

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE.

The meeting was called to order by Chairperson David Corbin at 10:45 a.m. on February 20, 2002, in Room 519-S of the Capitol.

All members were present except: Senator Goodwin

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: Stephen S. Richards, Secretary, Department of Revenue
Ken Peterson, Kansas Petroleum Council
Tom Palace, Petroleum Marketers and Convenience Store
Association of Kansas

Others attending: See attached list.

The minutes of the February 19, 2002, meeting were approved.

SB 537—Taxation of motor fuels; concerning the point of tax

Stephen S. Richards, Secretary, Kansas Department of Revenue, testified in strong support of **SB 537**. (Attachment 1) He referred to a diagram attached to his written testimony to illustrate the state's current motor fuel taxing structure and the changes the bill makes. He noted that Kansas currently taxes motor fuel at the distributor of first receipt level and explained that the bill would move the point of taxation from the distributor to the supplier implementing what is known nationwide as "Tax at the Rack," which was implemented by the federal government in 1994. He informed the Committee that "Tax at the Rack" has been recognized as the most efficient and effective method to collect motor fuel taxes, and several states have adopted it. He outlined the following benefits which the Department feels are the most significant: (1) Potential increase in collections/revenues, (2) Reduction in fuel tax evasion ("daisy chain" schemes become ineffective), (3) Same point of taxation as the federal government, (4) Enhancement of the Department's fuel tax evasion project, and (5) Reduction in the number of taxpayers responsible for collecting and remitting the state motor fuel tax.

Secretary Richards said that he and his staff presented the proposed legislation to representatives of the industry early last year. He noted that distributors expressed concerns regarding the ability to maintain the float on tax dollars, the loss of handling allowance, and the ability to export product to another state without remitting both states' taxes up front and seeking credit or a refund. He outlined the provisions the Department included in the bill to address each of the concerns. He explained that suppliers hesitated to support deferred payments of the tax by distributors if there was no provision for protecting them from losses. In response to this concern, the Department included provisions under the bonding section which provides indemnity for any loss sustained where the collection of the tax is unsuccessful.

Ken Peterson, Kansas Petroleum Council, testified in opposition to **SB 537**. (Attachment 2) He acknowledged that there are benefits associated with moving the point of tax collection. However, in his opinion, **SB 537** is not the correct method to implement the policy. He pointed out that one of the common characteristics of laws adopted by states which moved the point of fuel tax collection to the terminal is that, in the beginning, there was no law. He noted that the Council's excise tax experts agree that the best way to develop this policy is to start with a clean slate. He contended that moving the point of collection is much more involved than changing the current law as **SB 537** attempts to do. In this regard, he informed the Committee that his office received an industry analysis which raised 22 questions about the bill. In his

CONTINUATION SHEET

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE at 10:45 a.m. on February 20, 2002, in Room 519-S of the Capitol.

opinion, the most glaring problem with the bill is that it may not accomplish its intended purpose. In conclusion, Mr. Peterson urged the Committee to take no action on the bill and, instead, direct that the process start anew with a clean slate as the issue is complicated and should not be rushed through the legislative process.

Tom Palace, Petroleum Marketers and Convenience Store Association of Kansas (PMCA), testified in opposition to **SB 537**. (Attachment 3) He commented that the industry was perplexed as to why a major change in how the motor the fuel excise tax is collected and paid to the Department of Revenue was considered. He noted that, to date, the industry has not received any statistical data which indicates tax evasion exists or warrants the move requested by the Department. In this regard, he pointed out that, after a 1995 Post Audit report, the Department initiated a fuel tax evasion program that includes reporting requirements for both the petroleum marketers and retailers that sell and acquire fuel. He emphasized that moving the point of taxation is a very complex issue which needs to be reviewed extensively. In his opinion, rushing the issue through this legislative session would be a mistake. He suggested that the Department and the industry come together during the coming summer months to craft legislation which is agreeable to all involved.

There being no others wishing to testify, the hearing on **SB 537** was closed.

Senator Corbin opened a discussion on three previously heard bills, **SB 413** concerning setoff of taxpayer refunds against liabilities, **SB 414** concerning the addition of a penalty provision regarding sand and gravel royalties to the taxing statutes, and **SB 553** concerning the submission of a report on land devoted to agricultural use valuation procedures.

Don Hayward, Revisor of Statutes Office, suggested that **SB 413** be technically amended on page 1, line 31, by striking "Provided, That."

Senator Praeger moved that **SB 413** be technically amended as suggested by Mr. Hayward and that it be recommended favorably for passage as amended, seconded by Senator Taddiken. The motion carried.

Senator Jenkins moved that **SB 414** be technically amended on page 1, line 34, by striking "(a)(1)," and that it be recommended favorably for passage as amended, seconded by Senator Praeger. The motion carried.

Senator Lee moved that **SB 553** be technically amended on line 18 by striking "have been" and inserting "were" and on line 19 by striking "during the next preceding eight years" and inserting "within the past ten years, when the change was made," seconded by Senator Clark. The motion carried.

Senator Lee moved to recommend **SB 553** favorably for passage as amended, seconded by Senator Clark. The motion carried.

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

The next meeting is scheduled for February 21, 2002.

SENATE ASSESSMENT AND TAXATION COMMITTEE GUEST LIST

DATE: February 20, 2002

NAME	REPRESENTING
Anne Spier	KC BAR - K.C. Realtors
Steve Robinson	KCOA
Dodie Platt	KBOR
Richard Cron	KBOR
Ann Dukes	DOB
Jim Coorsney	ADRP
Tom WHITAKER	Ks MOTOR CARRIERS ASSN
Deann Williams	Ks MOTOR CARRIERS ASSOC.
Christi Stewart	Ks Motor Carriers Assoc.
Mike A. Whit	PMCA
BILL YANEK	Kansas Assn. of REALTORS
GEORGE PETERSEN	Ks Taxpayers Network
Marlee Carpenter	KCCI
Tom Bevno	Williams
Tom PALACE	PMAA OF KANSAS
Ken PETERSON	Ks Petroleum Council
Joe Lieber	Ks Co-op Council
Julie Hein	Hein Law Firm

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Office of the Secretary

Secretary Stephen Richards

Senate Tax Committee
SB537

February 20, 2002

Mr. Chairman and members of the Committee, I want to thank you for the opportunity to appear before you today and share with you the benefits, the Department of Revenue feels strongly, will be achieved with enactment of this bill.

Before doing that however, I'd like to give a brief explanation of the state's current motor fuel taxing structure and explain briefly the changes the proposed bill makes. I've attached a visual to help clarify those changes. (Slide) Kansas currently taxes motor fuel at the distributor of first receipt level. The proposed legislation would move the point of taxation from the distributor to the supplier implementing what is known nationwide as "Tax at the Rack". Moving the taxation point upstream decreases the number of taxpayers and increases the dollar amount collected per taxpayer. The federal government first passed legislation implementing "Tax at the Rack" in 1994. Since then it has been recognized nationally as the most efficient and effective method to collect motor fuel tax. Several states have adopted Tax at the Rack, including Midwest states of: Minnesota; Wisconsin; South Dakota; Iowa; Missouri; Oklahoma and Wyoming.

There are substantial benefits for moving the point of taxation on motor fuels. Those that the Department feels are most significant are:

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Potential for Increase in Collections/Revenues – The federal government and states that have implemented “Tax at the Rack” have seen substantial increases in collections. (Potential of \$3 to \$10 million)

Reductions in Fuel Tax Evasion – “Daisy chain” evasion schemes become obsolete or wholly ineffective with this level of taxation. All fuel leaving a refinery or pipeline terminal is tracked and is either taxed or exempt under the provisions of K.S.A. 79-3408(c). Exchange of information on imports/exports between states is more valuable and effective in detecting evasion schemes when states points of taxation are at the same or at similar levels.

Same point of taxation as the Federal Government – Simplifies for industry, differences in rules/regulations between federal motor fuel taxes and state motor fuel tax. Same point of taxation enhances the potential for joint compliance efforts between the state and IRS. The Department is able to implement and leverage the IRS’s total fuel tracking system “ExFirs” more effectively, ensuring higher rates of compliance.

Enhances Departments Fuel Tax Evasion Project – “Tax at the Rack” will enhance the effectiveness of this project, which began in 1995 as a result of a legislative post audit. The audit estimated the state could be losing as much as \$66 million dollars a year in fuel taxes due to evasion schemes.

Reduces the number of taxpayers – “Tax at the Rack” reduces the number of taxpayers responsible for collecting and remitting the state motor fuel tax. Today’s 800 reporting distributors would be reduced to 160 suppliers or less.

My staff and I met with representatives from industry early last year and presented to them the Department’s plans for proposing this legislation. We’ve worked with them over the last several months to address and resolve any issues or adverse impacts. Distributor’s concerns primarily revolved around the ability to maintain the float on tax dollars, the loss of the handling allowance and the ability to export product to another state without remitting both state’s taxes up front and seeking credit or refund. We have included provisions in the legislation to address each of these issues.

1. Provisions for moving the due date of the tax from the 25th of the month to the last day of the month, allowing payment of the tax by the distributor to the supplier two days before the tax is due the state.
2. We've included a provision that the 2-1/2% handling allowance be prorated between the distributor and the supplier, with the distributor retaining 2-1/4%.
3. Also included are conditions where exports to another state can qualify as exempt sales from Kansas motor fuel tax.

The supplier's hesitated to support deferred payments of the tax by distributors if there was no provisions for protecting them from losses. The department responded to this concern by including provisions under the bonding section (K.S.A. 79-3405) that provides indemnity for any loss sustained by any person where the collection of the tax is unsuccessful.

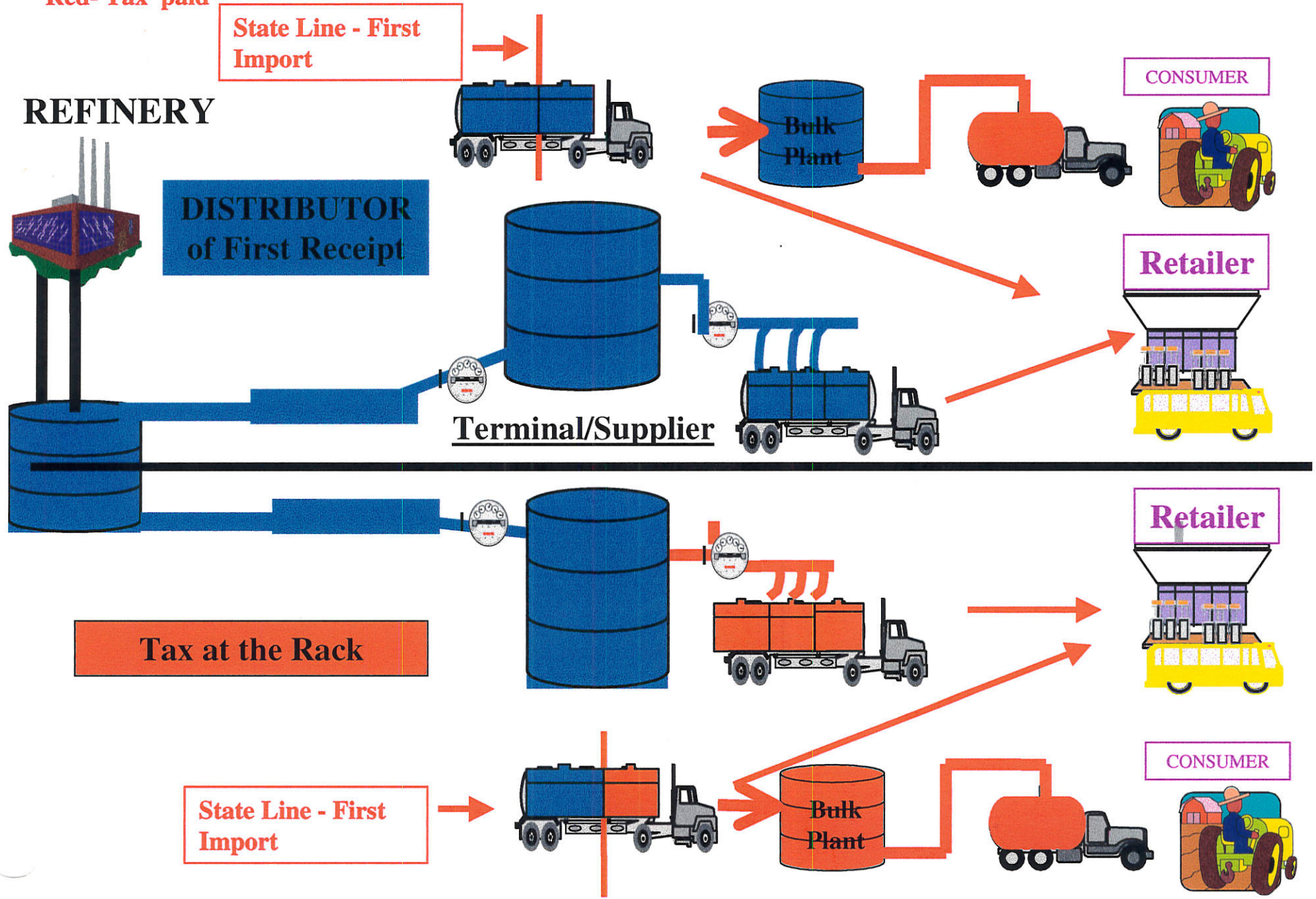
In closing, the Department believes strongly in the benefits that would be achieved by moving the point of taxation on Motor Fuel to the supplier level. We also believe that we have heard and addressed to industry's satisfaction, any issues or concerns that arose as a result of our proposal.

Mr. Chairman, I will be happy to stand for any questions.

Fuel Distribution/ Taxation

Blue-tax Free

Red- Tax paid



State Line - First Import

REFINERY

DISTRIBUTOR of First Receipt

Terminal/Supplier

Bulk Plant

CONSUMER

Retailer

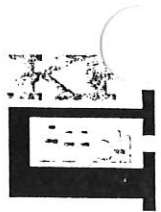
Retailer

Tax at the Rack

State Line - First Import

Bulk Plant

CONSUMER



**Comments Submitted to the Senate Assessment and Taxation Committee
By Ken Peterson, Kansas Petroleum Council**

**In Opposition to Senate Bill 537
Moving the Point of Motor Fuel Tax Collection**

February 20, 2002

Mr. Chairman and members of the Committee, I appreciate the opportunity to offer these comments on Senate Bill 537. The Petroleum Council is a trade association that represents several refiners and suppliers in Kansas, companies that would be directly affected by this Revenue Department proposal.

Our membership includes bp (formerly BP-Amoco), Texaco, Conoco, and Phillips. Sinclair, while not a Council member, actively participated in discussions on this issue.

We join the Petroleum Marketers and Convenience Store Association of Kansas in opposing passage of Senate Bill 537.

Several of our companies wish to commend the Revenue Department, and Secretary Richards, for seeking to address this issue. Moving the point of motor fuel taxation to the terminal rack can be a worthy goal – if it is done correctly.

By our count, at least 15 states now collect motor fuel taxes at the terminal rack. This practice has several advantages, including aligning Kansas with the method of collecting taxes to not only the federal government, but several neighboring states as well, including Oklahoma, Missouri and Texas. States and the federal government can share information to ensure that all parties are paying the appropriate taxes to the appropriate parties. A uniform reporting method helps suppliers meet their reporting obligations.

Despite the benefits associated with moving the point of tax collection, there are right ways and wrong ways to implement the policy. Senate Bill 537 is not the right way, and we cannot support this legislation.

One of the common characteristics of laws adopted by states that moved the point of fuel tax collection to the terminal is that, in the beginning, there was no law. Excise tax experts in our companies agree that the best way to develop this policy change is to start with a clean slate. Moving the point of collection is much more involved than changing the current law, as Senate Bill 537 tries to do.

Moving the tax point, whether to the terminal rack, retail pump or points in between, requires a new set of definitions, new licensing requirements, language to address tax payment changes and new provisions concerning exemptions, to name a few. Implementing these changes is difficult, if not impossible, by seeking to amend existing statutes. Every state that has adopted a tax at the terminal started with a blank page and brought in state tax officials, suppliers, jobbers and retailers. Examples include Tennessee, South Carolina, North Carolina, Missouri, and most recently, Virginia.

Senate Bill 537 has a lot of areas that trouble our companies. Although they do not market in Kansas, ExxonMobil is one of our trade association's lead companies on this issue nationwide. An analysis sent to our office raised 22 questions about the bill, including definitional problems with the fuel to be taxed, unclear licensing requirements and what entities are covered, vague bonding language and apparently unnecessary reporting and paperwork requirements for distributors.

Perhaps the most glaring problem with the bill, however, is that this legislation may not even accomplish its intended purpose – to move the point of tax collection to the terminal rack.

As one of our company representatives observed, "For state tax purposes, taxing fuel at the terminal rack is premised on the basic fact that the tax will be imposed when one of two things happen: (1) when fuel crosses the terminal rack at a terminal located in Kansas, and (2) for product that is imported from an out-of-state terminal, when the fuel is imported into Kansas by truck or railcar.

"Nowhere in the Kansas bill is this spelled out, or at least spelled out in a way that is clear to us."

Another said, "If the state wants tax at the rack, it would appear that they would mention that the point of taxation is when product is removed from the terminal rack."

The Council respectfully suggests that the Committee take no action on this bill, and instead direct that the process start anew – with a clean slate – involving the state and industry. This is a complicated issue that should not be rushed through the Legislature this year.

Legislation can be crafted that is straightforward and easy to follow. We are not breaking new ground here. Other states have implemented rack tax laws that work, but negotiations require more than the short time afforded this bill. States have worked on this issue for at least a year and achieved a bill that all sides could support. Many of our companies believe that Missouri has enacted a workable law, and Kansas could use it as a good starting point to develop its own proposal. Thank you.



MEMO TO: Senate Assessment and Taxation Committee
FROM: Thomas M. Palace, Executive Director of the Petroleum Marketers and
Convenience Store Association of Kansas
DATE: February 20, 2002
RE: Comments on SB 537

Mr. Chairman and members of the Senate Assessment and Taxation Committee.

My name is Tom Palace and I am the Executive Director of the Petroleum Marketers and Convenience Store Association of Kansas (PMCA), a statewide trade association that represents over 360 independent petroleum marketers, gasoline retailers and convenience store owners throughout Kansas.

I appreciate the opportunity to appear before you today in opposition to SB 537.

SB 537 makes a major change in how motor fuel excise tax is collected and paid to the Kansas Department of Revenue (KDOR). As such, representatives from the petroleum industry both marketers and refiners, had several meetings last summer with KDOR staff to discuss the ramifications of moving the point of taxation to the rack (terminal supplier). Currently, the distributor is responsible for paying the 21 cents per gallon motor fuel excise tax to the state and for generating corresponding monthly reports. It is estimated that petroleum distributors collect in excess of \$300 million in motor fuel excise taxes.

Moving the point of taxation to the rack caught industry off guard and perplexed as to why this move was being considered. We have been told that tax evasion exists, but to date, we have not received any statistical data that indicates tax evasion exists or warrants such a drastic move. We should point out that in 1995 after a Post Audit report, KDOR initiated a fuel tax evasion program that includes reporting requirements for both the petroleum marketers and retailers that sell and acquire fuel. Requirements of the program include: distributor licensing, requiring the destination of fuel to be specified on the bill of lading, retailer reporting and licensing, dyeing diesel fuel to indicate that the fuel is exempt from tax and Electronic Data Interchange (EDI), a system in which distributors file monthly motor fuel tax returns electronically. EDI was the most recent addition to KDOR reporting requirements (1999), and the state paid approximately \$4 million dollars to implement this program. When these safeguards were implemented and in the six years since that time, we have assumed they were doing what they were intended to do - stop fuel tax evasion.

While moving the point of taxation is a possibility, it's a very complex issue that needs to be reviewed extensively. The working sessions that industry participated in last year were good meetings wherein both marketers and suppliers attempted to find common ground on this difficult issue. However, additional time is needed to review this bill in its entirety, making sure

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that everyone understands what KDOR is trying to accomplish by moving the point of taxation to the rack.

It is unfortunate that the PMCA Motor Fuels Committee did not have this bill to review before it was introduced. It was understood that a bill draft would be prepared, distributed and discussed prior to the 2002 Legislative session. This did not occur. A draft of the bill was received on January 12. Making sure that the petroleum marketers and suppliers can agree to the terms of a rack tax and at the same time steering clear of any potential conflicts that may impact supplier contracts is paramount. We do not understand the urgency of this legislation, and we feel additional time is needed to review this issue.

As stated earlier, PMCA is willing to come to the table to discuss this issue further with the suppliers and KDOR to work out an equitable solution. Crafting good legislation is important; rushing this issue through this legislative session would be a mistake. We request that this committee oppose this bill, and let KDOR, PMCA and the suppliers come together this summer and craft legislation that is agreeable to everyone.