

MINUTES OF THE HOUSE COMMITTEE ON TAXATION

The meeting was called to order by the Chairman at 9:00 a.m. February 21, 2001 in Room 519-S of the Capitol.

All members were present.

Committee staff present: Chris Courtwright, Legislative Research Department
April Holman, Legislative Research Department
Don Hayward, Revisor
Winnie Crapson, Secretary

Conferees appearing before the committee: Representative Mason
Charles R. Ranson, Kansas, Inc.
Terry Leatherman, Kansas Chamber of Commerce and Industry

Others attending: See attached list.

Hearing was opened on:

HB 2505 - Venture Capital Best Practices

Representative Mason presented testimony in support of HB 2505 (Attachment #1) and responded to questions from members of the Committee.

Charles R. Ranson presented testimony in support of HB 2505 on behalf of Kansas, Inc (Attachment #2). Mr. Ranson distributed and discussed Best Practices of State Sponsored Seed and Venture Capital Programs and Alternatives to State Funding, a research report prepared by Kansas, Inc. He distributed written testimony of Tom Blackburn, Executive Vice President of Kansas Venture Capital, Inc., which was presented to the Senate Commerce Committee February 2, 2001 (Attachment #3). Mr. Ranson responded to questions from members of the Committee.

Terry Leatherman presented testimony in support of HB 2505 on behalf of the Kansas Chamber of Commerce and Industry (Attachment #4) and responded to questions from members of the Committee.

Hearing on HB 2505 was closed.

Hearing was opened on:

HB 2219 - Tax incentive effectiveness report.

Charles R. Ranson presented testimony in support of HB 2219 on behalf of Kansas, Inc (Attachment #5). Mr. Ranson described difficulties experienced in gathering data required for the report.

During questioning of Mr. Ranson members of the Committee noted that the reporting provisions were put into law to provide some accountability for moneys spent to guarantee that intended results were being achieved. Members questioned whether the confidentiality barriers could not be overcome by requiring those utilizing the program to agree to divulge the information necessary to prepare the required report.

Hearing on HB 2219 was closed.

Representative Hutchins, Chair, presented report of the Subcommittee on HB 2128 - Income tax credit for historic preservation project expenditures (Attachment #6). The Subcommittee report included balloon with amendment to include in line 18, page 1 language clarifying that to become eligible total amount of expenditures on the project must equal \$5,000 or more. The Department of Revenue indicates this amendment would not change the Fiscal Note.

Chairman Edmonds complimented the Subcommittee on the thoroughness of their work and the quality and clarity of its report.

CONTINUATION SHEET

The Committee took under consideration **HB 2505** on which hearing was held today.

Representative Huff moved to amend **HB 2505** in line 9, page 5 to reduce maximum tax credits from \$25,000,000 to \$12,500,000 and maximum per fiscal year from \$2,500,000 to \$1,250,000. Representative Vickery seconded. Motion failed.

Representative Powers moved that **HB 2505** be reported favorable for passage as amended Representative Osborne seconded and motion was adopted..

The Committee took under consideration **HB 2219** on which hearing was held today.

Representative Osborne moved to table **HB 2219**. Representative Newton seconded and motion was adopted.

Meeting was adjourned at 10:40 a.m. Next scheduled meeting is February 28.

GUEST LIST

DATE Feb. 21, 2001

NAME	REPRESENTING
Christy Caldwell	Topeka Chamber of Commerce
CHRISTY DAVIS	KANSAS STATE HISTORICAL SOCIETY
Richard D. Keady	Pioneer Group, Inc.
Trudy Aron	Am Inst of Architects
Malle Carpenter	KCCI
Richard Crum	KDOR
George W. Wiggins	Ruffin Company
W. Marka Jewett	KMHIA
Wm. Smiles	DOB
Scott Anglemeyer	KDOC#H
Julie Hein	Hein & Co.
E. O'Malley	OP Chamber
Rae Petrough	KS Taxpayers Network
Larry Kleiman	LKM
Kelly Kultala	City of Overland Park
John Frederick	Brum
Deby Schly	Kansas Inc

WILLIAM G. (BILL) MASON
REPRESENTATIVE, 75TH DISTRICT
BUTLER COUNTY



TOPEKA

HOUSE OF
REPRESENTATIVES

COMMITTEE ASSIGNMENTS
CHAIRMAN: ECONOMIC DEVELOPMENT
CHAIRMAN: JOINT COMMITTEE ON ECONOMIC DEVELOPMENT
MEMBER: EDUCATION
MEMBER: TOURISM
MEMBER: FEDERAL AND STATE AFFAIRS
BOARD MEMBER: KANSAS TECHNOLOGY ENTERPRISE CORPORATION

House Taxation Committee
February 21, 2001

Mr. Chairman and Members of the Committee

Thank you for the hearing today and allowing us to talk about a very important bill to Kansas, HB 2505.

For several years all of the experts have agreed that Kansas must develop an early stage Venture Capital System to pick up and grow seed Capital successes. Providing one state of Venture Capital is not enough. Kansas must work to develop funds which would be able to meet the growing needs of its seed stage companies whose capital needs are expanding as they leave the early stage.

HB 2505 will help to accomplish the seed Capital needs for many emerging new ideas and processes that have great potential for growth and for good employment. HB 2505 would set up a 50,000,000 dollar fund with a maximum 50% tax credit of 2,500,000 in any one year.

Last year a similar bill that had 100% tax credits was passed in the House but stalled in the Senate. Kansas, Inc. was the lead proponent of the bill but it was opposed by Secretary Sherrer of Kansas Department of Commerce and Housing. The heads of Kansas, Inc., KTEC and KDOC&H have had many meetings and have agreed on most of the bill before you. They have incorporated all of the changes necessary to satisfy those that opposed it in 2000.

Established facts about seed capital in Kansas

- Seed capital is essential to the development of high-growth early stage companies.
- Seed capital needs cannot be met by banks or other traditional institutions.
- Seed capital does not flow far from its source therefore Kansas companies must leave to access essential seed capital.
- Seed capital is virtually non-existent in Kansas.

Kansas stakeholders invest millions to develop these early stage companies only to lose them later due to a lack of seed capital in their home state.

Those losses represents untold missed opportunities for Kansas.

- New industry development
- Thousands of new jobs
- New tax revenues
- New employment opportunities for Kansas' best and brightest
- Entrepreneurial infrastructure losses

Kansas can reverse these losses and begin building the economy of tomorrow by developing a seed capital infrastructure in Kansas.

HB 2505 is the necessary catalyst.

I urge you to pass HB 2505 favorably so that we can start companies with high potential and profitability and to save companies that must move out of state to get Venture Capital.

I quote Tom Blackburn, Executive Vice President, Kansas Venture Capital, Inc. *"My view is that Kansas, and the Heartland in general, is still under-served. In particular, capital for seed, start-up and early stage investments as well as risk capital for established and later stage smaller companies, particularly those located in non-metropolitan areas, is still in short supply. The risk capital markets continue to be generally focused elsewhere - on the Coasts and in the major metropolitan areas. There are not a lot of funds spending time canvassing for deals in Kansas with the*

Date 2-21-01
AH No. 1
Page 2 of 3

exception of the Kansas City metro area, and to a lesser degree in Wichita. Even then, they tend to be focused on the bigger deals.

With respect to the early stage deals, the big institutional players also tend to lean toward putting out bigger dollars. They also prefer deals closer to home, with seasoned management and blue chip sponsorship. This is more true today after the "tech wreck" on Wall Street in 2000. I just don't see many firms in our market making very many new early stage investments at this time."

We lost Knowledge Communication - Wichita to Dallas. We lost Digital Archeology of Lenexa to Missouri, Agri Technologies of Winfield to out-of-state production and many more. Many great jobs and many great taxes were lost. The tax credits in this bill will not be a cost to the state. It will be a great investment into our state.

Thank you for your quick attention to this bill. I would be happy to stand for questions.

Date 2-21-01
AH No. 1
Page 3 of 3

Testimony in Support of HB2505
Charles R. Ranson, President
Kansas, Inc.

Mr. Chairman and Members of the Committee.

I appreciate the opportunity to come before you today to speak in support of HB2505, a bill to satisfy the well documented need for seed and venture capital with which to support the growth of Kansas' economy. HB2505 accomplishes this objective by offering a 50% tax credit against personal, corporate, premium or privilege tax liability as an inducement to qualified investors to capitalize for profit, privately managed, privately owned privately funded, and publicly regulated investment firms authorized to do business as certified Capital Formation Companies.

This bill is represents the culmination of more than three years work. Beginning in 1998 with a Kansas, Inc sponsored "best practices" study of successful seed and venture capital programs around the country, our focus was on how to meet the capital needs of Kansas entrepreneurs without direct state investment in recipient companies. Given our history with KPERS and Ad Astra programs, it was deemed essential that whatever proposal came forward emphasize transparency and accountability, and that it safeguard against the State (or its instrumentality) picking "winners and losers." Also, it was imperative that our program protects the important proprietary interests of businesses that receive investment from disclosure of sensitive trade secrets. Finally, it was essential that the proposed program meet the need of growing concerns that have the potential to diversify and strengthen an economy that continues to rely on traditional pillars of strength that are increasingly unreliable as the underpinnings of Kansas' economy. HB2505 meets all of these tests, and I am pleased and confident to commend it for your favorable consideration.

Kansas regularly places near the bottom among states in venture capital investment. One recent measure reports that per capita venture capital investment in the U.S. amounted to \$130.91. In that report, the per capita investment in Kansas was \$9.88. In the same report, per capita venture capital investment in Colorado amounted to \$328.84, and in Missouri, to \$52.16. Make no mistake, Mr. Chairman and Members, just as capital is highly mobile in today's market so too are the companies that willingly relocate if they must to satisfy their capital needs. Kansas reports a sad litany of young, vibrant, entrepreneurial companies that, since we began our efforts, have relocated out-of-state or been sold to out-of-state interests as they seek to satisfy their needs for growth capital. The most striking example of this is Knowledge Communications, but the list is extensive, containing Food Labs, Agri-Technologies, HELP Innovations, Newteck, Brite Voice Systems and Coaches Edge.

Mr. Chairman, HB2505 gives us the opportunity to keep the next generation of companies like those mentioned here at home. It creates within KDOCH a self-funding program to certify and to monitor the operations of between 3 and 10 Capital Formation

House Taxation
Date 2-21-01
AH No. 2
Page 1 of 2

Companies (the final number depending upon the final authorized tax credit). It provides clear criteria for who can invest, how investments will be made, how tax credits will be earned and redeemed, and what will be the consequences for failure by a CFC to abide by the requirements of the law. It requires annual reporting by the CFCs and it gives to the Secretary of KDOCH audit authority. It spreads the impact of the tax credit over a ten year period by specifying that no more than ten percent of the total allowable tax credit may be redeemed in any given year, beginning in the fiscal year commencing July 1, 2003. Finally, it provides that the State shall receive 10% of the profits of each CFC as compensation for extending the tax credit.

HB2505 will promote new industry development. It will create thousands of new jobs. It will result in new tax revenues. And it will establish a defense against the further out-migration of so many of our best and brightest as we seek to build a strong 21st Century Kansas economy.

Mr. Chairman, I will be pleased to answer your questions.

Date 2-21-01
AH No. 2
Page 2 of 2

3

Testimony of Tom Blackburn

Executive Vice President,
Kansas Venture Capital, Inc.

Presented to
Senate Commerce Committee
February 2, 2001

Thank You Madam Chair and members of the Senate Commerce Committee. My name is Tom Blackburn. I am Executive Vice President and a Board Member of Kansas Venture Capital, Inc. ("KVCI") located in Overland Park. I appreciate the opportunity to be here today to provide testimony on venture capital in Kansas and HB2688 as I understand its current version. I stand before you today as a senior officer and Director of KVCI - the most active venture capital firm in Kansas over the past decade; as a venture capital practitioner having been directly involved in the venture capital investment process in Kansas for the past decade; and as a past member of the Kansas, Inc. Technical Advisory Committee on Seed & Venture Capital ("TAC"). My intent is to specifically address a few issues in my testimony. The first issue - Is there lack of seed or venture capital available to Kansas businesses? The second - Can (or should) State government play a role in addressing these needs by facilitating risk capital formation? And third, What are some of the key issues, potential risks and potential rewards to the State for enacting legislation in addressing the State's seed and venture capital needs?

First, a little background on KVCI for those of you who do not know us or our history. KVCI was incorporated in 1976 as a private for-profit licensed Small Business Investment Company as a subsidiary of the Kansas Development Credit Corporation. In 1987, KVCI was restructured subsequent to the economic development initiatives passed during the 1986 Kansas legislative session on the heels of the Redwood-Krider Report. Specifically, two pieces of legislation provided the impetus for the restructuring. The first, the Kansas Venture Capital Company Act provided new investors in KVCI a 25% tax credit against various Kansas taxes. To qualify, "certified" venture capital companies were required to, among other things, invest 60% of their funds in "qualified" Kansas businesses. The second legislative initiative - the Kansas Statewide Risk Capital Act required the State's Pooled Money Investment Board ("PMIB") to match private sector investments in KVCI up to \$10 million in the form of a direct preferred stock investment in KVCI with the caveat that all venture capital investments had to be in Kansas. The resulting capital structure was \$6.6 million in private capital, predominantly from Kansas banks and a \$5 million investment from the State's PMIB.

In 1998, Governor Graves signed into law SB487 which established a mechanism for the repayment of the State's direct PMIB investment in KVCI and the privatization of KVCI. The genesis of the legislation was in response to concerns over direct public investment in venture capital companies. KVCI completed the preferred stock redemption in September 1999, fully repaying the \$5 million PMIB investment well ahead of the scheduled repayment commitment. KVCI subsequently completed a \$6 million stock offering to replace the \$5 million in financial footings depleted as a result of the PMIB stock redemption pursuant to the Kansas Venture Capital Act and as such all investors who subscribed received the 25% Kansas state tax credit.

House Taxation
Date 2-21-01
AH No. 3
Page 1 of 5

Today, KVCI has in excess of \$50 million in capitalization consisting of approximately \$15 million equity capital and an additional \$35 million in SBIC leverage availability. We are actively making investments in Kansas companies, creating and retaining jobs that would, in many instances otherwise be non-existent or at risk. An important note is that KVCI was, and still is, a successful public/private business model, fashioned by the Federal Government through the SBIC program, the Kansas Legislature through the legislation I referenced earlier and Kansas banks - large and small who stepped up and provided the original risk capital that seeded our company. KVCI has a significant track record in creating jobs, taxes and wealth for Kansans throughout the State, as I will better detail in a minute.

Is there lack of seed and venture capital available to Kansas businesses? Yes, I believe there is. I will not reference the statistical data that has been previously disseminated by Kansas Inc., or KTEC, but rather speak from what I see going on in our marketplace. My view is that Kansas, and the Heartland in general, is still under-served. In particular, capital for seed, start-up and early stage investments as well as risk capital for established and later stage smaller companies, particularly those located in non-metropolitan areas, is still in short supply. The risk capital markets continue to be generally focused elsewhere - on the Coasts and in the major metropolitan areas. There are not a lot of funds spending time canvassing for deals in Kansas with the exception of the Kansas City metro area, and to a lesser degree in Wichita. Even then, they tend to be focused on the bigger deals. The average size of the institutional equity funds has gotten so large that, by necessity, they need to invest big chunks of money - \$10 million, \$20 million or more at a time. Many companies in Kansas in need of equity oriented financing are simply not going to be on the radar screen of these large institutional players because of geographic location and/or company size. That's a reality. KVCI and other SBIC's are able to serve many of these smaller businesses, however I believe there are others that do not receive funding as venture firms focused on these smaller company investments are few in number and relatively small in size such as KVCI.

With respect to the early stage deals, the big institutional players also tend to lean toward putting out bigger dollars. They also prefer deals closer to home, with seasoned management and blue chip sponsorship. This is more true today after the "tech wreck" on Wall Street in 2000. I just don't see many firms in our market making very many new early stage investments at this time. Taking the Kansas City market as an example, investment activity in early stage companies significantly accelerated in 1999 and the first half of 2000. Most of the funding since then has been follow-on investments to fund big burn rates (negative cash flow) - not investments in new companies. Valuations for technology companies have crashed and the follow-on financing is not available to the extent it was last year at this time. This will likely continue to be the case for some time. Additionally, the appetite of angel investors seems to be softening. This too is to be expected, given the tech wreck and dot-com disasters. Also, the long term viability of many of early stage growth companies' business models are receiving greater scrutiny. This too is, as it should be. Clearly, more deals have gotten done in our market over the past few years, but many did not get sufficient capital or may not have investors with the financial wherewithal or network to take the companies to a point of critical mass necessary to be self-supportive or to access the institutional or public equity markets. In light of these factors I believe the availability of seed and early stage investment capital, which has been on a positive trend line over the past few years, will reverse and the scarcity of capital for such investments will continue. Therefore, I do believe there is merit to legislative consideration of the state government playing a role in increasing the supply of risk capital for seed and early stage growth companies.

Date 2-21-01
AH No. 3
Page 2 of 5

Can (or should) State government play a role in addressing these needs by facilitating risk capital formation? Absolutely. Let me address this by referencing the success of the KVC I model. Since 1988, KVC I has invested over \$30 million in 36 Kansas-based companies located in 17 Kansas counties. Many of these companies would not have received the capital to grow or get through some tough times had it not been for KVC I. I have attached an Exhibit to the back of this testimony to highlight the investment provided to KVC I and the subsequent returns, financial and other, resulting from the State's investment. I won't go into detail as it is pretty much speaks for itself, but will point out that the economic development story is significant. The state and local taxes paid by KVC I portfolio companies alone has paid for the State's investment several times over. This is exclusive of taxes paid as a result of significant capital gains taxes paid by equity holders in many of our successful investments - the so-called "wealth effect." Additionally, the returns continue to accrue as KVC I makes new investments and our past investments continue to employ more Kansans, make additional capital investments and pay significant state and local taxes. These returns continue to accrue without additional State support. Clearly the Kansas Legislature, along with Kansas banks, led by the Kansas Bankers Association, played a critical role in the KVC I success story. I believe the attached Exhibit validates this success. State government can and, I believe should play an important role in risk capital formation as needed and appropriate.

What are the key issues, potential risks and potential rewards to the State for being involved in seed and venture capital initiatives? Assuming the premise that the need has been established and the Legislature elects to play a role in fulfilling the need, the key issues in my mind are as follows:

- 1) Drafting a bill with specific language to ensure legislative intent - the language must be specific enough to ensure that the target companies receive the benefits.
- 2) Establishing appropriate oversight to ensure compliance and legislative intent - accountability and integrity is critical.
- 3) Confidentiality of all portfolio company information and financial records - without it the companies, the CFC's and the program will not succeed will be in jeopardy.
- 4) Attraction of experienced fund managers to manage CFC's - crucial for program success.
- 5) Clearly establishing the State's role as a facilitator and the CFC as the investment manager - state government should not be in the business of picking winners and losers, but rather facilitating those with the expertise to do so.
- 6) Shaping realistic expectations - because these are high risk investments the track record may be poor. That is why the availability of capital is scarce.

The macro risks of State sponsored risk capital initiatives are well documented, debated and have even been litigated over the past several years in Kansas. The micro risks are relevant and primarily go to appropriate drafting and merit. Similar programs in other states have often found that legislative intent was not accomplished due to poor drafting. Additionally, merit is often challenged based on program structure and reach. The costs, benefits and reach must be carefully analyzed. The rewards of State sponsored risk capital initiatives can be significant. Rewards to the state can and must be measured beyond financial return on investment. The KVC I model validates this premise.

Finally, with respect to the proposed CFC legislation, I stand in support of the initiative as currently being contemplated. Reducing the tax credit to 50%, while being more cost effective to the taxpayer, will also ensure that capital is at risk and necessitate that appropriate risk/reward scrutiny is applied to potential investments in order to generate returns for CFC shareholders. This is healthy and I believe this is a significant improvement to the previous bill. Establishing an oversight mechanism through KDOC to ensure that the spirit of the legislation is carried out is also important. If the target

is seed and early stage investments, there needs to be a mechanism to monitor compliance. I believe there is merit to legislative initiatives to encourage investing in Kansas companies not effectively served by existing private seed and venture capital investors. The CFC initiative as contemplated should provide ample incentives to the private sector to step forward and play an important role in filling the financing gap that currently exists for Kansas-based start-up, seed and early stage businesses. Additionally, I believe the revised legislation also incorporates the necessary provisions to ensure appropriate accountability and integrity.

Thank You for the opportunity to be here and I would be happy to answer questions.

STATE INVESTMENTS AND RELATED RETURN ON INVESTMENT

State investments into KVCII

- \$5 million PMIB direct investment in KVCII preferred stock
- \$3.2 million in Kansas state tax credits to KVCII investors

Returns on the State's investment in KVCII (unaudited - thru 12/31/00)

- KVCII repaid the entire \$5 million PMIB investment in full
- KVCII paid the PMIB \$75,000 in dividends
- KVCII has invested approximately \$30 million in 36 companies located in 17 counties in Kansas
- Approximately 25% of investment activity has been focused in smaller Kansas communities
- 5,500+ jobs created or retained by KVCII portfolio companies since initial investment
- \$600+ million in cumulative payrolls paid to employees of KVCII portfolio companies
- \$100+ million in federal, state and local taxes paid by KVCII portfolio companies
- \$20+ million in state and local taxes paid by KVCII portfolio companies
- \$80+ million in capital expenditures made by KVCII portfolio companies
- 90% of KVCII portfolio companies increased sales subsequent to initial KVCII investment
- 90% of KVCII portfolio companies increased employment subsequent to initial KVCII investment
- 100% of KVCII portfolio companies invested in capital equipment and facilities subsequent to initial KVCII investment
- 100% of KVCII portfolio companies leveraged KVCII funding with other private sector financing (banks, other venture capital or private investors)
- 80% of KVCII portfolio companies continue today as going concerns
- Six portfolio companies have transitioned to the public markets via IPO or an M&A transaction
- Current payroll of KVCII's 24 existing portfolio companies exceeds \$100 million
- Since privatization, KVCII has continued to invest primarily in Kansas-based companies with over \$8 million of the \$10.7 million in investments in 1999 and 2000 going to Kansas businesses including seven new investments.

Development of risk capital markets in Kansas

- \$30+ million invested by KVCII in Kansas-based businesses
- \$100+ million invested by other (non-Kansas) venture capital firms in KVCII portfolio companies
- \$11+ million of public market equity raised by KVCII portfolio companies
- \$160+ million of private sector bank debt
- KVCII has been the sole, lead or co-lead investor in 70% of all portfolio investments
- KVCII has been the primary conduit for importing institutional venture capital to Kansas-based small businesses
- Financial leverage on the State's \$5 million investment exceeds 60 to 1

Date 2-21-01
AH No. 3
Page 5 of 5

LEGISLATIVE TESTIMONY



The Unified Voice of Business

835 SW Topeka Blvd. • Topeka, KS 66612-1671 • 785-357-6321 • Fax: 785-357-4732 • E-mail: kcci@kansaschamber.org • www.kansaschamber.org

HB 2505

February 21, 2001

KANSAS CHAMBER OF COMMERCE AND INDUSTRY

Testimony Before the

House Taxation Committee

by

Terry Leatherman

Vice President -- Legislative Affairs

Mr. Chairman and members of the Committee:

I am Terry Leatherman, Vice President for Legislative Affairs for the Kansas Chamber of Commerce and Industry. Thank you for allowing me the opportunity to speak to you in support of HB 2505.

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.

KCCI has long advocated for policies that will stimulate economic expansion through new jobs and new investment. Over the years the Kansas Legislature has enacted economic development

House Taxation
Date 2-21-01
AH No. 4
Page 1 of 2

legislation which has been widely emulated, and which has clearly resulted in new jobs and opportunities for Kansas citizens.

One area where our state has consistently lagged is in its ability to attract venture capital. Kansas has consistently ranked among the lowest states in venture capital funding, at about one third the national average. Start up and early stage venture capital, in fact, in certain years has been virtually nonexistent. This suggests a gap in support for firms with high growth potential, clearly a competitive disadvantage.

While KCCI does not advocate direct taxpayer investment in private ventures, we believe the state can play an important role in encouraging private investment in promising entrepreneurial companies. The tax credits provided in HB 2505 do not make these investments risk-free. However, they may serve to retain private investment within the state, and employ that capital to create new jobs, and thus future revenues for state and local governments.

The use of income tax credits to stimulate private investment in new and promising ventures represents a sound approach to resolving the competitive issue of Kansas' risk capital deficit. With the adoption of this bill, the Kansas Legislature can take an important step to encourage private investment, enable more entrepreneurs to turn their ideas into vital, growing business enterprises, and create economic opportunity for Kansas residents.

I appreciate this opportunity to express our support, and would be happy to respond to any questions.

Date 2-21-01
AH No. 4
Page 2 of 2

Testimony in Support of HB2219
Charles R. Ranson, President
Kansas, Inc.

Mr. Chairman and Members of the Committee.

HB2219 repeals a requirement that Kansas, Inc. prepare an annual report of the cost effectiveness of utilization of various income tax credits and sales tax exemptions enacted to encourage economic development within the state. This bill has been filed at the request of the Agency. It is not a request that we make lightly, because it runs counter to the evaluative mission of Kansas, Inc. It is, however, legislation that we support for the following reasons.

When enacted in the mid-1990s, Kansas, Inc was charged with the responsibility to evaluate utilization of these credits and exemptions by corporate taxpayers only. The use of these credits and exemptions is equally available to individual taxpayers. Therefore, the basis upon which the Legislature would assess the effectiveness of this system of economic development incentives is incomplete.

Secondly, the method by which Kansas, Inc gathers data for its report is based upon a questionnaire filled out as part of the corporate tax package. Upon receipt by the Department of Revenue, that document is manually separated and forwarded to Kansas, Inc. This results in the delivery of thousands of forms completed by corporations at their considerable expense. Our experience has shown that more than 90% of the forms are completed by firms that have not used these incentives. The burden placed upon Kansas, Inc staff has been to individually contact the company to determine if they should or should not be properly considered in our evaluation. This is very time consuming for an Agency as small as Kansas, Inc is.

Thirdly, our efforts to resolve this matter have been unsuccessful. The Department of Revenue possesses taxpayer information that would enable Kansas, Inc to conduct a complete and accurate evaluation but, by statute, this information cannot be divulged outside the Department. We cannot gain access to this information absent legislative authorization.

During the 1999 and 2000 Sessions of this Legislature, Kansas, Inc sought legislation that would broaden the scope of our review to include individual tax payers who utilize the incentive credits and exemptions. This legislation also would have enabled the Department of Revenue to share pertinent taxpayer information with Kansas, Inc, and would have imposed a strict burden upon the Agency to safeguard the sensitive information that it would receive. This legislation failed of passage, and there is some evidence that corporate taxpayers were greatly concerned by the prospect of sensitive and confidential information in the possession of the Department of Revenue being released to Kansas, Inc.

House Taxation
Date 2-21-01
AH No. 5
Page 1 of 2

Kansas, Inc is, therefore, in a quandary. We have a statutory obligation to annually prepare a report that we (and you) know is fundamentally flawed and of no real value in determining the utilization and effectiveness of the system of credits and exemptions. We do not have legal access to data that would enable us to provide a worthwhile report. Corporate taxpayers suffer needless expense in completing a form that serves no public policy purpose. And the wasted effort by a small staff undermines our ability to discharge the other responsibilities of the Agency.

For these reasons, Mr. Chairman and Members, I urge your favorable consideration of HB2219. Thank you.

Date 2-21-01
AH No. 5
Page 2 of 2

MEMORANDUM

February 21, 2001

To: House Taxation Committee
From: Rep. Becky Hutchins, Rep. Vern Osborne, Rep. Vaughn Flora
Re: Subcommittee Report on HB 2128

The subcommittee on HB 2128 met on three different occasions and is prepared to recommend the bill favorably for your consideration with one substantive amendment.

HB 2128 would provide state tax credits of 25 percent for qualified expenditures incurred in the restoration and preservation of a qualified historic structures pursuant to a qualified rehabilitation plans. "Qualified rehabilitation plan" would be defined as a project consistent with rehabilitation standards and guidelines adopted by the federal Secretary of the Interior and further approved by either (1) the Kansas State Historical Society's Cultural Resources Division; or (2) a local government certified by the Division. Unlike federal law, which generally allows historic preservation and restoration tax credits only for income-producing properties, the state credits authorized by HB 2128 also would be available to residential and other properties not producing income. Proponents of the legislation indicated that the bill is similar to a law on historic preservation credits already authorized by Missouri. According to research by Christy Davis of the Kansas State Historical Society, some form of state tax credit is available in at least 17 states.

The practical impact of the bill is that it would authorize qualifying projects on income-producing property to obtain combined state and federal tax credits amounting to a 45 percent subsidy. (The federal credit is equivalent to 20 percent of qualified expenditures, and the state credit would be 25 percent of such expenditures.) Qualifying residential property such as that owned by several of the conferees during the original hearing on the bill would be eligible for the 25 percent state credit.

Credit to ALL Qualified Expenditures Above \$5,000

The original bill would have provided the credits in amounts equal to 25 percent of qualified expenditures IN EXCESS OF \$5,000. The Subcommittee amendments would change the bill such that the 25 credit would apply to ALL qualified expenditures above \$5,000. This change more closely mirrors the federal tax credit in Section 47 of the federal Internal Revenue Code.

No Recommendation for Caps

The Subcommittee discussed - but at this juncture does not recommend - two different kinds of caps which could be considered to offset concern about the fiscal implications of the bill. One kind of cap - currently in place in six states - would be a limitation on the amount of tax credit which could be claimed attributable to any given project. A second kind of cap - currently in place in three states - would be an annual limitation on the total amount of credits which could be claimed statewide for a given year.

(over)

House Taxation
Date 2-21-01
AH No. 6
Page 1 of 3

Fiscal Note

The Department of Revenue indicated that the original fiscal note provided for the bill would not change, even under the Subcommittee amendments. That fiscal note suggested that qualified expenditures might be \$2.2 million per year and could be expected to grow by 10 percent per year. The fiscal note further assumed that 2/3 of the credit would be used in each year and the remaining 33 percent would be carried forward against the next tax year's liability. Such a scenario produces the following fiscal notes:

(\$ in millions)

Tax Year	Qualified Expenditures	Amount of Credit at 25%	2/3 claimed 1/3 carry forward	
2001	\$2.200	\$0.550	\$0.367	FY 2002
2002	\$2.420	\$0.605	\$0.587	FY 2003
2003	\$2.662	\$0.666	\$0.645	FY 2004
2004	\$2.928	\$0.732	\$0.710	FY 2005
2005	\$3.221	\$0.805	\$0.781	FY 2006

Date 2-21-01
AH No. 6
Page 2 of 3

HOUSE BILL No. 2128

By Committee on Taxation

1-23

9 AN ACT relating to income taxation; allowing credits for certain historic
10 preservation project expenditures.

11
12 *Be it enacted by the Legislature of the State of Kansas:*

13 Section 1. (a) For all taxable years commencing after December 31,
14 2000, there shall be allowed a tax credit against the income tax liability
15 imposed upon a taxpayer pursuant to the Kansas income tax act in an
16 amount equal to 25% of qualified expenditures incurred in the restoration
17 and preservation of a qualified historic structure pursuant to a qualified
18 rehabilitation plan by a qualified taxpayer. If the amount of such tax credit
19 exceeds the qualified taxpayer's income tax liability for the year in which
20 such costs and expenses were incurred, such excess amount may be car-
21 ried over for deduction from such taxpayer's income tax liability in the
22 next succeeding year or years until the total amount of the credit has been
23 deducted from tax liability, except that no such credit shall be carried
24 over for deduction after the 10th taxable year succeeding the taxable year
25 in which the qualified expenditures were incurred.

26 (b) As used in this section, unless the context clearly indicates
27 otherwise:

28 (1) "Qualified expenditures" means the costs and expenses incurred
29 by a qualified taxpayer in the restoration and preservation of a qualified
30 historic structure pursuant to a qualified rehabilitation plan which are in
31 excess of \$5,000, and which are defined as a qualified rehabilitation ex-
32 penditure by section 47 (c)(2) of the federal internal revenue code;

33 (2) "qualified historic structure" means any building, whether or not
34 income producing, which is defined as a certified historic structure by
35 section 47 (c)(3) of the federal internal revenue code, is individually listed
36 on the register of Kansas historic places, or is located and contributes to
37 a district listed on the register or Kansas historic places;

38 (3) "qualified rehabilitation plan" means a project which is approved
39 by the cultural resources division of the state historical society, or by a
40 local government certified by the division to so approve, as being consis-
41 tent with the standards for rehabilitation and guidelines for rehabilitation
42 of historic buildings as adopted by the federal secretary of interior and in
43 effect on the effective date of this act. The society shall adopt rules and

if the total amount of such expenditures
equal \$5,000 or more

Date 2-21-01
AH No. 6
Page 3 of 3