

Approved: 2-25-00  
Date

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE.

The meeting was called to order by Chairperson Senator Audrey Langworthy at 11:10 a.m. on February 21, 2000, in Room 519-S of the Capitol.

All members were present except: Senator Greta Goodwin – Excused

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

Conferees appearing before the committee: Senator Anthony Hensley  
Karla Pierce, Secretary, Department of Revenue  
Shirley Sicilian, Department of Revenue

Others attending: See attached list.

The minutes of the February 16 and 17, 2000, meetings were approved.

**SB 616—Relating to income taxation; requiring audits of corporations**

Senator Anthony Hensley testified in support **SB 616**. He explained that the bill directs the Kansas Department of Revenue to perform at least as many corporate tax audits as the average monthly number conducted from 1996 to 1998. He called attention to copies of an article appearing in the *Lawrence Journal World* which highlights the dramatic drop in the number of corporate audits performed from 1994 to 1998. He pointed out that the decline in corporate audits came at a time when the number of Kansas corporations that generate more than \$500,000 in taxable income rose by 42 percent. He noted that, through January of fiscal year 2000, corporate income taxes have fallen \$11.8 million below projections, the largest shortfall of all revenue sources. In his opinion, **SB 616** will help to ensure that Kansas corporations pay their share of taxes. (Attachment 1)

Senator Langworthy pointed out to Senator Hensley that the chart published in the *Lawrence Journal World* stops at 1998; however, more current information is available. She informed him that statistics reflecting corporate income tax audit assessment activity from 1995 to 1999, which is included in the written testimony of Karla Pierce, Secretary, Department of Revenue, show a reverse in the trend in 1999.

Secretary Pierce followed with an update on the Department's corporate audit program. At the outset, she emphasized that the state of the program is sound. She noted, if **SB 616** is enacted, the fiscal impact would likely be zero in terms of state revenues for various reasons. She explained that the main reason the numbers appear to have fallen is that the Department has changed the way it tracks the number of audit assessments. She stated that the potential for large corporate assessments decreased over the last decade due to the following circumstances: (1) law changes, (2) voluntary compliance, (3) improved quality of audits, (4) staff turnover, and (5) the national trend to shift to other ownership types.

Secretary Pierce called attention to two charts attached to her written testimony, one comparing salaries for state auditors to salaries of private sector auditors and other state jobs and one comparing the number of auditors per one million people in states with populations between two and six million. She pointed out that the Kansas audit staff ratio compares equally to other mid-western states. In addition, she noted that this information shows the importance of managing the Department's limited resources in a manner to leverage the highest compliance impact from each action taken, and it also means that creative programs such as self-managed audits need to be added to improve compliance activities. She concluded that requiring a set number of audits may not be the best way to ensure the highest level of compliance, and the requirement would not guarantee a significant increase in the amount of revenue raised. (Attachment 2)

CONTINUATION SHEET

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE  
Room 519-S, Statehouse, at 11:10 a.m. on February 21, 2000.

With regard to Senator Hensley's statement that corporate income tax collections fell \$54 million between 1998 and 1999, Secretary Pierce reminded the Committee that, in 1998, a Kansas corporate income taxpayer paid two very large tax payments amounting to over \$50 million. She believes that, for the most part, those payments account for the decrease in corporate collections the following year.

Following brief committee discussion, Senator Langworthy closed the hearing on **SB 616** and called the Committee's attention to a bill heard on January 31, **SB 410** which would provide benefits and incentives for statutory compliance by certain taxpayers. She reminded the Committee that the Department of Revenue requested the bill and called upon Shirley Sicilian, Department of Revenue, to assist in a review of the six provisions.

Senator Langworthy recalled that the Committee questioned the provision in New Section 6 allowing individual income taxpayers a \$2 credit (coupon) for filing electronically for tax years 2000 and 2001 as the fiscal note on this provision was at least \$720,000. Ms. Sicilian noted that immediately after the Department introduced the bill, the federal government announced that it would also be pursuing a credit of \$10 for every electronic filing. She also informed the Committee that, after the tax season began, the Department noticed a significant increase in electronic filing.

Senator Lee moved to delete New Section 6 from **SB 410**, seconded by Senator Donovan. The motion carried.

Senator Lee moved to report **SB 410** as amended favorable for passage, seconded by Senator Praeger. The motion carried.

The meeting was adjourned at 11:55 a.m.

The next meeting is scheduled for February 22, 2000.



# State of Kansas

## Senate Chamber



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## Senate Assessment and Taxation Committee

### Senate Bill No. 616

February 21, 2000

Senator Langworthy and Committee Members:

I testify today in support of Senate Bill No. 616, a bill which directs the Kansas Department of Revenue to perform at least as many corporate tax audits as the average monthly number conducted from 1996 to 1998. Similar language was contained in a proviso to Senate Bill 39, the Fiscal Year 2000 recession bill that was approved earlier this session.

Our caucus introduced this legislation after reading the attached news article in the *Lawrence Journal World*. The news article highlights the dramatic drop in the number of corporate tax audits performed by the Kansas Department of Revenue in the past few years. Since 1994, the number of corporate tax audits performed by the Department has fallen from 215 to only 26 in 1998. Over that same period, revenue collected from audits has fallen by over \$43 million.

This decline in corporate audits comes at a time when the number of Kansas corporations that generate more than \$500,000 in taxable income has risen by 42% from 1994 to 1998. Over that same period of time, the number of corporate audits on these businesses has decreased by 88%.

Secretary of Revenue Karla Pierce explained the dramatic drop in corporate audits when she stated, "We're experiencing a lot more voluntary compliance." If that were the case, shouldn't corporate tax revenue be increasing during this time of great economic boom? In reality, corporate income tax collections fell \$54 million last year, from \$281 million in FY 1998 to \$227 million in FY 1999. Through January of Fiscal Year 2000, corporate income taxes have fallen \$11.8 million below projections, the largest shortfall of all revenue sources.

I understand that the Department has been experiencing problems with the new computer system Project 2000. However, we can not afford to abandon important aspects of our revenue collection because of these problems.

Senate Assessment & Taxation  
2-21-00  
Attachment 1

Senate Bill 616 Testimony  
Senator Anthony Hensley  
February 21, 2000

It appears the Department's motto of "putting the customer first" applies more to some taxpayers than others. The other day, I overheard President Bond quote a former Senate Minority Leader who used to say, "when some pay less, others pay more." This bill will help to insure that Kansas corporations pay their share.

I urge you to pass Senate Bill 616.

# Corporate tax audits down

● **The state's kinder, gentler tax collector audits fewer big corporations these days, and the amount Kansas collects also is declining.**

BY DAVE RANNEY *Lawrence*  
JOURNAL-WORLD WRITER

11/28/99

Would you trust giant corporations such as General Motors, Exxon and Wal-Mart to file honest tax returns?

Increasingly, the Kansas Department of Revenue does.

Five years ago, the state's tax collector logged 215 corporate audits, resulting in assessments of \$56.38 million against the audited firms. In 1998, the latest year for which the revenue department has published reports, there were only 26 audits. Assessments were down to \$13.28 million.

The dramatic drop is part of the department's campaign to be more friendly toward large corporate taxpayers. Even before adopting its business-friendlier

stance, the agency rarely audited smaller businesses.

Nowadays, department officials claim, it's better to spend less time auditing and more time educating because most large corporations are honest and won't scrimp on their taxes, if they know not to.



Pierce

Pierce, state revenue secretary.

"We're experiencing a lot more voluntary compliance," said Karla

## \$54 million decline

But does a kinder, gentler revenue department put more money in the state treasury?

That's hard to say because there's no way to know how much a corporation would have paid if it had been audited.

A recent Kansas Legislative

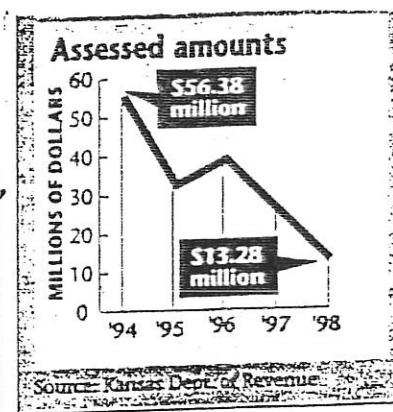
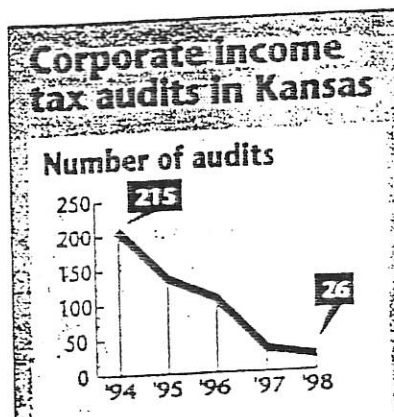
Research Department report shows that, despite a robust economy, corporate income tax collections last year fell \$54 million. There was \$281 million in corporate tax collected in fiscal 1998 versus \$227 million in fiscal 1999.

Pierce said revenues from the state's corporate income tax tend to fluctuate from year to year and aren't necessarily tied to the number of audits.

But others aren't so sure.

"Nobody likes to be audited," said Tom Docking, a Wichita lawyer who specializes in tax issues. "But, at the same time, audits play a very important role in fostering the basic belief that 'My fellow taxpayer is paying his fair share, so I should, too.'

"Without an active audit process, that belief, over time,



Source: Kansas Dept. of Revenue  
BARRY NICHOLS/JOURNAL-WORLD GRAPHIC

# Audits of corporations fall

Continued

will change to 'Others aren't following the rules, why should I?' and that's not good."

Docking said he was "surprised" to learn the revenue department is doing fewer audits.

But it is no surprise to Carol Bonebrake, a Topeka tax attorney.

## More firms, fewer audits

"I haven't seen many new audits coming across my desk, which was not the case four or five years ago," said Bonebrake, who was state director of taxation from 1983 to 1987.

"And I can tell you that customers I've heard from in the past because they were being audited, I haven't heard from lately," she said. "Now, maybe that's because they're dissatisfied with me, but I don't think that's the case. I suggest it's because they're not being audited. I think the numbers bear that out."

State records show that in 1994, there were 528 corporations whose Kansas operations generated more than \$500,000 in taxable income. That year, revenue officials conducted 215 corporate audits.

Last year, 750 corporations had

more than \$500,000 in taxable income. The department logged 26 audits.

Pierce said the decline in audits is a consequence of the state's 1997 Tax Equity and Fairness Act, enacted after a national business magazine ranked Kansas' tax-collection practices among the most hostile in the nation.

The new law forced the department to open many of its closed-door deliberations to those being audited and to give businesses more opportunity to settle disputes without going through a formal audit.

## Streamlined process

As the department adjusted to the new law, Pierce said, more resources were committed to its Project 2000, a five-year plan that calls for improved relations with taxpayers, installing an automated telephone system and switching to a computer system that officials hope will be state of the art.

"I don't mean to leave the impression that everything is fine," Pierce said. "I have three auditor positions that are vacant. I'd like to get those filled and I'd like to do more audits — more good audits — because I happen

to see audits and education as going hand in hand.

"As businesses change the way they do business, we need to be out there understanding how those changes affect our tax laws and what we need to do to ensure a level playing field," she said.

The department's new computer system eventually will streamline the process for deciding which corporations warrant audits, Pierce said.

"Once we get Project 2000 wrapped up, I think you'll see an increase or, at least, an improvement in audit activity," she said.

Some legislators say they're puzzled by the department's move toward fewer audits.

"I thought (Project 2000) was going to allow them to do more audits more swiftly," said Rep. Phill Kline, R-Shawnee, a key sponsor of the Tax Equity and Fairness Act.

"If that's not happening, I have to wonder why," he said.

**STATE OF KANSAS**

*Bill Graves, Governor*

**DEPARTMENT OF REVENUE**

*Karla J. Pierce, Secretary*

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**Office of the Secretary**

**Testimony**

**To:** Committee on Assessment & Taxation  
Chairperson Senator Langworthy

**From:** Karla Pierce, Secretary of Revenue

**Date:** February 21, 1999

Senator Langworthy and members of the committee, thank you for allowing me the opportunity to give you an update on the Kansas Department of Revenue corporate audit program. The state of the program is sound. Senate Bill 616, if enacted, would require the Department to complete a minimum number of audits, as measured by a baseline in fiscal year 2001. The fiscal impact of this requirement is likely to be zero in terms of state revenues for various reasons.

**Kansas Department of Revenue  
Corporate Audit Assessment Data**

This table reflects the corporate income tax audit assessment activity for the last five years.

Fiscal Year Ended June 30,	Number of Audits	Amount Assessed
1995	51	\$ 8,472,424
1996	113	\$ 39,568,715
1997	38	\$ 26,456,180
1998	26	\$ 13,284,918
1999	31	\$ 34,352,040

The main reason the numbers appear to have fallen is that we have changed the way we track the number of audit assessments. Prior to 1997, if we audited a large corporation with 25 subsidiaries it would be recorded as 26 audits. During and after 1997, we began recording this as one audit. We do not have the information readily available to correlate the two different methods.

*Senate Assessment & Taxation  
2-21-00  
Attachment 2*



I do want to take this opportunity to share with you some of the current trends in the corporate audit program. The key reasons that the potential for large corporate assessments have decreased over the last decade is listed below.

1) Law changes – Beginning in 1988, 80% of foreign dividends and 100% of foreign dividend gross-up are exempt from Kansas tax. Many taxpayers excluded these dividends from Kansas taxable income and we assessed it back on audit. This accounted for very large assessments. Because most of our audits are completed two to five years after the return year, we were still generating big dollars from the pre-1988 law well into the 1990s. In addition to law changes, there has been a court case that has further defined Kansas taxable income. This clarity has reduced the number of issues found upon audit, thus reducing the overall audit assessment.

2) Voluntary compliance - In the late 1980s, very few taxpayers were filing returns on a combined basis as required for unitary groups. Again, assessments from combinations were lucrative through mid -1990s due to the time delay. Starting in the early 1990s, most of the largest corporations started filing combined reports in Kansas due to both our prior audits and the prevailing law across the nation requiring combinations. Voluntary compliance with this issue increased dramatically during the 1990s.

3) Improved quality of audits to more accurately represent what is collectable. We used to make assessments based on very general guidelines. Audit would “get the numbers” along with a few facts, make the assessments, and let our attorneys flesh out the case. As you recall, this approach was not acceptable to the business community or legislature and was in part responsible for the Taxpayer Fairness Act in 1997.

In October 1996, the process was redesigned to fully develop and support the audit findings before making assessments. This big change was praised by the taxpayers and has sped up collections in many cases. We now resolve 74% of the audit findings prior to the issuing the final assessment. This approach does take longer to properly complete each audit.

4) Staff Turnover. We have not been at full staff for several years. It’s getting harder to recruit and especially retain good associates. Our starting salary is not competitive and the “career ladder” is non-existent. It may take several years before an income tax auditor is fully trained, confident, and productive. Over the last three years, we have lost seven or eight corporate income tax auditors...most of them just when they were getting up to speed. Of the eight positions assigned to corporation income tax auditing, we currently have three vacancies and two new staff members that are completing the extensive training required. This leaves three full performing auditors. To supplement our audit activity we have supervisors completing audits that were assigned to auditors who have resigned.

See  
chart

5) National trends show corporate income tax as a percent of total business taxes paid is going down. The shift to LLC and other ownership types cause income to be passed through to individual tax returns.

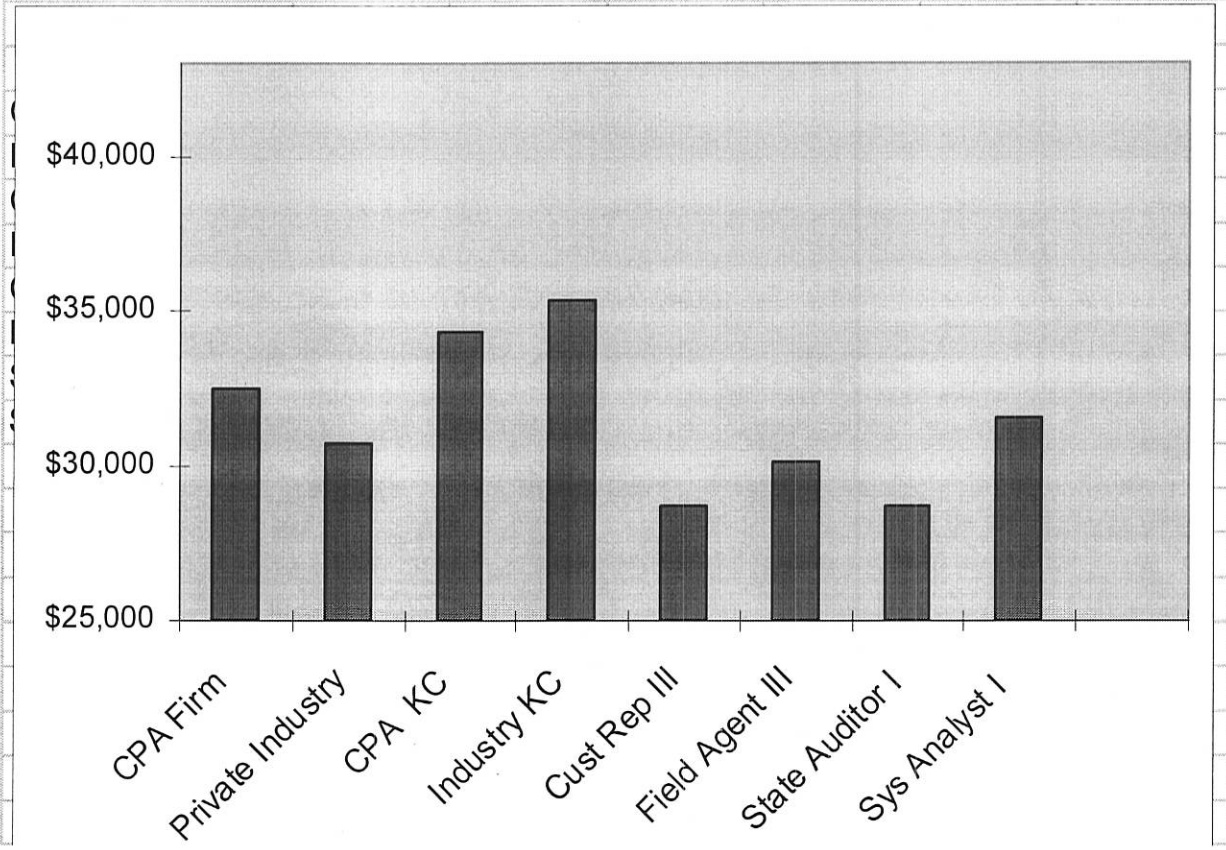
In 1999, as part of Project 2000, we installed software that we will use to improve audit selection. This software estimates the probability that a taxpayer is fully complying with the tax laws, much like a credit rating is assigned to individuals. This approach will allow the Department to assign our limited resources to cases that will most in need of audit attention. We are anxious to measure the effectiveness of this tool on our audit program in the coming years.

I have attached two charts showing starting salaries for state auditors compared to private sector and state jobs and a comparison of auditors per 1 million in state population to other states. As you can see Kansas lags behind in salary. Kansas audit staff ratio compares equally to other mid-western states. This information shows the importance of managing our limited resources in a manner to leverage the highest compliance impact from each action taken. It also means we must add creative programs such as self-managed audits and self audit questionnaires to improve compliance activities.

As Secretary of Revenue, one of my values is that taxpayers pay the right amount of tax pursuant to statute. By "right amount" I mean no more and no less than is required. I am provided a set amount of resource to maximize compliance with Kansas Tax Laws. Requiring a set number of audits may not be the best way to ensure the highest level of compliance, and can not be counted on to raise a significant amount of revenue.

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# SALARY COMPARISON



Developing a proposal similar to the programs we are using to recruit and retain Information Technology professionals.

Note: External data is from internet survey information on entry level auditing positions.

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# STATE COMPARISON

Number of auditors per 1 million people in states with populations between 2 and 6 million.

