

Approved: 2-16-99
Date

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE.

The meeting was called to order by Chairperson Senator Audrey Langworthy at 11:10 a.m. on February 10, 1999, in Room 519-S of the Capitol.

All members were present except: Senator Hardenburger - Excused

Committee staff present: Chris Courtwright, Legislative Research Department
April Holman, Legislative Research Department
Don Hayward, Revisor of Statutes Office
Shirley Higgins, Committee Secretary

Conferees appearing before the committee: Senator Les Donovan
Craig Grant, KNEA
Mary Kay Culp, Kansas Catholic Conference
Shirley Sicilian, Department of Revenue
Natalie Bright, KCCI
Joyce Rush, Rush Plumbing & Heating

Others attending: See attached list.

The minutes of the February 9, 1999, meeting were approved.

SB 227—Income taxation; providing credits for teaching aid contributions

Senator Les Donovan, sponsor of **SB 227**, testified in support. He noted that he requested the introduction of a House bill with the same provisions two years ago. He explained that **SB 227** simply provides that teachers in public or private schools, who spend their own funds for classroom supplies, can apply to the Department of Revenue each year and receive an income tax credit not to exceed \$200.00.

Craig Grant, KNEA, testified in support of **SB 227** as a partial thank you for those teachers who go the extra mile for their students by underwriting their education with a number of materials and extra teaching aids. He concluded that a tax credit, rather than a deduction, would allow all teachers to benefit from their generosity rather than just those who itemize their tax returns. (Attachment 1)

With regard to the fiscal note on the bill, Senator Donovan asked Mr. Grant if he believed that all certified teachers would claim the maximum total of \$200.00 each year. Mr. Grant responded that the vast majority of teachers do purchase at least \$200.00 worth of materials yearly.

Mary Kay Culp, Kansas Catholic Conference, gave further testimony in support of **SB 227**. In her opinion, a tax credit for teachers who go out of their way to provide materials for their classroom adds to the prospect of retaining good teachers in Kansas and in the teaching profession, which is not known for its monetary rewards. (Attachment 2)

In response to a question regarding the language in **SB 227**, Senator Donovan clarified that it the income tax credit applies only to teachers who are teaching in accredited schools, not in home schools. However, Senator Donovan is not opposed to including home schooling in the provisions of the bill.

Senator Steinger asked Shirley Sicilian, Department Revenue, what the Department would require the teachers to file in order to document their expenditures for classroom supplies. Ms. Sicilian explained that it would be a line item on the income tax form, and, in all probability, the Department would request that teachers maintain a record of their expenditures. With this, the hearing on **SB 227** was closed.

CONTINUATION SHEET

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE, Room 519-S Statehouse, at 11:10 a.m. on February 10, 1999.

SB 250—Sales taxation; taxation of contractor and subcontractor services.

Shirley Sicilian, Department of Revenue, informed the Committee that **SB 250** addresses the current confusion regarding how sales tax should apply to businesses that operate as both a contractor and a retailer, including the circumstances under which a project exemption certificate should be obtained. Ms. Sicilian discussed the background of the bill, summarized the issues relating to the bill, and explained the intent of the two sections of the bill. (Attachment 3) In conclusion, Ms. Sicilian noted that Department auditors have rated this issue as number one in the top five most confusing areas of the law.

Ms. Sicilian explained further to the Committee that, in a nut shell, it comes down to the fact that a contractor pays tax when he buys business materials, but a retailer does not. A retailer buys materials tax exempt with a retailer exemption certificate and then charges tax when the materials are sold. The problem for exempt entities is they do not know which way they should be purchasing. Religious organizations are exempt only when they buy from a retailer. Thus, if they are dealing with a contractor/retailer, they may not know if the purchase is exempt or not or whether they need a project exemption certificate, which they cannot obtain under statute currently. Furthermore, persons who can get a project exemption certificate and do have an indirect exemption to a contractor, do not know if they should get a project exemption certificate or not. The confusion surrounding these circumstances causes problems for the Department when auditing the situation. The Department is in sympathy with customers when the exemption was handled incorrectly because it is very difficult to understand current sales taxation statutes. The bill would help the Department administratively.

Natalie Bright, Kansas Chamber of Commerce and Industry (KCCI), testified in support of **SB 250**. KCCI members feel that the proposed changes set out in the bill will greatly improve the current sales tax laws affecting contractors. However, several members have raised minor concerns they believe need to be addressed before the bill passes out of committee. (Attachment 4) She introduced Joyce Rush, Rush Plumbing and Heating, who on a daily basis has had first hand experience with the issues affecting the contractor/retailer when wearing "different hats."

Ms. Rush, whose business is located in El Dorado, discussed her experience with sales tax audits, the bookkeeping burden she has experienced due to sales tax exemption laws, and her solutions to the problem. She said her difficulties began while being audited in 1998 by the Department of Revenue after her business sales tax classification had changed from retailer to contractor/retailer. She supports **SB 250** as it clearly defines whether the tax base is cost or retail. She noted that once the statutory code changes and clarifications are made, the Department of Revenue can change the regulations to be more consistent with the statutes. Once the new regulations are in place, it will help to clean up the tax exempt issues and project exemption forms that now burden the contractor/retailer. (Attachment 5)

To further illustrate the confusion in current law, Ms. Rush recounted the following example described to her by a Department of Revenue auditor. Basically, when a tax exempt entity comes into a contractor/retailer's place of business and buys a faucet, it is considered a direct retail sale and is tax exempt. However, if that same tax exempt entity calls the place of business on the telephone for a service call to repair the faucet, the labor is sales tax exempt, but if the faucet cannot be repaired and a new faucet is installed, the tax exempt entity must pay sales tax on the faucet because the plumbing company used its expertise. Ms. Rush then described the resulting bookkeeping problems for the contractor/retailer. In conclusion, Ms. Rush said **SB 250** needs some language clarification, but it is a good start and is much better than current law.

There being no further persons wishing to testify on **SB 250**, the hearing was closed. Senator Langworthy noted that the bill may be in need of further study by a subcommittee.

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

The next meeting is scheduled for February 10, 1999.



KANSAS NATIONAL EDUCATION ASSOCIATION / 715 W. 10TH STREET / TOPEKA, KANSAS 66612-1686

Craig Grant Testimony Before
Senate Assessment and Taxation Committee
Wednesday, February 10, 1999

Thank you Madame Chair. Members of the Committee, I am Craig Grant and I represent Kansas NEA. I appreciate this opportunity to visit with the committee in favor of SB 227.

Teachers everywhere underwrite the education of their students with a number of materials and extra teaching aids. In an unscientific survey of Kansas teachers conducted by Kansas NEA about eight years ago, our instructional staff found that the average expenditure of the teachers who responded (over 10,000) on classroom materials was between \$700 and \$800 per year. If teachers see a need, they usually respond if they can afford to do so.

SB 227 would be a partial thank you for those teachers who continue to go the extra mile for their students. We wish that there was unlimited resources in the schools to purchase materials and added teaching aids; however, we all know that this just is not the case. A tax credit, rather than a deduction, would allow all teachers to benefit from their generosity rather than just those who itemize their tax returns.

Kansas NEA would ask that you report SB 227 favorably for passage. Thank you for listening to our concerns.

Senate Assessment & Taxation
2-10-99
Attachment 1

TESTIMONY IN FAVOR OF SENATE BILL 227
SENATE ASSESSMENT AND TAXATION COMMITTEE

FEBRUARY 10, 1999
by
Mary Kay Culp
Associate Director of Education
Kansas Catholic Conference

Ms. Chairwoman, members of the Senate Assessment and Taxation Committee, thank you for allowing me to speak today on behalf of Senate Bill 227, which would provide up to a ² \$500.00 annual Kansas tax credit to teachers for out-of-pocket expenditure for classroom instructional equipment and supplies.

We are especially gratified that this bill includes private as well as public school teachers. We would also like to see included, and are working towards passage of a bill that would include a tax credit for public and private school parents for educational supplies and fees, but for today's purposes I will concentrate on the matter at hand.

Yesterday the House and Senate Education Committees heard from an education expert from Tennessee who pointed out that perhaps the most notable difference in student achievement had to do with the quality of the teacher.

In supporting this bill today, I want to point out that it is the above average teacher that goes out of their way to provide for their classroom by purchasing instructional equipment and supplies out of their own pocket. A tax credit of up to \$500²⁰⁰ a year for these teachers can only add to the prospect of retaining good teachers in Kansas and in the profession -- a profession not known for it's monetary rewards, much less reimbursements.

In conversations with several school principals about this bill, I learned that very often schools are limited in the audio-visual equipment they can purchase, and teachers often have to get on a schedule to utilize that equipment. In many cases a frustrated educator will go out and purchase their own VCR, slide projector or power point presentation equipment and absorb the cost themselves.

Again, it is likely to be an especially conscientious teacher who goes to the trouble and expense--because they care about what they are teaching and how it is best taught. Ultimately, they care about their students and are willing to do what it takes to do the best for them.

Ultimately, it is students that this bill is about, and we ask your support of Senate Bill 227.

*Senate Assessment & Taxation
2-10-99
Attachment 2*

Office of Policy & Research
Shirley K. Sicilian, Director
915 SW Harrison St.
Topeka, KS 66625



(785) 296-3081
FAX (785) 296-7928
Hearing Impaired TTY (785) 296-6461
Internet Address: www.ink.org/public/kdor

Office of Policy & Research

TESTIMONY

To: Senator Audrey Langworthy
Chair, Senate Committee on Assessment and Taxation
From: Shirley Sicilian
Director of Policy & Research, Kansas Department of Revenue
Re: Senate Bill 250 -
Date: February 10, 1999

Senator Langworthy and members of the committee, thank you for the opportunity to testify today on Senate bill 250. This bill addresses the current confusion in how sales tax should apply to businesses that operate as both a contractor and a retailer, including the circumstances under which a project exemption certificate should be obtained.

1. Background.

On November 6, 1998, the Joint Committee on Economic Development held an interim hearing on problems with administration of sales tax project exemption certificates for exempt entities. The department testified to the significant statutory, regulatory and policy improvements that have been implemented by the legislature and the department over the last two years. We also identified the root cause of the remaining problems as the inability to definitively identify certain transactions as the sale of either contractor services or retailer sales. But at that time, we did not have solutions. The Interim Committee encouraged the department to convene a working group to identify solutions. With the generous help of the Kansas Chamber of Commerce and Industry, and the Kansas League of Municipalities, we created a working group that had at least one representative from every segment involved: the vendors, the contractors that buy from them, the entities (including exempt entities) that employ those contractors, and the department. Senate bill 250 represents our working group's best effort at a solution. Our intent is that it does not stand alone, but would enable the department to make further clarifications through regulations.

2. Summary of the issues.

Contractors and retailers pay, collect and remit sales tax differently. A contractor pays tax on materials when it purchases them. A retailer doesn't. Instead, the retailer uses a resale exemption certificate, and collects and remits tax on the "marked-up" price of the materials when it sells them. Customers, including sales tax exempt entities, have different obligations, and must follow different procedures, depending on whether they are buying from a contractor or a retailer. If they are buying contractor services, they must secure (and must have the statutory authority to secure) a project exemption certificate.

When a transaction involves a business that does both contracting and retailing, it is often very difficult for everyone involved to know what their responsibilities are. The business doesn't

Senate Assessment & Taxation
2-10-99
Attachment 3

now whether they should a) charge sales tax on their selling price, like a retailer, or b) pay sales tax on their wholesale purchase price, like a contractor. The tax exempt customer may be unsure whether they are a) making a tax exempt direct purchase, as from a retailer, or b) making an indirect purchase which is only tax exempt if they secure (and have the statutory authority to secure) a project exemption certificate. This uncertainty leads to situations where entities thought their purchases were exempt, but in fact they are either not tax exempt, or the appropriate certificate was not secured to establish the exemption.

The department and legislature have taken steps to alleviate the *symptoms* of this confusion, including allowing exempt entities to issue their own project exemption certificates, and allowing refunds where the required project exemption certificate was mistakenly not issued before the purchases were made. But to really address the root of the confusion, we need to clarify the law and minimize the chance these mistakes are made in the first place. One statutory provision should be clarified, and two others should be modified because they are in direct conflict with each other. Clearing up these statutes will allow the department to issue regulations which 1) clarify when a contractor/retailer is operating as a contractor and when it is operating as a retailer, and 2) identify what the customer's responsibilities are in either case. The goal is to relieve the confusion and resulting administrative burden for taxpayers and exempt entities, and the businesses that sell to them.

3. Summary of the bill.

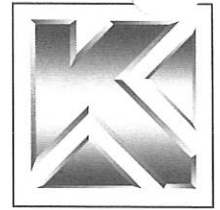
Senate bill 250 has only two sections. The first section amends two of the sales tax definitions in K.S.A. 79-3602. The second section amends one of the sales tax impositions in K.S.A. 79-3603.

• Section One - amendment to definitions.

- ◇ **amendment to definition of "gross receipts."** The definition of "gross receipts" in K.S.A. 79-3602(h) would be clarified in two ways, so that contractors and retailers know what their tax base is. The first clarification involves those situations where a business does contracting jobs as well as sell at retail. The business will usually make its purchases with a resale exemption certificate, like a retailer. Then, if it turns out the business does not resell the item, and instead uses the items in a contract job, it will remit tax at the time it removes the item from its inventory. The tax remitted under these circumstances should be based on the contractor's *purchase* price (not on a marked-up *selling* price). This has been the practice for 30 years. But it should be codified by statute. The second clarification would specify the tax base for contractors is the contract price less tax paid materials. That means items like overhead and profit are part of the tax base for contractor services. This would codify department policy and regulations which have been in place, but frequently subject to questions, since 1972 (with the exception of excavation services). It should be in statute.
- ◇ **amendment to definition of "contractor."** K.S.A. 79-3602(r) currently requires a contractor to be treated as a retailer if it maintains an inventory. It should be amended to allow for situations where a business does both contracting and retailing. Furthermore, it is currently in conflict with K.S.A. 79-3603(l) which taxes sales to all contractors - an entirely different tax treatment than if the contractor were treated as a retailer.

- **Section Two - amendment to imposition of sales tax on contractor purchases.** K.S.A. 79-3603(l) currently taxes sales of tangible personal property to all contractors. As mentioned above, this statute is in direct conflict with 3606(r) which treats any contractor that has an inventory as a retailer and would tax all of their sales. The statute should be amended to allow for situations where a business does both contracting and retailing.

LEGISLATIVE TESTIMONY



Kansas Chamber of Commerce and Industry

web: www.kansaschamber.org

835 SW Topeka Blvd. Topeka, KS 66612-1671 (785) 357-6321 FAX (785) 357-4732 e-mail: kcci@kansaschamber.org

SB 250

February 10, 1999

KANSAS CHAMBER OF COMMERCE AND INDUSTRY

Testimony Before the

Senate Assessment and Taxation Committee

by

Natalie Bright

Director of Taxation and Small Business

Honorable Chair and members of the Committee:

My name is Natalie Bright, Director of Taxation and Small Business for the Kansas Chamber of Commerce and Industry. In December, I assisted the Kansas Department of Revenue with establishing a working group to review the Department's suggestions for clarifying the sales tax laws that govern contractors and project exemptions. To date the members of the group have met on three separate occasions to review proposed language by the Department of Revenue. I appear before you today to express the working group's general approval of the overall concepts set out in SB 250.

The Kansas Chamber of Commerce and Industry (KCCI) is a statewide organization dedicated to the promotion of economic growth and job creation within Kansas, and to the protection and support of the private competitive enterprise system.

KCCI is comprised of more than 3,000 businesses which includes 200 local and regional chambers of commerce and trade organizations which represent over 161,000 business men and women. The organization represents both large and small employers in Kansas, with 46% of KCCI's members having less than 25 employees, and 77% having less than 100 employees. KCCI receives no government funding.

The KCCI Board of Directors establishes policies through the work of hundreds of the organization's members who make up its various committees. These policies are the guiding principles of the organization and translate into views such as those expressed here.

*Senate Assessment & Taxation
2-10-99
Attachment 4*

SB 250, represents the work product of our group to date, and it is the sentiment amongst the members that the proposed changes set out in SB 250 will greatly improve the current sales tax laws affecting contractors. However, after reviewing SB 250 in bill draft several of the groups members have raised additional concerns they believe need to be addressed before the bill passes out of committee. For example, SB 250 in its current form has no language clarifying the requirements for project exemption certificates, an area of the sales tax law contractors indicate needs additional clarification.

In conclusion, I would like to reiterate the working groups believes the proposed changes set out in SB 250 represent a vast improvement over the current law and only request that the working group be given additional time to address the few remaining concerns with the committee.



Plumbing & Heating, Inc.

Residential - Commercial

Repair - Remodeling - Contracting

P.O. Box 12 / 530 Oil Hill Road

(316) 321-0662

El Dorado, KS 67042

January 10, 1999

To: Senator Audrey Langworthy, Chairperson
Senate Committee on Assessment and Taxation

Re: Senate Bill No. 250

Senator Langworthy and committee members, I would like to thank you for the opportunity to come before you today. Before you is a general outline of my testimony and the points I would like to call to your attention and consideration.

1. Sales tax audits

- a. Sales Tax audit for the period January 1, 1989 thru December 31, 1991 found no errors in invoicing sales tax, collection, computation or remittance of same (Bobby VanBurean auditor)
- b. Rush Plumbing had continued to invoice, collect, compute and remit sales tax in the same manner. However, according to the May 8, 1998 sales tax audit by Jennifer Bond, auditor, there were errors in the manner of invoicing, collection, computation and remittance regarding tax exempt entities *indirect sales* by Rush Plumbing
 - i. Problem—interpretation and possible re-interpretation of tax exempt entities *Direct Sales*
 - (1) Conferred with Representative Bill Mason—no change in tax laws by the legislature
 - (2) Conferred with our accountant, Dennis Hanson, CPA—when asked to define how to invoice sales and what were the tax ramifications for tax exempt entities, his response, “*All sales are tax exempt*”
 - (3) Conferred with Kansas Plumbing, Heating & Cooling Contractors Association—“have not heard anything about a difference in direct and indirect sales on tax exempt entities with indirect sales being taxable. All sales for tax exempt entities are *tax exempt*”
 - (4) Direct/indirect sales interpretation regarding tax exempt entities per information per various booklets and guides in my possession did not necessary support the directive from Jennifer Bond, auditor.
 - (5) Informal meeting with John LaFaver, Secretary of Department of Revenue, Shirley Sicilian, Director of Office of Policy & Research, Representative Bill Mason, and others. It was clear none of the tax exempt entities represented knew they were to pay sales tax on indirect sales.

Senate Assessment & Taxation
2-10-99
Attachment 5

- (6) Verbal clarification, by Shirley Sicilian, of *direct/indirect sale* regarding tax exempt entities

“When a tax exempt entity comes into our shop and purchases a lavatory faucet, this sale is tax exempt as it is considered a *direct* sale. Should the same entity request us to come to their premisses to repair a leaking faucet, and we find the faucet cannot be repaired, recommend and install a new faucet—this constitutes an *indirect* sale as we used our expertise, therefore the faucet is to be taxed.”

- ii. Problem—interpretations of Contractor/Retailer status
- (1) To purchase materials tax exempt from wholesaler or to pay tax on materials purchased from wholesaler
 - (2) What is the correct tax base for retail sales and/or contract sales

2. Bookkeeping burden

- a. The Contractor/Retailer statue today, means we essentially, are wearing “two hats”
- i. As a Contractor, we are to pay sales tax on materials purchased
 - ii. As a Retailer we purchase materials tax exempt for the purpose of resale
 - iii. Jennifer Bond, state auditor, stated: “Contractors sales tax regulations are so difficult bookkeeping wise, many contractors build the sales tax into their selling price.” This is not an acceptable answer or option for Rush Plumbing
- b. Services of a Subcontractor—to purchase or not to purchase tax exempt?
- c. Equipment rentals
- i. Rush to pay sales tax to equipment rental agency
 - ii. Invoice equipment at our cost + sales tax paid + markup (profit & overhead) + sales tax on dollar amount of markup
- d. Our computer program has 10 sales tax breakdowns. I was using 9 categories prior to '98 tax audit—I now use all 10 and need at least two additional categories
- e. Invoicing to tax exempt entities:
- i. Laborious and time consuming
 - ii. Project exemptions forms and recent changes
 - iii. Computers are programmed to compute sales tax on selling price not on the cost of materials
 - iv. To date all tax exempt entities, Unified School Districts, Butler County Community College, Cities, county, state and hospitals, have refused to pay sales tax invoiced on *indirect sales*
- f. The November 2, 1998 answer to Rush Plumbing & Heating, Inc.'s request for *Private Letter Ruling* by Tom Hattan addresses the problem very well:

“Over the past ten years, the department of revenue has presented the Kansas legislature with a number of proposals that were intended to help eliminate the contradictions in the statues. None of the proposals have been enacted. Recently, we have been working on a series of notices that would reconcile some of the inconsistencies in the statues while providing contractor/retailers with clearer guidance on their duties under the sales tax act. The notices would be later published as regulations. While our proposal is not complete, it would require changing the basic policies and regulations that govern this area to the current problems. Because the statues are so contradictory, any change that is made to the current policy and regulations will conflict with one or more statutes, just as the

current regulations do. This indicates that the statues will also need to be amended.”

3. Solutions

- a. **Statutory code Clarification** regarding *Contractor/Retailer* status
- b. **Statutory code change** allowing the *Contractor/Retailer* to wear one hat (the hat of choice) regarding purchasing materials
 - i. Tax exempt as a retailer or
 - ii. Paying sales tax on wholesale materials as a contractor
- c. **Regulation changes and clarification** regarding direct/indirect sales to Tax Exempt entities project exemption forms for the newly tax exempt churches and religious organizations
- d. Senate Bill No. 250
 - i. Clearly defines what the tax base is—whether the tax base is cost or retail
 - ii. Once the Statutory Code changes and clarifications are made, the Tax Department can change the regulations to be more consistent with the statues
 - iii. Once the new regulations are in place, it will help to *clean-up* the tax exempt issues and project exemption forms that now burden the Contractor/Retailer today

Joyce Rush

Joyce Rush