

Approved: 2-16-98  
Date

## MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION.

The meeting was called to order by Chairperson Audrey Langworthy at 11:05 a.m. on February 11, 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: Senator Paul Feleciano  
Shirley Sicilian, Kansas Department of Revenue  
Jim Maag, Kansas Bankers Association  
John Radebaugh, Kansas Credit Union Association

Others attending: See attached list

The minutes of the February 10 meeting were approved.

### **SB 541--Privilege tax on financial institutions; consolidated returns.**

Senator Langworthy noted that **SB 541** was introduced at the request of Senator Don Steffes and Senator Paul Feliciano.

Senator Steffes explained that, as chairman of the Financial Institutions and Insurance Committee, the privilege tax issue was brought to his attention after the consensus estimating group forecasted in November of 1997 that there would be a significant decrease in privilege tax collections. The Financial Institutions and Insurance Committee initiated discussion as to the cause of the decline in collections, and it was determined that the issue was a tax matter to be considered by the Assessment and Taxation Committee with input from the Department of Revenue. He commented that the bill deals with a major policy decision involving a substantial amount of tax money.

Senator Feleciano explained that the issue **SB 541** addresses is the law which allowed the Kansas Banking Commissioner to issue a "wild card" statute in 1995 in order to equalize state banks with national banks. At that time, state banks were given the same ability as national banks to use investment subsidiaries to hold their U.S. securities, thus avoiding payment of privilege tax on the earned interest. Senator Feleciano recalled that the last time the Legislature addressed the issue of the privilege tax was in regard to the interstate financial institutions issue. At that time the intent of the law was to insure that all banks doing business in Kansas pay the appropriate privilege tax. In his opinion, the Legislature has not amended that public policy in order to exempt banks from paying the privilege tax. Noting that the responsibility of raising taxes or exempting businesses from taxation lies within the purview of the Legislature, he contended that in essence, through a quirk in the law, the Bank Commissioner was allowed to provide a window of opportunity for a massive reduction of taxes to the state of Kansas. Senator Feleciano concluded that **SB 541** was the proper forum to address the issue of the privilege tax.

Shirley Sicilian, Kansas Department of Revenue, provided information on the basics of the privilege tax and the effect of investment subsidiaries. She explained the four subsections in **SB 541** which would eliminate a financial institution's ability to avoid tax through the use of investment subsidiaries. (Attachment 1)

Jim Maag, Kansas Bankers Association, testified in opposition to **SB 541**. Mr. Maag noted that when Kansas chose to impose a franchise tax on banks in 1964, there was a great difference in the financial

CONTINUATION SHEET

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

environment compared to today. Banks had a much larger share of the financial services picture than any other entity in 1964. The banking share of that financial picture has dropped dramatically, by almost 50% over the last 20 years. Today, entities which are strong competitors of commercial banks are either not paying any privilege tax or are paying the corporate income tax. Thus, he believed it behooved the Legislature to take an indepth look at how financial services in the state of Kansas should be taxed because the state has an unlevel playing field. In his opinion, **SB 541** raises a number of questions relating to the issue of how financial institutions and services are taxed. Furthermore, he believed the bill in its present form would be subject to litigation. (Attachment 2)

Senator Bond informed the committee that he and Senator Langworthy met with the Secretary of Department of Revenue and posed several unanswered questions regarding **SB 541**. The Department is presently conducting research to compile data comparing Kansas to other states and to answer other questions posed.

Senator Langworthy announced that a subcommittee would be formed on the issue.

Senator Langworthy called attention to written testimony in opposition to **SB 541** in its present form submitted by Mike Astle, Community Bankers Association of Kansas. (Attachment 3)

John Federico, Kansas Credit Union Association, stood to introduce John Radebaugh, Vice President of Association Services, who presented an overview of the difference between banks and credit unions. Mr. Radebaugh defended the tax exempt status of credit unions. (Attachment 4)

There being no further persons wishing to testify, the hearing on **SB 541** was closed.

Staff briefed the committee on a bill to be heard at the next meeting, **HB 2631** concerning revenue bonds for the development of a motor speedway in Wyandotte County. Committee members were encouraged to review the supplemental note on the bill prior to the hearing.

The meeting was adjourned at 12:22 p.m.

The next meeting is scheduled for February 12, 1998.

# SENATE ASSESSMENT AND TAXATION COMMITTEE GUEST LIST

DATE: February 11, 1998

NAME	REPRESENTING
W. NEWTON MALE	OFFICE / STATE BANK COMM.
Judi Stork	✓
KEVIN CHASE	FIRST NAT'L BANK DERBY, KS.
Kathly Olsen	KS Bankers Assn.
Chuck Stones	KBA
Alan Steppat	Pete McLoire & Assoc.
George Costanza	NY Yankees Baseball Organization
Lafayette Cole	Intern Joe Sen. Tyson
Sue Krusche	Sen. Pres. Off
Rick Barker	Senator
Clyde Hauber	Governors Office
John Federico	KS Credit Union Assoc
Melanie Reepin	Federico Consulting
Matt Craddard	Heartland Community Bankers Assn.
Poppy Frauder	Nationsbank
Bridget M Brown	Tobacco Free KS. Coalition.
Karl Peter John	KS Taxpayers Network
Meg Wible	KS Credit Union Assn.
Fred Achmelger	KCUA



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



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 FAX (913) 296-7928

Office of Policy & Research

MEMORANDUM

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

**FROM:** Shirley Klenda Sicilian  
 Director, Policy & Research

**RE:** **Senate Bill 541 - Requiring consolidated filing of banks and investment subsidiaries.**

**DATE:** February 11, 1998

Senator Langworthy and members of the Committee, thank you for asking me to provide background 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.<sup>1</sup> (31 USCA 3124(a)(1)). Another point of comparison between corporate income and privilege tax is the rate: the marginal privilege tax rate is 6.75% 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.

<sup>1</sup> Werner Machinery Co. v. Director of Taxation, Dept. of Treasury, State of N.J., 76 S.Ct. 534, 350 U.S. 492; Raymond Bag Co. v. Bowers, 76 S.Ct. 777, 351 U.S. 928; Monroe County Sav. Bank v. City of Rochester, 1867, 37 N.Y. 365.

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 Attachment 1

estimate the impact this issue could have on revenues, the department examined FY 94 through 1997 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. An alternative analysis using actual historic data for all banks through June 30 of 1997 more than supports this conclusion. It illustrates 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 4.1% below our revised estimate.

### **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)** requires a bank to file a consolidated return with any subsidiary 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.2<sup>nd</sup> 706). However, this case is not on point when it comes to a bank consolidation with its investment subsidiary.



The KANSAS BANKERS ASSOCIATION  
A Full Service Banking Association

TO: Senate Committee on Assessment and Taxation  
RE: **SB 541** – Consolidated returns for financial institutions

Madam Chairman and Members of the Committee:

Thank you for the opportunity to appear before the committee to discuss the provisions of **SB 541**. This bill would require any bank in Kansas with an investment subsidiary to file a consolidated return when determining its tax liability under the provisions of the state privilege tax law. Due to the nature of the dual banking system the taxation of banks has a long and difficult history and once again the KBA is willing to work with the Legislature and the Department of Revenue to establish an equitable tax policy for our industry.

It should be noted at the outset that actual privilege tax collections through the end of FY 1997 do not reflect an unusual pattern for that particular tax. Charts furnished by the Department of Revenue (DOR) show that fluctuations of several million dollars annually are common. This is due to the fact that the taxpayer base is quite small (less than 450 institutions) and a high percentage of the tax is paid by a relatively small percentage of the taxpayers. The widely reported figures of a \$16 million to \$25 million drop in privilege tax revenues are simply projections based on assumptions by the DOR.

It is also important to know, before any changes are made in privilege tax law, exactly what effect the method of taxing branches of out-of-state banks has had on privilege tax collections. That law has been in effect since mid-1996 so there should be sufficient data to compare what those entities were paying in privilege tax when they were still Kansas chartered institutions and what they are paying now as branch offices of out-of-state banks. There may be a need to revisit the factors involved in determining the Kansas tax liability for those branch operations.

It should be further noted that Kansas banks, in fact, pay a lot of taxes. In 1996 Kansas chartered banks paid nearly \$130 million in federal and state income and franchise taxes. This figure does not include millions more paid by out-of-state banks with only branch operations in Kansas. The Kansas tax impact on our banks compared to banks in other states becomes evident when one looks at the ratio of state and local taxes paid to federal income taxes paid. It ranges from two to seven times higher than the impact on banks in other states. In light of such statistics, we believe the Legislature must take an in-depth look at how financial institutions and services are taxed – or not taxed in this state. **SB 541** raises a number of questions relating to this issue.

First, we question whether this state or any state has the authority to impose a state tax on

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the income on exempt federal government obligations except in those instances where federal law specifically allows the states to impose a franchise tax on financial institutions. The investment subsidiary of the bank is a separate corporate entity paying corporate income tax. The state does not impose that tax on any tax-exempt U. S. government obligations held by a non-bank corporation in the state nor do we believe they have the authority to do so. We would certainly urge the committee to review the existing U. S. Supreme Court decisions on similar legislation before proceeding with this bill.

Second, there is the issue of attempting to allow or require consolidated returns on two different types of state taxes. While the investment subsidiary of the bank pays state corporate income tax based on the income of the corporation the bank pays a franchise tax, i.e., a tax for the "privilege" of doing business in the state. In 1989 the Kansas Court of Appeals ruled in First National Bank of Manhattan v. the Kansas Department of Revenue that consolidated returns of the bank's holding company and the bank were not valid. In the opinion the Court noted that "the corporate income tax and the privilege tax differ in many significant ways." The Court further stated that "the differences between the privilege tax and the corporate tax lead us to the conclusion that a privilege tax filer and a corporate tax filer should file separate returns." We believe the passage of **SB 541** in its present form would very quickly trigger litigation challenging the constitutionality of requiring a consolidated return of the bank and the investment subsidiary.

Third, if we were to assume for a moment that the bill could withstand constitutional muster, then it obviously follows that the bank's holding company should also be allowed to file a consolidated return with the bank. For years the DOR has taken the position that banks should not be allowed to file a consolidated return with their holding companies since they paid two different types of taxes. The DOR cannot have it both ways by requiring the consolidated return for one entity connected with the bank and denying a consolidated return for another entity connected with the bank.

Fourth, the bill raises the larger question of why banks should be treated differently than other types of corporations for state tax purposes. Why is it considered a tax "loophole" if a bank does not pay state taxes on income from certain federal government obligations and good tax policy if any other type of corporation does not pay state taxes on those same federal obligations? The Legislature should conduct an in-depth study of the taxation – or non-taxation – of all financial service providers to determine what is the most appropriate and fair method of taxation.

Fifth, it is important to understand how the financial services arena has changed since the state privilege tax was first imposed over three decades ago. The competition for deposit dollars and for loans has expanded dramatically. The commercial bank share of the financial services market has dropped by nearly 50% in that time period and many of the

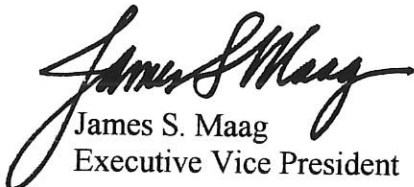


banks' most aggressive competitors are institutions that are paying the state corporate tax rather than the privilege tax or they are paying no state taxes at all. For instance, we do not understand how it can be good state tax policy to allow an institution providing a wide range of financial services and with nearly \$200 million in assets (which makes it larger than 95% of all Kansas banks) and which openly advertises that any person in several counties is eligible to use its services to avoid state income or privilege taxation.

Lastly, the concept that the creation of investment subsidiaries by banks has resulted in a change in the lending habits of those banks or in a shifting of their asset mix is simply not true. Over 60% of the banks with such entities presently have a loan to deposit ratio higher than the statewide average and over 80% have increased their loan to deposit ratio since forming their subsidiary. In fact, lending by Kansas banks is at a record high and many banks are finding it more and more difficult to gather the necessary deposits to meet their loan demands. Further, in 1996 banks with investment subsidiaries held 65.1% of their total securities in U. S. Treasury and agency obligations. In 1997 that number increased by less than 1%.

To summarize, we have serious concerns about the provisions of **SB 541** and we believe the Legislature should examine closely the present method of taxation – or non-taxation – of financial institutions to determine what is the most fair and equitable way to tax them in order for them to remain a viable part of the state's economic progress.

We appreciate very much your willingness to consider our comments and we stand ready and willing to work with the committee to find any reasonable solutions on the taxation of financial institutions.

  
James S. Maag  
Executive Vice President

2/11/98

	A	B	C	D	E	F	G	
2	STATE	ASSETS	NET INCOME	FEDERAL TAXES	ST & LOCAL TAXES	St & Local to Income	St & Local to Assets	St & Local to Fed Tax
3	Wyoming	8,183,505	189,123	95,373	43	0.02%	0.0005%	0.05%
4	Vermont	7,552,065	116,996	53,335	355	0.30%	0.0047%	0.67%
5	Ohio	177,778,869	2,354,101	1,130,719	12,827	0.54%	0.0072%	1.13%
6	Louisiana	48,258,834	576,058	276,377	4,005	0.70%	0.0083%	1.45%
7	Virginia	89,932,974	1,205,084	561,977	8,683	0.72%	0.0097%	1.55%
8	Washington	71,695,661	1,044,157	517,456	8,028	0.77%	0.0112%	1.55%
9	Texas	213,027,368	2,534,001	1,232,411	24,057	0.95%	0.0113%	1.95%
10	Kentucky	52,685,913	636,800	279,720	6,369	1.00%	0.0121%	2.28%
11	Maine	15,573,992	191,201	84,842	2,237	1.17%	0.0144%	2.64%
12	Michigan	113,199,098	1,533,073	734,720	19,594	1.28%	0.0173%	2.67%
13	North Carolina	195,489,009	1,956,101	924,262	25,463	1.30%	0.0130%	2.75%
14	Nevada	32,405,911	775,449	434,707	11,148	1.44%	0.0344%	2.56%
15	Colorado	40,404,495	546,474	277,268	14,139	2.59%	0.0350%	5.10%
16	Pennsylvania	259,415,442	3,207,812	1,537,721	85,950	2.68%	0.0331%	5.59%
17	Nebraska	27,765,944	308,547	146,730	8,663	2.81%	0.0312%	5.90%
18	Georgia	147,081,354	1,559,009	792,930	46,183	2.96%	0.0314%	5.82%
19	Oklahoma	36,134,142	370,477	150,499	11,243	3.03%	0.0311%	7.47%
20	Mississippi	28,547,658	391,496	167,574	12,845	3.28%	0.0450%	7.67%
21	Alabama	63,220,415	771,885	357,028	31,379	4.07%	0.0496%	8.79%
22	Illinois	252,843,935	2,335,793	1,025,230	97,010	4.15%	0.0384%	9.46%
23	New Mexico	15,416,218	199,012	95,938	8,634	4.34%	0.0560%	9.00%
24	Arkansas	30,729,238	386,355	171,624	16,942	4.39%	0.0551%	9.87%
25	South Carolina	26,352,879	330,496	155,501	15,563	4.71%	0.0591%	10.01%
26	Missouri	88,407,396	1,191,799	550,791	59,447	4.99%	0.0672%	10.79%
27	Delaware	119,354,460	2,207,449	1,167,345	111,013	5.03%	0.0930%	9.51%
28	West Virginia	22,267,593	318,902	146,141	20,271	6.36%	0.0910%	13.87%
29	Maryland	38,970,066	402,793	194,234	26,546	6.59%	0.0681%	13.67%
30	Iowa	42,514,839	527,467	209,594	34,820	6.60%	0.0819%	16.61%
31	Wisconsin	74,082,492	860,145	370,433	57,008	6.63%	0.0770%	15.39%
32	Florida	160,708,396	2,005,830	1,035,058	136,160	6.79%	0.0847%	13.15%
33	South Dakota	29,334,779	682,863	354,794	47,132	6.90%	0.1607%	13.28%
34	Kansas	28,501,753	297,019	107,721	21,248	7.15%	0.0745%	19.73%
35	Tennessee	75,969,043	961,131	454,935	70,985	7.39%	0.0934%	15.60%
36	Rhode Island	11,607,861	168,133	85,649	12,510	7.44%	0.1078%	14.61%
37	North Dakota	9,153,136	107,715	44,469	8,490	7.88%	0.0928%	19.09%
38	Utah	35,991,332	433,525	201,160	35,002	8.07%	0.0973%	17.40%
39	Connecticut	43,428,517	376,474	129,779	30,848	8.19%	0.0710%	23.77%
40	Oregon	22,622,704	373,183	174,563	30,728	8.23%	0.1358%	17.60%
41	New York	1,090,941,269	9,680,674	1,950,367	812,554	8.39%	0.0745%	41.66%
42	New Hampshire	18,738,351	271,378	138,676	22,887	8.43%	0.1221%	16.50%
43	Alaska	5,949,300	88,601	35,696	7,513	8.48%	0.1263%	21.05%
44	Hawaii	22,067,942	216,413	93,353	18,586	8.59%	0.0842%	19.91%
45	Indiana	67,848,852	910,824	413,582	78,888	8.66%	0.1163%	19.07%
46	Idaho	6,657,438	86,647	32,721	7,778	8.98%	0.1168%	23.77%
47	Minnesota	72,123,697	989,506	463,957	90,762	9.17%	0.1258%	19.56%
48	New Jersey	91,285,798	838,762	422,306	80,006	9.54%	0.0876%	18.95%
49	Montana	8,669,987	114,210	55,488	11,537	10.10%	0.1331%	20.79%
50	Arizona	48,051,930	513,575	324,964	76,386	14.87%	0.1590%	23.51%
51	California	417,222,993	3,951,844	1,977,274	624,812	15.81%	0.1498%	31.60%
52	Massachusetts	200,588,523	2,305,946	978,050	368,624	15.99%	0.1838%	37.69%

A-1

	A	B	C	D	E	F	G	
2	STATE	ASSETS	NET INCOME	FEDERAL TAXES	ST & LOCAL TAXES	St & Local to Income	St & Local to Assets	St & Local to Fed Tax
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32	Rhode Island	11,607,861	168,133	85,649	12,510	7.44%	0.1078%	14.61%
33	Wisconsin	74,082,492	860,145	370,433	57,008	6.63%	0.0770%	15.39%
34	Tennessee	75,969,043	961,131	454,935	70,985	7.39%	0.0934%	15.60%
35	New Hampshire	18,738,351	271,378	138,676	22,887	8.43%	0.1221%	16.50%
36	Iowa	42,514,839	527,467	209,594	34,820	6.60%	0.0819%	16.61%
37	Utah	35,991,332	433,525	201,160	35,002	8.07%	0.0973%	17.40%
38	Oregon	22,622,704	373,183	174,563	30,728	8.23%	0.1358%	17.60%
39	New Jersey	91,285,798	838,762	422,306	80,006	9.54%	0.0876%	18.95%
40	Indiana	67,848,852	910,824	413,582	78,888	8.66%	0.1163%	19.07%
41	North Dakota	9,153,136	107,715	44,469	8,490	7.88%	0.0928%	19.09%
42	Minnesota	72,123,697	989,506	463,957	90,762	9.17%	0.1258%	19.56%
43	Kansas	28,501,753	297,019	107,721	21,248	7.15%	0.0745%	19.73%
44	Hawaii	22,067,942	216,413	93,353	18,586	8.59%	0.0842%	19.91%
45	Montana	8,669,987	114,210	55,488	11,537	10.10%	0.1331%	20.79%
46	Alaska	5,949,300	88,601	35,696	7,513	8.48%	0.1263%	21.05%
47	Arizona	48,051,930	513,575	324,964	76,386	14.87%	0.1590%	23.51%
48	Connecticut	43,428,517	376,474	129,779	30,848	8.19%	0.0710%	23.77%
49	Idaho	6,657,438	86,647	32,721	7,778	8.98%	0.1168%	23.77%
50	California	417,222,993	3,951,844	1,977,274	624,812	15.81%	0.1498%	31.60%
51	Massachusetts	200,588,523	2,305,946	978,050	368,624	15.99%	0.1838%	37.69%
52	New York	1,090,941,269	9,680,674	1,950,367	812,554	8.39%	0.0745%	41.66%

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## FINANCIAL INSTITUTIONS PRIVILEGE TAX COLLECTIONS

	<u>TOTAL \$\$</u>	<u>\$\$ INCREASE/ DECREASE</u>	<u>% CHANGE</u>
FY 1988	\$12,375,000		
1989	19,565,000	\$ 7,190,000	58.1%
1990	34,087,000	14,522,000	74.2%
1991	24,497,000	(9,590,000)	(28.1%)
1992	25,171,000	674,000	2.7%
1993	49,504,000	24,333,000	96.7%
1994	41,991,000	(7,513,000)	(15.2%)
1995	30,438,000	(11,553,000)	(27.5%)
1996	35,262,000	4,824,000	15.8%
1997	26,506,000	(8,756,000)	(24.8%)
<i>1998</i>	<i>20,000,000</i>	<i>(6,506,000)</i>	<i>(24.5%)</i>
<i>1999</i>	<i>10,000,000</i>	<i>(10,000,000)</i>	<i>(50.0%)</i>

*Consensus Revenue Estimate in italics*

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2-6

A-4  
2-7

**Example Comparison of Kansas Privilege Tax and Kansas Corporate Income Tax**  
**Example 1: Different Tax Liabilities for Identical Firms**

<u>Kansas Privilege Tax</u>		<u>Kansas Corporate Income Tax</u>	
Federal Taxable Income for Kansas Privilege Tax purposes	\$1,800,000	Federal Taxable Income	\$1,800,000
plus		plus	
State and municipal interest income	\$463,000	State and municipal interest income	\$463,000
other additions (bad debts, operating losses, other)	\$1,000	other additions (bad debts, operating losses, other)	\$1,000
less		less	
Other subtractions	\$41,000	Interest on U.S. obligations	\$1,250,000
		Other subtractions	\$41,000
Subtotal	\$2,223,000	Subtotal	\$973,000
Less		Less	
Kansas reductions to tax base	\$5,000	Kansas reductions to tax base	\$5,000
Privilege Tax base	\$2,218,000	Corporate Income Tax base	\$968,000
Normal Tax (4.25%, 4.5% for S&Ls)	\$94,265	Normal Tax (4.0%)	\$38,720
Surtax on base over \$25,000 (2.125%, 2.25% for S&Ls)	\$46,601	Surtax on base over \$50,000 (3.35%)	\$31,591
<b>TOTAL TAX LIABILITY</b>	<b>\$140,866</b>	<b>TOTAL TAX LIABILITY</b>	<b>\$70,311</b>

Prepared by: Office of Policy and Research, Kansas Department of Revenue  
Filename: C:\WINNT\Profiles\rvprdmz\Taxes\Privilege\test111997examples.xls]Sheet1  
Updated: 11/19/97 9:08 AM  
Printed: 11/19/97 9:38 AM



**Testimony for the  
Senate Committee on Assessment & Taxation  
Regarding: Senate Bill 541  
February 11, 1998**

Madame Chair and members of the Committee. Thank you for the opportunity to present our views on Senate Bill 541 - an act concerning financial institutions, consolidated returns for taxation under article 11 of Chapter 79 of the Kansas Statutes Annotated.

The Community Bankers Association represents approximately 150 banks located throughout Kansas. Our member banks tend to be one of two types: 1) closely held and typically managed by the owners; or 2) owned by members of the community and managed by people from the community. The majority of our membership is located in rural communities. Many are in county seat towns.

We are first of all Kansans and not beholden to any outside interests. Our members' profits are not exported out-of-state. Their profits tend to be reinvested in their capital accounts enabling the communities they serve to grow and prosper.

Most of our members do not own an investment subsidiary. However, our members are interested in seeing that we establish an equitable tax policy for all financial institutions operating within the state.

As this Committee is aware, state and local governments are not permitted to tax certain investment securities. The State of Kansas cannot assess state income taxes on individuals and corporations for interest earned on direct obligations of the United States Government. Banks, on the other hand, are not allowed this exclusion of interest earned on direct obligations of the U.S. Government.

Instead, banks are assessed a franchise or "privilege" tax on their net profits, which includes interest income on direct obligations of the federal government. This assessment becomes a "penalty" tax in that banks are not allowed the exclusions afforded other corporations and individuals. Perhaps it is time to consider treating banks in the same manner as Kansas farmers, retirees, corporations and other citizens who own federal government obligations.

As I previously mentioned, most of our members do not own an investment subsidiary. On the other hand, some do have the resources to manage such a tax strategy. The CBA has no quarrel with either decision as it relates to tax management. But, we do believe that state chartered and nationally chartered banks should have equal opportunity in tax matters.

*Senate Assessment & Taxation  
2-11-98*

*Directed By The Members We Serve*

Senate A&T Committee  
Senate Bill 541  
February 11, 1998  
Page -2-

With the attention of the Legislature focused on taxation of financial institutions, we respectfully suggest *all* financial institutions be scrutinized. One missing segment of the industry controls total assets in Kansas of nearly \$2 billion yet has no taxes assessed on its undivided profits.

Lastly, no data has been presented which shows the effect of out-of-state banks acquiring Kansas banks and turning them into branches. According to the Department of Revenue, income from these types of branches is to be "apportioned," but no data has been provided to show what, if any, privilege tax was paid by these out-of-state giants. The DOR has said that apportioning income should have little or no effect on the amount of privilege taxes paid. What has not been said is how much were they paying before the "apportionment" law was enacted? It is a question that needs an accurate answer from the Department of Revenue.

In conclusion, we can support a fair and equitable tax over all aspects of the financial industry. However, we cannot support SB541 in its present form. Senator Langworthy and members of the Committee, the opportunity to comment on this bill is appreciated. I regret that I was unable to present this testimony before you in person.

Respectfully Submitted,  
Mike Astle as legislative liaison for the  
Community Bankers Association of Kansas

[W:\MACOMMITTEE\ST-LEG\PRIVTAXC.#2]



KANSAS CREDIT UNION ASSOCIATION

TESTIMONY ON SB 541 BEFORE SENATE  
ASSESSMENT AND TAXATION COMMITTEE  
FEBRUARY 11, 1998

Madame Chairwoman and Committee Members, I am John Radebaugh, Vice President of Association Services at the Kansas Credit Union Association. Thank you for allowing us the opportunity to respond.

First of all I would like to emphasize that the issue before the committee of whether or not to reimpose privilege taxes on banks and their subsidiaries is not our issue. And we do not believe that taxing credit unions is the answer to the question before the committee. Banks are pointing their fingers at credit unions' tax exempt status rather than addressing the issue at hand.

Secondly, as many of you know, credit unions and banks are very different creatures. Credit unions are not-for-profit cooperative financial institutions that by law, can only serve those individuals who are members of the credit union. In addition, credit unions are run by volunteer boards of directors, who themselves are members of the credit union and who are not paid for their services.

Earnings made by credit unions, in addition to meeting their regulatory reserve requirements, are returned to the members in the form of lower loan rates, higher savings rates and any additional services the board of directors may deem as good for the membership. I would also point out that if a credit union board decides to make a capital expenditure, such as erecting a new building or adding a branch, a credit union's only source of capital is its retained earnings. Credit unions, unlike banks, cannot go to the open market for financing.

Credit unions are also not driven by the profit motivation of making money for their stockholders as are banks. Credit unions only motivation is to better serve their members. This philosophy and way of doing business along with their cooperative structure are the reasons for credit unions' tax exempt status.

For a quick overview of the difference between banks and credit unions, I have attached an handout entitled "The Credit Union Difference". The handout delineates the differences in structure, ownership, purpose, sources of income, tax treatment, growth, etc.

Again, thank you for the opportunity to respond. I would be happy to answer any questions you may have.

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Senate Assessment & Taxation  
2-11-98

The trade association and financial services provider for credit unions.

Attachment 4



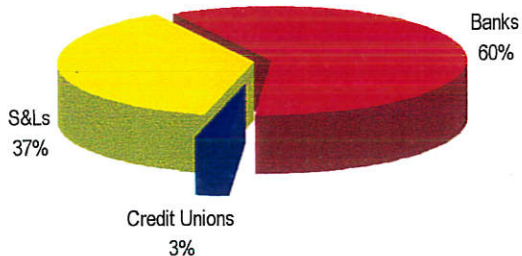
**THE CREDIT UNION DIFFERENCE**  
(Data as of 12/31/96)

	<u>Credit Unions</u>	<u>Banks</u>
<b>Structure:</b>	<ul style="list-style-type: none"> <li>• Not-for-Profit Cooperatives</li> <li>• State or Federal Charter</li> </ul>	<ul style="list-style-type: none"> <li>• For-Profit Corporations</li> <li>• State or Federal Charter</li> </ul>
<b>Owners:</b>	<ul style="list-style-type: none"> <li>• Members</li> <li>• One Vote per Member</li> </ul>	<ul style="list-style-type: none"> <li>• Stockholders</li> <li>• One Vote Per Share of Stock Owned</li> </ul>
<b>Purpose:</b>	<ul style="list-style-type: none"> <li>• Provide Economic Benefit to Members by Pooling Their Savings, thus Providing Low Cost Services</li> </ul>	<ul style="list-style-type: none"> <li>• Provide a Return to Stockholders</li> </ul>
<b>Primary Source of Income:</b>	<ul style="list-style-type: none"> <li>• Member Loans</li> <li>• Investments</li> </ul>	<ul style="list-style-type: none"> <li>• Consumer &amp; Commercial Loans</li> <li>• Investments</li> <li>• Service Fees</li> </ul>
<b>Tax Treatment of Income:</b>	<ul style="list-style-type: none"> <li>• Credit union income passed to members in form of dividends, and members pay taxes on dividends received</li> </ul>	<ul style="list-style-type: none"> <li>• Majority of banks pay federal income tax and state privilege tax, and stockholders taxed on dividends received</li> <li>• Banks designated as subchapter S only pay state privilege tax, and stockholders pay federal income tax on their share of income</li> </ul>
<b>Services Offered:</b>	<ul style="list-style-type: none"> <li>• Member Savings</li> <li>• Member Loans</li> <li>• Member Business Loans</li> </ul>	<ul style="list-style-type: none"> <li>• Consumer Savings</li> <li>• Consumer Loans</li> <li>• Commercial Loans</li> <li>• Investment of Public Funds</li> <li>• Trust Services</li> </ul>
<b>Growth and Capital:</b>	<ul style="list-style-type: none"> <li>• Capital Raised from Retained Earnings</li> </ul>	<ul style="list-style-type: none"> <li>• Capital Raised from Retained Earnings, and</li> <li>• Sale of Stock</li> </ul>
<b>Number in Kansas:</b>	<ul style="list-style-type: none"> <li>• 151 credit unions</li> </ul>	<ul style="list-style-type: none"> <li>• 416 banks</li> </ul>
<b>Total Assets in Kansas:</b>	<ul style="list-style-type: none"> <li>• \$2 billion</li> </ul>	<ul style="list-style-type: none"> <li>• \$28.6 billion</li> </ul>
<b>Average Size in Kansas:</b>	<ul style="list-style-type: none"> <li>• \$13 million</li> </ul>	<ul style="list-style-type: none"> <li>• \$69 million</li> </ul>

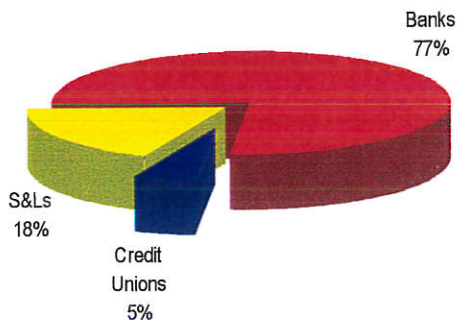
# FACTS ABOUT KANSAS CREDIT UNIONS

Number of Kansas Credit Unions.....	151
Number of Credit Union Members.....	592,671
Total Assets.....	\$2 Billion

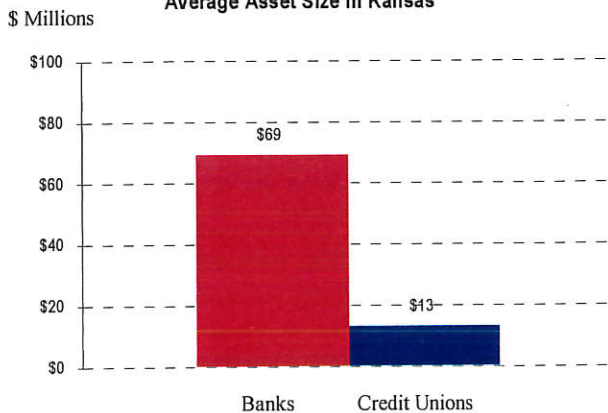
**Kansas Market Shares - 1985**  
Percent of Total Assets  
in Financial Institutions



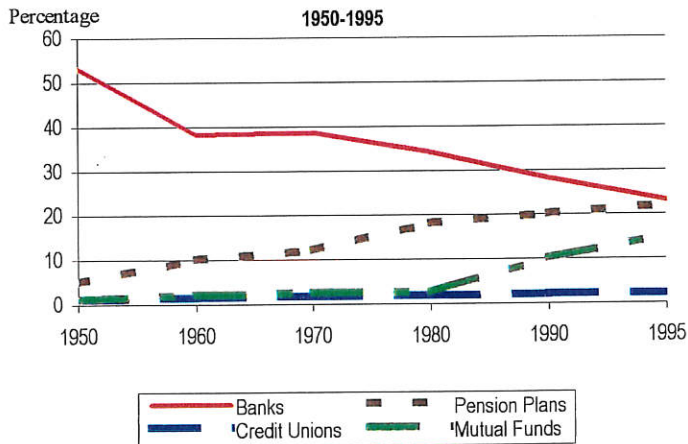
**Kansas Market Shares - 1996**  
Percent of Total Assets  
in Financial Institutions



**Average Asset Size in Kansas**



**Distribution of U.S. Financial Assets 1950-1995**



Data as of 12/31/96  
Sources: FDIC, Credit Union National Association, Federal Reserve Bank