

Approved: _____

Date

1-25-00

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 January 20, 2000, in Room 519-S of the Capitol.

All members were present except:

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: Shirley Sicilian, Kansas Department of Revenue
Marlee Berthoff, Kansas Chamber of Commerce & Industry
David Allison, CBIZ
Dan Morgan, The Builders' Association
Joyce Rush, Rush Plumbing & Heating, Inc.
Gus Rau Meyer, Rau Construction Company
Kenneth Daniel, Jr., Midway Wholesale

Others attending: See attached list.

Senator Bond discussed a bill which he plans to introduce. The provisions of the proposed bill would increase the state sales tax by .3 of a percent. The funds from that increase would be earmarked for deposit in the state school district finance fund. In his opinion, additional sources of revenue for education will be needed in the near future. It is estimated that the proposed increase in sales tax would raise \$102 million in the first year (2001) and \$122 million in the second year. He explained that he is offering the bill as a means of beginning a discussion of the reality of school finance in light of tax cuts enacted by the Legislature in recent sessions.

Senator Lee requested the introduction of a bill dealing with the oil lease working interest income tax credit which was passed in the 1999 Legislative Session. She explained that a problem has developed in regard to how it is being administered. The proposed bill would change how the refund is made available.

Senator Lee moved to introduce the proposed bill, seconded by Senator Bond. The motion carried.

SB 377--Sales taxation; treatment of certain contractor sales and purchases

April Holman, Legislative Research Department, called attention to copies of the interim report regarding the topic of sales tax treatment of contractors who also sell at retail. (Attachment 1) She noted that the topic was the subject of **SB 250** in the 1999 Legislative Session, and that bill was referred to the Special Committee on Assessment and Taxation for further study. According to testimony heard by the Committee, the current sales tax is confusing for contractors who also sell items at retail. The Committee concluded that clarification is needed regarding the payment and calculation of sales tax by contractors, therefore, recommended the introduction of a bill providing an exception to the general rule of payment of sales tax by the contractor at the time of purchase of property.

Shirley Sicilian, Kansas Department of Revenue, presented background information on **SB 250** and **SB 377**. She noted that there is no fiscal note on **SB 377** since it would clarify the law to support the Department's current policy. She explained that the source of confusion is K.S.A. 79-3602(r) and discussed the two substantive sections of **SB 377**. The Department supports the bill as a means to relieve the confusion and resulting administrative burden for taxpayers, exempt entities, and the businesses that sell to them. (Attachment 2)

CONTINUATION SHEET

MINUTES OF THE ASSESSMENT AND TAXATION COMMITTEE
Room 519-S, Statehouse, at 11:10 a.m. on January 20, 2000.

Marlee Berthoff, Kansas Chamber of Commerce and Industry(KCCI), testified in support of **SB 377**. She noted that KCCI was part of the working group formed to study how the laws and remitting procedures could be clarified for taxpayers, and she described the issues the group studied. She pointed out that the regulations that were developed are fiscally neutral and reflect the daily practice of contractor/retailers. (Attachment 3)

David Allison, CBIZ, testified in support of **SB 377**. He explained that CBIZ is the seventh largest accounting and consulting firm in the United States. He noted that the issue has been significant for his clients as they have been audited in the past by the Department of Revenue. His clients have been confused as to if they were classified as a contractor or retailer for taxation purposes. He believes the clarification in the bill is important as it identifies contractor/retailers and clarifies when a transaction should be considered a contractor sale versus a retailer sale. In conclusion, he called attention to the last page of his of his testimony which includes a chart regarding how materials are taxed. (Attachment 4)

Dan Morgan, The Builders Association, followed with further testimony in support of **SB 377**. Mr. Morgan served on the sales tax study group formed to review the sales tax treatment of contractors, retailers, and companies that operate both as a contractor and as a retailer. He echoed the opinion of other conferees that this area of Kansas law is very complicated and confusing for those who conduct their business at times as a contractor and at other times as a retailer. He noted that the bill does not address another equally confusing area of sales tax law--sales tax on labor services involved in commercial remodeling construction. He asked that the Committee keep this issue in mind for consideration in a future session. (Attachment 5)

Joyce Rush, Rush Plumbing and Heating, testified in support of **SB 377**. As owners of a small business that operates as a contractor/retailer, she and her husband have been frustrated and confused by sales tax laws. She has also worked with the tax study group and feels that the bill will relieve the confusion and the bookkeeping problems associated with current sales tax law. (Attachment 6)

As a general contractor, Gus Meyer, President of Rau Construction Company, testified in support of **SB 377**. He believes the sales tax working group, of which he was a member, has made recommendations which are a start in clarifying several taxation issues in the construction industry. (Attachment 7)

Kenneth Daniel, Jr., Midway Wholesale, gave final testimony in support of **SB 377**. He stated that the bill will help small businessmen and their customers conform to the law and to know they are conforming. In addition, he noted that the bill will clarify ambiguous issues for the Department of Revenue. In his opinion, the provisions in the bill will make Kansas more "business friendly." (Attachment 8)

Senator Langworthy called attention to written testimony in support of **SB 377** submitted by Janet Stubbs, representing the Kansas Building Industry Association. Senator Langworthy read the portion of the testimony which expresses appreciation for the knowledge, ability, and dedication Shirley Sicilian contributed to the study. (Attachment 9)

Senator Donovan moved to recommend **SB 377** as favorable for passage, seconded by Senator Goodwin. The motion carried.

The meeting was adjourned at 11:50 a.m.

The next meeting is scheduled for January 25, 2000.

SALES TAX TREATMENT OF CONTRACTORS*

CONCLUSIONS AND RECOMMENDATIONS

The Committee concluded that clarification is needed regarding the payment and calculation of sales tax by contractors and other similar persons. The Committee voted to recommend favorably a bill providing an exception to the general rule of payment of sales tax by the contractor at the time of purchase of property (KSA 79-3603(l)).

Under the bill recommended by the Committee, those contractors who maintain a dual purpose inventory of property for ordinary retail sale and for incorporation in a project would calculate and pay sales taxes as follows:

- **Ordinary Retail Sale.** Sales tax would be due when the contractor who maintains a dual purpose inventory resells the property to the ultimate consumer. The sales tax would be based on the retail sale price and would be paid by the consumer.
- **Incorporation into a Project.** Sales tax would be due when the contractor who maintains a dual purpose inventory incorporates the property into a project. The sales tax would be paid by the contractor upon the basis of the total cost of the property to the contractor.

BACKGROUND

The application of sales tax to contractors and retailers was the subject of SB 250 which was introduced during the 1999 Legislative Session. The Chairman of the Senate Committee requested that the topic be referred to the Special Committee on Assessment and Taxation.

The current system has resulted in confusion for businesses that function both as contractors and retailers. Under the current statutes, retailers must pay, collect and remit sales tax differently from contractors and repairmen. A retailer does not pay tax on materials purchased for resale, but instead, uses a Resale Exemption Certificate. A retailer then collects and remits tax on the "marked-up" price of the materials (final sale at retail) paid by the ultimate consumers.

A contractor or other repairman, on the other hand, does pay tax on the original purchase price of the materials. This is because a contractor, unlike the retailer, is considered the ultimate consumer of the materials. When a contractor later uses those materials in a job, the contractor does not explicitly charge any additional tax on the materials. However, the tax generally flows through to the customer as a cost of doing business. Some exempt entities, such as schools and political subdivisions, have indirect or pass-through exemption authority under the statutes. These exempt entities can provide a Project Exemption Certificate (PEC) which authorizes the contractor to make purchases exempt from tax on their behalf. Entities with only direct exemption authority, such as certain not-for-profit organizations, cannot relieve the contractor of his tax payment responsibility, but can purchase the materials exempt directly from the supplier.

* SB 377 was recommended by the Committee.

Many businesses do both contracting (or repairing) and retailing. Examples include electrical supply and contracting and plumbing supply and contracting. The Department of Revenue interprets the current statutes to require a "transaction-based" approach to taxing contractor/retailers whereby contractor/retailers are treated as contractors when performing contracting work and retailers when engaging in retail sale. Under this interpretation, a contractor/retailer:

- Buys all materials exempt from tax with a resale exemption certificate, like a retailer, since it is unclear at this point which materials will be used in contract work;
- If the material is sold at retail, sales tax is collected on the marked-up selling price unless the customer has an exemption certificate; and
- If the material is used in contract work, sales tax is remitted to the state on the purchase price unless the customer has a project exemption certificate (only those with indirect, as well as direct, authority).

COMMITTEE ACTIVITIES

The Committee held a public hearing on this topic at the August meeting, at which time representatives of the Department of Revenue, Kansas Chamber of Commerce and Industry (KCCI), and various businesses testified in support of clarifying the sales tax law for contractor/retailers.

A bill draft was presented to the Committee and approved at the September meeting.

At the October meeting, the Committee approved a draft Committee report.

CONCLUSIONS AND RECOMMENDATIONS

The Committee concluded that clarification is needed regarding the payment and calculation of sales tax by contractors and other similar persons. The Committee voted to recommend favorably a bill providing an exception to the general rule of payment of sales tax by the contractor at the time of purchase of property (KSA 79-3603(l)).

Under the bill recommended by the Committee, those contractors who maintain a dual purpose inventory of property for ordinary retail sale and for incorporation in a project would calculate and pay sales taxes as follows:

- **Ordinary Retail Sale.** Sales tax would be due when the contractor who maintains a dual purpose inventory resells the property to the ultimate consumer. The sales tax would be based on the retail sale price and would be paid by the consumer.
- **Incorporation into a Project.** Sales tax would be due when the contractor who maintains a dual purpose inventory incorporates the property into a project. The sales tax would be paid by the contractor upon the basis of the total cost of the property to the contractor.

The practical effect of the exception is to delay the payment of sales tax on property purchased by a contractor who maintains a dual purpose inventory until such time as the property is incorporated into a project or sold at retail.

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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 377 – Contractor/ Retailer Clarification**
Date: January 20, 2000

Senator Langworthy and members of the committee, thank you for the opportunity to testify today on Senate bill 377. This bill addresses the current confusion in 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 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.

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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 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.

X 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 or 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 preclude the "transaction based" approach currently followed by the department. It would also preclude regulations that identify when a contractor/retailer is operating as a contractor and when it is operating as a retailer. It 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 this 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 clarified to 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 clarifies 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 as follows:

- **Ordinary retail sale.** Sales tax would be due when the contractor who maintains a dual-purpose inventory resells the property to the ultimate consumer. The sales tax would be based on the retail sale price and would be paid by the consumer.
- **Incorporation into a project.** Sales tax would be due when the contractor who maintains a dual-purpose inventory incorporates the property into a project. The sales

tax would be paid by the contractor upon the basis of the total cost of the property to the contractor.

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

LEGISLATIVE TESTIMONY



The Unified Voice of Business

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SB 377

January 20, 2000

KANSAS CHAMBER OF COMMERCE AND INDUSTRY

Testimony Before the

Assessment & 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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red 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 SENATE COMMITTEE
ON ASSESSMENT AND TAXATION
REGARDING SENATE BILL NO. 377

Sales Tax Treatment of Contractors, Retailers and
Contractor/Retailers

By

David N. Allison, CPA
BCC Business Services, Inc.,
on January 20, 2000

Madam Chairman 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

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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 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

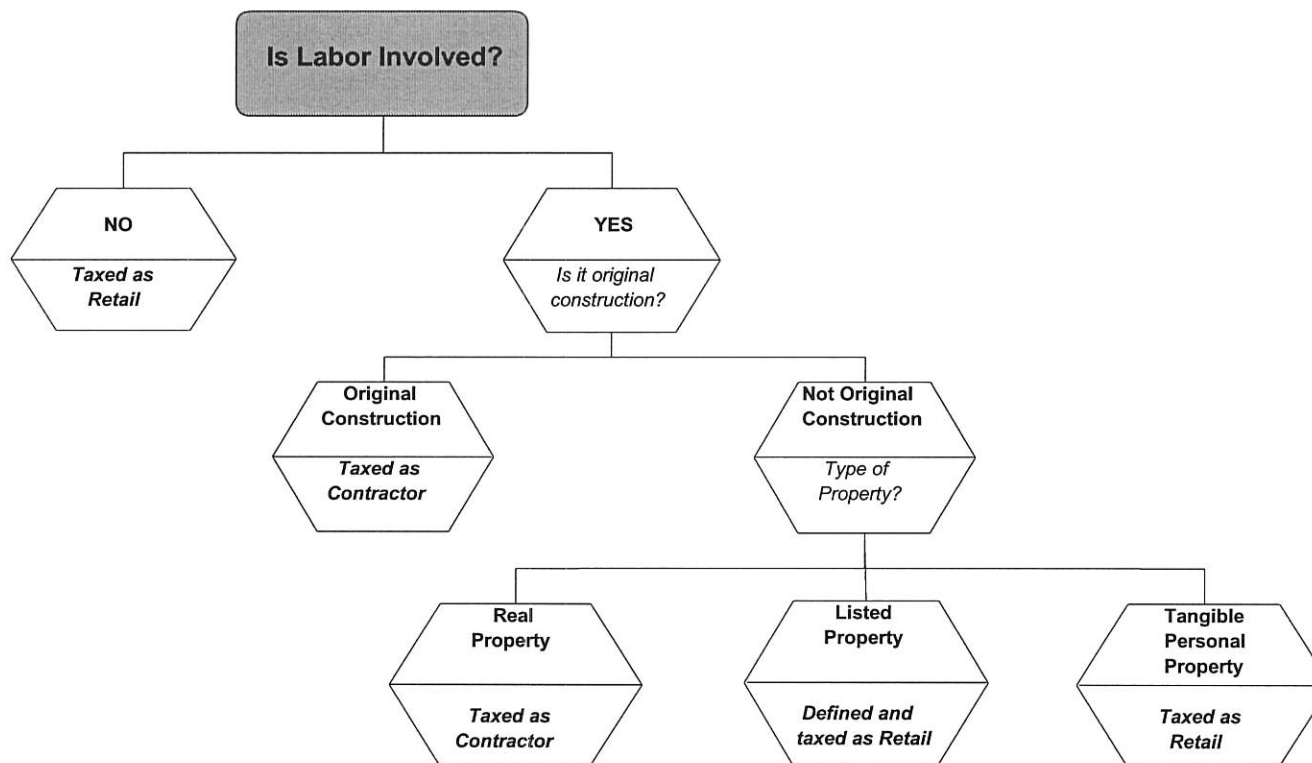
because it more closely follows real and tangible personal property definitions used in assessing property taxes.

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

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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)

4-8

**TESTIMONY TO THE SENATE COMMITTEE
ON ASSESSMENT AND TAXATION
Regarding Senate Bill 377**

**Sales Tax Treatment of Contractors, Retailers and Contractor/Retailers
By: Dan Morgan, Kansas City Chapter, AGC and The Builders' Association
January 20, 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. 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. 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 born out of the complexity that permeates this area of the law. This area of Kansas tax law is very complicated and confusing and it can become incomprehensible for those who conduct their businesses at times as contractors and at other times as retailers.

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 addition, our illustration or model had to be revenue-neutral and consistent with industry practice. I believe that, with the help of Shirley Sicilian and Tom Hatten with KDOR, we have accomplished all of those things. From our industry's perspective, a primary goal in making this area of the law more "user friendly" 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, given the current budget situation, we do ask that you keep repeal of that tax in mind for future consideration. 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.

*Senate Assessment & Taxation
1-20-00
Attachment 5*



Residential - Commercial
Repair - Remodeling - Contracting

P.O. Box 12 / 530 Oil Hill Road

(316) 321-0662

El Dorado, KS 67042

January 20, 2000

Testimony before the Senate Committee
on Assessment and Taxation

Senator Audrey Langworthy, Chairperson

Re: Senate Bill #337 - Sales tax treatment of Contractors, Retailers and Contractor/Retailers

Senator Langworthy and committee members, I would like to thank you for the opportunity to, once again, 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. Our sales ratio between light commercial and residential varies from year to year depending on the economy. 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*.

As you may remember, I am here because I went through a second Sales Tax Audit last year. 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 Kansas Contractor/Retailer sales tax statutes, regulations and the ensuing confusion and bookkeeping burden in processing same. Since I have twice testified before you, I will not bore you with all of those details again.

I have been a part of the Contractor/Retailer Sales Tax Working Group, 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 so, 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.

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Attachment 6

- 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. From which, we always returned to the guidelines set forth in the *flow chart* which was introduced to this Committee last August. 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 since written proposed changes to the Contractor/Retailer statutes to define the tax base accordingly.

Essentially, the flow chart and clarification of the Contractor/Retailer statutes 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 appreciate and support the *simplicity and tax base clarification* the flow chart and statute change now defines, as well as leveling the playing field between the Contractor and Contractor/Retailer who engage in competitive bidding. Throughout our discussions, it was evident that the flow chart is equally workable for the small Contractor/Retailer as well as the large Contractor.

**TESTIMONY BEFORE THE
COMMITTEE ON ASSESSMENT AND TAXATION**

**SB 377 - SALES TAX TREATMENT OF CONTRACTORS,
RETAILERS AND CONTRACTOR/RETAILERS**

January 20, 2000

My name is Gus Rau Meyer and I am President of Rau Construction Company. Rau is a mid sized general contracting construction company founded in 1870, and doing business in the Kansas City Metropolitan area since the early 1900's. Our headquarters for the last 40 years has been in Overland Park. Our main focus is on commercial and industrial projects in the private sector.

Over the past 11 months, I have been working with a group or representatives from the construction industry, along with representatives of the Builders Association, KCCI as well as staff from the Kansas Department of Revenue is reviewing how Contractors, Retailers and Contractor/Retailers are treated in respect to Sales Tax.

This problem does not directly effect us, nor should it effect many, if any general Contractors. This mainly effects subcontractors and suppliers. The problems at their level include:

- The unknown as to how the tax code will be applied during an audit.
- The economic disadvantage they may be burdened with if they make the most conservative interpretation of the regulations as they exist.
- The fact that most subcontractors are not aware of the implications or interpretation that does exist as it implies to what may be deemed as retail sales.
- The implications that a strict interpretation and implementation of current laws could be very costly for business who use construction services.

In light of this, I believe this committee has worked very hard to propose changes which very closely follow how contractors and retailers have been applying these regulations on an industry wide basis. This group is making recommendations to this Committee based on our findings and discussions.

As a General Contractor, I fully support these recommendations. These recommendations will clarify the existing inconsistency in law to match what is actually being practiced throughout the State. These regulations should give clear guidance to both remitters of Sales Tax, as well as the collectors of Sales Tax, on how to collect the tax due on these transactions. Although the extremely burdensome Sales Tax on Construction Services used in Commercial Remodel is still in place, these changes are a start in trying to clarify some issues in the construction industry

I thank you Madam Chairman and members of this committee for allowing me to appear before you today. I appreciate your favorable consideration and ask for your support of SB 377.

*Senate Assessment & Taxation
1-20-00
Attachment 7*



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

MIDWAY WHOLESALE

Topeka • Salina • Lawrence • Manhattan • St. Joseph

SB 377

Testimony before the Assessment and 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.

Senate Assessment & Taxation

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.



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SENATE
ASSESSMENT & TAXATION COMMITTEE

SB 377
January 20, 2000

Madam Chair and Members of the Committee

My name is Janet Stubbs, Executive Director of the Kansas Building Industry Association. Although I am not able to appear in person today, the Kansas Building Industry Association is supportive of the effort to correct the confusion in the industry among those companies which operate as both a contractor and retailer. It would appear that the language in SB 377 achieves this goal and the KBIA would like to add their voice to those organizations presenting testimony in support of SB 377 today.

I have participated in the meetings with the Department of Revenue as we attempt to assist them in writing Rules and Regulations which carry forth the intent of the amendment to the statute which is before you in SB 377. I want the Committee to know that Shirely Sicilian has been extremely cooperative in these efforts and is very knowledgeable about the complexities and differences in the contracting area.

Without the strong cooperation of Ms. Sicilian, the effort to clear up this confusion would have been totally non-productive. The industry recognizes her efforts and greatly appreciates her abilities and dedication.

We request that you recommend SB 377 favorably.

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Attachment 9

