

Approved: 2-9-98
Date

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION.

The meeting was called to order by Chairperson Audrey Langworthy at 11:10 a.m. on February 5, 1998, in Room 519--S of the Capitol.

Members present: Senator Langworthy, Senator Corbin, Senator Lee, Senator Bond, Senator Donovan, Senator Goodwin, Senator Hardenburger, Senator Karr, Senator Praeger, Senator Steffes and Senator Steineger.

Committee staff present: Tom Severn, Legislative Research Department
Chris Courtwright, Legislative Research Department
Don Hayward, Revisor of Statutes
Shirley Higgins, Secretary to the Committee

Conferees appearing before the committee: Shirley Sicilian, Kansas Department of Revenue
Tom Palace, Kansas Oil Marketers Association
Curt Wright, Taylor Oil, Inc.
Joe Lieber, Kansas Cooperative Council

Others attending: See attached list

SB 418--Taxation of motor vehicle fuels; filing of certain reports; providing for a motor fuel credit.

Shirley Sicilian, Kansas Department of Revenue, explained that legislation was passed in 1995 which allows the Director of taxation to require a distributor who receives more than 50,000 gallons of motor fuel a month to file its motor fuel tax returns electronically. **SB 418** is a part of the Department's effort to reduce the potential for motor fuel tax evasion in Kansas because it enables the Department to track the motor fuel through each stage of distribution to ensure appropriate taxes are paid. It creates a motor fuel tax credit for distributors who file returns electronically. (Attachment 1)

Senator Langworthy noted that the fiscal note prepared on **SB 418** by the Budget Division indicated a fiscal impact of \$5.4 million, contrary to Ms. Sicilian's reported fiscal impact of \$3.6 million. Ms. Sicilian explained that the Budget Division based its calculation on the number of all distributors of motor fuel in Kansas; however, the calculation regarding **SB 418** is based on only those distributors who receive more than 50,000 gallons a month. She noted that **HB 2737**, currently in the House Transportation Committee, applies to all distributors; therefore, the Division of Budget report would apply to that bill.

Senator Lee suggested that the bill be amended on line 42 to change "may" to "shall" as lines 27 through 41 are meaningless without "shall" on line 42. Ms. Sicilian was in agreement with Senator Lee's suggestion.

Tom Palace, Kansas Oil Marketers Association, testified in support of **SB 418** if the following changes are made: (1) the Electronic Data Interchange (EDI) be voluntary and not mandatory, and (2) the tax credit of \$8,000 be extended from July 1, 1998, to December 31, 1998, leaving intact the other deadlines for tax credit. (Attachment 2)

Curt Wright, Taylor Oil, Inc., testified in support of **SB 418** as a step to reduce tax evasion. However, with the expected revenue gain for the state, he felt the state should put forth the capital expenditure to put the mandated system (EDI) in place because it will be costly, and many marketers have already allocated their budgets toward meeting the deadlines for updating underground tank systems. (Attachment 3)

Joe Lieber, Kansas Cooperative Council, testified in support of the concept of **SB 418** but expressed concerns about the mandatory requirement of electronic filing and the July 1, 1998, implementation date. He suggested that the date be moved to December 31, 1998, to allow distributors an opportunity to get the process established. (Attachment 4) With this, the hearing on **SB 418** was closed.

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION, Room 519-S
Statehouse, at 11:00 a.m. on February 5, 1998.

SB 421--Taxation of motor vehicle fuels; imposing the incidence of tax on the distributor.

Shirley Sicilian, Department of Revenue, stated that the Department believes that the legislative intent of the motor fuel tax act is to levy a tax on motor fuel distributors, not retailers, and not customers. **SB 421** contains amendments that clean up individual portions of the act which lack clarity and could possibly be construed to the contrary. In conclusion, Ms. Sicilian summarized the six proposed amendments. (Attachment 5)

Tom Palace, Kansas Oil Marketers Association, stood in support of the proposed clarifying technical changes in **SB 421**.

The hearing on **SB 421** was closed.

The meeting was adjourned at 12:00 p.m.

The next meeting is scheduled for February 9, 1998.

Shirley K. Sicilian, Director
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Kansas Department of Revenue
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Office of Policy & Research

MEMORANDUM

TO: Senator Audrey Langworthy
Chair, Senate Assessment and Taxation Committee

FROM: Shirley Klenda Sicilian
Director, Policy & Research; Kansas Department of Revenue

RE: **Senate Bill 418 - Creating a motor fuel tax credit for distributors that file returns electronically.**

DATE: February 5, 1998

Senator Langworthy and members of the Senate Committee on Assessment and Taxation, thank you for the opportunity to testify today regarding the Department's proposed motor fuel tax credit.

In 1995, legislation was passed which allows the director of taxation to require a distributor who receives more than 50,000 gallons of motor fuel a month to file its motor fuel tax returns electronically. This legislation is a critical part of our comprehensive effort to reduce the potential for motor fuel tax evasion in Kansas. In 1994, legislative post audit estimated potential revenue losses of between \$50 and \$60 million dollars. Electronic filing enables the department to track the motor fuel through each stage of the distribution chain and ensure appropriate taxes are paid. The information collected electronically is the same as what had been collected on paper. Electronic filing simply allows us to use that information more effectively.

While electronic filing is critical for tax collection, the department realizes it may require additional capital expenditures for some distributors who don't yet have full computer and electronic filing capability. For this reason, we've worked closely with industry and vendors in developing this tax credit proposal. The credit would be \$8,000 if the distributor files electronically on or before July 1, 1998; \$6,400 if the distributor files after July 1, 1998 and before July 1, 1999; and \$4,000 if the distributor files after July 1, 1999 and before June 30, 2000. The credit phases out over these three years to encourage early compliance. If a distributor claims the credit but ceases to file electronically within ten years of claiming the credit, the distributor must reimburse the state for the amount of the credit claimed.

Currently four motor fuel distributors are filing electronic returns. There are approximately 450 licensed distributors receiving 50,000 gallons of motor fuel each month. Should each distributor elect to file by electronic means between now and July 1, 1998, the fiscal year 1998 impact would be \$3.6 million (450 x \$8,000). If all distributors elect to file during fiscal year 1999, the credit would be about \$2.9 million (450 x \$6,400). If all distributors elect to file during fiscal year 2000, the credit would be about \$1.8 million (450 x \$4,000).

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Attachment 1



KANSAS OIL MARKETERS ASSOCIATION

Convenience Store Association of Kansas

Testimony on Senate Bill 418
Submitted by the Kansas Oil Marketers Association/
Convenience Store Association of Kansas
To The Senate Assessment and Taxation Committee

Madam Chair, and members of the Senate Assessment and Taxation Committee:
My name is Tom Palace. I am Executive Director of the Kansas Oil Marketers Association, a statewide trade association representing over 350 independent Kansas petroleum companies which distribute petroleum products at the wholesale and/or retail level. KOMA is also the flagship organization for the Convenience Store Association of Kansas, and as such, represents the interests of the owners and operators of convenience stores across the state.

We appreciate the opportunity to appear before you to provide testimony on S.B. 418.

In 1994, The Kansas Department of Revenue was requested by the Legislative Post Audit Committee to thoroughly investigate options for improving controls over the collection of motor fuel taxes and report their findings to the 1995 legislature. Best guess estimates were that the state could be losing up to \$66 million in combined gasoline and diesel fuel taxes. Fuel taxes were being evaded due to the fact that the state could not track fuel sales and deliveries to their final destination. Additionally, the Kansas Department of Revenue could not verify whether or not fuels sold as non-taxable, were truly tax-exempt sales under the motor fuel tax laws. Tax exempt sales are: fuel sold to the Federal Government, fuel sold to a contractor performing work for the Federal Government, fuel exported to another state, fuel sold on Indian reservations, aviation fuel, the first sale of fuel to a distributor and dyed diesel fuel. Basically, tax exempt sales constitute fuel sold for NON-highway purposes.

A coordinated effort by the petroleum industry and representatives from 6 state agencies formed the Motor Fuels Advisory Committee in 1994 to develop a solution to the problem of fuel tax evasion. The committee agreed that the key to resolving fuel tax evasion would require a complete fuel tracking system along with visible enforcement.

In 1995, HB 2161 was passed. The bill included a comprehensive package aimed at improving the fuel tracking system and combating fuel tax evasion in Kansas. The law increased penalties for violators; diesel fuel that is sold for tax-exempt purposes was required to be dyed red so that when inspected, it could be easily ascertained that the fuel was not taxable; bills of lading were required to show complete addresses so that fuel could be tracked from the terminal to the ultimate destination; licensed retailers were required to complete fuel reports so that the state could better track fuel they received from distributors, and a phase in period for electronic filing of monthly fuel tax returns **may** be required.

This final phase of the 1995 legislation provides for Electronic Data Interchange (EDI), a method by which fuel tax returns would be transmitted to the state on a monthly basis. Currently, the state reviews monthly fuel tax returns from over 900 distributors and twice that many retailer reports, manually. According to the 1994 Post Audit Report, the revenue department was running six months behind in processing motor fuel returns. I don't know what the backlog is today, but I would anticipate that they are not running six months behind in the audit process.

In an attempt to become more modernized and efficient, the Department of Revenue wants to mandate EDI, and require any licensed distributor that receives 50,000 gallons of fuel or more per month, to file with the state electronically. KOMA supports the idea of electronically filing monthly fuel tax returns and has worked closely with the Department in efforts to educate distributors throughout the state about the benefits of EDI. However, EDI is a method of filing that will first and foremost serve the Department of Revenue. It will allow for more definitive tracking returns. That is its sole purpose. It has never been viewed as a method of making the job of tax filing easier for the filer.

With all the benefits that the Department receives from EDI, licensed distributors affected by EDI will not only be forced to comply with this new record keeping measure, but will also be required to pay for this new record keeping measure. For years, licensed motor fuel distributors in Kansas have served the state well by the timely filing of monthly motor fuel tax returns. No matter what system of filing is in place, they will continue to be reliable tax collectors for Kansas. Some distributors welcome EDI; quite clearly others do not. There are many smaller operations in Kansas which are not computer-based and are angered for having to change their way of doing business. That message was made loud and clear as KOMA and KDOR held meetings last summer throughout the state explaining EDI. There are two areas of concerns that the distributors have; being forced to implement EDI and the cost. Fortunately the Department, in an attempt to soften the blow of EDI, has suggested an \$8,000 one time tax credit for distributors affected by the implementation of EDI, which is included in SB 418. However, the Department has not changed their view on mandatory vs. voluntary.

SB 418 mandates the use of EDI and provides a tax credit to distributors that are affected by EDI. KOMA will support SB 418 with the following changes made;

1. Electronic Data Interchange be voluntary and not mandatory.
2. That the tax credit of \$8,000 be extended from July 1, 1998 to December 31, 1998, leaving intact the other deadlines for a tax credit. This will give distributors and the Department adequate time to implement EDI and receive the full credit for the initial enrollment period.

We appreciate the opportunity to appear before you today and will stand for any questions you may have.

Taylor Oil, Inc.

Specializing in Gasoline and Diesel Fuel Supply

My name is Curt Wright. I am Vice President of Operations for Taylor Oil, Inc. located in Wellsville, KS. Taylor Oil is a family owned and operated business delivering gasoline and diesel fuel to our eastern Kansas customers for over 25 years. I am also a member of the executive board of the Kansas Oil Marketers Association.

My company and our Association fully support the idea of reducing and even eliminating excise tax evasion. In 1995, we backed the changes in fuel tax legislation because they were designed to do so. Tax evasion creates an uneven playing field for the marketer who plays by the rules as well as depriving the state of highway funds. EDI is the next step to reducing tax evasion. However, it will be an expensive endeavor for the members of the industry.

Many small marketers will be forced to either automate their business or pay a service bureau to file their taxes electronically for them. The cost of automation is not merely the cost of computer hardware and software. You must include the productivity lost to the company due to training and the additional time required to complete the new procedures. There are also on-going maintenance costs to maintain the computer system and update the software whenever a law changes in the future. The larger members of the industry already have computer systems in place to handle their accounting functions. Many of these systems do print the required paper fuel tax reports now. Due to the specialized nature of excise taxes, we simply can not run down to the local computer store and pick up a \$150 software package to run our business. In fact, our company updated our computer system two years ago at a cost of \$85,000, and our company is just a little larger than the average distributorship. We will be forced to purchase EDI software and pay for the software modifications to integrate the EDI software with our

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existing software. All of the members of our industry who have existing software will face this same choice; either pay for the integration or double enter the information into both the EDI software and their existing computer system.

Taylor Oil's capital budgets are already allocated toward meeting the 1998 deadlines for updating our underground tanks systems. I know there are many marketers in this same position. For some, another capital purchase or monthly expense may make some small marketers feel that it is not worth the trouble to remain in business.

The only benefit EDI has for the marketer is to help make the playing field fair. Even so, we fully support the broader EDI concept. However, with the expected revenue gain for the state we feel the state should be putting forth the capital expenditure to put the system in place. If not, EDI becomes just another unfunded government mandate.

Thank you for the opportunity to express my viewpoints. I will be happy to answer any questions you may have.

Respectfully,



Curt Wright

Testimony on SB418
Senate Assessment and Taxation Committee
February 5, 1998
Prepared by Joe Lieber
Kansas Cooperative Council

Madam Chair, and members of the Committee, I'm Joe Lieber, Executive Vice President of the Kansas Cooperative Council. The Council has a membership of nearly 200 cooperative businesses, which have a combined membership of 200,000 Kansans. Approximately 130 of our members are farm supply cooperatives, and most of them sell motor fuel.

The Kansas Cooperative Council supports the concept of SB418 but would like to address two concerns:

1. Some of our members have expressed concerns about the mandatory requirement of electronic filing. They don't have the equipment and some feel it would require a change in paperwork.
2. The second concern has to do with the July 1, 1998 date. If SB418 is passed, we would like to see the date moved to December 31, 1998. This would give the distributors an opportunity to get the process established.

As state earlier, we support the concept of SB418, but some of our members have expressed concerns.

Thank you for your time. I will be happy to attempt to answer any questions.

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Attachment 4

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Office of Policy & Research

MEMORANDUM

TO: Senator Audrey Langworthy
Chair, Senate Assessment and Taxation Committee

FROM: Shirley Klenda Sicilian
Director, Policy & Research; Kansas Department of Revenue

RE: **Senate Bill 421 - Amendments clarifying motor fuel tax is imposed on the distributor**

DATE: February 5, 1998

Senator Langworthy and members of the Senate Committee on Assessment and Taxation, thank you for the opportunity to testify today regarding the Department's proposed clarifications to the motor fuel tax act.

I. Background

This bill is intended to clarify that the legal incidence of the motor fuel tax is on motor fuel distributors, not retailers, and not customers. Prior to 1995, some distributors claimed an exemption for the fuel they sold to retailers on Indian reservations, under the theory that that fuel was delivered to an "agency" of the United States, which would be exempt from taxation. In 1995, the legislature amended the motor fuel tax act to create an exception to that exemption. The exception made it clear, even fuel delivered to a reservation retailer would not be exempt if that retailer sold or delivered to non-tribal members. The purpose of the 1995 legislation was to level the competitive playing field between retailers on the reservation and near-by off-reservation retailers.

Objections were raised as to whether the department could actually enforce collection and the secretary of revenue requested an Attorney General's opinion. The AG upheld the state. In so doing, the AG explained that if the legal incidence of the tax fell on the tribe or its members, the state could not collect. However, "if the legal incidence of the tax rests on non-tribal members, the state may impose the tax and require the tribe to perform functions to assist in collection of the tax..."¹ The Attorney General found the legal incidence of the motor fuel tax to be on the distributor; not the tribal retailer or the ultimate, tribal and non-tribal, consumers.

¹ Attorney General Opinion No. 95-80.

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Attachment 5

In September of 1995, the department began enforcement of the new law. That same month, several lawsuits were filed contending, contrary to the AG's opinion, that the legal incidence of the motor fuel tax falls on the retailer, and thus cannot be collected from tribal retailers.

The department believes the legislative intent of the motor fuel tax act is to levy a tax on the distributor. The act, on the whole, is actually quite clear about that. Our bill contains amendments that clean up individual portions of the act which lack clarity and could possibly be construed to the contrary. Some of the proposed changes are prompted by how courts in other states have interpreted similar language.

II. Summary of proposed amendments.

Section one clarifies the wording on causes for motor fuel license revocation, to clearly differentiate between making payment of tax, penalty or interest which is only required of distributors, from making a report which is required of both distributors and retailers.

Section two states that the incidence of this tax is imposed on the distributor of first receipt of the motor fuel. The proposed language in Section two, subsection (c) clarifies that the 2.5% deduction afforded to distributors is for the physical loss of fuel due to spillage, shrinkage, evaporation, and other causes while handling the fuel, and not for any administrative costs incurred by a distributor in remitting the fuel tax.

Section three new subsection (c) comports with Attorney General opinion 95-80 that tribal retailers cannot be held liable for the inventory tax that occurs from time to time when fuel tax rates increase.

Section four allows the distributor's cost of doing business, as well as the tax paid, to be included in the selling price of fuel; and clarifies that when the posted price of the fuel does not include the state and federal tax, the tax referred to is the tax that the dealer's distributor paid, or for which the distributor was liable.

Section five changes language from "delinquent distributor, manufacturer, importer or retailer" and "taxpayer" to "person."

Section six repeals a statute that disallows the tax-free sales of gasoline and special fuels to retail dealers located on an Indian reservation in Kansas, if the fuel is sold and delivered to a nonmember of the reservation.