

Approved: 3/31/00
Date

MINUTES OF THE HOUSE TAXATION COMMITTEE.

The meeting was called to order by Chairperson Wagle at 9:00 a.m. on March 16, 2000, in Room 519-S of the Capitol.

All members were present except: Representative Howell - excused

Committee staff present: Chris Courtwright, Legislative Research Department
April Holman, Legislative Research Department
Don Hayward, Revisor of Statutes
Shirley Sicilian, Department of Revenue
Ann Deitcher, Committee Secretary
Edith Beaty, Taxation Secretary

Conferees appearing before the committee: Senator Ben Vidricksen
Don Schnacke
Charles Yunker
Shirley Sicilian, Dept. of Rev.
Marlee Bertholf, Ks Chamber of Commerce & Industry
David N. Allison, BCC Business Services Inc.
Dan Morgan, KC Chapter AGC & The Builders' Assoc.
Ken Daniel, Midway Sales & Distributing

SB 613 - World War II Memorial income tax check-off.

Senator Ben Vidricksen spoke to the Committee as a proponent of **SB 613** and provided an artist's rendering of the proposed World War II Memorial planned for Washington, D.C. (Attachments 1 and 2).

Next to speak in support of **SB 613** was Don Schnacke who also provided a letter from Jack A. Quinlan, former State Senator and veteran of World War II. (Attachments 3 and 4).

Charles M. Yunker, Adjutant for the American Legion Department of Kansas, spoke as a proponent of **SB 613**. (Attachment 5).

The hearing on **SB 613** was concluded.

SB 377 - Relating to sales taxation; treatment of certain contractor sales and purchases.

Shirley Sicilian of Legislative Research testified as a proponent of **SB 377**. (Attachment 6).

Marlee Bertholf of the Kansas Chamber of Commerce and Industry appeared next in favor of **SB 377**. (Attachment 7).

David Allison of BCC Business Services, Inc., appeared as a proponent of **SB 377**. (Attachment 8).

Dan Morgan, Kansas City Chaptr, AGC and the Builders' Assoc., spoke in support of **SB 377**. (Attachment 9).

Appearing as a proponent for **SB 377** was Kenneth L. Daniel, Jr. of Midway Sales and Distributing, Inc. (Attachment 10).

CONTINUATION SHEET

Offering written testimony only in support of **SB 377** were: Joyce Rush of Rush Plumbing and Heating, (Attachment 11); and Natalie Bright, Governmental Affairs Consultant for the Wichita Independent Business Association, (Attachment 12).

The hearing on **SB 377** was concluded.

The Chair spoke to the Committee about the recent release of the Attorney General's copy of the video regarding attorney fees for the tobacco litigation. She asked what their will was as to viewing the film. It was decided, after some discussion, that the video would be shown following the Friday, March 17 meeting for those members who wished to see it.

The meeting was adjourned at 10:10 a.m. The next meeting is scheduled for Friday, March 17, 2000.

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SENATE CHAMBER

Assistant Majority Leader

COMMITTEE ASSIGNMENTS
CHAIRMAN: TRANSPORTATION AND TOURISM
CHAIR/VICECHAIR: JOINT COMMITTEE ON STATE
BUILDING CONSTRUCTION
VICECHAIR: NATIONAL CONFERENCE OF STATE
LEGISLATURES—TRANSPORTATION
KANSAS TURNPIKE AUTHORITY
MEMBER: CONFIRMATIONS OVERSIGHT
ELECTIONS AND LOCAL GOVERNMENT
FEDERAL AND STATE AFFAIRS
INTERSTATE COOPERATION
ORGANIZATION CALENDAR AND RULES
COUNCIL OF STATE GOVERNMENTS
GOVERNOR'S COMMISSION ON TRAVEL
AND TOURISM
LEGISLATIVE CONSULTANT TO KANSAS
FILM COMMISSION
EISENHOWER COMMISSION

SB 613: WWII MEMORIAL INCOME TAX CHECK-OFF

What the bill does: It places a new individual income tax check-off on tax returns to provide funding on behalf of Kansas for a WWII memorial in Washington, D. C. The check-off would be included on returns for only two tax years - 2000 and 2001. All designated amounts would be deposited in the Kansas WWII Memorial Fund, which is created by the bill.

There were well over 15 million men and women in our Armed Forces during WWII. These men and women are today dying at the rate of 1,000 per day—so all too soon they will all be gone. SORTA DEPRESSING REALLY! I'm proud to have served with the U.S. NAVY in the Philippine Islands in 1945 and 1946.

The WWII Memorial Building is being built to honor those who served in the military forces during WWII. You must remember that actually the war was fought on three fronts; in

Europe; in the Pacific-Asia area and in the United States. This Memorial will be a part of the history of those millions who participated in all theaters of war, and the home front as well; the Army, Navy, Army Air Corps, Coast Guard, Merchant Marines; Navy Waves, Army Wacs; the Wafs, the Spars, the Rosie Riveters and others on the home front.

The National WWII Memorial is a long overdue tribute to the individual Americans who helped win WWII, the largest war of all time and the defining event of the 20th century. Never before or since has our country shared such a common bond of purpose and determination. This will be the first national memorial acknowledging the commitment and achievement of the entire nation.

We now have a Vietnam Memorial and a Korean Memorial. It is time we have a Memorial for World War II.

In closing, we need to remember we were not there to win a war, but rather to end a war. Again, let us consider this Memorial as an unusually significant part of this great country of ours. It must also be remembered that a nation that neglects or forgets its history has no future because it goes without saying that we learn from

history.

I have placed on your desks the items I asked for from Senator Bob Dole's office. I would urge you to read the material I have provided. It explains in more detail other information regarding the WWII Memorial.

I urge your support of **SB 613**.



THE NATIONAL WORLD WAR II MEMORIAL
WASHINGTON, DC
PRELIMINARY DESIGN-JUNE 1999

AERIAL VIEW FROM WASHINGTON MONUMENT

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Attachment # 2

DONALD P. SCHNACKE, P.A.

ATTORNEY AT LAW

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Testimony of Donald P. Schnacke

RE: SB 613 March 16, 2000

I am Don Schnacke of Topeka. I am appearing in favor of the passage of SB 613, which would allow Kansans, in the next two years, to make a contribution to the World War II memorial to be built on the Mall in Washington, D.C.

I am a veteran of World War II. I joined the U.S. Marines late in the war for the duration of World War II and six months. Two older brothers of mine preceded me in the U.S. Marines. All three of us served in the South Pacific and I spent considerable time with the 1st Marine Division in China.

As of July 1, 1999, there were 241,300 living Kansas veterans of all wars; 56,400 of them are World War II veterans. Historically there were 212,000 Kansans that participated in World War II. 4,295 were killed; 7,957 were wounded. Quite a sacrifice for freedom!

There has been a lot written about the memorial. Our own Senator Bob Dole is Co-Chair of this effort. The purpose of the World War II memorial is:

“The World War II Memorial will be the first national memorial dedicated to all who served in the armed forces and Merchant Marine of the United States during World War II and acknowledging the commitment and achievement of the entire nation. All military veterans of the war, the

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citizens on the home front, the nation at large, and the high moral purpose and idealism that motivated the nation's call to arms will be honored.

Symbols of the defining event of the 20th century in American history, the memorial will be a monument to the spirit, sacrifice, and commitment of the American people, to the common defense of the nation and to the broader causes of peace and freedom from tyranny throughout the world. It will inspire future generations of Americans, deepening their appreciation of what the World War II generation accomplished in securing freedom and democracy. Above all, the memorial will stand for all time as an important symbol of American national unity, a timeless reminder of the moral strength and awesome power that can flow when a free people are at once united and bonded together in a common and just cause.”

When I first heard of this effort I became of Charter member. I have made further contributions since - as I believe in this effort. So far, the World War II Society has raised \$70 million of their goal of \$100 million. Financial support has come in from corporations, foundations, veterans groups, states, and individual Americans. Several well known Kansas businesses have contributed.

I'm pleased to know the State of Kansas has contributed a modest amount. I belong to two veterans groups that have contributed - the First Marine Division Association and the Marine Corps League.

Gifts are tax deductible and give Kansans over the next two years the opportunity to contribute.

I urge that this Committee pass SB 613 and work for its enactment during this Session.

BEFORE THE SENATE ASSESSMENT AND TAXATION
COMMITTEE OF THE KANSAS STATE SENATE
RE: SENATE BILL 613

There were well over 15 million men and women in our Armed Forces during World War II. These men and women are today dying at the rate of 1,000 per day--so that we all soon will be gone. The World War II Memorial Building, it is said, is being built to honor those who served in the military forces during World War II, I would remind you that the war was fought actually on three fronts. It was fought in Europe, fought in the Pacific Asia area and on the home front. This memorial should be a part of the history of those millions who participated in the home front as well as the front lines. After all, those at home made huge sacrifices. Their standard of living and way of life was abruptly interrupted and because of age or physical problems, they were not eligible to serve in the military forces. They are the ones who worked in the factories building the tanks, the planes and the armored vehicles, the ships at the shipyard, and so forth. Many were fathers and mothers with gold stars for sons, daughters, grandsons and granddaughters who made the supreme sacrifice. Those on the home front sacrificed, as they were subjected to rationing such things as sugar, coffee, gasoline, etc. Gasoline, of course, was to be used for the war machine; and, in fact, to even run the generators so we would have lights in our tents in the jungles of New Guinea.

While it is very appropriate to recognize those of us who served in the military, it is likewise appropriate that this memorial be a part of our history also recognizing those who fought on the home front. It has been said that it took 25 to 30 men and women to keep a soldier at the front, or to keep a plane flying, or battleship afloat.

In short, I consider such a memorial to be more than a memorial for those who served in the military forces only, but likewise, all those who fought on the home front to keep us supplied with the necessities to fight this war. The logistics, and you can well imagine, of everything needed by our military forces is difficult to comprehend.

In closing, I think we were not there to win a war, but rather we were there to end a war. So, again, I consider this memorial as a part of the history of this great country of ours, and I believe that a nation that neglects or forgets its history has no future. It goes without saying that we learn from history.

I am pleased to appear before this Committee and give you these few thoughts, and were I still in the Senate, I would consider it an honor to carry this Bill on the floor of the Senate when you have resolved yourself into the Committee of a whole for debate. I believe it entirely appropriate to pass this legislation.

If I can answer any questions, I would be glad to try to do so.

Thank you.

Jack A. Quinlan
Scott, Quinlan & Hecht

HOUSE TAXATION COMMITTEE
ROOM 519S
SENATE BILL 613
MARCH 16, 2000

Thank you for providing me this opportunity to testify in favor of Senate Bill 613 which will provide every Kansas taxpayer the means to contribute to the construction of this nation's National World War II Memorial in Washington, D.C. My name is Charles M. Yunker and I am the Adjutant for The American Legion Department of Kansas.

In the late nineteen seventies and early eighties \$3.1 million in private donations was raised to construct the National Vietnam Veterans Memorial in Washington, D.C. In the nineteen eighties and nineties even more was raised to build the National Korean War Memorial in Washington; again with private donations.

Last year the State of Kansas donated ten thousand dollars of tax revenue to the National World War II Memorial along with a similar amount to the National Women Veterans Memorial. Somewhere a goal of one dollar per World War II veteran per state was established and many states have made such donations with tax funds. I understand two similar bills have been introduced during this session of the Kansas Legislature and I commend the authors and co-sponsors of those bills. If funds are available The American Legion fully supports those bills and sees no reason those bills can not co-exist with SB 613 especially during this calendar year.

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There may be a few Kansans who are not familiar with the effort to build a National Memorial honoring the World War II generation. And that is whom the Memorial will honor; veterans and non-veterans alike; an entire generation who pulled together for the very survival of our free nation.

While most Kansans are aware of the efforts to build the Memorial, I can not help but believe the majority of those same citizens have made mental notes to make a contribution, but for whatever reason have forgotten to do so. Senate Bill 613 will not only remind our citizens of the need to build a Memorial to honor the World War II generation, it will also provide immediate means to make a first time contribution, or to supplement an earlier donation.

Additionally Senate Bill 613 will provide citizens of our State the opportunity and freedom to make as large or small donation to memorialize those who preserved our individual freedoms during World War II. Again thank you for providing me this opportunity to speak to you today in support of Senate Bill 613.

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Office of Policy & Research

TESTIMONY

To: Madame Chairman Wagle
House Taxation Committee
From: Shirley Sicilian
Director of Policy & Research, Kansas Department of Revenue
Re: Senate Bill 377 – Contractor/ Retailer Clarification
Date: March 16, 2000

Madame Chairman and members of the committee, thank you for the opportunity to testify today on Senate bill 377. This bill addresses confusion over how sales tax should apply to businesses that operate as both a contractor and a retailer. There is no fiscal note since the bill would clarify the law to support the department's current policy.

1. Background.

On November 6, 1998, the Joint Committee on Economic Development held an interim hearing to address confusion over when an exempt entity, like a college or political subdivision, needs to obtain a project exemption certificate for their purchases to be exempt, and when they don't. 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 confusion as our 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 Joint Economic Development Committee encouraged the department to convene a working group to identify solutions. With the generous and expert help of the Kansas Chamber of Commerce and Industry, we created a working group that has representatives from the various businesses involved: retailers, the contractors that buy from them, contractor/retailers, and the department. The result of our discussions was Senate Bill 250, which was introduced during the 1999 session, and became a 1999 interim study topic. The Special Committee on Taxation heard testimony over the interim and ultimately recommended a bill, SB 377, which we fully support. Our intent is that it would not stand alone, but would enable the department to make further clarifications through regulations. In fact, our working group is continuing to meet to develop those regulations.

2. Summary of the issues.

Contractors pay, collect and remit sales tax differently from retailers. A contractor pays tax on the cost of materials when it purchases them. A retailer doesn't. Instead, the retailer uses a resale exemption certificate. When the retailer later sells to its customer, the retailer will collect and remit tax on the "marked-up" price of the materials. When a transaction involves a business that

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does both contracting and retailing, it is often very difficult for everyone involved to know what their responsibilities are. The business doesn't know whether it 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 SB 377 really addresses the root of the confusion.

The source of confusion is K.S.A. 79-3602(r), which defines a "contractor, subcontractor or repairman" as "a person who agrees to furnish and install tangible personal property or install tangible personal property at a specified price." But goes on to state that "[a] person who maintains an inventory ... which enables such person to furnish and install the tangible personal property ... shall not be deemed a contractor but shall be deemed a retailer." As a matter of practical reality, virtually every contractor/retailer (and many straight contractors) maintains an inventory for resale from which it also draws materials for its contract jobs. Thus, this statute could be read to mean that a contractor/retailer can never be treated as a contractor, even if the transaction it is engaged in is a contract job. This interpretation would require contractor/retailers to remit tax on the marked-up selling price, even when in competition with straight contractors, which pay tax on the lower, purchase price.

The department reads K.S.A. 79-3602(r) as applying only to that inventory which is held for ultimate sale at retail. Under the department's interpretation, tax treatment depends on the type of transaction. The contractor/retailer only remits tax on the marked-up selling price when the item is sold at retail. When the contractor/retailer performs a contract job, it remits tax based on the lower, purchase price. If the legislature supports the department's current transaction based approach, then KDOR should issue regulations to make that approach understandable, and the statutes should be amended to clearly support those regulations.

3. Summary of SB 377.

Senate bill 377 contains only two substantive sections. Section 1, deletes the existing provision which deemed contractors to be retailers if they have an inventory. Section 2 would clarify that a contractor/retailer will be treated for tax purposes as a contractor when doing a contract job, and as a retailer when selling at retail. The practical effect of this approach is to delay the payment of sales tax on property purchased by a contractor /retailer until the property is either used in a contract job or sold at retail. Once the contractor/retailer knows how the property will be used, they will know how the property should be taxed, and they will remit tax accordingly.

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 the resulting administrative burden for taxpayers and exempt entities, and the businesses that sell to them.

LEGISLATIVE TESTIMONY

SB 377

March 16, 2000

KANSAS CHAMBER OF COMMERCE AND INDUSTRY

Testimony Before the
House Taxation Committee

by

Marlee Bertholf
Director of Taxation & Small Business

Madam Chair and members of the Committee:

My name is Marlee Bertholf, Director of Taxation and Small Business for the Kansas Chamber of Commerce and Industry. I am here today in support of Senate Bill 377. This bill encompasses our effort to clarify the sales tax law and remitting procedures applicable to those taxpayers that act as contractors, retailers or contractors/retailers.

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 2,000 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 48% of KCCI's members having less than 25 employees, and 78% 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.

The Kansas Chamber of Commerce along with the Department of Revenue established a working group to study how the laws and remitting procedures could be clarified or simplified for taxpayers. The working group was formed at the request of Senator Pat Ranson after this issue was

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during an interim hearing of the 1998 Economic Development Committee. Our group is comprised of contractors, retailers, contractor/retailers, accountants, lawyers, association representatives and staff from the Department of Revenue.

As the group studied this issue, it became apparent that there is a great amount of confusion and disparity in practices of the business owners who are engaged in both contract services and retail sales. A business that sold both over the counter items as a retailer and bid for jobs as a contractor did not have a way to remit sales tax that reflected their business practice. The business either had to choose if they were a retailer or a contractor for tax purposes. This practice created much confusion in remitting procedures. Senate Bill 377 will clarify this confusion by carving out a place for contractor/retailers in the Kansas Statutes. A contractor/retailer will buy the good tax exempt and then remit the tax to the state on the basis of their use. If a contractor/retailer sells a product over the counter, they will remit sales tax on the retail price of the item. If a contractor/retailer uses a product in a construction contract, they will remit sales tax on the wholesale price of the good, as contractors do.

The working group has worked hard to develop regulations that are both fiscally neutral and reflect the daily practice of contractor/retailers. This bill is not the final answer to clarifying the confusion of the sales tax system. Our working group has discussed other possibilities to simplify this system and have come up with answers, but these changes have significant fiscal notes. In these tough budget times, this is a sound and fiscally neutral way to clarify some of the confusion of the practices of contractors and retailers in the State of Kansas.

Thank you for allowing us the opportunity to appear before you today. I will stand for questions.

TESTIMONY TO THE
HOUSE TAXATION COMMITTEE
REGARDING SENATE BILL NO. 377

Sales Tax Treatment of Contractors, Retailers and
Contractor/Retailers

By

David N. Allison, CPA
BCC Business Services, Inc.,
on March, 2000

Chairman Wagle and members of the Committee, I am David Allison, CPA and construction industry group leader for the Kansas City BIZCenter of Century Business Services ("CBIZ"). CBIZ is a publicly-traded integrated business services which is currently the seventh largest accounting and business consulting firm in the United States. In the six state region I serve from our office in Topeka, CBIZ has nearly 300 contractors, architects and engineers, with over 200 Kansas contractor clients. Further, I am an associate member and former board member of the Associated General Contractors of Kansas, Inc. and a member of the Kansas Society of Certified Public Accountants.

I have been a member of a special Construction Sales Tax Group which has met numerous times over the last year to discuss "contractor/retailer" issues. Our Sale Tax Group consisted of construction industry members and organizations, business organizations, and representatives of the Kansas Department of Revenue. Our Group discussed the evolution of the present day "contractor/retailer" business, the current confusion over sales tax laws applicable to a "contractor/retailer", and resulted in our Group's suggestion for a framework for developing necessary clarifying legislation and regulations.

EVOLUTION OF THE "CONTRACTOR/RETAILER"

There has been a change in business over the last 50 years. The retailer in the 1950's sold his goods to homeowners or businessmen who performed small repair projects themselves. If the job was too large or complex, the homeowner or businessman would hire a contractor to purchase the materials from the retailer and perform the construction project. Over the next 50 years, many retailers saw the opportunity to attract more customers by adding repair/replacement/engineering/design/build services to their capabilities. Contractors, striving to even out the historical boom-bust building cycle, also began to store common inventories and

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offer service contracts after performing a construction contract. As a result of economic factors, the contractor/retailer was born.

The business environment of the 1950's supported the sales tax laws and regulations of that era. A retailer was truly a retailer; a contractor was truly a contractor. However, with the emergence of the economic demand for the contractor/retailer, confusion was created in the application of the sales tax law. If I am a "retailer" for sales tax purposes, how would I report a remodeling project at a manufacturing plant when I removed some materials from inventory and I also drop-shipped custom-made materials to the job site? If I am a "contractor" for sales tax purposes, why do I have to pay sales tax on the materials I keep in stock for my tax-exempt governmental customers?

CONFUSION CREATED BY ONLY A "RETAILER" OR "CONTRACTOR" CLASSIFICATION

Even today, a business can create a significant competitive advantage based on its selected designation as a "retailer" or "contractor," depending on the facts-and-circumstances of the project. However, there can also be a substantial risk to the businessman in the way of additional sales tax, penalties and interest if the Kansas Department of Revenue contends that, in their opinion, the "contractor" or "retailer" designation does not support the businessman's conclusion.

Unfortunately, I have seen numerous contractors be forced to pay sales tax, interest and penalties because their conclusion of the appropriate sales tax law differed from the KDOR's opinion. Further, as several KDOR representatives I know readily admit, the KDOR conclusion on the same facts-and-circumstances may vary 100%, depending on the agent or supervisor in charge of the audit. As late as July 1999, I have had contractor clients receive one opinion from the Policy Office on a contractor/retailer sales tax question and then receive the opposite opinion from the Sales Tax Department (we agreed with Policy's opinion). Such is the extent of the current confusion over when should a business transaction be considered a "retail" sale or a "contractor" sale.

FRAMEWORK FOR SALES TAX CLARIFYING LEGISLATION

The Sales Tax Group believes that the solution to this problem can be solved through a combination of legislative change, regulatory change, and education.

The change that should be corrected through legislation is clarification of the term "gross receipts" when material is removed

from a retailer's inventory to be consumed in a construction project.

First, a few definitions:

A "contractor" purchases materials that result in the contractor paying sales tax on the cost of the materials paid by him to the vendor.

A "retail" sale results in the retailer charging sales tax at the price billed to the customer for the materials, including markup.

The issued to be clarified by legislation is how do you define "gross receipts" when a contractor with untaxed inventory removes that material to be consumed in a construction project. Without clarification, this issue will be left to the sales tax auditors to inconsistently define.

Our Group believes that the "gross receipts" from the sale of material removed from the untaxed inventory of a retailer to be installed in a construction project by the contractor should be the carrying cost of the untaxed inventory.

The choice of how a transaction and business entity is defined for sales tax purposes can result in significant advantages to one entity over another. A sale of material that is considered a "contractor sale" has an advantage over the same transaction considered a "retail sale" if the sale is made by a "retailer" because the "contractor" sale does not subject the markup to sales tax. However, as previously discussed, if the KDOR disagrees with the businessman and defines the transaction as a "retail" sale, then the businessman usually absorbs the additional sales tax that should have been billed to the customer, plus penalty and interest.

FRAMEWORK FOR SALES TAX CLARIFYING REGULATION

The Sales Tax Group has also concluded that regulatory changes are necessary to clarify when a transaction should be considered a "contractor" sale versus a "retailer" sale. Currently, the practices used by contractors and retailers to apply sales taxes are not consistent on the same transaction. Several issues are involved in creating this inconsistent tax treatment. I will explain why this inconsistent treatment occurs while I explain the Sales Tax Group's proposal for a framework for clarifying regulation.

Please see the enclosed Exhibit 1.

The first question a transaction must answer is whether labor services are involved. If no labor services are involved, then the

sale should be considered a "retailer" sale. If there are labor services involved, then the material sold or consumed in the transaction is subject to sales tax as either a "retailer" or as a "contractor."

We will assume that all the transactions we will discuss from now forward will have labor services involved with them.

The second question a transaction must answer is whether the transaction qualifies for treatment as "original construction" of a building or facility. If the answer is "yes", then the transaction is considered as performed by a "contractor," and, therefore, the materials are subject to sales tax at the businessman's cost. If the answer is "no", then we need to determine for which of the following three categories the non-original construction transaction qualifies:

- 1.) Real property;
- 2.) Listed property; or
- 3.) Tangible personal property.

Let us define these categories.

"Real property" is defined for sales tax purposes the same as it is defined for property tax purposes.

"Tangible personal property" is defined for sales tax purposes the same as it is defined for property tax purposes.

"Listed property" is defined as a list of specific property that is attached to real property, but which is specifically carved out to be treated as tangible personal property for sales tax purposes.

Our Sales Tax Group believes that the average person would find it much easier to understand sales tax rules if they were as consistent as possible with the commonly understood property tax rules. For example, guttering may have been considered in the past to be treated as tangible personal property for sales tax purposes, whereas that same guttering would have been considered part of the real property for property tax assessment purposes. Except for the items considered to be "listed property," the property tax definitions will apply for sales tax purposes.

Therefore, a "real property" transaction will be treated as a "contractor" sale transaction. The materials are subject to sales tax at the businessman's cost. This transaction considers the "contractor" to be the consumer of the material as he converts the former tangible personal property into real property.

Further, a "tangible personal property" transaction will be treated as a "retailer" sale transaction. The materials are subject to sales tax at the "retail" selling price to the customer, if separately stated on the billing, or the lower of the businessman's cost of the material or his normal selling price for the material. This transaction considers the customer to be the consumer of the material since it retains its character as tangible personal property for property tax purposes.

Finally, our Sales Tax Group believes that "listed property" transactions should be clarified through the regulatory process. Our Group has met many times this fall to discuss the proposed regulations. We believe we are very close to reaching a consensus of support for the proposed regulations on the contractor/retailer issue. The proposed regulations should reflect the intent of proposed Senate Bill No. 377 and clarify when a businessman acts as a both a retailer and a contractor. We believe these regulatory changes will help the "contractor/retailer" to properly implement the sales tax law, since it will follow commonly understood property tax definitions, except for specific listed items.

CONCLUSION

In conclusion, the Sales Tax Group believes that legislative acknowledgement of the emergence of the "contractor/retailer" is needed in the sales tax laws of Kansas. A business can gain an advantage in the installation of materials depending on if the business is considered a "contractor" or a "retailer" for sales tax purposes.

We believe the State of Kansas needs a legislative change to define the "gross receipts" subject to sales tax in a transaction where untaxed inventory of a retailer is removed to be installed in a construction project by a contractor/retailer should be the carrying cost of the retailer.

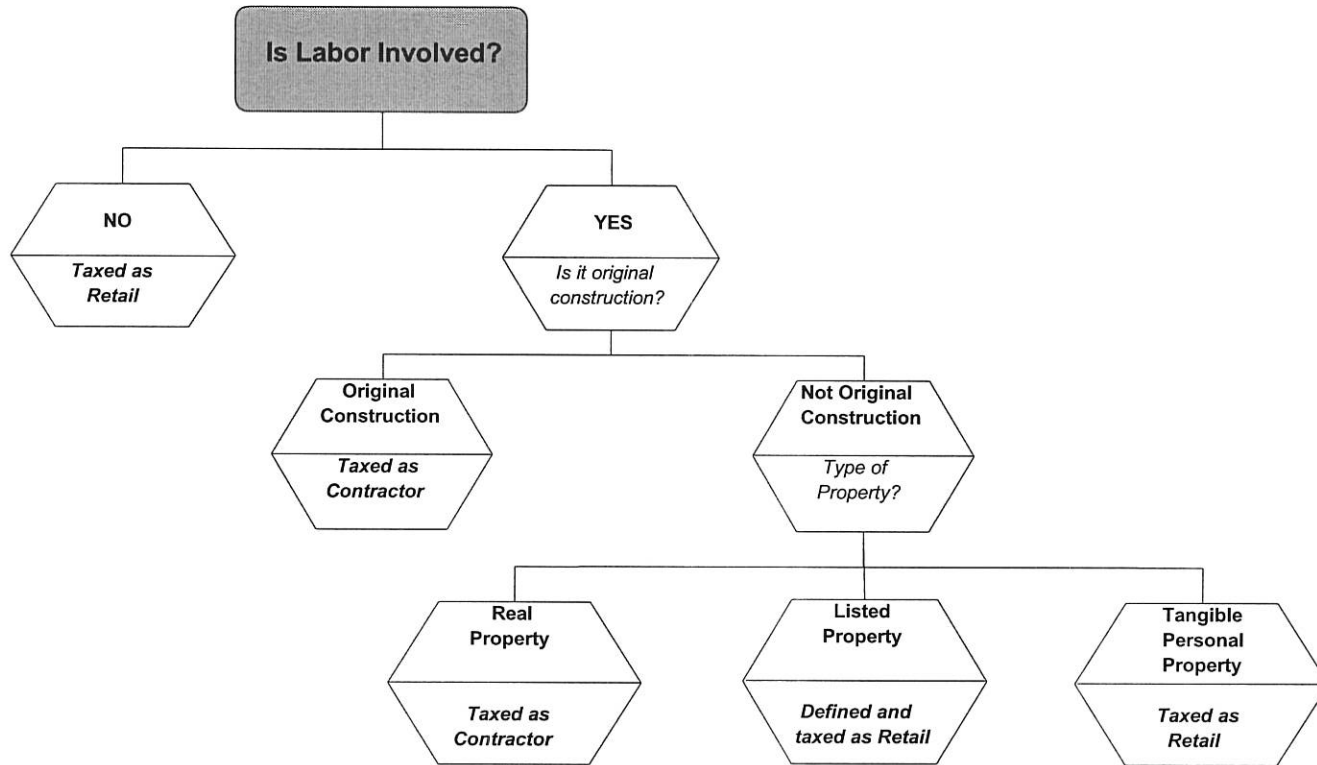
We also believe that the regulatory changes needed to implement our model at Exhibit 1 will change historical sales tax rules and regulations to reflect current business practices. The proposed regulations that our Group has participated in writing support the legislative change being discussed here today.

Finally, we believe that the model will be easier to administer and understand by the common person because it more closely follows real and tangible personal property definitions used in assessing property taxes.

Thank you for your consideration of our Group's research and discussion.

HOW ARE MATERIALS TAXED?

REGULATORY CHANGE



STATUTORY CHANGE

Contractor Sale = Taxed at carrying value of inventory

Retail Sale = Taxed at billed material price
(including markup)

TESTIMONY TO THE HOUSE TAXATION COMMITTEE
Regarding Senate Bill 377
(Sales Tax Treatment of Contractors, Retailers and Contractor/Retailers)
presented by
Dan Morgan, Kansas City Chapter, AGC and The Builders' Association
March 16, 2000

Madam Chairman and members of the Committee, my name is Dan Morgan. I am Director of Governmental Affairs for the Kansas City Chapter, Associated General Contractors of America (AGC) and The Builders' Association. We represent over 850 commercial and industrial building contractors, subcontractors and suppliers in Kansas and Missouri. Approximately 450 of our members are located in the Kansas City area and virtually all of them perform work in Kansas. Over 150 of our metro-area member firms are located in Kansas and a large number of owners of our Missouri-based companies are Kansas residents themselves. The Kansas City Chapter, AGC is a sister chapter to the Associated General Contractors of Kansas and the Kansas Contractors Association, both located here in Topeka.

My comments will be brief. Along with several others who are giving testimony today, I served on the Sales Tax Group which has reviewed a variety of issues regarding the sales tax treatment of contractors, retailers and companies that operate both as contractors and as retailers. Over the past year, we have met many times and to examine the pertinent Kansas sales tax law and the prevailing tax remittance practices in the construction and retail industries. As you would hope and expect, the prevailing sales tax remittance practices of contractors and retailers do conform with current laws and regulations. At the same time, however, there are a number of misconceptions regarding the proper application of sales tax in certain situations and most of these misunderstandings are caused by the complexity that permeates this area of the law. Indeed this area of Kansas tax law is very confusing and it can become almost incomprehensible for those who conduct businesses at times as contractors and at other times as retailers.

In our efforts to clarify the law it was the Sales Tax Group's goal to find a way to clearly illustrate when construction materials are properly taxed at cost and when they are taxed at a marked-up retail price. In so doing, our illustration or model had to be revenue-neutral and consistent with industry practice. I believe that, with the help of Shirley Sicilian, her staff and Revisor of Statutes staff, we have accomplished all of those things. From our industry's perspective, a primary goal in making this area of the law more understandable is to level the playing field for competitors within the industry. If this proposal is adopted and explained in clear and concise written instruction (through information guides, notices and regulations), and if that information can be widely distributed, we will go a long way toward leveling that field of competition. We will be very happy to continue to be actively involved in that effort.

While this proposal would bring clarity to a very confusing area of sales tax law, it does not address another area that is equally, if not more, troublesome and confusing. I am speaking of the sales tax on the "labor services" involved in commercial remodeling construction. While there is little likelihood that this counterproductive and confusing tax will be repealed this year, we do ask that you keep repeal of that tax in mind for consideration in the near future. In the meantime, you can help to clear up the law as it relates to contractor/retailers by passing this proposal and we urge your support of Senate Bill 377. Thank you all very much.

House Taxation

Date: 3/16/00

Attachment # 9



Midway Sales & Distributing, Inc. d/b/a

MIDWAY WHOLESALE

Topeka • Salina • Lawrence • Manhattan • St. Joseph • Kansas City

SB 377

Testimony before the House Taxation Committee

by Kenneth L. Daniel, Jr.
Chairman and CEO, Midway Sales & Distributing, Inc.

Madam Chair and members of the Committee:

My name is Ken Daniel. I am the Chairman of the Board and CEO of Midway Wholesale. We have five locations in Kansas from which we serve over 2000 contractors and subcontractors. In addition to being a wholesaler, I am a retailer and a contractor under Kansas law.

We wish to urge you to support Senate Bill 377. This bill is badly needed to help small businessmen like myself and my customers conform to the law and know we are conforming to the law. The vast majority of small business people in Kansas want to pay their taxes and pay them correctly. This bill is needed to clarify ambiguous issues, not just for businesses but for the employees of the Department of Revenue.

We believe Senate Bill 377 to be revenue-neutral. Lowering taxes is not the only way to make Kansas more "business-friendly"--having simple, straight-forward laws is also extremely important.

House Taxation

P.O. Box 1246 • 218 SE Branner Street • Topeka, KS 66601-1246 • (785) 232-4572
www.midwaywholesale.com

Date: 3/16/00

Attachment # 101

This bill won't solve all the problems, but it will give all parties concerned some guidelines to use while we work to develop other improvements.

I urge you to support Senate Bill 377. Thank you.



Plumbing & Heating, Inc.

Residential - Commercial

Repair - Remodeling - Contracting

P.O. Box 12 / 530 Oil Hill Road

(316) 321-0662

El Dorado, KS 67042

March 16, 2000

Testimony before the House Taxation Committee

Representative Susan Wagle, Chairperson

Re: Senate Bill #377 - Sales tax treatment of Contractors, Retailers and Contractor/Retailers

Representative Wagle and committee members, I would like to thank you for the opportunity to present my testimony.

I am Joyce Rush. My husband, Gene, and I own Rush Plumbing & Heating. I would define our shop as a small business with 7 employees, including Gene and myself. We are located in El Dorado, Kansas, a community of approximately 13,000. Operating in a small town, we have to be multifaceted in order to survive. Our main emphasis, and thrust, is residential and light commercial plumbing—which includes new construction, remodel, installation and repair service. Shops in larger cities usually operate with a small inventory, due to their immediate proximity to Wholesalers. We do not have that luxury. Therefore, we maintain a large inventory in order to have materials readily at hand. We average approximately 5 to 8 small material sales per week that would be classified as *over-the-counter* sales. Remaining sales and service are *contract* and/or *time & material* which are initiated through telephone contact. Our sales tax classification is *Contractor/Retailer*.

I have an interest in Senate Bill #377, stemming from our second Sales Tax Audit, May 8, 1998. I sailed through our first sales tax audit, in 1992, which uncovered *no* errors in collection, computation or remittance of same. Rush Plumbing continued to collect, compute and remit sales tax in the same manner. Therefore, you can imagine my surprise when informed, by the state sales tax auditor, I was in error in the manner of invoicing, collection, computation and remittance of Kansas sales tax. Unknown by me, at some point, between the two audits, our Sales Tax Classification was changed from *Retailer* to *Contractor/Retailer*. Thus, changing the tax base in areas regarding a contractor, and creating much confusion in invoicing and collecting sales tax on some tax exempt entity sales.

As a Contractor/Retailer I essentially wear "two hats." The State expects me to be able to determine if I am a Contractor or Retailer and handle the purchasing and invoicing accordingly. I remain frustrated with the present Kansas Contractor/Retailer sales tax statues, regulations and the ensuing confusion and bookkeeping burden in processing same. I have testified before the house Joint Committee on Economic Development and the Senate Committee on Assessment and Taxation. I want to thank Representative Bill Mason for his help in getting the attention of both the Department of Revenue and the legislature, that there is indeed, a great need to clarify the vague *Contractor/Retailer* tax base existing today. As a result of his help, a Contractor/Retailer Sales Tax Working Group was formed.

House Taxation

Date: 3/16/00

Attachment # 11-1

March 16, 2000

Testimony before the House Taxation Committee

Page 2

I have been a part of this committee, whose goal was to determine areas of inconsistency and how best to clarify the vague areas of the Contractor/Retailer tax base and restore the same tax base for both the Contractor and the Contractor/Retailer. Problem areas per the current statute are:

- Confusion and tax ramifications as to who we are and which statutes apply ... Contractor? Or Retailer? Or Contractor/Retailer?
- How do we handle material purchases ... pay tax on materials at time of purchase? Or purchase materials tax exempt?
- Confusion on the tax base of materials sold ... is the tax base cost of materials? Or on the retail selling price; if retail, what determines retail selling price?
- Inequity in competitive bidding ... tax base is *cost of materials* for the Contractor, tax base is the *retail selling price* for the Contractor/Retailer.
- Existing Contractor/Retailer sales tax regulations and statutes are vague, at times contradictory and therefore open to inconsistent interpretation.

The Contractor/Retailer sales tax issue is very complicated. The Contractor/Retailer Sales Tax Working Group, through numerous meetings, have discussed a wide range of Contractor/Retailer taxation events, their appropriate tax base and resulting tax consequence that are used by states other than Kansas. Also, using various taxing methods, we have entertained many contractor/retailer taxation scenarios and their resulting tax ramifications. Throughout our discussions, it was evident that the committee's flow chart was equally workable for the small Contractor/Retailer and the large Contractor through all scenarios. The *flow chart* presents a simplistic, bright line clarification by concisely defining the tax base for the Contractor/Retailer's varied types of sales, while bringing equality to the Contractor/Retailer tax base as compared with businesses who operate solely as a Contractor or Retailer. The Committee has also written proposed changes to the Contractor/Retailer statutes to clarify and define the tax base according to the flow chart guidelines.

The flow chart and clarification of the Contractor/Retailer statutes *is* revenue neutral, and does *not* make changes in taxing events or the manner in which sales tax is collected today. It does bring clarification to the above mentioned problem areas. As a Contractor/Retailer, I ask your support in *simplifying, clarifying and leveling the playing field between the Contractor and Contractor/Retailer who engage in competitive bidding*, that the flow chart and statute change (Senate Bill #377) now defines.

Thank you for your time and consideration.

A handwritten signature in cursive script that reads "Joyce Rush". The signature is written in black ink and includes a small smiley face above the letter "h" in "Rush".

Joyce Rush



Wichita Independent Business Association

THE VOICE OF INDEPENDENT BUSINESS

March 16, 2000

Written Testimony Submitted
To the House Taxation Committee
By Natalie Bright on SB 377

Madam Chair and members of the Committee:

My name is Natalie Bright and I am the Governmental Affairs Consultant for the Wichita Independent Business Association. On behalf of the 1,100 independent business members we represent, I would like to thank you for the opportunity to submit written testimony in support of SB 377.

As explained, SB 377 proposes language that will clarify current sales tax law and remitting procedures applicable to those taxpayers acting as a contractor, retailer or contractor/retailer. Under current law, our members have found a great amount of confusion and disparity in the remitting practices of business taxpayers engaged in both retail sales and contract services. Last session, the Kansas Chamber of Commerce along with the Department of Revenue established a working group to study how the sales tax laws and remitting procedures could be clarified or simplified for Kansas taxpayers. It is the work of this group that is represented in SB 377.

Adoption of the language set out in this bill accommodates the business practices of those merchants who maintain a dual-purpose inventory for retail sales and for incorporation into projects they bid on as a contractor. Under this proposal, the "contractor/retailer" may either remit as a retailer or a contractor, depending on how the inventory is used. SB 377 creates an option for a "contractor/retailer" to delay the payment of sales tax on property purchased by a "contractor/retailer" until the property is either incorporated into a project or sold at retail. This option will alleviate a great amount of frustration for both the "contractor/retailer" taxpayer and the Kansas Department of Revenue.

SB 377 is a pro-business proposal with little fiscal impact to the state. The members of WIBA strongly urge you to favorably recommend SB 377. Thank you for allowing WIBA the opportunity to submit written testimony in favor of SB 377.