

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE.

The meeting was called to order by Chairperson Senator David Corbin at 10:45 a.m. on January 15, 2002, in Room 519-S of the Capitol.

All members were present except: Senator Pugh

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

Conferees appearing before the committee: None

Others attending: See attached list.

Senator Corbin called upon April Holman and Chris Courtwright, Kansas Legislative Research Department, for a briefing on the committee reports of the Special Committee on Assessment and Taxation on 2001 Interim study topics.

Ms. Holman reviewed the reports on the following topics:

- Implementation of the Federal Mobile Sourcing Act (Attachment 1)
- Implications of Professional Employer Organizations on the Kansas Tax Code (Attachment 2)
- Property Tax on Rental Equipment (*Kansas Enterprises, Inc. v. Frantz*) (Attachment 3)
- Sales and Use Taxation of Telecommunications and Broadband Equipment (Attachment 4)

Mr. Courtwright reviewed the reports on the following topics:

- Agricultural Land Use Valuation for Property Tax Purposes (Attachment 5)
- Investment Service Company Apportionment (Attachment 6)
- Local Sales Tax on Natural Gas (Attachment 7)
- Regents Foundation Income Tax Credits (Attachment 8)
- Shortline Railroad Income Tax Credits (Attachment 9)
- Streamlined Sales Tax (Attachments 10 and 11)

The meeting was adjourned at 11:40 a.m.

The next meeting is scheduled for January 22, 2002.

IMPLEMENTATION OF THE FEDERAL MOBILE SOURCING ACT

CONCLUSIONS AND RECOMMENDATIONS

The Committee recommends introduction of a bill conforming Kansas law to the federal Mobile Telecommunications Sourcing Act (MTSA). In so doing, the Committee recognizes the importance of minimizing any loss in state tax revenues due to the implementation of the federal mobile sourcing provisions in other states. Members of the Committee expressed the preference that Kansas not create a state database assigning each street address within the state to the appropriate set of taxing jurisdictions as this would likely result in a considerable cost to the state. Instead, the Committee would prefer to allow telecommunications service providers to create their own databases assigning street addresses to taxing jurisdictions using a nine-digit zip code methodology, as is permitted under the MTSA.

Proposed Legislation: The Committee recommends one bill.

BACKGROUND

At the request of the mobile telecommunications industry, the Legislative Coordinating Council (LCC) assigned the topic of implementation of the federal MTSA to the Special Committee on Assessment and Taxation.

On July 28, 2000, the federal MTSA was signed into law. The law provides for a uniform method of sourcing tax revenues from the sales of mobile transactions, thereby avoiding multiple taxation of a customer's purchase of wireless telecommunications services. Two key components of the law are establishment of a "place of primary use," and the creation of state databases assigning street addresses to state and local taxing jurisdictions.

Under the law, tax revenues from sales of wireless telecommunications services are sourced to the customer's place of primary use. This is defined as the residential or business street address of the customer, regardless of the state

where the individual's calls originate, terminate, or pass through. This address also must be within the licensed service area of the customer's home service provider.

In order to facilitate the new method of sourcing, the MTSA allows for states to create a state-level database assigning each street address within the state to the appropriate set of taxing jurisdictions. Carriers using a state database are held harmless for mistakes in assigning street addresses to taxing jurisdictions. If a state chooses not to create the database, a carrier may develop a database that assigns street addresses to taxing jurisdictions using a nine-digit zip code methodology. So long as the carrier exercises due diligence in creating and maintaining the database, the carrier is held harmless under the law for any under-collected tax liability arising from a good faith mistake in matching street addresses to taxing jurisdictions.

The effective date of the MTSA is August 2, 2002.

COMMITTEE ACTIVITIES

The Committee held hearings on this topic at the September meeting. At that time representatives of Verizon Wireless, Sprint PCS, Cingular Wireless, and AT&T Wireless stood in support of Kansas conformity to the MTSA. Conferees explained that the provisions of the MTSA will take effect in August, 2002. At that time, any benefit that Kansas has received from calls originating in Kansas by non-Kansas customers will end. In order to offset the loss of these revenues, it will be necessary to implement the MTSA so that calls made by Kansas customers originating out-of-state will be sourced to Kansas.

Conferees also requested language in any MTSA conformity bill to require customers who have received an erroneous tax billing to first notify the mobile telecommunications service provider of the error and allow the provider an opportunity to remedy the error before the

customer could file a class action lawsuit against the service provider.

CONCLUSIONS AND RECOMMENDATIONS

The Committee recommends introduction of a bill conforming Kansas law to the MTSA. Enactment of this bill would accomplish this recommendation. In so doing, the Committee recognizes the importance of minimizing any loss in state tax revenues due to the implementation of the federal mobile sourcing provisions in other states. Members of the Committee expressed the preference that Kansas not create a state database assigning each street address within the state to the appropriate set of taxing jurisdictions as this would likely result in a considerable cost to the state. Instead, the Committee would prefer to allow telecommunications service providers to create their own databases assigning street addresses to taxing jurisdictions using a nine-digit zip code methodology, as is permitted under the MTSA.

IMPLICATIONS OF PROFESSIONAL EMPLOYER ORGANIZATIONS ON THE KANSAS TAX CODE

CONCLUSIONS AND RECOMMENDATIONS

The Committee learned that Professional Employer Organizations (PEOs) are a relatively new but growing business in Kansas. PEOs assist primarily smaller businesses (those under 200 employees) with all aspects of human resource services necessary to run an effective business.

As to the treatment of PEOs for tax purposes, both the Department of Revenue and the Department of Commerce and Housing testified that statutory language is necessary to clarify that qualifying tax credits and that the employment factor of the apportionment formula remain with the primary business should such business enter into a co-employment agreement with a PEO. The Committee heard from the Association of Professional Employer Organizations that they would support such legislation.

The Interim Committee therefore recommends passage of Section 2 (definitions) and Section 3(c) (requirement of written contract and tax language) of 2001 Senate Substitute for SB 121 be enacted by the 2002 Legislature. Other issues in that bill should more appropriately be dealt with by the House Labor and Industry Committee, which currently has SB 121 before it.

Proposed Legislation: None

BACKGROUND

The tax issues surrounding professional employer organizations (PEOs) were a part of 2001 Substitute for SB 121, which passed the Senate in the 2001 Legislative Session.

A PEO is a business organization that contracts with small business owners to provide comprehensive human resource services through a co-employment arrangement. Legislation was proposed in the 2001 Legislative Session to codify the relationship between a PEO and the business and employees for whom they provide services.

In its current form, Substitute for SB 121 includes provisions relating to con-

tracts, employment/labor law, and liability in addition to the tax implications studied by the Committee. The tax implications fall into two areas: identifying the responsible party for income tax withholding and identifying the employer for tax and tax incentive treatment.

Under the bill, the PEOs would be considered the employer for purposes of Kansas income tax withholding, while the client would give payroll information for assigned workers to the Department of Revenue for income tax purposes and would be considered the employer to qualify for certain tax incentives.

COMMITTEE ACTIVITIES

At the August meeting, the Director of

the Office of Research and Policy at the Department of Revenue told the Committee that the amendments relating to taxation made in Substitute for SB 121 satisfied the Department of Revenues concerns about the bill.

The Committee also held a public hearing on the PEO topic at the August meeting. At that time, a representative of Oasis Outsourcing, a Kansas PEO, testified in favor of Substitute for SB 121. He described the role of a PEO and requested support for the statutory clarification of that role as provided in the substitute bill.

A representative of the Kansas Department of Commerce and Housing testified in support of the substitute bill, noting that the PEO arrangement is becoming more common and the agency does not want the use of a PEO to prevent otherwise qualified businesses from receiving economic development tax credits.

The Kansas Trial Lawyers Association testified in opposition to Substitute for SB 121, saying that it would create unnecessary statutory rights and immunities.

At the October meeting, the Committee reviewed a draft committee report and approved language for conclusions and recommendations.

CONCLUSIONS AND RECOMMENDATIONS

The Committee learned that PEOs are a relatively new but growing business in Kansas. PEOs assist primarily smaller businesses (those under 200 employees) with all aspects of human resource services necessary to run an effective business.

As to the treatment of PEOs for tax purposes, both the Department of Revenue and the Department of Commerce and Housing testified that statutory language is necessary to clarify that qualifying tax credits and that the employment factor of the apportionment formula remain with the primary business should such business enter into a co-employment agreement with a PEO. The Committee heard from the Association of Professional Employer Organizations that they would support such legislation.

The Interim Committee therefore recommends passage of Section 2 (definitions) and Section 3(c) (requirement of written contract and tax language) of 2001 Senate Substitute for SB 121 be enacted by the 2002 Legislature. Other issues in that bill should more appropriately be dealt with by the House Labor and Industry Committee, which currently has SB 121 before it.

PROPERTY TAX ON RENTAL EQUIPMENT
(KANSAS ENTERPRISES, INC. V. FRANTZ)

CONCLUSIONS AND RECOMMENDATIONS

The Committee has no recommendation on this topic at the present time. However, the Committee acknowledges the concerns voiced by conferees and agreed that it would revisit the issue if the property tax treatment of rental equipment becomes a widespread problem.

Proposed Legislation: None

BACKGROUND

At the request of Representative John Edmonds, Chairman of the House Taxation Committee, the Legislative Coordinating Council (LCC) assigned the topic of property tax on rental equipment to the Special Committee on Assessment and Taxation for further study.

The Kansas Supreme Court issued an opinion this year in the case of *Kansas Enterprises, Inc. v. Frantz*, which dealt with the property tax treatment of rental equipment.

Facts of the Case

The taxpayer in this case was a company that both rents and sells machinery and equipment. The taxpayer's business had originally been primarily the rental and sale of equipment used in home improvement, with a smaller portion of equipment being larger, and more expensive equipment used in construction. Over the years, the taxpayer went from having a majority of rental business in the smaller equipment to having a majority of sales business in larger equipment. In 1994, the taxpayer claimed a property tax exemption on the basis that the prop-

erty was merchant's inventory under Article 11 of the *Kansas Constitution* and KSA 79-201m.

Law

Constitutional. Article 11, section 1(b) of the *Kansas Constitution* provides a property tax exemption for property used for a variety of specific purposes, including "merchant's and manufacturer's inventories."

Statutory. KSA 79-201m provides an exemption from ad valorem property taxes for merchant's and manufacturer's inventory. The statute defines "merchant" as a person, company, or corporation that owns or holds personal property which has been purchased primarily for resale in the ordinary course of business without modification and without any intervening use except that incidental use (including the rental or lease of any such property) will not be deemed to be an intervening use. The statute goes on to define "inventory" as items of personal property which are either primarily held for sale in the ordinary course of business, are in the process of production for such sale, or are to be consumed either directly or indirectly in the production of

finished goods.

Case History

The State Board of Tax Appeals (SBOTA) found that the taxpayer in this case was a merchant under the statutory definition. However, SBOTA concluded that the taxpayer failed to present sufficient evidence to establish that the personal property for which the exemption was claimed was "purchased primarily for resale in the ordinary course of business and without any intervening use."

The case was appealed to the district court. That court held that the taxpayer was not a "merchant," but otherwise affirmed SBOTA's denial of the exemption. The case was then appealed to the Kansas Court of Appeals, but the Kansas Supreme Court exercised its jurisdiction over the case instead.

Supreme Court Ruling

The Kansas Supreme Court held that definitions of "merchant" and "inventory" are intertwined in KSA 79-201m. Therefore, SBOTA was in error when it found the taxpayer to be a merchant but denied the property tax exemption for its "inventory."

The Court went on to restate its ruling on a prior case, *Action Rent to Own, Inc.*, 266 Kan. at 300-304. That case dealt with whether a rent-to-own business could qualify for the merchant's inventory exemption under KSA 79-201m. In the *Action* case, the Court found that the Legislature did not intend to expand the merchant's inventory exemption to include assets that are rented in the ordinary course of business. Instead, the Court said that a 1989 amendment allowing for "incidental" use was enacted to

protect the inventory exemption of large equipment businesses that temporarily rent out their equipment for demonstration purposes prior to sale.

The Court also affirmed SBOTA's use of factors that may be considered in determining whether a taxpayer who holds the same tangible personal property for sale or rent is holding the property primarily for sale. These are:

- the age of inventory available for sale or rent;
- the average number of times a unit was rented prior to purchase; and
- the average length of the period for which units were rented prior to being sold. The Court clarified that this is not an exclusive test, but the taxpayer must demonstrate its entitlement to the exemption in some form.

The Court found that the taxpayer's argument that personal property physically located in the store on January 1, 1994, qualifies as exempt merchant's inventory was without merit, stating that the "ultimate question is the manner in which the property is being held, not its location at the time of assessment."

The Court found that the 1986 constitutional amendment to Article 11, section 1 of the *Kansas Constitution* is self-executing. As a result, the Legislature does not have the power to restrict the constitutional exemption for merchants' inventories or to adopt a definition of merchants' inventory that is inconsistent with the language of the amendment. The words in the *Kansas Constitution* are to be given the meaning that the words imply to people of common understanding. The Court also noted that the standard for determining whether a statute

regulating business is unconstitutionally vague is a common sense determination of fairness. If an ordinary person exercising common sense can understand and comply with the statute, it is constitutional.

Finally, the Court found that while uniformity and equality in valuation and rate of taxation are required by Article 11, section 1 of the *Kansas Constitution*, enforcement is an area that is historically nonuniform. Uniform and equal enforcement is not required by the *Kansas Constitution*.

COMMITTEE ACTIVITIES

The Committee held a hearing on this topic at the September meeting. At that time, Linda Terrill of Neill, Terrill &

Embree, L.L.C., presented testimony reviewing the *Kansas Enterprise* case and cautioning the Committee that this decision could place car dealers, retailers with rental inventory, and businesses that do not keep separate records for rental and sale inventory at risk of having all of their inventory be subject to property taxation.

CONCLUSIONS AND RECOMMENDATIONS

The Committee has no recommendation on this topic at the present time. However, the Committee acknowledges the concerns voiced by the conferee and agreed that it would revisit the issue if the property tax treatment of rental equipment becomes a widespread problem.

SALES AND USE TAXATION OF TELECOMMUNICATIONS AND BROADBAND EQUIPMENT

CONCLUSIONS AND RECOMMENDATIONS

The Committee recommends the concept of a sales tax exemption for telecommunications and broadband equipment for favorable consideration by the 2002 Legislature. In so doing, the Committee recognizes the important role played by the telecommunications industry in Kansas and the need for capital investments to keep up with rapidly advancing technology in that industry. The Committee also acknowledges that 18 other states and the District of Columbia already provide a sales tax exemption for telecommunications and broadband equipment or offer a tax credit for their purchase. Because technological advances have enabled telecommunications service providers to place switches in states with favorable tax policies, this serves to put Kansas at a competitive disadvantage.

Proposed Legislation: None

BACKGROUND

At the request of the telecommunications industry, the Legislative Coordinating Council (LCC) referred the topic of sales and use taxation of telecommunications and broadband equipment to the Special Committee on Assessment and Taxation for further study.

Under current Kansas law, purchases of telecommunications and broadband equipment are subject to state sales and use taxes. According to the telecommunications industry, this is a factor in the financial feasibility of expanding in Kansas and upgrading equipment to keep up with rapidly advancing technology.

COMMITTEE ACTIVITIES

The Committee held a hearing on this topic at the September meeting. Conferrees testifying in favor of a sales and use tax exemption for telecommunications and broadband equipment included representatives from AT&T, SBC Commu-

nications, Sprint, and Verizon.

The telecommunications industry pointed to several factors in favor of providing the sales tax exemption for telecommunications and broadband equipment. The first of these was in relation to economic development. Industry conferees noted that 18 states and the District of Columbia either currently exempt communications equipment from sales tax or offer a tax credit for their purchase. They also noted that new technology allows telecommunications service providers considerable flexibility in determining the placement of digital switches. As a result, the service providers can choose to place switches in states with favorable tax policies.

The industry pointed to the growing demand from business and residential customers for broadband services, including high-speed Internet access via fiber optics, cable modems, hybrid fiber coaxial cable, digital subscriber line (DSL), and wireless technologies. It was noted

that virtually every industry in the state relies on telecommunications and a quality telecommunications system is a vital component of a strong economy. However, telecommunications service providers investments in this area will be made where it makes the greatest economic sense for the provider.

Conferees argued that manufacturing equipment is exempt from Kansas sales and use taxes and therefore telecommunications equipment should be afforded similar treatment.

Finally, conferees explained that the current economic slowdown and deterioration in the capital markets are causing telecommunications service providers to take a closer look at future capital spending plans. According to the telecommunications industry, passage of a sales tax exemption for telecommunications and broadband equipment would result in a fiscal note of between \$6.0 and \$8.0 million, once fully phased in.

CONCLUSIONS AND RECOMMENDATIONS

The Committee recommends the concept of a sales tax exemption for telecommunications and broadband equipment for favorable consideration by the 2002 Legislature. In so doing, the Committee recognizes the important role played by the telecommunications industry in Kansas and the need for capital investments to keep up with rapidly advancing technology in that industry. The Committee also acknowledges that 18 other states and the District of Columbia already provide a sales tax exemption for telecommunications and broadband equipment or offer a tax credit for their purchase. Because technological advances have enabled telecommunications service providers to place switches in states with favorable tax policies, this serves to put Kansas at a competitive disadvantage.

Special Committee on Assessment and Taxation

AGRICULTURAL LAND USE VALUATION FOR PROPERTY TAX PURPOSES

CONCLUSIONS AND RECOMMENDATIONS

The Committee recommends that the Property Valuation Division (PVD) of the Department of Revenue continue the current crop mix adjustment methodology; provide enhanced use-value educational programs; and provide documentation narrative regarding statutory interpretation and implementation of use valuation procedures.

Proposed Legislation: None

BACKGROUND

The Legislative Coordinating Council approved the request for an interim study on agricultural land use valuation issues, a number of which were discussed in a technical assistance report prepared by a consultant and which were also addressed in 2001 SB 129. That bill passed the Senate on March 15, 31-9, and currently remains in the House Taxation Committee.

SB 129, as amended by the Senate Committee of the Whole, would make a number of amendments to the statute providing for the use valuation of agricultural land for property tax purposes. Regarding the valuation of pasture or rangeland, net rental income normally received by landlords as derived from data collection by such landlords within each county or homogeneous region, as well as the stocking rate for such counties or homogeneous regions, would be re-

quired to be the sole basis for determining agricultural income from such land. Soil classifications for such land would be prohibited from being considered in the determination of agricultural income.

County or district appraisers also would be given authority to deviate from state use valuation guidelines by applying influence factors that have been approved by the Land Devoted to Agricultural Use Influence Factor Approval Board (LDAUIFAB), a new entity which would be created by the bill. The LDAUIFAB would be composed of three county appraisers appointed by the Kansas Association of County Appraisers (one such appointee from crop reporting districts one through three, one appointee from districts four through six, and one from districts seven through nine); and one member designated by the Property Valuation Director. Any decisions of the LDAUIFAB regarding the application of influences would not affect the ability of

taxpayers to prosecute valuation appeals.

Additional amendments would provide definitions for "land class" and "homogeneous region." A land class would be deemed to include cultivated dry land, cultivated irrigated, wetlands, native pasture and rangeland, and tame pasture and rangeland. Homogeneous region would be deemed to mean "an area of land which shares the same or similar topography, soil composites, climatic and rainfall conditions, which has a prevailing common usage, and which may include all or part of one or more counties."

The bill would have an impact on local effort for school finance purposes to the extent that the valuation of agricultural land would be changed relative to current law.

A fiscal note from the Department of Revenue on the original bill said that at least one part of the bill, the prohibition against considering soil classifications in the determination of income from pasture or rangeland, could be expected to INCREASE valuation on a statewide basis.

COMMITTEE ACTIVITIES

At the September meeting, the PVD Director explained the methodology used to value agricultural land. In October, the Director presented the technical assistance report. The Committee also then held the public hearing on SB 129

and on other use value issues. Conferees from Kansas Farm Bureau and the Kansas Livestock Association were supportive of the provisions of SB 129, especially the section giving county appraisers greater authority to deviate and apply influence factors. Other suggestions included recommending that PVD continue to utilize the current procedure relating to adjustments to crop mixes and incomes (net income recalculation and averaging when a crop first occupies more than 5 percent of the acres); and recommending additional use-value educational programs.

The Kansas County Appraisers Association opposed two different provisions of SB 129: the determination of net rental income received by landlords and stocking rates exclusive of soil classifications; and language allowing the LDAUIFAB to substitute its opinion over the opinion of professional soil scientists.

CONCLUSIONS AND RECOMMENDATIONS

The Committee recommends that PVD continue the current crop mix adjustment methodology. The Committee further recommends that PVD provide enhanced use-value educational programs for taxpayers. Finally, the Committee asks that PVD provide documentation or a narrative regarding statutory interpretation and implementation of all use valuation procedures. The Committee makes no recommendation regarding SB 129.

INVESTMENT SERVICE COMPANY APPORTIONMENT

CONCLUSIONS AND RECOMMENDATIONS

The Committee recommends that the Legislature approve new legislation being developed by the Department of Revenue and proponents of HB 2061 that would provide, effective for tax year 2002, favorable tax treatment for investment fund service companies but with a provision that phases in the fiscal impact over two years.

Proposed Legislation: None

BACKGROUND

The Legislative Coordinating Council approved the request for an interim study on the subject matter of 2001 HB 2061. That bill would provide an exception to the three-factor income apportionment formula for investment funds service companies. (The three-factor formula is based on property, payroll, and sales.) The bill would allow such companies to elect to have income apportioned to Kansas based on the number of shares owned by resident shareholders at the end of the year divided by the total number of shares owned by all shareholders. Proponents said that HB 2061 was based on a similar law in effect in Missouri for investment fund service companies.

After an initial public hearing, the bill was referred by the House Taxation Committee to a subcommittee chaired by Representative Peggy Palmer.

Based on input from the Department of Revenue, the subcommittee asked that a number of issues with respect to the original bill be addressed by proponents relative to differences between the legislation and Missouri's law. (The proponents subsequently responded with suggested amendatory language to address these concerns, though such changes

were never forwarded by the subcommittee for adoption by the full committee prior to the end of the session.) Some of those issues included:

- The Department of Revenue noted that the definition of such companies in HB 2061 includes no restriction as to the percentage of total business activity, income, or gross receipts from providing management, distribution, advisement, or administration services to or on behalf of investment companies, while Missouri's law limits such income to 50 percent.
- The Department also said that Missouri's law uses the average number of shares throughout the year rather than the number owned at the end of the year.
- The Department said that Missouri's law excludes certain nonqualifying income of such companies from the special apportionment option, while HB 2061 does not.
- The Department said that the bill contains no details as to how or when the election could be made by the taxpayer.

The Department also noted that cur-

rent language in KSA 79-3288 authorizes investment service fund companies to petition the Secretary of Revenue for relief to the extent that the current apportionment formula does not fairly represent the extent of their business activity in Kansas.

The Department of Revenue and the Budget Division indicated that the original bill would have a fiscal note of \$3.84 million.

COMMITTEE ACTIVITIES

The Special Committee held a public hearing on the issue in August. A representative of Waddell and Reed indicated that a letter from the Secretary of Revenue had indicated that he felt it was beyond his scope of authority to grant tax relief administratively. Proponents of HB 2061 also said that the mutual fund industry was highly competitive and that Kansas' tax structure did not compare favorably with the aforementioned provisions of law in Missouri.

The Department of Revenue reiterated its belief that the fiscal impact would be \$3.84 million and said that it would continue to work with Waddell and Reed on some of the issues identified in the subcommittee discussion.

In October, the Committee reviewed its policy options and heard additional testimony from Waddell and Reed. Two proposed amendments distributed at that time would bring HB 2061 into greater conformity with the Missouri apportionment law.

CONCLUSIONS AND RECOMMENDATIONS

The Committee agrees that Kansas should remain competitive with Missouri and other states relative to the taxation of investment fund service companies.

The Committee therefore recommends that the 2002 Kansas Legislature give favorable consideration to new legislation similar to HB 2061, with several amendments. The new bill should have changes suggested by the Department of Revenue that would bring it into closer conformity with Missouri's law for investment fund service companies; should be effective for tax year 2002 in lieu of tax year 2001; and should contain a mechanism by which the fiscal impact is phased in over two years. The new legislation should be introduced as soon as the Department of Revenue and proponents of the change in the income apportionment formula have agreed to language that would accomplish this recommendation.

LOCAL SALES TAX ON NATURAL GAS

CONCLUSIONS AND RECOMMENDATIONS

The Committee recommends that the Legislature develop and approve legislation that would repeal the local sales tax on certain natural gas sales and allow affected local units of government to replace lost revenues with a new tax based solely on the volume of gas sold.

Proposed Legislation: None

BACKGROUND

The Legislative Coordinating Council approved the request for an interim study on the subject matter of 2001 SB 233. That bill, as amended by the Senate Assessment and Taxation Committee, would exempt until July 1, 2002, natural gas sales for residential and agricultural use from local sales taxation.

Residential and agricultural utility services are exempt from the state sales tax but are subject to sales taxes imposed by cities, counties, and municipal universities.

The fiscal information on the bill at the time it was worked in committee indicated that local sales taxes would have been expected to decline by about \$11.5 million annually.

Senator Allen and other proponents argued that the bill would help provide relief for consumers who were paying record natural gas prices and would prevent local units of government from receiving a windfall in sales tax receipts because of the winter price spike. Proponents also noted that the multistate streamlined sales tax effort is seeking to require participating states to have uniformity between state and local sales tax

bases and that SB 233 represents an initial step toward such uniformity.

In late February, the bill was passed as amended by the Senate Assessment and Taxation Committee; referred briefly to the Senate Ways and Means Committee; and referred back to the Senate Assessment and Taxation Committee.

At the August meeting, the Special Committee received data from the Department of Revenue indicating that local sales tax receipts on residential natural gas probably increased from about \$7 million during the winter of 2000 to about \$12 million during the winter of 2001.

In September, the Committee received information from the cities of Wichita and Lawrence indicating that their franchise fee agreements contain a volumetric based component.

The Department of Revenue also provided a good deal of additional data on natural gas prices and sales by region. During the public hearing, conferees representing local units of government expressed concern over the potential narrowing of the local sales tax base.

In October, the Committee directed

the Department of Revenue to provide data that would enable local units of government to have a revenue-neutral tax based on volume if the local sales tax on residential and agricultural gas sales were to be repealed.

CONCLUSIONS AND RECOMMENDATIONS

The Committee finds that residential and agricultural consumers should have additional protection from unusual gas price spikes such as that which transpired during the winter of 2000-2001. The Committee also agrees that removal of the local sales tax on residential and agricultural natural gas sales represents an important initial step in achieving state and local sales tax base uniformity, which is one of the important "simplification" prerequisites being discussed as part of the ongoing multistate streamlined sales tax effort. But the Committee also is

concerned that the narrowing of the local sales tax base could force local units of government to place greater reliance on property taxes.

The Committee therefore recommends that the 2002 Kansas Legislature give favorable consideration to new legislation that would repeal the local sales tax on residential and agricultural natural gas sales and would allow local units of government with sales tax authority (cities, counties, and municipal universities) to replace lost revenue in a revenue-neutral fashion with a new tax based solely on the volume of residential and agricultural gas sales. Kansas Gas Service and the Department of Revenue should continue to work together and assist the standing tax committees in the development of this legislation relative to the determination about what maximum rate the new tax should be.

REGENTS FOUNDATION INCOME TAX CREDITS

CONCLUSIONS AND RECOMMENDATIONS

The Committee recommends that the Senate Assessment and Taxation Committee act favorably on HB 2569 after advancing the effective date to tax year 2002.

Proposed Legislation: None

BACKGROUND

The Legislative Coordinating Council approved the request for an interim study on the subject matter of 2001 HB 2569 relating to Regents Foundation income tax credits. HB 2569, as amended, would authorize nonrefundable income, premiums, and privilege tax credits beginning in tax year 2001 equal to 66.67 percent of amounts donated to the Kansas Regents Foundation. That legislation was approved by the House in late April and is now in the Senate Assessment and Taxation Committee.

Under the bill, KSA 2000 Supp. 79-32.117 would be amended to require income taxpayers to add back to federal adjusted gross income any such amounts donated to the extent they have been claimed as the basis for the new credit. (This effectively prohibits income taxpayers from receiving a state deduction as well as a credit for the donations.)

A final provision of the bill would require that the total amount appropriated to the State Board of Regents for the fiscal year next following the taxable year for which any credit is allowed be reduced by the total amount of such credit.

The original bill would have limited the amount of credits claimed in a given fiscal year to \$10 million. The House

Taxation Committee struck that limitation and inserted the provision seeking to reduce appropriations to the State Board of Regents by the amount of credit claimed for the prior tax year.

The bill would be expected to reduce individual income, corporation income, financial institution privilege, and insurance premiums taxes by an indeterminate amount beginning in FY 2002. Appropriations to the State Board of Regents also would be required to be reduced by that amount pursuant to the Committee's amendment.

COMMITTEE ACTIVITIES

The Committee held public hearings on the bill at the September meeting. At that time, Clay Blair, the Chairman of the Kansas Board of Regents, appeared as the principal proponent. He said the bill represented an innovative approach for Board of Regents funding.

CONCLUSIONS AND RECOMMENDATIONS

The Committee agrees that the bill represents an innovative approach and recommends that the Senate Assessment and Taxation Committee act favorably on HB 2569 after changing the effective date to tax year 2002.

SHORTLINE RAILROAD INCOME TAX CREDITS

CONCLUSIONS AND RECOMMENDATIONS

The Committee recommends that the Senate Assessment and Taxation Committee act favorably on HB 2586 as a way of supporting the maintenance and restoration of rail service to rural Kansas.

Proposed Legislation: None

BACKGROUND

The Legislative Coordinating Council approved the request for an interim study on the subject matter of 2001 HB 2586. That legislation, as amended by the House Committee on Transportation, would provide a refundable income tax credit for tax years 2002 through 2021 equal to the total amount attributable to the retirement of bonds issued by a single city port authority. The amount of any such credits claimed would be limited to \$0.5 million in any one fiscal year. Assuming that bonds would in fact be issued, the bill would be expected to reduce SGF receipts as follows, beginning in FY 2003:

	<u>(\$ in millions)</u>
FY 2003	(\$0.5)
FY 2004	(\$0.5)
FY 2005	(\$0.5)
FY 2006	(\$0.5)
FY 2007	<u>(\$0.5)</u>
5-Yr Total	<u>(\$2.5)</u>

The bill passed the House on April 30 on a vote of 120-3 and was referred to the Senate Assessment and Taxation Committee, where it remains. During hearings in the House Transportation Com-

mittee, proponents of the bill included Representative Wilson, the Kansas Department of Transportation, and the Kansas Grain and Feed Dealers Association. The Kansas Motor Carriers Association appeared in opposition.

A related measure which was enacted by the 2001 Legislature was HCR 5032. That concurrent resolution approved the creation of the City of Pittsburg, Kansas, Port Authority in accordance with the provisions of KSA 12-3402.

The concurrent resolution noted that the economic prosperity and well-being of the City of Pittsburg, Kansas, will be enhanced by the creation of a port authority, and that the city commission proposes to pass an ordinance to create such authority.

COMMITTEE ACTIVITIES

The Committee held public hearings on HB 2586 at the August meeting. Proponents included WATCO Companies, the Kansas Rural Development Council, the Kansas Grain and Feed Association, the Kansas Railroad Users Association, Farmco, the Kansas Cooperative Council, and Kansas Farm Bureau. The proponents argued that enactment of the income tax credit would help bring an end to rail abandonment in central and west-

ern Kansas and also would help improve traffic safety on rural roads on highways by reducing truck traffic. Opponents to HB 2586 included the Kansas Motor Carriers Association and the United Transportation Union. Opponents argued that the bill sought to create an uncompetitive climate between transportation modes and further expressed concern about what the loss of revenue would mean in the context of an already tight state budget.

At the October meeting, the Committee received additional testimony from WATCO Companies summarizing the arguments in favor of the proposed income tax credit.

CONCLUSIONS AND RECOMMENDATIONS

The Committee strongly supports the maintenance and restoration of rail service to rural Kansas by WATCO Companies and finds that this effort should be considered as an important component of the Kansas transportation system. The Committee also believes that improved rail service in rural areas would slow the deterioration of rural roads to the extent that less heavy truck traffic would be necessary.

The Committee therefore recommends that the Senate Assessment and Taxation Committee act favorably on HB 2586.

STREAMLINED SALES TAX

CONCLUSIONS AND RECOMMENDATIONS

The Committee recommends that the House Taxation Committee approve the Kansas version of the Uniform Sales and Use Tax Administration Act (2001 SB 252), encourages the Legislature to support additional legislation extending the sunset date on the pilot project, and requests the Department of Revenue to inform the Legislature on the extent of efforts to assure that retailers with nexus are being required to collect sales taxes.

Proposed Legislation: None

BACKGROUND

The Legislative Coordinating Council approved the request for an interim study on the subject matter of 2001 SB 252. That bill would authorize the Department of Revenue to become a signatory to the multistate streamlined sales and use tax agreement and make preparations for its implementation, which would not occur until such time as the Legislature takes further action to bring the state's laws into compliance with the agreement.

Under the bill, the Department specifically would be required to identify all changes in law and rules and regulations necessary and sufficient to meet the agreement's compliance requirements.

The bill also would clarify that the Secretary of Revenue or designee is authorized to represent Kansas before other states participating in the streamlined sales tax project or that are signatories to the agreement.

The Legislative Coordinating Council also approved a request to study streamlined sales tax issues relating to the telecommunications industry, but the Special Committee determined that this

study could best be done in conjunction with the broader review of streamlined sales tax issues.

Legislation enacted in 2000, the "Streamlined Sales Tax System for 21st Century Act," authorized the Department of Revenue to enter into discussions and agreements with other states in an effort to construct a system to collect taxes on transactions involving remote sellers.

That law includes explicit findings by the Legislature that state and local tax systems should treat transactions in a competitively neutral manner to strengthen and preserve sales and use taxes as a vital revenue source; and that states working together have the opportunity to develop a simple, uniform, and fair system of taxation absent federal "mandates of interference."

The Department was authorized to develop along with other states "joint requests of information" from potential public and private parties governing the specifications for a multi-state, voluntary, streamlined system of sales and use tax collection and administration. The Department also was authorized to participate in a sales tax pilot project with other

states and selected businesses to test methodologies for simplifying administration of the system. Kansas is currently one of four states selected to be directly involved in the pilot project.

The 2000 law also established a legislative oversight committee and required the Department to report to the Governor, the President of the Senate, the Speaker of the House, the Senate Minority Leader, the House Minority Leader, and the oversight committee by March 1, 2001, on the status of the multi-state discussions and to recommend whether the state should participate in any proposed system arising out of such discussions.

SB 252 represents the Kansas version of the Uniform Sales and Use Tax Administration Act as one piece of model legislation proposed by the ongoing multistate discussions.

The bill passed the Senate 26-13 on February 14 and was referred to the House Taxation Committee. The streamlined sales tax issue was subsequently reviewed by the tax conference committee late in the 2001 Session and recommended for additional study in the interim.

COMMITTEE ACTIVITIES

At the August, September, October, and November meetings, the Committee received updates from the Department of Revenue on the status of the pilot project, the ongoing multistate streamlined discussions, and action in Congress.

In October, the Committee held the public hearing on SB 252. In addition to the Department of Revenue, other proponents included Audrey Langworthy,

Kansas Chamber of Commerce and Industry, Varney's Book Store, the League of Kansas Municipalities, and the Kansas Association of Counties. Proponents generally emphasized that the streamlined sales tax topic should be viewed in the context of an equity issue for main-street businesses.

Telecommunications conferees also stressed how important the "simplification" issues were for their industry.

A report from the University of Tennessee distributed at the October meeting indicated that the estimated revenue loss incurred by Kansas state and local governments as a result of their inability to collect sales taxes on e-commerce transactions from remote sellers is at least \$71.2 million in 2001 and is expected to grow to \$241.3 million by 2006.

The Kansas Soft Drink Association expressed concern over the possibility that the streamlined sales tax project would seek to define "soft drinks" separately from "food."

The Committee also asked the Department of Revenue to investigate why retailers such as Amazon.com and Walmart.com were not collecting sales taxes under current law.

The Department also indicated that it would support legislation extending the sunset on the pilot project from December 31, 2001, to December 31, 2003.

CONCLUSIONS AND RECOMMENDATIONS

The Committee finds that the streamlined sales tax effort should continue to be supported in an effort to provide tax equity for main-street Kansas businesses. The Committee therefore recommends

that the House Taxation Committee act favorably on SB 252, the Kansas Version of the Uniform Sales and Use Tax Administration Act, to allow Kansas to be a full participant in the ongoing multistate streamlined discussions.

The Committee further anticipates that the Department of Revenue will request the introduction of legislation extending the sunset on the pilot project

for two years and encourages the 2002 Legislature to enact such legislation.

Finally, the Committee requests the Department of Revenue to keep the standing tax committees informed on the extent of their efforts to assure that retailers with nexus in the state are being required to collect sales taxes.

STREAMLINED SALES TAX TELECOMMUNICATIONS IMPLICATIONS

CONCLUSIONS AND RECOMMENDATIONS

The Committee acknowledges the difficulties the telecommunications industry faces in complying with current state and local sales taxes and encourages Kansas in the ongoing multistate discussions to support multistate streamlined sales tax provisions that encourage additional simplification. The Committee further recommends that the Legislature review Florida's telecommunications tax simplification efforts.

Proposed Legislation: None

BACKGROUND

The Legislative Coordinating Council (LCC) approved the request for an interim study on the implications of streamlined sales tax issues for the telecommunications industry. But the LCC also approved a broader interim study on all streamlined sales tax issues, and the Special Committee determined that the telecommunications issues could be addressed appropriately under the broader topic.

COMMITTEE ACTIVITIES

At the August, September, October, and November meetings, the Committee received updates from the Department of Revenue on the status of the streamlined sales tax pilot project, the ongoing multistate streamlined discussions, and action in Congress.

In October, the Committee held public hearings on all streamlined sales tax issues. Conferees representing telecommunications said that the streamlined

sales tax project was very important for their industry because of the "simplification" components. They testified that requiring greater uniformity in the administration of state and local sales tax laws would help reduce the difficulties in compliance for multi-jurisdictional collection entities such as telecommunications companies.

CONCLUSIONS AND RECOMMENDATIONS

The Committee acknowledges the difficulties the telecommunications industry faces in complying with the current system of state and local sales taxes and encourages Kansas to support, during the ongoing multistate discussion, provisions that encourage additional simplification and streamlining of state and local sales tax systems.

The Committee also recommends that the 2002 Legislature review Florida's experiences with telecommunications tax simplification issues.