Approved: January 29, 2001
Date

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE.

The meeting was called to order by Chairperson David Corbin at 10:45 a.m. on January 25, 2001, in Room 519-S of the Capitol.

All members were present except:

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

Conferees appearing before the committee: Bill Dvorak, AT&T
Mark Beshears, Sprint
Robert J. Fasl, SBC Communications
Richard Cram, Kansas Department of Revenue

Others attending: See attached list.

The minutes of the January 24, 2001, meeting were approved.

SB 1–Sales taxation; concerning the taxation of certain services provided by telecommunications companies.

April Holman, Legislative Research Department, explained that **SB 1** deals with the taxation of "bundled" telecommunications services and that a study of the this topic was requested by the telecommunications industry in response to their new practice of "bundling" services such as local telecommunications, interstate and intrastate long distance telecommunications, Internet, data services, and other related products and services. She reviewed the report of the Interim Special Committee on Assessment and Taxation which held hearings on taxation of "bundled" telecommunications services and recommended the introduction of the Department of Revenue's proposal to facilitate the taxation of "bundled" telecommunications services. The Interim Committee Report indicates that the Committee recognizes the changing nature and services provided by the telecommunications industry and the resulting concerns with the traditional system of telecommunications taxation. (Attachment 1)

Bill Dvorak, AT&T, testified in support of **SB 1**. (Attachment 2) He explained that local phone service, long distance, wireless, Internet, and cable television will be offered in a single package for a single price on a single non-itemized customer bill. He noted that, unfortunately, some of the services are subject to sales tax under Kansas law and some are not. The bill would recognize this change in technology and would apply the sales tax only to the taxable elements in the package. Mr. Dvorak noted that a recent study on "bundling" indicated that approximately 40 percent of consumers desire to have a bundled package. He said, on the industry side, it is easier to bill because there is no need for several individual billing systems. He explained that, rather than companies having to break services up on the bill and specify which ones are taxed and which are not, **SB 1** would allow companies to maintain records and apply taxes according to which items are subject to state tax and then apply those taxes in a separate tax line item on the bill. In conclusion, Mr. Dvorak noted that last year the telecommunications industry suggested three possible solutions to taxing bundled communication services, and the Department of Revenue reviewed the proposals as did the Interim Committee.

Mark Beshears, Sprint, testified in support of **SB 1**, reiterating that the bill is the result of discussions between the telecommunications industry and the Department of Revenue over the past year. (Attachment 3) In addition, he discussed venders who have a cable product which is "bundled." He explained that in billing, Sprint would give the components of the bundle a product identification code and then run that code through their taxing system. All applicable taxes would then be put on the customer's bill. He commented that nothing is changing on the invoice from a tax perspective. The part that is changing is the price for each component is not specifically stated.

Robert Fasl, SBC Communications, gave final testimony in support of **SB 1**. (Attachment 4) He informed the Committee that SBC is currently preparing to compete in the Kansas market where service offerings may include "bundling" of taxable and nontaxable services. Therefore, SBC encourages passage of **SB 1**, with the knowledge that the sales tax base of communications services "bundles" is only the taxable services provided in each bundle.

Richard Cram, Kansas Department of Revenue, discussed an amendment to **SB 1** as recommended by the Secretary of Revenue. He distributed copies of the suggested amendment which adds a new sentence beginning on page 1, line 23, as follows: "Prior to billing taxable services on a combined basis with nontaxable services, the retailer shall enter into a written agreement with the Secretary identifying the records to be used in determining the taxable portion of the selling price of those combined services." (Attachment 5) Mr. Cram said the Secretary offered the amendment because he believes that it would be better for the Department and the telecommunications company to verify up front what is and what is not taxable and how the tax is calculated so that, when a state audit is conducted later, there will be no surprises.

Chairman Corbin asked representatives of the telecommunication industry present for a response with regard to the Revenue Department's suggested amendment. Mr.Teshears stated that he did not believe that the industry would have a problem with the amendment.

Senator Allen began a discussion regarding the separation of taxable and nontaxable services in the "bundling" process. She confirmed that if a provider does not separate taxable and nontaxable services, all services will be taxed. She commented that, in cases where the retailer was not able to separate services, both taxable and nontaxable services, including Internet access, would be taxed. In response, Mr. Dvorak said that the requirement for a separation of taxable and non taxable services is the way most states prevent sales tax avoidance. Mr. Cram said, if a retailer was unable to show the Department how the costs were broken down, the Department would assume that all the costs are attributable to taxable services. He noted, if Internet services were included in the "bundle," it would be clear that it is a nontaxable component. Senator Lee commented that the bill relates to highly technical businesses which know, without a doubt, the cost of every service in the "bundle" or they would not be bundling them. She noted that **SB 1** simply provides a safeguard to ensure that companies will break down the services for the Department of Revenue or be held responsible for taxation on all the services included in the "bundle." She commented that there would be no reason for businesses not to break down the services in a "bundle" because they are in a highly competitive business; therefore, they would not want to increase the cost of a "bundle."

Chairman Corbin observed that the bill involves an issue between companies and the Department of Revenue and does not create any new tax. He agreed with Senator Donovan's comment that the ultimate watch dog is the consumer. He noted that the consumer has the right to call the companies and find out what services in the "bundle" are being taxed. With this, he closed the hearing on **SB 1**.

Senator Clark moved to amend **SB 1** as recommended by the Department of Revenue, seconded by Senator Donovan. The motion carried.

Senator Clark moved to recommend **SB 1** as amended favorably for passage, seconded by Senator Donovan. The motion carried.

The meeting was adjourned at 11:25 a.m.

The next meeting is scheduled for January 29, 2001.

SENATE ASSESSMENT AND TAXATION COMMITTEE
GUEST LIST

DATE: January 25, 2001

NAME	REPRESENTING
Tom Palace	PMCA of Kansas
Ann Durkes	DOB
[illegible]	Sen. Clark
[illegible] Hotchens	WR
Bruce Graham	KEPCo
John C. Bottenberg	Western Resources
Ed O'Malley	O.P. Chamber of Commerce
Marlee Carpenter	KCCI
Doug Smith	Pinegar-Smith Company
Tom Bruno	Gaches, Braden, Barbee
William Dvořák	AT&T
Judy Bromich	Sen. President's Office
Cleta Renyer	Wee Life
John Peterson	CompTel
Colleen Miller	Kathy Damron & Assoc

Reports of the Special Committee on Assessment and Taxation to the 2001 Kansas Legislature

CHAIRPERSON: Representative Clay Aurand

VICE-CHAIRPERSON: Senator Audrey Langworthy

RANKING MINORITY MEMBER: Representative Melvin Minor

OTHER MEMBERS: Senators David Corbin, Les Donovan, Janis Lee, and Chris Steineger; Representatives Carol Beggs, Dan Johnson, Bruce Larkin, Sharon Schwartz, Tim Tedder, and Susan Wagle

STUDY TOPICS

Property tax exemptions for property leased for retail purposes by not-for-profit corporations in small communities

Constitutional Amendment authorizing Legislature to reduce property tax assessment level for land devoted to recreational use (HCR 5057)

Review Department of Revenue's local sales distribution process in the wake of recently implemented computer changes

Constitutional Amendment increasing sales and use tax by 0.25 percent and earmarking new revenues for soil and water conservation, state park and lake maintenance, and wildlife habitat restoration programs (HCR 5055)

Recommendations of the Streamlined Sales Tax for the 21st Century Legislative Oversight Committee

Taxation of "bundled" telecommunications services

Sales tax treatment of public water district purchases (1999 HB 2011 as passed by House)

December 2000

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Attachment 1

SPECIAL COMMITTEE ON ASSESSMENT AND TAXATION

TAXATION OF "BUNDLED" TELECOMMUNICATIONS SERVICES

CONCLUSIONS AND RECOMMENDATIONS

The Committee recognizes the changing nature of services provided by the telecommunications industry and the resulting concerns with the traditional system of telecommunications taxation. At the same time, the Committee acknowledges the reluctance of the Department of Revenue to engage in "pre-audit" agreements, a practice for which the Department does not believe it has statutory authority. By way of a compromise, the Committee supports the Department of Revenue's proposal regarding the taxation of bundled telecommunications services. To that end, the Committee recommends legislation to facilitate the taxation of bundled telecommunications services.

Proposed Legislation: The Committee recommends one bill on this topic.

BACKGROUND

A study of this topic was requested by the telecommunications industry. The industry has begun to "bundle" services such as local telecommunications, interstate and intrastate long distance telecommunications, Internet, data services and other related products and services. In the case of bundled telecommunications services, the entire bundle is purchased for periodic flat charges. The consumer is then given the right to use an unlimited amount or a specified limit of communications services. This is a departure from the traditional system of usage-based charges and the taxation of bundled services is a source of concern to the industry. At issue is the sales tax base of communications bundles and whether the Department of Revenue may enter into pre-audit agreements regarding that sales tax base.

COMMITTEE ACTIVITIES

The Committee held hearings on this topic at the Sprint Campus in Overland Park in September. Conferees were members of the telecommunications industry including representatives of Sprint, AT&T and SBC Communications.

The telecommunications industry is seeking the authority to enter into pre-audit agreements with the Department of Revenue. These agreements would allow the industry and the department to agree on how a bundled transaction should be taxed. Conferees told the Committee that the telecommunications industry is also working with other states to establish pre-audit agreements and both Utah and Illinois have agreed to the new system.

According to the industry, the only issue regarding the Kansas Department of Revenue's statutory authority to accept bundled telecommunications services as the taxable base for sales tax purposes is whether the industry may impose upon its customers a total charge for multiple services without separately stating the individual charges for each on the bill. Citing marketing strategy and industry competition, conferees told the Committee that the intent of the telecommunications providers is to provide customer invoices which identify that a particular telecommunications service bundle includes both taxable and nontaxable services but do not list a individual charge for each service. The subsequent billing for the bundle will then reflect the amount of tax due on the total charges attributable to the taxable components within the bundle only.

While the industry believes that Kansas law does not require taxable and nontaxable communications services to be separately stated on customer bills or condition the nontaxable treatment of certain communications services upon their being separately stated on customer bills, a representative of the Department of Revenue testified that the Department does not believe that the law provides authority to enter into pre-audit agreements.

The telecommunications industry suggested the following three possible solutions to taxing telecommunication service bundles:

- **Bundling Language**. If services taxable under the sales tax act are combined with services which are not taxable under the act, then the "price" of those combined services shall include only those charges for services which are taxable under the sales tax act if those charges can be disaggregated on the seller's books and records.

- **Agreement Authorization**. The Secretary may enter into pre-audit or similar agreements to permit taxpayers to establish the proper price of services that are bundled together so as to preserve the exempt nature of the non-taxable services.

- **Legislation Based on the Federal Mobile Telecommunication Sourcing Act**. If a taxing jurisdiction does not otherwise subject charges to taxation and if these charges are aggregated with and not separately stated from charges that are subject to taxation, then the charges for nontaxable services may be subject to taxation unless the service provider can reasonably identify charges not subject to such tax, charge, or fee from its books and records that are kept in the regular course of business.

At the November meeting, the Department of Revenue proposed a legislative change limited to the telecom industry which would facilitate the taxation of bundled telecommunication services while avoiding the precedent of a pre-audit agreement. The Committee called on a representative of the industry, who expressed industry support for the Department's proposal. After discussion, the Committee recommended legislation be introduced in the 2001 Legislative Session to codify the Department's proposal.

CONCLUSIONS AND RECOMMENDATIONS

The Committee recognizes the changing nature and services of the telecommunications industry and the resulting concerns with the traditional system of telecommunications taxation. The Committee supports the Department of Revenue's proposal regarding the taxation of bundled telecommunications services. To that end, the Committee recommends _____B____ containing the following pertinent language:

The gross receipts from retailers providing services taxable under KSA 79-3603(b) of the Kansas retailers' sales tax act that are billed on a combined basis with nontaxable services, shall be accounted for and the tax remitted as follows: the taxable portion of the selling price of the those combined services shall include only those charges for taxable services if the selling price for the taxable services can be readily distinguishable in the retailers books and records from the selling price for the nontaxable services. Otherwise, the gross receipts from the sale of both taxable and nontaxable services billed on a combined basis shall be deemed attributable to the taxable services included therein. The burden of proving that any receipt or charge is not taxable shall be upon the retailer. Upon request from the customer, the retailer shall disclose to the customer the selling price for the taxable services included in the selling price for the taxable and nontaxable services billed on a combined basis.

1-4

AT&T

William A. Dvorak
Tax Director
External Tax Policy

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512 370-1012

TESTIMONY ON BEHALF OF AT&T
BEFORE SENATE ASSESSMENT & TAXATION COMMITTEE
SENATE BILL 1
January 25, 2001

Mister Chairman and members of the committee:

My name is William Dvorak and I am a Tax Director for AT&T's External Tax Policy organization. I am here today to ask for your consideration and approval of Senate Bill 1, which addresses the application of sales tax on communication services which are billed on a combined basis (taxable and non-taxable services).

The rapid pace of converging technology is quickly erasing the historical distinctions between cable TV, telephone and the Internet. In the near future, the public will enjoy an exploding array of services through a single communications pipeline into the home. The communications and entertainment industries are rapidly moving toward vertical integration. Today most households receive a local phone bill from one company, a separate long distance bill from another company, a cable bill from a traditional cable company and an Internet bill from a separate Internet service provider – as many as four separate bills from four different companies. However, consumers soon will have the option of one-stop shopping. Local phone service, long distance, wireless, Internet, and cable TV will be offered in a single package, for a single price, on a single non-itemized customer bill.

The metamorphosis of the telecommunication industry has and will continue to cause uncertainty in the application of existing state and local taxing schemes. As different ways of bundling communications services are developed, they may or may not be covered by the existing state and local statutory provisions. Communications are now possible over a growing number of mediums never envisioned when state and local telecommunication taxes were developed. Despite technological advancements, most state and local taxing statutes have not been significantly amended in decades and do not adequately reflect today's converging communications environment.

In its basic form, a "bundle" is simply a combination of two or more communications services marketed together for a flat non-itemized retail price. Increasingly popular with

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subscribers, bundling will at times combine taxable and non-taxable elements. For example, the State of Kansas taxes local and long distance telecommunications services but does not tax Internet access services.

AT&T and the telecommunications industry have suggested three possible solutions to taxing bundled communications services:

- Adoption of Bundling Language
  If services that are taxable under the sales tax are combined with services that are not taxable, then the "price" of those combined services will include only those charges that are taxable under the sales tax act if those charges can be disaggregated on the seller's books and records.

- Authorization of Pre-Audit Agreements
  Allows the Secretary of Revenue to enter into pre-audit or similar agreements to permit taxpayers to establish the component price of services that are bundled together so as to preserve the exempt nature of the non-taxable services.

- Adopt Legislation Based on the Federal Mobile Telecommunications Sourcing Act
  Under provision in the Act, non-taxable elements may be subject to tax if bundled for sale with taxable elements unless the provider can identify the non-taxable elements from its own books and records.

The Department of Revenue has reviewed this issue along with the industry proposals and provided their recommendation to the 2000 Special Committee on Assessment and Taxation. The Committee, after reviewing the issue, supported the Departments proposal regarding the taxation of bundled telecommunications services. Senate Bill 1 would implement the Department's proposal and the Committee's recommendation.

AT&T respectfully requests your approval of Senate Bill 1. Thank you for the opportunity to address this issue and I am available to answer any questions you may have.

Sprint®

Memorandum

Mark Beshears
Assistant Vice President
State & Local Corporate Tax
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Fax: (913) 315-0324
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TO: Kansas Senate Assessment and Taxation Committee
DATE: January 25, 2001
SUBJECT: Senate Bill No. 1

Due to increasing customer demand and accelerated technological changes in the communications industry, Sprint is providing to its subscribers in Kansas and elsewhere multiple types of communications services (including local telecommunications services, interstate and intrastate long distance telecommunications services, internet services, data services and other related products and services) in a variety of bundled offerings (the "communication services bundles"). Sprint's offering of these communications services bundles is consistent with the growing trend in the communications industry to depart from traditional usage-based charges in favor of periodic flat charges for the customer's right to use an unlimited amount or a specified limit of communications services.

Senate Bill No.1, is the result of discussions between the telecom industry and the Department of Revenue over the past year. The language in Senate Bill No. 1, proposes a change limited to the telecom industry which facilitates an agreeable method for the taxation of bundled telecommunications services. Sprint supports the Interim Committees' recommendation and the language contained in Senate Bill No.1 and would ask the committee to recommend this bill favorable for passage.

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Attachment 3

Robert J. Fasl
Director-Property Taxes

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Testimony on behalf of SBC Communications Inc.
Before the Senate Assessment & Taxation Committee
Presented by Robert J. Fasl
January 25, 2001

Senator Corbin, members of the Committee, good morning.

My name is Robert Fasl. I am a Regional Director of Property Tax for SBC Communications Inc. (SBC), the parent company of Southwestern Bell.

I appear before you today to voice SBC's support of Senate Bill 1 regarding the sales tax base of "communication services bundles." SBC believes that the sales tax base of "communication services bundles" is the gross receipts generated by only the taxable communication services provided in each bundle.

As SBC has obtained approval from both the Kansas Corporation Commission and the Federal Communications Commission to provide interstate long distance service in Kansas, the company is now preparing to compete in the Kansas market where service offerings may include "communication services bundles" of both currently taxable and non-taxable services. Accordingly, SBC may now seek to operate in the Kansas market identical to that of its **CLEC** * competitors. Therefore, SBC encourages the Committee to adopt Senate Bill 1 regarding the taxable base of "communication services bundles" for sales tax purposes.

On behalf of SBC Communications Inc., I thank you Mister Chairman and each member of the Committee for this opportunity to voice SBC's support of Senate Bill 1.

* **CLEC** ~ **C**ompetitive **L**ocal **E**xchange **C**arrier *(e.g., Birch Telecom, KMC Telecom, etc. For additional information, consult the July 2000 Southwestern Bell Topeka and Vicinity Telephone Directory – pages 5 & 6.)*

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form, content, code or protocol of the information to be transmitted; (D) any telecommunication service to a provider of telecommunication services which will be used to render telecommunications services, including carrier access services; or (E) any service or transaction defined in this section among entities classified as members of an affiliated group as provided by federal law ([26] U.S.C. Section 1504). For the purposes of this subsection the term gross receipts does not include purchases of telephone, telegraph or telecommunications using a prepaid telephone calling card or prepaid authorization number. As used in this subsection, a prepaid telephone calling card or prepaid authorization number means the right to exclusively make telephone calls, paid for in advance, with the prepaid value measured in minutes or other time units, that enables the origination of calls using an access number or authorization code or both, whether manually or electronically dialed*; and (3) the gross receipts from the provision of services taxable under this subsection which are billed on a combined basis with nontaxable services, shall be accounted for and the tax remitted as follows: The taxable portion of the selling price of those combined services shall include only those charges for taxable services if the selling price for the taxable services can be readily distinguishable in the retailer's books and records from the selling price for the nontaxable services. Otherwise, the gross receipts from the sale of both taxable and nontaxable services billed on a combined basis shall be deemed attributable to the taxable services included therein. The burden of proving that any receipt or charge is not taxable shall be upon the retailer. Upon request from the customer, the retailer shall disclose to the customer the selling price for the taxable services included in the selling price for the taxable and nontaxable services billed on a combined basis*;

Prior to billing taxable services on a combined basis with nontaxable services, the retailer shall enter into a written agreement with the secretary identifying the records to be used in determining the taxable portion of the selling price of those combined services.

(c) the gross receipts from the sale or furnishing of gas, water, electricity and heat, which sale is not otherwise exempt from taxation under the provisions of this act, and whether furnished by municipally or privately owned utilities;

(d) the gross receipts from the sale of meals or drinks furnished at any private club, drinking establishment, catered event, restaurant, eating house, dining car, hotel, drugstore or other place where meals or drinks are regularly sold to the public;

(e) the gross receipts from the sale of admissions to any place providing amusement, entertainment or recreation services including admissions to state, county, district and local fairs, but such tax shall not be levied and collected upon the gross receipts received from sales of admissions to any cultural and historical event which occurs triennially;

(f) the gross receipts from the operation of any coin-operated device dispensing or providing tangible personal property, amusement or other services except laundry services, whether automatic or manually operated;

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