

MINUTES OF THE HOUSE COMMITTEE ON TAXATION

The meeting was called to order by Chairman Edmonds at 9:00 a.m. on April 2, 2002 in Room 519-S of the Capitol.

All members were present except: Representative Mays, excused

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

Conferrees appearing before the Committee: Senator Jenkins
Representative Larkin
Chuck Stones, Kansas Bankers Association
Jack Ovel, Commerce Trust Company, Kansas City
Ace Rowley, Private Bank of Bank of America

Others Attending: See attached list.

Hearing was opened on

SB 575 - Income tax withholding required upon certain income distributions and prize money.

Representative Jenkins presented testimony in support of **SB 575** (Attachment #1), testifying that this provision would give the Department of Revenue authority to require Kansas income tax withholding on nonresident individual partners of S corporation shareholders and professional athletes. Under current law nonresident partners, shareholders, and athletes are already required to pay Kansas tax on Kansas source income. This proposal helps ensure that Kansas does collect the tax and may accelerate the receipt of payments.

Charles Stones presented testimony in support of **SB 575** on behalf of the Kansas Bankers Association (Attachment #2). Mr. Stones testified that the language in Section 2 would clarify when taxes are required to be withheld at the state level for those payers other than an employer.

Hearing was closed on SB 575.

Hearing was opened on

HB 3030 - Resident trust definition for income tax purposes.

Jack Ovel, Executive Vice President, presented testimony on behalf of Commerce Trust Company in opposition to **HB 3030** (Attachment #3). He commented on three general issues: (1) the most important concern is the costly administrative burden and enforcement challenges it would create; (2) it would likely create very little additional revenue; and (3) this change would have an unintended consequence of affecting the Kansas economy adversely if an individual who wishes to preserve his trusts from the potential of paying Kansas tax on gains and accumulations might move out of Kansas.

In response to questions, Mr. Ovel said you could avoid paying Kansas income tax if the trust is administered by a Missouri bank and that is an incentive to have trusts in Missouri banks.

Testimony in opposition to **HB 3030** was presented by Ace Rowley, Senior Vice President, Bank of America (Attachment #4). He believes the present statute embodies a practical taxing policy and the proposed amendment will thrust Kansas into an existing controversy, referring to litigation in the Missouri Supreme Court. He mentioned unintended consequences that were of concern.

CONTINUATION SHEET

In response to questions he said in *Swift*, the first Missouri case, it was found unconstitutional (*John C. Swift, et al v. Director of Revenue, State of Missouri*, 727 S.W.2d 880, Supreme Court of Missouri 1987). In *Westfall*, the second case, it was found to be constitutional (*Westfall v. Director of Revenue, State of Missouri*, 812 S.W.2d 513, Supreme Court of Missouri 1991).

The Committee recessed at 9:30 a.m. and reconvened at 12:00 noon

Representative Larkin presented testimony in support of **HB 3030 (Attachment #5)**. He explained that the bill attempts to close a loophole or tax avoidance discovered a number of years ago. This proposal has passed the house in prior years at least once. A trust administered by out-of-state bank is not subject to state income tax. Representative Larkin's testimony included a letter from the General Counsel of the Department of Revenue dated March 14, 1994 explaining that the existing definition of resident trust allows certain trust income to avoid taxation by the State of Kansas. At present a trust administered in Missouri or any other state can legally avoid paying the Kansas tax.

Richard Cram, Department of Revenue, provided for the Committee a copy of the Missouri Statute and of the *Swift* and *Westfall* decisions. He also provided information on two other cases involving resident trusts: *District of Columbia v. Chase Manhattan Bank*, 689 A.2d 539 (1997); and *Chase Manhattan Bank, Trustee, et al. v. Gene Gavin, Commissioner of Revenue Services*, 249 Conn. 172, 733 A2d 782, Supreme Court of Connecticut 1999.

Hearing was closed on **HB 3030**.

Consideration was opened on **HB 2396 - Property tax valuation increases limited**.

Chairman Edmonds noted the Committee held hearing March 19, 2001 on **HB 2396**. On March 23, 2002 it was amended and reported favorable for passage as amended. It was rereferred March 29, 2001.

Representative Palmer moved, Representative L. Powell seconded, that HB 2396 be amended by returning it to the form it was reported by the Committee. Motion was adopted.

Representative L. Powell moved, Representative T. Powell seconded, that HB 2396 be reported favorable for passage as amended. Motion was adopted.

Meeting adjourned at 12:15 p.m. Next meeting is April 3.

GUEST LIST

DATE April 2, 2002

NAME	REPRESENTING
Daryl Craft	K Banks & Asso. TRUST Division
Larry R Base	CKM
Chuck Stoms	KBA
Jack Ovel	Commerce Bank of KC
Jackie Clark	Hallmark Agency
Bill Sneed	Kansas Speedway Corp.
Ann Danko	DOB
Erik Sartorius	City of Overland Park
J.P. Small	Koch Industries
Samantha Blakney	
Alan Miller	
Chris Pyles	
Josh Garner	
Jesse Anderson	
Shirley Caldwell	Toshiba Channel of Comm.
Dorothy Smith	KMTA
Dell Gray	KCA
Ann Grebes	Commerce Bank
Mike Reese	AT&T
Andy Shaw	Kearney Law Office



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LEGISLATIVE POST AUDIT
JOINT COMMITTEE ON
ECONOMIC DEVELOPMENT

House Taxation Committee

April 2002

SB 575

Mr. Chairman and members of the committee, thank you for the opportunity to appear today in support of Senate Bill 575. The concept behind this proposal is simple and is borrowed from other states, a few of which surround us.

This provision would simply give the Kansas Department of Revenue the authority to require Kansas income tax withholding on nonresident individual partners or S corporation shareholders, and professional athletes. Under current law nonresident partners, shareholders, and athletes are already required to pay Kansas tax on Kansas source income. All this proposal does is to help insure that Kansas does collect the tax, and it may accelerate the receipt of the payments.

I believe the department already requires similar withholding on nonresident beneficiaries of estates and trusts, and obviously we require withholding from the majority of hard working Kansas residents. I don't believe nonresidents should receive favorable tax consideration.

The fiscal note is a positive \$500,000, which is the result of the acceleration effect. It is unknown how the increase in compliance would affect the state, but that should have an additional positive affect.

I'd be happy to stand for questions.

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Attach. No. 1
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The Kansas Bankers Association

April 2, 2002

To: House Committee on Taxation

From: Chuck Stones, Kansas Bankers Association

Re: SB 575

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to appear before you today in support of SB 575, specifically Section 2 of the bill. That section will clarify when taxes are required to be withheld at the state level for those payors other than an employer.

K.S.A. 2001 Supp. 79-32,100a was passed by the 2000 Legislature to provide for state withholding of taxes on payments other than wages or distributions. Examples of the types of payments covered include periodic payments of pensions, annuities and other deferred income (including IRA's).

Since the passage of this law, there has been some confusion among payors regarding when the payor is **required** by the state to withhold state taxes. There are instances when taxpayers **elect** to have taxes withheld and there are instances when federal law **requires** that taxes be withheld. The language in Section 2 would clarify that payors are required to withhold taxes at the state level when they are required to withhold taxes at the federal level. Taxpayers may still elect to withhold taxes at the federal and at the state level as they wish and payors will be required to comply with their request.

Thank you once again for the opportunity to present this testimony. We would respectfully request that the Committee look favorably upon the provisions of **SB 575**.

House Bill 3030

House Taxation Committee

Testimony by

**Jack Ovel
Executive Vice President
Commerce Trust Company**

April 2, 2002

Good morning, Chairman Edmonds, and members of the committee. My name is Jack Ovel. I am Executive Vice President and head of trust services for Commerce Bank in the Kansas City region. I have spent more than 30 years in the trust industry, and have been with Commerce for the last two years. Commerce provides trust services in Kansas, Missouri and Illinois.

I'm here this morning to testify in opposition to House Bill No. 3030, the resident trust bill. My purpose is to share with you Commerce Bank's perspective on how this bill would affect Kansas. I actually appeared before committees in the Kansas Legislature in 1995 when this issue was considered (and rejected) previously.

HB 3030 would modify the Kansas statutes affecting the definition of resident trusts that are subject to Kansas income tax. Under current law, a resident trust is a trust administered in the state of Kansas. The change would make a trust a resident trust if its creator were a resident in the state of Kansas at the time of death.

There are three general issues I will focus on this morning in describing the disadvantages of changing this definition of resident trusts.

1. The most important concern is the costly administrative burden and enforcement challenges this bill would create.
2. In addition to being costly to administer, this bill would likely create very little additional revenue.
3. And finally, this change could have an unintended consequence of affecting the Kansas economy adversely.

Administration/Enforcement

The administrative burdens and enforcement issues are significant. For instance, it will not always be clear where the residence of the creator is located. Many trusts in existence today are very old, and records are often lacking for determining the state of residence of the creator at the time trust was established. Further, some trusts have multiple creators, not always residents of the same state. And since trusts are scattered across the country, it is very likely that remote trustees would be unaware of this tax liability.

From a tax enforcement standpoint, the Kansas Department of Revenue would face the same challenges as trustees in identifying trusts with Kansas creators.

Under the current definition of resident trust, Kansas can clearly identify the trusts subject to Kansas income tax, making enforcement thorough and efficient.

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Revenue

To our knowledge, no one has yet provided you with an estimate of how much revenue would be generated for the state of Kansas. Our own review of the Commerce trust activity in Kansas City suggests that the state would raise little additional revenue. First, many trusts are revocable, making all the income as well as the capital gains taxed in Kansas for a Kansas resident, regardless of where the trustee is located. Second, in the case of irrevocable trusts, the vast majority of these trusts do not accumulate the income, so a Kansas beneficiary receiving the income from the trust pays Kansas income tax. Here again, the location of the trustee does not make a difference.

There is no longer any significant tax advantage to accumulating income in trusts. Of the total of approximately 2,000 personal trust accounts in our Kansas City office, about 7% accumulate income. In many of those cases, the income is being accumulated for a minor until they reach age 21. And many of those accounts have no connection to Kansas.

Unintended Consequence

The final point I wanted to mention was the possibility that an unintended consequence could result from the passage of this proposal. An individual who wishes to preserve his trusts from the potential of paying Kansas tax on gains and accumulations might be advised to move out of Kansas. In that case, the state of Kansas loses the income tax revenue, the sales tax revenue, and the property tax revenue from that individual.

In closing, I want to emphasize that the proposal would be difficult to administer and enforce, the additional revenue generated may not be significant, and the worst consequence could be the creation of a disincentive for individuals to live in Kansas.

Thank you for this opportunity to discuss the resident trust issue with you today. For all of the reasons I have mentioned, I encourage you not to adopt HB 3030.

Resident Trusts (House Bill No. 3030)

Committee on Taxation

Testimony by

**Ace Rowley
Senior Vice President
Bank of America**

April 2, 2002

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Good morning, Chairman Edmonds and members of the committee. My name is Ace Rowley. I am a senior fiduciary officer with the Private Bank of Bank of America. In that capacity, I chair the Administrative and Investment Review Committee for the Kansas Region. On a national level, I am a member of our company's Trust Policy and Fiduciary Executive Committees. I have worked in the trust industry for more than seven years. For eight years prior to that, I was a litigation attorney with the Kansas City law firm of Stinson, Mag and Fizzell.

My testimony in opposition to House Bill No. 3030, the resident trust bill, will focus on three areas. First, I will comment on the strengths of the present statute. The statute is not broken, and therefore, it does not need to be fixed. Second, I will comment on the controversies that will accompany the adoption of the proposed bill. The compliance and enforcement burden that would be created by the proposed bill will be significant. Third, I will comment on the unintended consequences the proposed bill may cause. House Bill No. 3030 may not generate additional revenue nor assure that more trusts are taxed.¹

The Present Statute Embodies a Practical Taxing Policy

The current tax policy in K.S.A. Section 79-32,109(d) provides that if a trust is administered within Kansas, then Kansas income tax laws will apply to the trust. This approach gives all interested parties, including the Department of Revenue, what has been proven to be clear guidance regarding this issue. Indeed, the statute has never been challenged on constitutional or other grounds.

At its core, K.S.A. Section 79-32,109(d) is a practical taxing policy. Grantors and beneficiaries regularly choose to have their trusts administered in Kansas. They do so for a variety of reasons including a commitment to the people and institutions that make up Kansas. The individuals that choose to directly use and continuously use Kansas resources expect to pay Kansas taxes. As a result, Kansas' current tax policy in this area appears to be sound and reasonable.

The Proposed Amendment Will Thrust Kansas into an Existing Controversy

If Kansas adopts House Bill No. 3030, Kansas will be stepping into the middle of an existing controversy. State statutes that attempt to tax trusts solely on the basis of the domicile of the testator or grantor have been, and will continue to be, challenged on, among other grounds, due process concerns. These concerns will likely include significant enforcement and judicial challenges. Under these circumstances, a decision to adopt House Bill No. 3030 must also be accompanied by an expectation that tax dollars will be spent to enforce and defend the new law.

¹ To simplify my testimony, I will use the term trust or trusts to refer to the types of non-grantor trusts that would be affected by this proposed amendment, which are testamentary trusts and inter vivos irrevocable trusts.

The weakness in Missouri's law is a good example of why Kansas should not adopt House Bill No. 3030. Many years ago Missouri enacted a statute similar to House Bill No. 3030. Beginning in the late 1980's, Missouri's statute was subject to serious due process challenges. The Missouri Supreme Court on two separate occasions addressed the constitutionality of the statute with complex tests. This costly litigation introduced considerable compliance and enforcement uncertainty into the trust taxation area. In 2000, after 15 years of this uncertainty and in an attempt to address these problems, Missouri amended its statute to require an additional connection between Missouri and the trusts it taxes. There are, however, no assurances that this "fix" will resolve the due process concerns spawned by this approach. Because the present Kansas' statute works, there is no reason why Kansas should invite the problems experienced by Missouri by adopting House Bill No. 3030.

Unintended Consequences

If Kansas adopts House Bill No. 3030, the result may be remarkably different than is intended. House Bill No. 3030 will not assure that the State collects additional tax revenue. Moreover, it may not even assure that more trusts are taxed. This proposal may only create additional enforcement and litigation expenses.

House Bill No. 3030 will not assure that additional tax revenue will be captured. While the proposed amendment may result in "new" trusts being taxed, certain other trusts that are currently being taxed by Kansas will become exempt from taxation. This will occur because there are trusts administered in Kansas that were **not** created by Kansas residents. As a result, absent a comprehensive study (even if such a study is possible), from a revenue perspective, House Bill No. 3030 does not offer a certain, substantial increase in state revenue.

Once you move beyond the face of the proposed bill, the unintended consequences increase. As Kansas addresses the constitutional issues discussed above, additional tests will likely be added to the statute by judicial or legislative means. These additional tests will narrow the scope of the statute. This will further reduce the number of trusts that will be taxed. This will further reduce revenue. This was our experience in Missouri.

Even setting aside the concerns discussed above, numerous practical concerns will emerge from applying the proposed new statute to trusts, particularly older trusts. These concerns also place administrative burdens on trustees and enforcement burdens on Kansas. Moreover, for individuals that desire to fashion an estate plan that is free from the state's income tax, the change in the law will create an incentive for such individuals to avoid residing in Kansas. Thus, by adopting House Bill No. 3030, Kansas may also experience a decline in current revenue from income, sales and property taxes that it might otherwise earn from such individuals.

Thank you for your time in considering my comments. It is my hope that you will not adopted House Bill No. 3030.

4/2

BRUCE F. LARKIN
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MEMBER: AGRICULTURE
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INTERSTATE COOPERATION

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HOUSE OF
REPRESENTATIVES

TESTIMONY IN SUPPORT OF

HB 3030

**BEFORE THE
HOUSE TAXATION COMMITTEE**

Chairman Edmonds and Members of the Committee:

HB 3030 closes a loophole in the state law relating to trusts administered by out-of-state banks. Under current law, trusts administered by out-of-state banks are not subject to Kansas income tax. Missouri closed this loophole years ago and the language in this bill is similar to the law passed in Missouri.

Closing this loophole will have a positive fiscal note to the state. The House has passed this a couple times in the past, but it was never given consideration by the Senate.

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STATE OF KANSAS



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Department of Revenue
Legal Services Bureau

MEMORANDUM

To: The Honorable Keith Roe, Chairperson
House Committee on Taxation

From: Mark A. Burghart, General Counsel
Kansas Department of Revenue

Date: March 14, 1994

RE: H.B. 2987 - Definition of Resident Trust

Thank you for the opportunity to appear in support of H.B. 2987. The bill amends the definition of resident trust which is utilized for state income tax purposes. The Department of Revenue has recently learned that the existing definition of resident trust allows certain trust income to avoid taxation by the State of Kansas. Under current law, a trust is considered a resident trust and subject to the state income tax only if the trust is administered in the state. H.B. 2987 would amend the definition to provide that a resident trust includes: (1) a trust created by will of a decedent who at the time of death was domiciled in this state; or (2) a trust created by, or consisting of property of, a person domiciled in this state on the date the trust or portion of the trust becomes irrevocable. Missouri and a number of other states have adopted the definition of resident trust proposed in H.B. 2987.

KANSAS RATE STRUCTURE

K.S.A. 1993 Supp. 79-32,110(d) imposes a tax on the taxable income of trusts. The Kansas taxable income of a trust is the federal taxable income with certain state adjustments. The state adjustments generally are those used to determine Kansas taxable income for individual taxpayers. The rates applicable to trusts are as follows:

<u>Taxable Income</u>	<u>Tax Rate</u>
Not over \$20,000	4.4%
\$20,000 - \$30,000	7.5%
over \$30,000	7.75%

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Under the existing statutory scheme, Kansas residents need only appoint a Missouri trustee to avoid income tax on the trust income in both Kansas and Missouri. This situation is allowed to occur simply because of the differing definitions of resident trust between Kansas and Missouri.

EXAMPLE:

CURRENT LAW

Kansas resident creates a trust the assets of which consist primarily of intangibles (stocks, bonds, CD's.) A Missouri trustee is appointed. The trust generates taxable income of \$40,000. Under these circumstances, no tax is paid in Kansas or Missouri on the trust income.

H.B. 2987

Same facts as above. Under H.B. 2987, the tax liability to the State of Kansas would be \$2,405. No tax would be paid to the State of Missouri on the trust income.

The further development of interstate banking is expected to increase the number of Kansas residents creating trusts which are administered in Missouri or other states. The revenue loss to Kansas resulting from the current statutory scheme cannot be determined because no data exists which identifies the precise number of trusts where a nonresident trustee has been appointed. It is apparent that the enactment of H.B. 2987 would have a positive fiscal impact on the state general fund.

The Department respectfully requests your favorable consideration of H.B. 2987. I would be happy to respond to any questions you might have.