Approved: February 3, 2000
Date

MINUTES OF THE SENATE COMMERCE COMMITTEE.

The meeting was called to order by Chairperson Alicia Salisbury at 8:00 a.m. on February 1, 2000 in Room 123-S of the Capitol.

All members were present except:

Committee staff present: Lynne Holt, Legislative Research Department
Jerry Ann Donaldson, Legislative Research Department
Bob Nugent, Revisor of Statutes
Betty Bomar, Secretary

Conferees appearing before the committee:
Lynne Holt, Legislative Research Department
Mikel Miller, Kansas, Inc.
Shirley K. Sicilian, Kansas Department of Revenue

Others attending: See attached list

SB 308 - Tax credits for contributions to public works

Lynne Holt, Legislative Research Department, reviewed a portion of the report by the 1999 Joint Committee on Economic Development on **SB 308**. She explained the the introduced version of **SB 308** authorizes up to $50 million in state tax credits over a five-year period (not to exceed $10 million per year) for investments in "qualified infrastructure projects." The bill establishes the Kansas Infrastructure Development Board to evaluate and approve grant applications to fund infrastructure projects based on criteria specified in the bill. The Committee held hearings during the 1999 Legislative Session and the bill was referred to a subcommittee. The subcommittee deliberations dealt primarily with the treatment of the tax credit, where the Kansas Infrastructure Development Board would be housed, the transferability of the proposed tax credits, the possible assignment of the program's administrative responsibilities to the Kansas Development Finance Authority and the potential conflict with its statutory mission. The Chairman requested the Legislative Coordinating Council refer the bill to the Joint Committee on Economic Development for further consideration. (Attachment 1)

The Joint Committee on Economic Development heard presentations in support of the bill over the interim and recommended that a substitute bill for **SB 308** be drafted to reflect the conceptual recommendations of the Kansas, Inc. staff as part of an analysis of the bill. The Joint Committee further recommended that the bill be referred to the Senate Commerce Committee for further consideration.

Mikel Miller, Kansas, Inc., stated Kansas, Inc.'s analysis of **SB 308** should not be construed as support by Kansas, Inc. of the legislation. Ms. Miller explained that the Joint Economic Development Committee asked Kansas, Inc. at its August 31st meeting, to perform an analysis of **SB 308**. The analysis was presented on November 3, 1999, and the Joint Committee accepted the recommendations and directed a substitute bill be drafted reflecting those recommendations. (Attachment 2)

The Proposed Substitute for **SB 308** creates a tax credit program closely fashioned after the Community Services Program administered by KDOC&H. The proposed program also would be administered by KDOC&H and would provide a 50% tax credit for individuals, businesses, and not-for-profit organizations making a charitable contribution to qualifying infrastructure development projects. The proposed bill provides a total allocation of up to $10 million in tax credits each year for a period of 5 years, not to exceed $50 million over the proposed 5-year life of the program.

Ms. Miller stated when considering the establishment of new economic development programs, the following questions must be addressed: 1) What is the overall goal of the program? 2) Would the program fill an identified gap or need? 3) Would the program duplicate existing programs? and 4) Would the program fit into the state's established economic development plan?

Ms. Miller stated that according to advocates of the bill, the goal of the program is to encourage the private sector's financial participation in a broad range of infrastructure development projects; increase the availability of funding for infrastructure development projects; and provide another tool for economic development practitioners when competing for and developing projects requiring infrastructure development.

Ms. Miller stated that the creation of a new tax program solely for the purpose of putting Kansas' economic development practitioners on an even playing field with Missouri when competing for projects does not constitute a real need, however; such a program would provide another tool for economic development in both metropolitan and more rural areas of the state.

Would the program duplicate existing programs? Ms. Miller stated there are presently two programs administered by KDOC&H which offer funding for infrastructure improvement. The Kansas Partnership Fund, designed to provide loans to local governing bodies to finance infrastructure projects related to basic enterprise development was last funded in 1993 and presently has approximately $1.4 million available for infrastructure loans. The second program is the Small Communities Development Block Grants (CDBG) which distributes federal HUD funds to local governmental agencies. Kansas, Inc. found very little, if any, of the CDBG funds are used for infrastructure improvement funds. The Department of Transportation provides a number of infrastructure improvement programs that are primarily for transportation-related infrastructure. A question was raised by the Joint Committee on Economic Development with regard to whether **SB 308** would duplicate of the Community Service Program (CSP). Ms. Miller replied that as written, Proposed Substitute **SB 308** would not duplicate the efforts of that program.

Does the program fit into the state's established economic development plan? Ms. Miller explained that the state's economic development strategy emphasizes the importance of public-private partnerships in building the state's economy and improving quality of life. The Redwood/Krider Report of 1986 identifies development and maintenance of public infrastructure systems as one of the seven foundations for economic development

Ms. Miller stated a determination must be made by policymakers as to whether the proposed program is of a high enough priority to merit funding. Although tax credits are not a direct appropriation, they must be allocated with care because they impact revenues the state ultimately has to spend for other programs.

One policy issued of concern to Kansas, Inc. is the broad-based nature of the definition of eligible projects contained in both the original and substitute **SB 308**. To facilitate better program administration and to clarify the objectives of the program, Ms. Miller recommended that the definition of eligible projects be rewritten to specifically define two categories of projects: "infrastructure development related to economic development projects" and "development and rehabilitation of public facilities." She noted the Joint Committee expressed an interest in allowing tax credits for other types of projects, such as prisons, municipal utilities, telecommunications facilities, and other projects not directly related to either an economic development project or the development of public facilities. Ms. Miller stated if the Committee determines that other types of projects should be eligible for tax credits that do not fit into the previously suggested categories, a third definition would need to be included.

Shirley K. Sicilian, Office of Policy & Research, Department of Revenue, submitted a table a comparing treatment of tax credit in the Proposed Substitute for **SB 308** with the Community Services Program. (Attachment 3) Ms. Sicilian also noted that contributions under the substitute for **SB 308** would likely qualify as a charitable contribution for federal tax purposes. Moreover, the credit could be transferred between taxpayers. The Department of Revenue recommends restricting transfers in the substitute for **SB 308** in a manner similar to the restrictions set forth for the old Kansas Business and Job credit, the tax credit for investment in certified Kansas venture capital companies, and tax credits authorized in the Community Service Program.

Ms. Sicilian stated the Proposed Substitute for **SB 308** has addressed several of the tax related points the Department felt needed clarification; however, she noted some points have not been addressed and outlined several provisions in the substitute bill that warranted further clarification.

The Committee, after clarification from Mikel Miller, determined almost any project appeared to be eligible for program investments based on the definition of "qualified infrastructure project"under the Proposed Substitute for **SB 308**.

Upon motion by Senator Steffes, seconded by Senator Ranson, the Minutes of the January 31, 2000, meeting were corrected by correctly spelling the name of Hal Hudson, and unanimously approved.

The meeting was adjourned at 9:00 a.m.

The next meeting is scheduled for February 2, 2000.

SENATE COMMERCE COMMITTEE GUEST LIST

DATE: February 1, 2000

NAME	REPRESENTING
Christy A. Caldwell	Gr. Topeka Chamber of Commerce
Bernie Koch	Wichita Area Chamber
Randy Allen	Kansas Association of Counties
Marlee Bertholf	KCCI
Ashley Sherard	Overland Park Chamber
Kathy Damron	KC K Chamber
Jon Josserand	KU
Don Seifert	City of Olathe
Kelly Kultala	City of Overland Park

Tax Credits for Private Contributions to Finance Community Infrastructure Projects (SB 308)

Conclusions and Recommendations

The Joint Committee on Economic Development recommends that a substitute bill for SB 308 be drafted and be referred to the Senate Commerce Committee for further consideration.

Background

Legislation Which is the Subject of Joint Committee Review. The Joint Committee on Economic Development reviewed the provisions and policy issues associated with 1999 SB 308. This bill would authorize up to $50 million in state tax credits over a five-year period (not to exceed $10 million per year) for investments in "qualified infrastructure projects" which are defined in the bill. The bill would establish the Kansas Infrastructure Development Board to evaluate and approve grant applications to fund infrastructure projects based on criteria specified in the bill. Tax credits would be authorized for up to 50 percent of the approved contributions to a fund established for infrastructure projects. Credits may be carried forward until exhausted or they may be transferred. If not exhausted, credits may be refunded to the taxpayer after five years. A similar tax credit program is currently administered by the Missouri Development Finance Board.

Legislative Action Prior to Interim Study. SB 308 was requested by the Overland Park Chamber of Commerce which viewed this program as a unique tool to encourage public-private partnerships for projects not otherwise served by existing state programs. The Senate Committee on Commerce held hearings during the 1999 Legislative Session on the bill. The bill was subsequently referred to a subcommittee chaired by Senator Nick Jordan. Issues that surfaced during subcommittee deliberations dealt primarily with the treatment of the tax credit and where the Kansas Infrastructure Development Board would be housed. Specifically, concerns were raised about the transferability of the proposed tax credits and the possible assignment of the program's administrative responsibilities to the Kansas Development Finance Authority (the Missouri Development Finance Board's counterpart). In discussions with the subcommittee, the Kansas Development Finance Authority staff observed that the program could potentially conflict with its statutory mission. Senator Alicia Salisbury, Chairman of the Senate Committee on Commerce, subsequently requested the Legislative Coordinating Council refer this bill and associated policy issues to the Joint Committee on Economic Development for further consideration.

Committee Activities

Arguments Raised by Conferees in Support of the Bill. The Joint Committee on Economic Development heard presentations in support of the bill from representatives of: several chambers of commerce—Overland Park, Lenexa, Topeka, and Kansas City; the Kansas Chamber of Commerce and Industry; the Kansas Association of Counties; the Olathe City Council; the Unified Government of Wyandotte County and Kansas City, Kansas; the Kansas City Area Council; and the Kansas Development Finance Authority. Arguments for the bill included the following:

- private entities and communities would be encouraged to form partnerships to plan and finance community projects;

Senate Commerce Committee
Date: 2-01-00

Attachment # 1-1 thru 1-7

- available funding for infrastructure projects could be increased;
- local community revitalization efforts could be enhanced;
- a means would be provided to alleviate the disparity in competitive tools necessary to attract and retain businesses in Johnson County and Northeast Kansas (according to testimony from the Greater Kansas City Chamber of Commerce, the tax credit program in Missouri was reported to have been instrumental in securing the relocation of major companies, such as Harley Davidson and Gateway 2000 in Kansas City, Missouri); and
- the program could strongly complement two existing programs administered by the Kansas Department of Commerce and Housing—Investments in Major Projects and Comprehensive Training (IMPACT) and Kansas Economic Opportunity Initiatives Fund (KEOIF)—that seek to encourage location and expansion of business in Kansas.

Policy Issues Raised by Committee Members and Conferees. In the course of Committee deliberations on the bill, Committee members raised several policy issues pertaining to SB 308. Moreover, even though no opponents testified on the bill, several conferees (Kansas Department of Commerce and Housing, Kansas Department of Revenue, the Unified Government of Wyandotte County and Kansas City, Kansas, and the Kansas Development Finance Authority) raised policy or technical issues and concerns in their testimony. Following the hearing on the bill, the conferee from the Overland Park Chamber of Commerce presented a list of policy issues for consideration in Committee discussion of the bill. The Committee subsequently requested Kansas, Inc. staff to provide an analysis, with recommendations, regarding the policy issues associated with SB 308. This analysis, with recommendations and justifications, was presented to the Committee on November 3, 1999. The key recommendations are summarized in the Conclusions and Recommendations section below.

Policy issues underlying the bill could be categorized into two sections:

- need for the tax credit program; and
- assuming the need for the program is established, the design of the program.

The following summary corresponds to policy issues addressed by Kansas, Inc. in its analysis of SB 308. For each policy issue, there is an explanation of how that issue is addressed in the introduced version of SB 308; how it is addressed in Missouri's tax credit program; Committee members' and conferees' concerns raised with that issue; and Kansas, Inc.'s recommendations and rationale for those recommendations.

- ***Need for the Tax Credit Program***
  - Issues to be considered are:
    - The overall goal of the program
    - Any identified gap or need to be filled
    - Duplication, if any, of existing programs
    - The incorporation of the program into the state's established economic development plan
- ***Design of Program***
  - <u>**Administration of Program**</u>. SB 308 provides for the creation of a new board (the Kansas Infrastructure Development Board), not affiliated with an existing agency, to administer the program. In Missouri, this tax credit program is one of many such programs administered by the Missouri Development Finance Board. The Committee and conferees raised the prospect of authorizing an existing agency, such as the Kansas Department of Commerce and Housing, to assume those administrative responsibilities.

Kansas, Inc. Recommendation. The bill should charge the Department of Commerce and Housing with administration of the program rather than establishing a new board, as proposed by SB 308.

Kansas, Inc. Rationale. The Department of Commerce and Housing has administered the Community Services Program since its inception in 1994. The expertise gained in administering that program would enhance the smooth development of the tax credit program proposed in the substitute bill.

- <u>Possession and Administration of Contributions</u>. SB 308 would assign management of the Kansas Infrastructure Development Fund and distribution of moneys from the Fund to the Kansas Infrastructure Development Board. This is similar to the centralized approach adopted in Missouri. The question raised concerning management or distribution of program funds is whether a centralized approach is better than a localized approach.

Kansas, Inc. Recommendation. The bill should require possession and management of contributions to remain with the sponsoring local development authority rather than establishing a statewide depository, as proposed by SB 308.

Kansas, Inc. Rationale. To maintain and manage the Kansas Infrastructure Development Fund, established in S.B. 308, on a statewide basis, would require considerable staffing and expense. With proper accountability measures in place, local possession and disposition of contributions are deemed preferable.

- <u>Earmarking the Contribution</u>. SB 308 provides that contributions would not be earmarked for specific projects and would be credited to the Kansas Infrastructure Development Fund. In Missouri's program, contributions are made to Missouri's infrastructure fund; projects are linked to contributors in practice but not in statute. Department of Revenue staff advised the Committee that explicit earmarking could jeopardize the charitable status of a contribution for federal tax purposes. The Committee raised the question of the most effective way of linking contributions to donors without jeopardizing a contribution's charitable tax status.

Kansas, Inc. Recommendation. Eligible projects should be allocated tax credits through an application process similar to the application process currently used in the Community Services Program. (See Conclusions and Recommendations for a brief summary of the Community Services Program application process.)

Kansas, Inc. Rationale. Very few contributions were made blindly to Missouri's infrastructure fund. In fact, donors only contribute to projects in which they have an interest. In response to this situation, the Missouri Development Finance Board adjusted the program (but not the statute) to link contributions to specific projects. The Community Services Program is structured in such a way as to recognize that linkage in statute.

- <u>Basis for Evaluation of Project Applications</u>. Like Missouri's program, SB 308 assumes applications should be considered on a first-come, first-serve basis. Testimony from the Kansas Department of Commerce and Housing raised the policy question about the optimal basis for using limited resources most effectively. Specifically, should the program be operated on a first-come, first-serve basis or should the program be oper-

1-3

ated on a competitive basis like most programs administered by the Department?

Kansas, Inc. Recommendation. No specific statutory provision is necessary regarding whether applications should be considered on a first-come, first-serve or on a competitive round basis.

Kansas, Inc. Rationale. Kansas, Inc. believes that the most effectively managed programs are those which allow the responsible agency the flexibility to establish and adapt internal policy in response to program usage and need. Allowing the Department of Commerce and Housing the flexibility to adjust the program as necessary to meet the established legislative goals is preferable to statutorily binding the Department to program management requirements that may or may not ultimately be the most effective means to achieve legislative goals.

- **Tax Credit Limit Per Donor**. Like Missouri's program, SB 308 includes no provision to limit the size of individual contributions. Missouri's program allows the Board to allocate credits over a number of years for larger projects so that the annual allocation ($10 million limit) is not overburdened. A policy question raising this concern was addressed in testimony of the Kansas Department of Commerce and Housing.

Kansas, Inc. Recommendation. There should be no statutory limit on the size of contribution per donor, nor on the size of the project given Missouri's experience and the demonstrated ability of the Department of Commerce and Housing to manage limited resources. Moreover, the Department has annual reporting requirements.

Kansas, Inc. Rationale. Kansas, Inc. believes that the leadership of the Department of Commerce and Housing has demonstrated the ability to make fair and reasonable funding decisions among the diverse communities of the state and that a statutory limitation on the size of projects or individual contributions would unnecessarily restrict the program's effectiveness. Nonetheless, the Department should not be prohibited from establishing internal policy with which to manage, as necessary, potential overburdening of the annual allocation attributable to the approval of one or more large projects.

- **Special Consideration for Rural or Blighted Areas**. SB 308 includes no special provision for rural or blighted areas as criteria for the Kansas Infrastructure Development Board's evaluation of a project application. Nonetheless, the definition of a "qualified infrastructure project" includes, among others, the acquisition of blighted real estate and the demolition of existing structures. In contrast to the proposed program in SB 308, Missouri's program includes a criterion that a contribution may be used to assist the development of a "blighted area." The issue of dedicating a portion of the funding to blighted areas was raised in testimony from the Unified Government of Wyandotte County and Kansas City, Kansas. A Committee member recommended that language be added to the bill to ensure that rural counties receive a certain percentage of funding.

Kansas, Inc. Recommendation. There should be no special provision for rural or blighted areas in view of the demonstrated sensitivity of the Department of Commerce and Housing to these issues and its annual reporting requirements which will provide monitoring of program usage.

Kansas, Inc. Rationale. In Kansas, Inc.'s experience, when inequities in resource allocation have been identified, the underlying explanation can be that fewer requests for allocations are received from rural areas than from urban areas of the state. It is the policy of the Department of Commerce and Housing to concentrate its marketing efforts on nonmetropolitan communities and to provide special technical assistance when necessary to nonmetropolitan applicants applying for funding and other resources. In addition, the Department would not be prohibited, as a matter of internal policy, from setting aside a portion of the tax credit allocation for rural or blighted areas (or both), if necessary.

- <u>**Project Eligibility**</u>. SB 308 would define "qualified infrastructure projects" to include "the purchase, construction, extension and improvement of real estate, buildings, structures or facilities, whether presently existing or not, used or to be used for highways, roads, bridges, water supply and distribution systems, mass transportation facilities and equipment, telecommunications facilities, sewers and sewage treatment systems, airports, railroads, reservoirs, dams and waterways, acquisition of blighted real estate and any improvements thereon, demolition of existing structures and preparation of sites in anticipation of future development, public facilities and other improvements provided by any infrastructure development agency, the fixtures, equipment and machinery necessary to carry out such projects, any demolition or relocation expenses associated with the project and any capital used to promote or facilitate such projects." Missouri's law authorizes tax credits for projects that are infrastructure facilities, economic development facilities, and job training or other vocational training facilities. Committee members raised a concern about the broad-based nature of the definition in SB 308. This concern ties back to the policy issues regarding the objectives of the bill and whether the program proposed in the bill duplicates existing programs.

Kansas, Inc. Recommendation. If the Legislature determines that the broad range of projects currently funded in Missouri should be eligible for tax credits under SB 308, the definition of infrastructure development projects currently contained in SB 308 should be tightened and a substitute bill should specifically allow for and define two additional categories: (1) economic development projects, and (2) public facilities projects.

Kansas, Inc. Rationale. The definition of eligible projects currently contained in SB 308 was developed using Missouri's definition which includes the broad range of projects. However, Kansas, Inc. believes the definition contained in SB 308 would not provide authority for the broader range of projects in which the Committee expressed interest.

- <u>**Treatment of Tax Credits**</u>. SB 308 would allow tax credits to be carried forward for up to five years. If not used by five years, any unused credits would be refundable. The bill also would allow credits to be sold or transferred. Like SB 308, Missouri's law provides for tax credits to be carried forward for up to five years. Missouri's law allows for tax credits to be transferred but, in contrast to SB 308, not refunded. Department of Revenue staff recommended that tax credits be refunded and not transferred if the tax credit exceeds the taxpayer's liability as it is, in staff's view, simpler and less costly to administer tax refunds than tax transfers. The Department of Revenue staff contrasted the transferability provisions in SB 308, in addition to other tax provisions, to the tax provisions governing contributors to the Community Services Program. In the latter program, taxpayers are only allowed to transfer their tax credit one time for the full amount and not an unlimited number of times, as is apparently permitted in SB 308.

SB 308 also contains no provision to limit tax credits that may be carried forward in the event there is a revenue shortfall. Missouri's law also contains no such provision but does limit total tax credits awarded in a given year to the greater of $10 million or 5 percent of the average growth in general revenue receipts in the preceding three fiscal years. The policy concern about flexibility in SB 308 to respond to revenue shortfalls was raised by Committee members, particularly in light of the projected revenue shortfall for FY 2001.

Kansas, Inc. Recommendations. The following recommendations pertain to the schedule for claiming tax credits, refundability, and transferability.

- With respect to the schedule for claiming credits, it is recommended that the substitute bill require the Secretary of Revenue to limit the amount of credits to be claimed each year and process those claims on a first-come, first-serve basis.

Kansas, Inc. Rationale. According to Department of Revenue staff, limiting the amount of tax credits that can be processed by the Secretary is the most effective way to protect the state from excessive or erratic claims against revenues when a carryforward of credits is allowed. This method is currently used for credits allowed under the Community Services Program.

- With respect to refundability as opposed to transferability of credits for Kansas taxpayers, it is recommended that the substitute bill allow refundability for Kansas taxpayers whose tax credit exceeds their liability.

Kansas, Inc. Rationale. From a fiscal standpoint, there is little difference between a refundable credit and a transferable credit. If a taxpayer cannot use a tax credit because he or she lacks sufficient tax liability, he or she can transfer (or sell) the credit to someone who can. However, the Department of Revenue states that it is less complex and costly to administer a refundable credit than a transferable credit. The Department estimated that transferability would add $185,292 (one time cost) to the total cost of administering SB 308, as originally written. Since the fiscal impact is the same, the Department recommends allowing Kansas taxpayers a refund should their tax credits exceed their tax liability.

- With respect to transferability, it is recommended that the substitute bill allow for transferability only in the case of a contributor not subject to Kansas income, premium, or privilege tax.

Kansas, Inc. Rationale. Without such a provision, there would be no incentive for contributors who are not subject to Kansas income, premium, or privilege tax to make a contribution.

Conclusions and Recommendations

The Joint Committee on Economic Development recommends that a substitute bill for SB 308 be drafted and be referred to the Senate Commerce Committee for further consideration. The substitute bill should reflect the conceptual recommendations of the Kansas, Inc. staff. These recommendations stem from the staff's analysis of the bill which was requested by and subsequently presented to the Committee. (See the section on Committee Activities.)

In broad terms, the proposed substitute bill would transform the mechanism for funding community development infrastructure projects from a grant program administered by a freestanding board with tax credits authorized for eligible investors to a program which is exclusively tax-credit based. Kansas, Inc. staff recommended a modified version of the Community Services Program as a model for the tax credit program in SB 308. Specifically, the proposed substitute bill would reflect the following key amendments.

Administration. The substitute bill would require the Kansas Department of Commerce and Housing to administer the Kansas infrastructure development tax credit program rather than establishing a new board, as proposed in the introduced version of the bill. The Department has administered the Community Services Program since its inception in 1994. The expertise gained in administering that program, according to staff of Kansas, Inc., would enhance the smooth development of the tax credit program proposed in the substitute bill.

Similarities to Kansas Community Services Program. The substitute bill would require the Kansas Department of Commerce and Housing to administer the proposed program in a similar manner to the Community Services Program. In the substitute bill, eligible infrastructure, economic development, and public facilities projects would be allocated tax credits through an application process similar to the application process currently used in the Community Services Program. That program's application process requires the sponsoring organization to submit an application for a community services project which is then reviewed by a three-member committee appointed by the Director of Community Development in the Department. Community services projects must include specified low-income assistance activities, crime prevention, or health care services. Applications are reviewed based on merits of each project. Applications containing pledges for contributions are considered more favorably than those without pledges. If approved, the sponsoring organization is authorized to offer tax credits to qualified contributors.

When qualified contributions are actually made, the donor completes a tax credit application which is reviewed by Community Services Program staff. If approved, the amount of the credit is deducted from the sponsoring organization's balance. Contributors claim the credit in accordance with the statute by submitting the approved tax credit application with their tax return.

Differences from Kansas Community Services Program. The substitute bill would treat tax credits for investments in infrastructure and other eligible projects somewhat differently from Community Services Program tax credits.

- The limit on the amount of credits authorized for the Community Services Program per year is $5 million, whereas the substitute bill would authorize up to $10 million per year.
- Community Services Program tax credits are transferable, whereas tax credits exceeding liability would generally be refundable in the substitute bill. However, as in the Community Services Program, the substitute bill would authorize the transfer of tax credits from contributors (nonprofit entities and out-of-state investors) who are not subject to Kansas income, premium, or privilege taxes to Kansas taxpayers who have tax liability.
- Eligible contributors under the Community Services Program are businesses only, whereas eligible contributors in the substitute bill could be businesses, as well as individuals and federal or political subdivisions of Kansas.

Elimination of Kansas Infrastructure Development Fund. The substitute bill would eliminate the need for the Kansas Infrastructure Development Fund (proposed in the introduced version of the bill) to which contributions could be credited and from which grants could be disbursed. Because the model for restructuring the funding mechanism would be the Community Services Program, no grants would be made for eligible projects.

Kansas, Inc. Testimony
Substitute for SB 308
Presented to
Senate Commerce Committee

by Mikel Miller

February 1, 2000

Thank you Madam Chairman and members of the Committee. In submitting this testimony, let me emphasize that this analysis should not be construed as constituting Kansas, Inc.'s support for the Proposed Substitute for SB 308, nor our opposition thereto.

Background: At its August 31st meeting, the Joint Economic Development Committee asked Kansas, Inc. to perform an analysis of SB 308. That analysis was presented on November 3, 1999. The Joint Committee accepted the recommendations made in that report and directed a substitute bill be drafting reflecting those recommendations.

The Proposed Substitute for SB 308 would create a tax credit program closely fashioned after the Community Services Tax Credit Program administered by the Kansas Department of Commerce & Housing. The new program, also to be administered by KDOC&H would provide a 50% tax credit for individuals, businesses, and not-for-profit organizations making a charitable contribution to qualifying infrastructure development projects. The Proposed Substitute for SB 308 would provide a total allocation of up to $10 million in tax credits each year for a period of 5 years, not to exceed $50 million over the proposed 5-year life of the program.

Suggested Methodology for Decision makers: When considering the establishment of a new economic development program, policymakers must objectively answer the following four questions.

- What is the overall goal of the program?
- Would the program fill an identified gap or need?
- Would the program duplicate existing programs?
- Would the program fit into the state's established economic development plan?

Once these questions have been answered, policy makers must then make a more subjective determination of whether the program is important enough to merit funding.

- Where among the list of funding priorities does this program rank?

The following offers a discussion of these questions with regard to the Proposed Substitute for SB 308.

What is the overall goal of the program? As purported by its advocates, the goal of the program is to 1) encourage the private sector's financial participation ir

Senate Commerce Committee
Date: 2-01-00

Attachment # 2-1 thru 2-5

infrastructure development projects; 2) increase the availability of funding for infrastructure development projects; and 3) provide another tool for economic development practitioners when competing for and developing projects requiring infrastructure development.

Would the program meet an identified need? Few would argue that creation of this new tax credit program is essential for the continued economic development of Kansas. However, proponents believe that Missouri's tax credit program, upon which the proposed program was modeled, puts Kansas' economic development practitioners at a disadvantage when competing for projects against Missouri. This, in itself, does not constitute real need, however, it is clear such a program would provide another tool for economic development practitioners in both metropolitan and more rural areas of the state.

Does the proposed program duplicate existing programs? Two programs, administered by KDOC&H currently offer funding for infrastructure improvements. The Kansas Partnership Fund, created in 1988, was designed to provide loans to local governing bodies to finance infrastructure projects related to basic enterprise development. The Partnership Program was last funded in 1993 and presently has approximately $1.4 million available for infrastructure loans.

The second program, the Small Communities Development Block Grants (CDBG) program distributes federal HUD funds to local governmental agencies. Funding is available through the CDBG program for public infrastructure improvements that directly create or retain permanent jobs. In addition, funding is available for community improvement projects such as water and sewer improvements, fire protection, bridges, community and senior centers, streets, architectural barrier removal, utilities, public service activities, and nonprofit entities. <u>Only communities that meet HUD's low to moderate income standards are eligible for CDBG funding through the State of Kansas</u>. The larger communities of Kansas City, Topeka, Wichita, Lawrence, Johnson County, and Leavenworth receive CDBG funding directly from HUD to use as each entity deems appropriate. When contacted, officials from these communities reported that very little, if any, of their community's block grant funding is used for what might be considered infrastructure improvement projects. Even in those instances, they report that improvements are almost always linked to residential projects citing the HUD requirement that beneficiaries of funds meet low-to-moderate income standards.

The Department of Transportation also provides a number of infrastructure improvement programs that provide funding to communities for improvement of transportation-related infrastructure. Many of these programs are grant programs which require matching funds from the local governmental agency. The Secretary of Transportation reports that the program most similar to the Proposed Substitute for SB 308 is a new program authorized by the 1999 Comprehensive Transportation Program. This program, currently under development, establishes a revolving fund to provide assistance in the form of loans, credit enhancements, or grants to governmental units for transportation projects. According to the Secretary of Transportation, the new program is intended to provide assistance to local entities or private enterprise acting on behalf of a local entity in development of transportation facility improvements.

In previous hearings discussion arose with regard to whether the proposed program was duplicative of the Community Service Tax Credit Program (CSP) administered by KDOC&H. The CSP program provides tax credits to businesses for contributions to organizations providing community services such as educational and social services for children, health care, and crime prevention. While organizations are not precluded from using contributions for infrastructure improvements, the improvements must be in connection with a community services project. As written, the Proposed Substitute for SB 308 would not duplicate the efforts of the CSP program.

Does the program fit into the state's established economic development plan? An integral ingredient for any economic development project is the infrastructure required to support the enterprise. The Redwood/Krider Report of 1986 identifies the development and maintenance of public infrastructure systems including roads, utilities, business sites, and telecommunications as one of the seven foundations for economic development.

"A Kansas Vision for the 21st Century," the state's strategic plan for economic development, also recognizes the importance of the state's infrastructure and has as its fourth goal to

> *"Maintain and improve the public and private infrastructure essential for growth and development."*

The state's economic development strategy also emphasizes the importance of public-private partnerships in building the state's economy and improving our quality of life.

Where among the list of funding priorities does this program rank? Having answered the first four questions, policymakers must then make a determination whether the proposed program is of a high enough priority to merit *funding*. As we know, while tax credits are not a direct appropriation and are not represented by a line item in any appropriations bill, they must be allocated with care because they impact revenues the state will ultimately have to spend for other programs.

Policy Concerns Addressed by the Proposed Substitute for SB 308

As mentioned earlier, Kansas, Inc. presented an analysis of the original SB 308 to the Joint Committee on Economic Development in November 1999. The Committee directed that those recommendations be incorporated into the proposed substitute bill before you today. Those recommendations relate to:

- program administration
- possession and management of contributions
- scope of eligible projects
- application process
- schedule and method for claiming credits
- refundability and transferability

Kansas, Inc. also presented recommendations regarding other concerns or policy issues raised by the Joint Committee. These included:

- method for consideration of applications
- limits on size of contribution
- special provisions for rural or blighted areas.

With respect to these, Kansas, Inc.'s analysis concluded that the most effectively managed programs are those which allow the responsible agency the flexibility to establish and adapt internal policy in response to program usage and need. Accordingly, allowing the Department the flexibility to adjust the program as necessary to meet the established legislative goals is preferable to statutorily tying the Department's hands with program management requirements that may or may not ultimately be the most effective means to achieve legislative goals.

With that in mind, Kansas, Inc. made no recommendation that these issues be addressed statutorily.

Policy Concerns left unaddressed by the Proposed Substitute Bill

One policy issue of concern still exists with regard to the broad-based nature of the definition of eligible projects contained in the original SB 308 and again in its substitute. In earlier testimony, proponents of the bill gave examples of the types of projects Missouri has funded with its program. These examples included two major types of projects.

> 1) **infrastructure development related to economic development projects** (Harley Davidson, American Pasta, etc.); and
>
> 2) **development and rehabilitation of public facilities** (Central Medical Center, Main Street Revitalization, Three Rivers Community College, Union Station Science City).
>
> To facilitate better program administration and to clarify the objectives of the program, it is recommended that the definition of eligible projects currently contained in the proposed bill be rewritten to specifically define these two categories of projects.
>
> The following is an example of a more specific definition of **infrastructure development related to economic development projects**:
>
>> *Eligible projects shall include but be not limited to the construction, reconstruction, rehabilitation, alteration, expansion or improvement of publicly owned infrastructure in connection with an economic development project including, but not limited to roads, streets, highways, storm drains, water supply treatment facilities and distribution lines, wastewater collection lines and any related improvements.*

A similar definition for **development and rehabilitation of public facilities** projects should be constructed.. As with Missouri's program, eligible projects in this category would not be limited to infrastructure improvement but would also allow for the purchase, demolition, or rehabilitation of real estate and buildings, purchasing fixtures, and other expenditures necessary to complete the approved project. Examples of such projects might include the construction and rehabilitation of publicly owned nursing or retirement facilities, job training or vocational educational facilities, public school improvements, and cultural or recreational facilities available to the general public.

Committee members also expressed interest in allowing tax credits for **other types of projects** that would not fall into the two categories above. Examples cited were prisons, municipal utilities, telecommunications facilities, and other projects not directly related to either an economic development projects or the development of public facilities. Should this committee determine that a broader base of projects should be eligible for tax credits, a third definition should be constructed to encompass those types of projects.

Other technical amendments. A number of technical amendments are recommended and have been communicated to the revisor.

This concludes my testimony. Thank you Madam Chairman for the opportunity to be here today. I now stand for questions related to today's testimony or recommendations presented to the Joint Committee on Economic Development.

STATE OF KANSAS
Bill Graves, Governor

DEPARTMENT OF REVENUE
Karla Pierce, Secretary

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

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

Office of Policy & Research

TESTIMONY

To:	Senator Salisbury Chair, Senate Commerce Committee
From:	Shirley K. Sicilian
Re:	**Senate Bill 308 – tax credit for private contributions to finance community development**
Date:	February 1, 2000

Senator Salisbury and members of the committee, thank you very much for the opportunity to testify today regarding senate bill 308. During the 1999 session I was asked to compare S.B. 308 with the existing Kansas Community Services Program Credit. (K.S.A. 79-32,194 *et seq.*) The Kansas Community Services Program Credit was extensively amended last session, and there are proposals for extensive amendment to SB 308, so I am providing an update of that comparison. Last session, the committee had also been interested in the potential federal tax treatment of contributions made to the Kansas infrastructure development fund under SB 308, so I will provide some information on that issue. Also, I will briefly address administrative issues with the credit transfer capability. Lastly, I will note a few sections of the bill that the department would request be amended either for ease of administration, or because we believe technical clean-up is necessary to read as intended.

1. Comparison of the SB 308 substitute with the Community Services Program Credit. Significant differences exist between the newly amended Community Services Program Credit and SB 308 substitute. The table below summarizes key aspects of the Community Services Program Credit and SB 308 (changes due to the substitute are in italics.)

	Community Service Credit	**SB 308 (*w/ amends. in sub.*)**
Credits authorized per year	$5 million	$10 million
Maximum credits per year	$5 million	No limit
Refundable	Yes, non-transferred credits	Yes, *after 5 years*
Carry-forward period	Transferred credits: 5 years, w/in 10 years of contribution	5 years, unless transferred, then 10 years
Credit may be transferred	By non Ks TP, once, full amount,	~~No limit~~ *By non Ks TP, in part or multiple times*
Credits authorized by	Revenue, KDoC&H	Revenue, ~~KIDB~~ *KDoC&H*
Time period during which contributions may be made	Any tax year beginning after 1/1/94	Tax years beginning between 12/31/00 and 1/1/06
Eligible contributors	business	

Senate Commerce Committee
Date: 2-01-00
Attachment # 3-1 thru 3-4

		political subdivision of Kansas
Eligible contribution	cash, services, property (inc. real estate and securities)	Cash, real estate, securities
Contribution to	Community service org. or govt. Entity	~~Ks Infrastructure Dev. Board~~ *Infrastructure dev. agency*
Share of contributions eligible	50 %; rural = 70 %	50 %
Eligible federal deduction as a charitable contribution	depends on the organization contribution is made to	likely is deductible under most circumstances
Add back to Kansas AGI	Yes	No

2. Potential federal tax treatment.

Briefly, our analysis indicates that contributions under the substitute for SB 308 would likely qualify as a charitable contribution for federal tax purposes. The federal government allows both corporations and individuals to deduct contributions made to charitable organizations. Contributions made to federal, state and local governments are eligible if the contribution is made solely for public purposes. Although some projects under SB 308 might benefit specific individuals or organizations, such benefits appear to fit within the eligibility requirements for charitable contributions. If a project would have a disproportionate benefit to a contributor, the deduction may be reduced proportionately. Only if a project contribution were to be earmarked for a specific recipient or beneficiary does the contribution appear to be completely ineligible as a deduction under federal income taxes. Our examination does not include all special cases, and is certainly not binding upon the IRS. The IRS recommends that taxpayers contact either the IRS or the charitable organization if there is doubt as to the deductibility of any contribution.

3. Transferability.

Under the substitute for SB 308 the credit could be transferred between taxpayers. There are currently three credits in Kansas that may be transferred, but only under restricted circumstances: 1) the old Kansas Business and Job Credit (K.S.A. 79-32,153; see K.S.A. 79-32,156), 2) the tax credit for investment in certified Kansas venture capital companies (K.S.A. 74-8304), and 3) the community service program tax credit (K.S.A. 79-32,194).

The department recommends restricting transfers in the substitute for SB 308 in a manner similar to the restrictions in the other three transferable credits. Entities transferring a credit would only be allowed to be transferred once, and then for the entire amount. Credits in excess of liability should be made refundable, unless the committee feels that carry forwards are essential. Transferred and nontransferred credits should be treated similarly with respect to carry forwards and refunds.

4. Potential clarifications.

SB 308, as introduced presented several tax related points that the department felt deserved clarification. The proposed substitute for SB 308 addresses several of those points. However, some points have not been addressed and a few additional points are raised.

The substitute addresses concerns over how the credit would be carried over, and ensures that the full amount of the credit is not claimed for each year into which the credit is carried over.

The substitute bill for SB 308 does not address several concerns raised with the original bill, including:

- Sections 3 and 4 of the Substitute. This original bill created an Infrastructure Development Board charged with adopting rules and regulations to administer the act. Under the substitute, the Board is no longer created and these responsibilities are apparently transferred to the Secretary of Commerce and Housing. However, the language is unclear regarding which agencies have responsibility for which aspects of the program. By statute, the Department of Revenue is charged with administration of the income tax and financial institutions privilege taxes, including administration of credits against those taxes. Our understanding of the bill's intent is that Commerce and Housing would administer the *program* created by this act, including the approval and administration of applications. But that the Department of Revenue would administer the *tax credit* created by this act, including determination of whether Commerce and Housing has approved an application, determination of the amount of carry-over credit for each taxpayer, and determination of whether the cumulative amount of credit authorized in any one [fiscal] year has reached $10,000,000. Perhaps language could be amended to clarify the division of responsibility between the secretary of revenue and the secretary of commerce.
- Section 2(b) of the Substitute. This section states the secretary of revenue shall "authorize" not more than $10,000,000 in tax credits. If the intent is to limit the amount of credit "allowed" in any one year, the language needs to be changed. Proposed amendments to SB 308, suggested during the interim session, would limit the credit allowed in any one fiscal year to $10,000,000 on a first come first serve basis.
- Section 2(a) of the Substitute. This section is not clear how carry forward rules for transfers, in section 2(b), affect the "5 year carryover then refund" rule. Proposed amendments to SB 308, suggested during the interim session, eliminate the carryover provisions and treat transferred and nontransferred credits similarly. Utilization of the credit by transferees would be subject to the same requirements as credits generated by other taxpayers.
- As indicated above, the substitute for SB 308 does not address several issues relating to transfers of credits. We request the bill require entities transferring a credit to transfer the entire credit, and specify that only one such transfer may occur.
- As indicated above, some taxpayers may be able to claim contributions as a charitable deduction for federal tax purposes. The substitute does not require taxpayers to add back any amounts previously deducted.

New concerns raised with the substitute for SB 308 include:

- The definition of contributor in section 1(b) may not require a contribution to actually take place.
- "Secretary" is used throughout the bill, and it is sometimes unclear if the instruction refers to the secretary of revenue or the secretary of housing and commerce.
- The bill makes reference to the secretary of revenue authorizing tax credits and instructs a "secretary" to approve or deny tax credit applications. We suggest the credit substantively function in the same manner as the Community Service Program, where the department of commerce and housing would handle administration of most, if not all, functions other than ensuring taxpayers only claim credits to which they are properly entitled.
- The substitute requires the secretary of revenue to allocate credits, without defining credit allocation, in the order approved by the secretary of commerce and housing. Tax returns are unlikely to be received in the order approved by commerce and housing. The bill should remove or replace this language.
- Several of the conditions a "secretary" is instructed to consider in approving tax credit application include determining the net benefit of the contribution to the contributor; if the contributor benefits at all, either directly or indirectly; if the credits will impose financial

hardship upon the state; or if the project will impose financial hardship upon local government revenues. The bill does not indicate who will make these determinations.

A comparison between the substitute for SB 308 and proposed amendments, some suggested during the interim session, is summarized below:

	SB 308 (*w/ amends. in sub.*)	**SB 308 (*Kdor proposed*)**
Credits authorized per year	$10 million	$10 million
Maximum credits per year	No limit	~~No limit~~ ***$10 million***
Refundable	Yes, *after 5 years*	Yes, ~~*after 5 years*~~
Carry-forward period	5 years, unless transferred, then 10 years	*None*
Credit may be transferred	~~No limit~~ ***By non Ks TP, in part or multiple times***	***By non Ks TP, once and for full amount***
Credits authorized by	Revenue, ~~KIDB~~ ***KDoC&H***	Revenue, KDoC&H
Time period during which contributions may be made	Tax years beginning between 12/31/00 and 1/1/06	Tax years beginning between 12/31/00 and 1/1/06
Eligible contributors	Individual, business, federal or political subdivision of Kansas	Individual, business, federal or political subdivision of Kansas
Eligible contribution	Cash, real estate, securities	Cash, real estate, securities
Contribution to	~~Ks Infrastructure Dev. Board~~ ***Infrastructure dev. agency***	Infrastructure dev. agency
Share of contributions eligible	50 %	50 %
Eligible federal deduction as a charitable contribution	Likely is deductible under most circumstances	Likely is deductible under most circumstances
Add back to Kansas AGI	No	*No?*