT HOUSE

ABILENE, KANSAS 67410

March 23, 1998

Rep. Phil Kline
Chairman, Taxation Committee
Committee Members

Dear Rep. Kline & Committee Members,

Thank you for the opportunity to appear before your Committee last week in regard to the hearing concerning House Bill 602.

We feel that Dickinson County needs some means to recover damages caused by excessive use by the quarry industry.

Visiting with many of you personally and heeding your advice, we feel it would be prudent to pursue this issue in the court system, however the outcome. At this point, we also feel we can negotiate with quarries for some type of revenue to offset these damages.

Thank you for your interest and consideration.

Leo L Lefert
Leo Lefert
Chairman, Dickinson County Commission

Paul Whitehair
Paul Whitehair

George Schlesener
George Schlesener

House Taxation
3-19-98
Attachment 3-1