

Approved April 4, 2002  
Date

MINUTES OF THE HOUSE COMMITTEE ON TAXATION

The meeting was called to order by Vice Chairman Huff at 9:00 a.m. on March 29, 2002 in Room 519-S of the Capitol.

All members were present except: Representative Cook, excused  
Representative Gilbert, excused  
Representative Howell, excused  
Representative Hutchins, excused  
Representative Mays, excused  
Representative Powers, excused  
Representative Tafanelli, excused  
Representative Vickery, excused

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

No Conferrees appeared before the Committee.

Others Attending: See attached list.

By unanimous consent bill known as the situs bill will be introduced at the request of Representative Edmonds.

Consideration of SB 129 - Valuation of pasture and rangeland for property tax purposes.

Chairman Edmonds introduced proposed amendment to strike contents and insert language representing the agreement between Kansas, Inc. and Department of Revenue, who had been asked by this Committee in 2001 to resolve their differences concerning the required reports and need for confidentiality (Attachment #1).

**Representative Larkin moved, Representative Gatewood seconded, to strike all language in SB 129 and amend as suggested. Motion adopted..**

**Representative Gatewood moved, Representative Sharp seconded, to report SB 129 favorable for passage as amended. Motion adopted..**

Consideration of SB 372 - Sourcing of mobile telecommunications services for sales tax purposes.

**Representative T. Powell moved, Representative Pyle seconded, to report SB 372 favorable for passage. Motion adopted.**

Consideration of SB 472 - Sales taxation of prepaid telephone calls.

**Representative T. Powell moved, Representative Pyle seconded, to report SB 472 favorable for passage. Motion adopted..**

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or correction.

CONTINUATION SHEET

Consideration of SB 553 - Report required by PVD on land devoted to agricultural use valuation procedures.

Representative Larkin presented a proposed amendment to **SB 553** (Attachment #2), information from the Agricultural Use Value Study Technical Assistance Project of the International Association of Assessing Officers prepared for the Department of Revenue (Attachment #3), and a report on Historic Capitalization Rates prepared by PVD October 1, 2001 (Attachment #4).

**Representative Larkin moved, Representative L. Powell seconded, to amend SB 553 as proposed. Motion adopted.**

**Representative Larkin moved, Representative L. Powell seconded, to report SB 553 favorable for passage as amended. Motion adopted..**

Meeting adjourned at 9:20 a.m. Next meeting is April 2.

GUEST LIST

DATE March 29, 2002

NAME	REPRESENTING
<del>Pat</del> Roger Hamm	KDOR PVD
Dith Hammon	Waddell Reed
Ken Gaches	GDA
Shirley Fehm	LACCT
Larry R Baer	LICM
Hal Hudson	NFIB/IKS
Jack Graves	Wash-P-76-UM

On page 1, by striking all in lines 19 through 43;

By striking all on pages 2 and 3;

On page 4, by striking all in lines 1 through 37 and inserting the following:

"Section 1. K.S.A. 2001 Supp. 74-8017 is hereby amended to read as follows: 74-8017. ~~(a)~~ On and after January 1, 2003, it shall be the duty of Kansas, Inc. to prepare an annual report evaluating the cost effectiveness of the various income tax credits and sales tax exemptions enacted to encourage economic development within this state and submit the same to the standing committees on taxation and economic development of the house and assessment and taxation and commerce of the senate at the beginning of each regular session of the legislature. The secretary of revenue, in consultation with the president of Kansas, Inc., shall develop a questionnaire on the utilization of state income tax credits and sales tax exemptions that shall be completed by all corporate taxpayers subject to state income tax that shall be submitted to the department of revenue concurrently with the filing of an annual corporate income tax return. The secretary shall provide the completed questionnaires to Kansas, Inc. for use in the preparation of such annual report. The questionnaire shall require respondents to indicate utilization of the following credits and exemptions:

~~(1)~~ (a) Income tax credits authorized under the provisions of the job expansion and investment credit act of 1976 and acts amendatory thereof and supplemental thereto;

~~(2)~~ (b) income tax credits for expenditures in research and development activities authorized by K.S.A. 79-32,182, and amendments thereto;

~~(3)~~ (c) income and financial institutions privilege tax credits for cash investment in stock of Kansas Venture Capital, Inc. authorized by K.S.A. 74-8205 and 74-8206, and amendments thereto;

~~(4)~~ (d) income tax credits for cash investment in certified

Kansas venture capital companies authorized by K.S.A. 74-8304, and amendments thereto;

(5) (e) income tax credits for cash investment in certified local seed capital pools authorized by K.S.A. 74-8401, and amendments thereto;

(6) (f) income tax credits for investment in the training and education of qualified firms' employees authorized by K.S.A. 2001 Supp. 74-50,132, and amendments thereto;

(7) (g) sales tax exemptions for property or services purchased for the purpose of and in conjunction with constructing, reconstructing, enlarging or remodeling a business, or retail business meeting the requirements of K.S.A. 74-50,115, and amendments thereto, and machinery and equipment for installation at such business or retail business authorized by subsection (cc) of K.S.A. 79-3606, and amendments thereto; and

(8) (h) sales tax exemptions for machinery and equipment used directly and primarily for the purposes of manufacturing, assembling, processing, finishing, storing, warehousing or distributing articles of tangible personal property in this state intended for resale by a manufacturing or processing plant or facility or a storage, warehousing or distribution facility. The secretary of revenue shall provide the completed questionnaires and copies of sales tax exemption certificates to Kansas, Inc. for the preparation of such report.

~~(b) Prior to the commencement of the 2002 legislative session, Kansas, Inc. and the Kansas department of revenue shall agree upon procedures for the purpose of disclosure of corporate and individual taxpayer information to fulfill the purposes of this section and protect sensitive taxpayer information to the extent possible consistent with this section. Such procedures shall be submitted to an appropriate committee at the commencement of such session in the form of a proposed bill.~~

Sec. 2. K.S.A. 2001 Supp. 74-8017 is hereby repealed.";

In the title, in line 14, by striking all after "ACT"; by striking all in lines 15 and 16 and inserting "relating to annual

reports concerning certain tax incentive effectiveness; amending  
K.S.A. 2001 Supp. 74-8017 and repealing the existing section."

The share of net income from land in the various land classes within each county or homogeneous region which is normally received by the landlord shall be used as the basis for determining agricultural income for all land devoted to agricultural use except pasture or rangeland. The net income normally received by the landlord from such land shall be determined by deducting expenses normally incurred by the landlord from the share of the gross income normally received by the landlord. The net rental income normally received by the landlord from pasture or rangeland within each county or homogeneous region shall be used as the basis for determining agricultural income from such land. The net rental income from pasture and rangeland which is normally received by the landlord shall be determined by deducting expenses normally incurred from the gross income normally received by the landlord. Commodity prices, crop yields and pasture and rangeland rental rates and expenses shall be based on an average of the eight calendar years immediately preceding the calendar year which immediately precedes the year of valuation. Net income for every land class within each county or homogeneous region shall be capitalized at a rate determined to be the sum of the contract rate of interest on new federal land bank loans in Kansas on July 1 of each year averaged over a five-year period which includes the five years immediately preceding the calendar year which immediately precedes the year of valuation, plus a percentage not less than .75% nor more than 2.75%, as determined by the director of property valuation, **provided, however, that the capitalization rate calculated for the tax year commencing January 1, 2003, and for all subsequent years, shall not be less than 11% nor shall it exceed 12%.**

Based on the foregoing procedures the director of property valuation shall make an annual determination of the value of land within each of the various classes of land devoted to agricultural use within each county or homogeneous region and furnish the same to the several county appraisers who shall classify such land according to its current usage and apply the value applicable to such class of land according to the valuation schedules prepared and adopted by the director of property valuation under the provisions of this section.

It is the intent of the legislature that appraisal judgment and appraisal standards be followed and incorporated throughout the process of data collection and analysis and establishment of values pursuant to this section.

For the purpose of the foregoing provisions of this section the phrase "land devoted to agricultural use" shall mean and include land, regardless of whether it is located in the unincorporated area of the county or within the corporate limits of a city, which is devoted to the production of plants, animals or horticultural products, including but not limited to: Forages; grains and feed crops; dairy animals and dairy products; poultry and poultry products; beef cattle, sheep, swine and horses; bees and apiary products; trees and forest products; fruits, nuts and berries; vegetables; nursery, floral, ornamental and greenhouse products. Land devoted to agricultural use shall not include those lands which are used for recreational purposes, other than that land established as a controlled shooting area pursuant to K.S.A. 32-943, and amendments thereto, which shall be deemed to be land devoted to agricultural use, suburban residential acreages, rural home sites or farm home sites and yard plots whose primary function is for residential or recreational purposes even though such properties may produce or maintain some of those plants or animals listed in the foregoing definition.

The term "expenses" shall mean those expenses typically incurred in producing the plants, animals and horticultural products described above including management fees, production costs, maintenance and depreciation of fences, irrigation wells, irrigation laterals and real estate taxes,

IAAO

TECHNICAL ASSISTANCE PROJECT

TECHNICAL ASSISTANCE PROJECT  
AGRICULTURE USE VALUE STUDY  
KANSAS DEPARTMENT OF REVENUE

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DECEMBER 2000



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## Recommendations

### Recommendation 1

- ♦ The statewide capitalization rate should be fixed at the current rate. Rates applied in each county should continue to be adjusted by the local tax rate.

#### Current Situation

The statewide capitalization rate uses a five-year average of the FCS agricultural land loan rate as its base. To this average rate a .75 percent statutorily specified amount is added. Further, the director of the Division of Property Valuation has the authority to add up to 2 percent additional to determine the statewide capitalization rate. In recent years, the full 2 percent has been added, and the director has requested (or may have been given) authority to add more than 2 percent to the calculated rate.

When determining value (whether it be market value or use value) using an income capitalization procedure, it is necessary to specify a capitalization rate. When determining market value, most states use a capitalization rate that is a blend of the mortgage rate of interest and the desired rate of return on equity. Following is an example of how a capitalization rate might be determined.

Suppose that the current mortgage rate is 7 percent, and the desired landowner equity rate is 13 percent. Further, suppose that a landowner has borrowed 25 percent of his asset value. An overall capitalization rate can be computed by adding together the mortgage rate times the percentage of investment and the equity rate times the percentage owned. In this case the overall capitalization rate is 11.5 percent.

	Rate	Percent of Investment	Adjusted Rate
Mortgage Rate	7%	25%	1.75%
Equity Rate Desired	13%	75%	<u>9.75%</u>
Overall Capitalization Rate			11.50%

A use value determined using a capitalization rate of 11.5 percent would indicate the owner would have sufficient income to pay 7 percent interest on 25 percent of the asset value borrowed and to receive 13 percent rate of return on the owner's 75 percent equity.

This procedure for determining an overall capitalization rate works well for determining what a prudent investor should pay for an asset (divide the net income of the investment by the overall capitalization rate), but direct application for determining use value requires some modifications. First, current procedures use a mortgage interest rate as the primary rate for determining the complete value with only arbitrary adjustments. According to Census of Agriculture numbers, agricultural landowners borrow 25 percent or less of asset value. This means that the mortgage interest rate should only provide 25 percent or less of the overall capitalization rate. Further, there is no clear guidance on what equity rate of return farmers should expect to receive.

Finally, that elusive equity rate of return should be used to determine approximately 75 percent of the overall capitalization rate. Even if a "good" equity rate of return were available, there is still a possibility that a decrease in the mortgage rate could cause an increase in land values not supported by an increase in farm income.

#### Goal of Use Value Taxation

The goal of using use values is to have agricultural land taxed at a rate supported by the expected income stream for that property. Further, it is desirable that the dollar amount of taxes not vary substantially from year to year and that what changes there are should cause taxes to vary directly with the expected income stream from the property.

\* As long as the capitalization rate depends on the mortgage rate of interest, it is impossible to be certain that changes in use values will occur in the same direction as changes in farm income.

#### Desirable Results of Fixing the Capitalization Rate

If the capitalization rate were fixed at the current capitalization rate used by the Division of Property Valuation, 11.69 percent, (or any other desired rate), the following desirable results would occur:

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## Historic Capitalization Rates

	Valuation Year															
	1995		1996		1997		1998		1999		2000		2001		2002	
	Yr	Rate	Yr	Rate	Yr	Rate	Yr	Rate	Yr	Rate	Yr	Rate	Yr	Rate	Yr	Rate
Federal Land Bank /	89	11.30	90	11.75	91	11.60	92	10.25	93	9.23	<b>94</b>	<b>10.53</b>	<b>95</b>	<b>9.60</b>	96	8.20
Farm Credit Bank	90	11.17	91	11.60	92	10.25	93	9.23	94	10.53	95	9.60	96	8.20	97	8.53
Agricultural Land	91	10.67	92	10.25	93	9.23	94	10.53	95	9.60	96	8.20	97	8.53	98	7.85
Loan Rate	92	10.25	93	9.23	94	10.53	95	9.60	96	8.20	97	8.53	98	7.85	99	7.81
	93	9.23	94	10.53	95	9.60	96	8.20	97	8.53	98	7.85	<b>99</b>	<b>7.81</b>	<b>00</b>	<b>8.67</b>
Five yr. avg. loan rate:	1993 values		10.67		10.24		9.56		9.22		8.94		8.40		8.21	
Add-on rate:	were used		0.75		0.75		0.75		0.75		0.75		0.75		0.75	
Directors add-on rate:	for 1994		0.38		0.81		1.49		2.00		2.00		2.00		2.00	
Capitalization Rate:	and 1995.		11.80		11.80		11.80		11.97		11.69		11.15		10.96	
											-2.34%		-4.62%		-1.70%	
											-0.28		-0.54		-0.19	

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