Approved: January 22, 2003
Date

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE

The meeting was called to order by Chairperson David Corbin at 10:30 a.m. on January 14, 2003, in Room 519-S of the Capitol.

All members were present except:

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

Conferees appearing before the committee: Richard Cram, Kansas Department of Revenue
Jim Weisgerber, Kansas Department of Revenue

Others attending: See attached list.

Senator Corbin discussed changes in Committee membership. Senator Les Donovan will serve as Vice Chair due to the fact that the former Vice Chair, Senator Lynn Jenkins, was elected as State Treasurer in 2002. Senator Lana Oleen will fill Senator Jenkins' committee position. Senator Mark Buhler will fill the committee position left by Senator Sandy Praeger, who was elected as State Insurance Commissioner in 2002.

Senator Corbin called upon Chris Courtwright and April Holman, both with the Legislative Research Department, for a review of the reports by the Interim Assessment and Taxation Committee concerning the following topics (Attachment 1):

- Family Development Account Program (**SB 231** and **SB 403**),
- Tax Credits for Property Taxes,
- Sunset Provision–Sales Tax Exemptions,
- Motor Vehicle Fuels Tax (**SB 537**),
- Property Tax Exemptions for Certain Not-for-Profit Independent Living Centers (**SB 479**), and
- Sales Tax Parity on the Sale of Firearms, Weapons, and Ammunition.

Richard Cram, Kansas Department of Revenue, began a briefing on administrative problems relating to estate and succession taxes. (Attachment 2) At the outset, he introduced Jim Weisgerber, a Department specialist on estate and inheritance taxes. Mr. Cram discussed the fiscal impact of the new succession tax in **SB 39**, which passed during the 2002 Legislative Session. He noted that the conference committee report on the bill describes the new succession tax as a "Class C inheritance tax reimposition." He explained that, at the time the Legislature considered **SB 39**, the Department provided a positive fiscal impact estimate of $15 million in tax revenue for FY 2003, based on the assumption that the legislation would be a reimposition of the inheritance tax on Class C heirs. However, the bill as passed clearly is not a reimposition of the inheritance tax, and none of the needed administration and compliance tools for the new succession tax were included. Based upon the anticipated administrative and compliance problems the Department will encounter, the fiscal impact estimate for the succession tax was reduced from $15 million to $5 million when the Consensus Estimating Group met in November 2002. To address the administrative problems, the Department is currently involved in drafting a legislative proposal for an alternative to the succession tax and existing Kansas estate tax.

Mr. Weisgerber explained further that Kansas had a stand-alone inheritance tax in place from 1915 through 1978. He outlined the new inheritance tax put in place by the 1978 Legislature to bring Kansas in conformity with federal law. He went on to discuss the "pick-up tax" put in place by the 1998 Legislature which replaced the inheritance tax and imposed only a tax equal to the federal credit for state inheritance or estate taxes. He noted that dramatic amendments to federal law in 2001 created two primary differences between state and

federal law, creating several problems with regard to compliance, administration, auditing, and enforcement. He noted that a state tax advisory committee working under the auspices of the Kansas Judicial Council proposed legislation to bring Kansas back in conformity with federal law during the 2002 Legislative Session; however, the proposal went no where. In the waning days of the 2002 Session, New Section 5 was amended into **SB 39** with the intent to reimpose the inheritance tax on Class C heirs; however, no detailed instructions on how to administer the tax were included. He explained that the Department is currently in the process of working with a group of attorneys to draft a proposal which would retroactively repeal the succession tax and which would parallel the federal law yet be independent from federal law.

Senator Lee moved to recommend the introduction a conceptual bill based on the Department of Revenue's recommendation to repeal the state inheritance tax passed by the 2002 Legislature, seconded by Senator Donovan. The motion carried.

Mr. Cram discussed the sales tax on custom computer software imposed in 2002 under Section 6 of **SB 39**. (Attachment 3) He noted that, under prior law, sales tax was imposed only on the sale of canned computer software. He explained that custom computer programs are those developed from scratch or those uniquely designed and tailored to meet the customer's specific requirements. He called attention to copies of the Department's Notice Number 02-10 attached to his written testimony, noting that it was published to answer anticipated questions concerning the new sales tax on custom software. He noted that the Department is also in the process of responding to private letter ruling requests raising additional questions about the imposition of the new sales tax. Mr. Cram went on to discuss the following related topics: (1) the estimated fiscal impact of the sales tax on custom computer software, (2) the historical background of taxation of computer software, and (3) the question raised by other states as to whether tangible personal property includes computer software.

The meeting was adjourned at 11:50 a.m.

The next meeting is scheduled for January 15, 2002.

SENATE ASSESSMENT AND TAXATION COMMITTEE
GUEST LIST

DATE: January 14, 2003

NAME	REPRESENTING
MARK CIARDULLO HB	KS DEPT OF REV.
Jim Wagerer	KDOR
Richard Cram	KDOR
Ron Seaberg	Hein Law firm
Bill Henry	Ks. Credit Union Assn
Ann Burkes	DOB
LARRY R BAER	LKM
Chris Wilson	KS Building Industry Ass'n
Debra Zehr	KAHSA
John Grace	KAHSA
Todd Johnson	KLA
Doug Lawrence	Westar Energy
Mike Murray	Sprint
Erik Sartorius	City of Overland Park
Stuart Little	Westar Energy
Patrick Hubbell	BNSF Railway
Bill Brady	KAHSA
Jackie Clark	Hallmark Cards
John Peterson	Ks Governmental Consulting

SENATE ASSESSMENT AND TAXATION COMMITTEE
GUEST LIST

DATE: January 14, 2003

NAME	REPRESENTING
George Petersen	KTN
Mike Reecht	AT&T
Bud Burke	Cessna
Andy Shaw	Kearney & Assoc. Inc.
Leslie Kaufman	Kc Farm Bureau
Martha Jo Smith	KMHA
Marlee Carpenter	KCCI
Natalie Burgess	WIBA
Robert Choromanski	KTLA
Steve Johnson	Ks. Gas Service
Anne Spiess	KTIA - Ks. Telecommunications Industry Assn

Special Committee on Assessment and Taxation

FAMILY DEVELOPMENT ACCOUNT PROGRAM

CONCLUSIONS AND RECOMMENDATIONS

The Committee endorses the concept of FDA legislation and encourages proponents to develop a bill for introduction in the House early in the 2003 Session.

Proposed Legislation: None

BACKGROUND

SB 231, which would have enacted the Family Development Account Program, was approved by the Senate during the 2001 Session and referred to the House Taxation Committee. During the 2002 Session, the Senate again approved a version of the legislation as part of the Senate Committee of the Whole version of SB 403, though the family development account provisions were removed by a conference committee. The Legislative Coordinating Council subsequently approved a request to have the Special Committee further study the issue and make whatever recommendations it deemed appropriate to the 2003 Legislature.

Under SB 231, as amended by the Senate Committee of the Whole during the 2001 Session, would have established a program under the Department of Commerce and Housing which would have enabled eligible families and individuals to establish tax-advantaged accounts for the purpose of funding specific purchases. (Under the 2002 Senate Committee of the Whole version of SB 403, the program would have been placed under the State Treasurer.)

Families or individuals with household income less than or equal to 200 percent of the federal poverty level would have been eligible to open family development accounts (FDAs) earmarked for higher educational expenses; job training costs; purchase of primary residence; major repairs or improvements to a primary residence; or start-up capitalization costs for small businesses.

The Secretary of Commerce and Housing would have been required to adopt rules and regulations and prepare a request for proposals from nonprofit or charitable community-based organizations seeking to administer the Family Development Account Reserve Fund (FDARF). The FDARF would have been created to fund administrative costs of the program incurred by financial institutions or community-based organizations, and also to provide matching funds for moneys in FDAs. No more than 20 percent of all funds in the FDARF could have been used for administrative costs during the first two years of the program, and the limitation

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would have been set at 15 percent in subsequent years.

The following tax provisions would have been effective for two tax years before sunsetting. Moneys deposited into FDAs by account holders would have been exempt from Kansas income tax unless withdrawn for an unapproved use. Interest earned on FDAs also would have been exempt from income taxes. Financial institutions also would have received a privilege tax exemption for earnings attributable to FDAs. A program contributor, defined to include "a person or entity who makes a contribution" to an FDARF, would have been allowed income tax credits up to $25,000 per contributor or 25 percent of the contribution amount, whichever was less. The total amount of all such tax credits authorized could not have exceeded $0.5 million in any fiscal year.

Account holders making nonqualified withdrawals from FDAs would have been required to forfeit all matching moneys in the accounts, which would then be returned to the FDARFs of the contributing community-based organizations.

FDA funds, including accrued interest, would have been disregarded when determining eligibility for public assistance or benefits.

During the 2001 hearings, proponents included Senator Haley, Heart of America Family Services, and the Washington University's Center for Social Development.

The fiscal note provided by the Department of Revenue during the 2001 Session suggested that the bill would have been expected to reduce receipts by about $519,000 and would have necessitated expenditures of an additional $59,889 in administrative costs.

Committee Activities

At the September meeting, the Committee held public hearings on the issue. Proponents for the Family Development Account legislation included El Centro, Heart of America Family Services, the Kauffman Foundation, the Emporia State Bank, and an individual FDA participant. The proponents generally argued that establishing the tax-advantaged accounts at the state level would encourage low to moderate income families to save and build long-term assets. No one appeared in opposition to the concept. The Chair requested that Senator Haley and other proponents work with staff to develop proposed legislation that could potentially be introduced as a recommendation to the 2003 Legislature. Among the issues to be resolved were where the program should be housed and the maximum amount of credit available to program contributors.

At the October meeting, staff presented a draft committee report discussing policy options; information on the federal poverty level; and amendments that were prepared after consultation with Senator Haley. The Committee voted to recommend the concept of FDA legislation to the 2003 Legislature.

Conclusions and Recommendations

The Committee endorses the concept of FDA legislation and recommends its enactment by the 2003 Legislature. The

Committee agrees with the argument of proponents that establishing the tax-advantaged accounts will encourage low to moderate income families to build long-term assets through saving.

The Committee encourages Senator Haley and other proponents with suggested amendments, including El Centro, to develop a single legislative proposal that would be introduced as a House bill early in the 2003 Session.

Legal Issues Regarding Expansion of Tax Credits to Railroads and Other State-Assessed Property

Conclusions and Recommendations

The Committee recommends the introduction of legislation that would clarify the intent of the 2002 Legislature by assuring that income tax credits for certain personal property taxes be extended to railroads beginning in 2005 but not other state-assessed public utilities.

Proposed Legislation: One bill is recommended.

Background

Legislation enacted in 1998 provided refundable income, premiums, and privilege tax credits beginning in tax year 1998 to offset 15 percent of property taxes accurately, and timely paid on commercial and industrial machinery and equipment and certain mineral leasehold machinery and equipment.

Major tax legislation enacted in 2002, SB 39, provided for an increase in such credits to 20 percent beginning in tax year 2005; and to 25 percent beginning in tax year 2007. The bill also made the credits initially available in 2005—at the 20 percent level—for taxes actually and timely paid on railroad property. These new credits also are scheduled to increase to the 25 percent level beginning in tax year 2007.

The following paragraphs are taken directly from explanatory information the Legislature had in its possession at the time the bill was adopted.

Business Machinery and Equipment Credits. The tax credits available for property taxes timely paid on business machinery and equipment are increased from 15 to 20 percent beginning in tax year 2005; and to 25 percent beginning in tax year 2007.

Tax Credits Extended to Railroads. The machinery and equipment tax credits for property taxes paid will for the first time be made available for railroad property beginning in tax year 2005 (when the credit amount will be 20 percent). The railroad property also will qualify for the subsequent credit increase in tax year 2007. The Joint Committee on Economic Development will be required to conduct an interim study regarding the necessity of extending the tax credits to railroad property.

Fiscal information prepared by the

Department of Revenue indicated that the initial provision would be expected to reduce State General Fund receipts by the following:

	$ in Millions	
FY	Business Machinery & Equipment Credit to 20% in tax year 2005; 25% in 2007	Business Machinery & Equipment Railroads to 20% in tax year 2005
2003	--	--
2004	--	--
2005	--	--
2006	$ (10.737)	$ (1.936)
2007	(11.810)	(1.990)
5-Year Total	$ (22.547)	$ (3.926)

Since the conclusion of the session, a concern has been raised that the language amending KSA 2001 Supp. 79-32,206 may appear to expand the credits to all property taxes paid by public utility tangible personal property (subclass 3 of class 2 of Article 11, Section 1 of the *Kansas Constitution*).

The Legislative Coordinating Council has subsequently charged the Special Committee with reviewing a number of the legal and fiscal questions surrounding expansion of the tax credits, including whether federal law may require the railroad property to be eligible, and whether additional state-assessed public utility property must be or should be included. The Department of Revenue also has been asked to report on the fiscal implications beginning in FY 2006 relative to its current interpretation of the law compared with the fiscal implications assumed by the Legislature at the conclusion of the 2002 Session.

COMMITTEE ACTIVITIES

At the September meeting, staff went over the explanatory information available to the 2002 Legislature at the time SB 39 was adopted. The Department of Revenue observed that if the tax credits were to be extended to all state-assessed public utilities beginning in tax year 2005, the unanticipated fiscal impact would be at least $42 million beginning in FY 2006.

At the October meeting, the Property Valuation Division (PVD) presented testimony and analysis on legal implications of the tax credit issue. PVD said that it was not entirely clear that the Legislature was legally compelled by The Railroad Revitalization and Regulatory Reform Act of 1976 (the 4-R Act) to extend the credits—which had been available since 1998—to railroads beginning in tax year 2005. PVD also said that the *Kansas Constitution* did not appear to require that the credits be extended to all state-assessed public utilities even if the Legislature chose to maintain its policy decision to extend the credits to railroads.

A conferee representing Kansas railroads stated his belief that the 4-R Act did require Kansas to make the tax credits available to railroads. The conferee also encouraged the Committee to recommend legislation making the credits available to railroads in tax year 2003. The Committee declined to make such a recommendation.

CONCLUSIONS AND RECOMMENDATIONS

The Committee finds that the fiscal notes and explanatory information

provided by the Department of Revenue and staff during the 2002 Session in no way contemplated expanding the credits to any state-assessed public utility beyond railroads. The Committee therefore recommends the introduction of legislation that would clarify the intent of the 2002 Legislature by assuring that income tax credits for certain personal property taxes be extended to railroads beginning in 2005 but not other state-assessed public utilities. Enactment of the legislation would provide that clarification.

SUNSETTING SALES TAX EXEMPTIONS

CONCLUSIONS AND RECOMMENDATIONS

The Committee encourages the Legislature to conduct a global study of overall Kansas state and local tax policy and structure. Since the policy implications of sales tax base expansion should be one very important part of that review, the Department of Revenue should continue to update fiscal notes associated with the removal of sales tax exemptions and with extending the tax to previously untaxed services.

Proposed Legislation: None

BACKGROUND

During the 2002 Legislature, elimination of sales tax exemptions was discussed frequently as one way of providing additional revenue. On March 13, for example, an unsuccessful House floor amendment offered by Representative Sharp would have repealed a number of sales tax exemptions and would have provided about $694 million in additional revenue at the 4.9 percent rate. The 2002 Legislature ultimately did eliminate an exemption for customized computer software as part of the final tax package in SB 39.

In the wake of these actions, House Taxation Committee Chair John Edmonds recommended to the Legislative Coordinating Council (LCC) that an interim study analyze the tax policy implications of sunsetting a large number of sales tax exemptions on a date certain in the future. The LCC assigned

the study to the Special Committee.

COMMITTEE ACTIVITIES

At the September meeting, staff distributed the fiscal note associated with Representative Sharp's floor amendment. Staff explained that several sales tax exemptions not on that list were associated with ingredient or component part exemptions (and still others which are mandated by federal law) would not be appropriate to consider for sunsetting or repealing. The Chair said that he hoped the interim activity could assess the concept of a wholesale exemption sunset and not focus on individual exemptions at this time.

At the October meeting, staff distributed additional fiscal information

updating the March 13 floor amendment based on the new 5.3 percent sales tax rate. During the public hearing, the League of Kansas Municipalities spoke in favor of considering a sunset for a number of sales tax exemptions and further encouraged the Legislature to commit to not granting any additional exemptions in the future. The conferee noted that exemptions had narrowed state and local sales tax bases alike and helped to drive up property taxes.

A number of conferees testified in opposition to the sunset concept, including the Kansas Chamber of Commerce and Industry, Farm Bureau, and the Kansas Livestock Association. The opponents generally argued that the uncertainty provided by the threatened sunset of a number of exemptions could provide an economic development disincentive.

The Committee also discussed the potential revenue which could be provided by expanding the sales tax base by extending the tax to previously untaxed services.

At the November meeting, staff provided the Committee with a list of policy options.

Conclusions and Recommendations

The Committee strongly encourages the incoming 2003 Legislature to conduct a global study and analysis of overall Kansas state and local tax policy and structure. Since the policy implications of sales tax base expansion should be one very important part of that review, the Committee asks the Department of Revenue to work on continuing to update fiscal notes associated with the removal of sales tax exemptions and with potentially extending the sales tax to previously untaxed services.

Motor Fuels Tax

Conclusions and Recommendations

The Committee encourages the incoming administration, if "tax-at-the-rack" legislation is still considered a priority, to work with the industry to develop a proposal different from SB 537.

Proposed Legislation: None

Background

During the 2002 Session, the Department of Revenue requested the introduction of SB 537, which would have moved the point of taxation on motor fuel to the supplier level, sometimes referred to as "tax-at-the-rack." The Senate Assessment and Taxation Committee held a public hearing on the legislation.

The bill would have allowed out-of-state terminal suppliers to pre-collect and remit taxes on motor vehicle fuels and special fuels imported

from another state into Kansas in the same manner as taxes would have been paid if the fuels were from within the state. The bill also would have defined blend, blender, export, import, state, supplier, and territory for the purposes of the motor fuels taxation. Additionally, the bill would have changed the bonding requirement for motor fuel suppliers and distributors and would have outlined how these requirements could be met. Bonding would have been required to be between $5,000 and $750,000 for suppliers; and between $5,000 and $100,000 for distributors. The bond amounts could have been used to cover losses sustained by anyone as a result of an act by the licensee which interferes with the collection of taxes.

Because of the change in the imposition of the tax from the distributor to the supplier level, the 2.5 percent handling fee (shrinkage) allowance also would have been amended. Instead of the full amount going to the distributor, 2.25 percent would have gone to the distributor and 0.25 percent would have gone to the supplier. Suppliers would have been added to the list of those having to pay an inventory tax on motor fuels, and the date due for those taxes would have been changed from the 25th of each month to the last day of each month.

Penalties for failure to have a license when required and failure, neglect, or refusal to pay tax, penalties, or interest as outlined in the motor fuels tax law would have been increased. Violations would have been changed from misdemeanors to a severity level 10, non-person felony. The bill was to have taken effect January 1, 2003.

A fiscal note during the 2002 Session indicated that the Department of Revenue believed the bill would have resulted in an additional $1.5 million in collections to the State Highway Fund in FY 2003 and $3.0 million per year beginning in FY 2004.

COMMITTEE ACTIVITIES

At the September meeting, the Committee held public hearings on the issue. Secretary of Revenue Stephen Richards appeared as a proponent and argued that the tax-at-the-rack concept had been recognized nationally as the most efficient and effective method to collect motor fuels tax, dating back to the adoption by the federal government of the methodology in 1994. He said that the benefits for Kansas would include a reduction in the number of taxpayers; simplification for the industry in that the state would be using the same point of taxation as the federal government; and a number of tax evasion schemes would become obsolete.

A conferee representing the Kansas Petroleum Council said that while that group did not oppose the tax-at-the-rack concept, a stalemate had developed in the industry's talks with the Department of Revenue regarding the development of legislation. The conferee suggested that rather than adopting SB 537, the Legislature should "start with a clean sheet of paper" and look closely at tax-at-the-rack legislation adopted by other states.

The Petroleum Marketers and Convenience Store Association of Kansas appeared in opposition, stating that a number of current safeguards exist to stop motor fuel tax evasion and that changing the point of taxation is

unwarranted.

In response to some of the testimony, Senator Lee asked to what extent industry opposition to the proposal would be lessened by further changes in the shrinkage allowance.

At the October meeting, the Committee discussed the issues raised at the public hearing—including the shrinkage allowance—and voted to encourage all interested parties to keep working on the development of legislation for consideration by the 2003 Legislature.

CONCLUSIONS AND RECOMMENDATIONS

The Committee does not at this time endorse the reintroduction of SB 537 as it was considered during the 2002 Session. The Committee instead encourages the incoming administration to determine whether a "tax-at-the-rack" proposal should be considered by the 2003 Legislature and, if it is still considered a priority, work with the industry in developing legislation that is acceptable to all parties.

RE-EVALUATION OF KSA 79-201b, *FIFTH*, RELATING TO THE PROPERTY TAX TREATMENT OF CERTAIN INDEPENDENT LIVING CENTERS

CONCLUSIONS AND RECOMMENDATIONS

The Committee recommends the formation of a working group to study the issue of the property tax exemption for independent living units owned by not-for-profit nursing homes. This working group will be bipartisan and members will be appointed by the chairmen of the Senate Committee on Assessment and Taxation and the House Committee on Taxation. The working group will use 2002 SB 479 as a basis to develop appropriate legislation by February 1, 2003.

Proposed Legislation: None

BACKGROUND

Controversy over the policy of providing a tax exemption for property which is owned by a not-for-profit organization and used as housing for elderly persons has existed for many years. During the 2002 Legislative Session, Senator Emler introduced SB 479 which would have eliminated the property tax exemption for this type of property in tax year 2002. The bill received a hearing in the Senate Committee on Assessment and Taxation, but died in Committee at the end of the Session.

KSA 79-201b, *Fifth*, was first enacted in 1975 and it exempts from property taxation the real and personal property of a corporation organized not-for-profit that is used exclusively as housing for elderly persons. In order to qualify for the exemption, the amount charged to residents by the corporation must not produce in aggregate an amount that is more than the actual cost of operation of the housing facility or the services must

be provided to the residents at the "lowest feasible cost." Under the law, any property used in a manner consistent with federal internal revenue ruling 72-124 issued pursuant to section 501 (c)(3) of the federal internal revenue code shall be deemed to be operating at the lowest feasible cost. The provision tying "lowest feasible cost" to the federal revenue ruling was added by the Legislature in 1999.

The federal revenue ruling provides that an organization, which is otherwise qualified for charitable status under section 501 (c)(3) of the federal income tax code, will qualify for charitable status if it operates in a manner designed to satisfy three primary needs of elderly persons. Those needs are:

- **Housing.** The need for housing is satisfied if the organization provides residential facilities that are specifically designed to meet some combination of the physical, emotional, recreational, social, religious, and similar needs of elderly persons.

- **Health Care.** The need for health care is satisfied if the organization either directly provides some form of health care, or maintains a continuing arrangement with other organizations to provide for the physical well-being of its residents.

- **Financial Security.** The need for financial security is satisfied if the organization is committed to maintaining in residence any persons who become unable to pay their regular charges, or the organization is providing its services to the elderly at the "lowest feasible cost." The "lowest feasible cost" takes into consideration such expenses as the payment of indebtedness, maintenance of adequate reserves sufficient to insure the life care of each resident, and reserves for the physical expansion of the facility commensurate with the needs of the community and the existing resources of the organization.

COMMITTEE ACTIVITIES

The Committee held a hearing on this topic at the September meeting. At this time, a variety of conferees offered testimony. Summaries of their testimony are as follows.

A representative of the Property Valuation Division, presented information outlining the administrative and judicial interpretation of KSA 79-201b, *Fifth*, enacted in 1975, which exempts from property taxation the real and personal property of a not-for-profit corporation that is used exclusively for housing for elderly persons. In addition, he discussed the provisions of IRS Revenue Ruling 72-124 relating to the charitable status of organizations, which was amended into the Kansas statute in 1999.

The Reno County Counselor discussed the details of two recent cases decided by the Board of Tax Appeals (BOTA) in which BOTA attempted to interpret the legislative intent in the use of the word "operated" in KSA 79-1439(b)(1)(D) pertaining to the classification rate for commercial property owned and operated by not-for-profit corporations. He emphasized that Reno County believes that the legislative intent was to apply the tax break for not-for-profit entities only when the property is used and occupied by the not-for-profit organization. In his opinion, it is imperative that the

Legislature clarify the statute.

The Reno County Appraiser compared photographs of several independent living units for the elderly in Reno County with photographs of similar duplex dwellings and low-income single family dwellings on tax rolls in the same area. He reported that a total of 269 independent living units in Reno County are tax exempt, resulting in a $289,162 tax loss for the county. In Harvey County, 466 elderly housing units with an appraised value of $34,819,210 are exempt, resulting in an estimated $467,763 tax loss for the county for 2002. He contended that elderly persons living in housing units operated by a not-for-profit corporation under KSA 79-201b, *Fifth*, should be paying property taxes because the units are not part of the nursing home facility proper, are not owned by a municipality, and are not financed with federal funding. He maintained that the issue is a matter of fairness, noting that low-income retired citizens who cannot afford to live in an independent living unit must pay property taxes which subsidize community services also used by higher-income persons living in independent living units.

The Harvey County Appraiser echoed concern with regard to the tax exempt status of several independent elderly housing units in South Central Kansas owned by not-for-profit retirement communities. In his opinion, the sizeable amount of up-front fees included in a typical retirement community life lease and the additional expenses residents must pay for electricity, telephone, meals, and housekeeping clearly indicate that the residents are affluent and can afford to pay property taxes. He emphasized that the issue does not concern raising taxes but concerns sharing the tax burden fairly and equitably.

The McPherson County Appraiser expressed concerns about the tax exempt status of independent living units in McPherson County on behalf of the McPherson County Commission. He noted that the Commission views the tax exemption not as an income issue but as an ad valorem tax issue. He went on to explain that individuals who live in independent living units must construct them with their own funds, and the units must be built according to specifications of the not-for-profit organization. The units are maintained by residents through a monthly lease arrangement. Upon the death of the resident, the not-for-profit organization may keep from 60 to 80 percent of the resale of the life lease. He observed that, due to the costs of construction and maintenance, only a very small segment of the elderly can afford independent living units. He discussed ramifications of the tax exemption extending beyond independent living communities for the elderly. For example, he noted that a not-for-profit organization in Lindsborg has recently acquired older homes not physically attached to the campus and not modified for Americans with Disabilities Act standards. Because the homes are now owned by a not-for-profit organization, the residents are exempt from property taxation. However, residents in similarly constructed homes on either side must pay taxes. As an example of another type of inequity, he noted that one of the residents of an independent living unit in McPherson is a professor at the University of New York who uses the unit for a summer home six

to eight weeks each year and then returns to New York. In his opinion, legislative intent did not include a property tax exemption for a summer home for high income individuals such as the professor. He noted that the removal of independent living facilities from property tax rolls results in a significant increase in the mill levy to meet ongoing public services. The Commission is concerned that private money is being used to build and support independent living units, but the residents do not share the burden of paying for the streets, ambulance service, and several other community services which they use.

The Harvey County Administrator commented that the property tax exemption issue is pitting local governments against retirement communities, splitting communities, and creating ill will between those who pay property taxes and those who do not pay property taxes. He outlined the history of the exemption and discussed the findings of a task force which studied the issue surrounding KSA 79-201b, *Fifth*. In his opinion, the Good Neighbor Program recommended by the task force is fatally flawed and poor public policy. He suggested that exempt independent housing units either be placed on the tax rolls after a three to seven year time period or be placed on the tax rolls in a tiered fashion over a certain number of years

A representative of the League of Kansas Municipalities reported that the League recently conducted a survey in conjunction with the Kansas Association of Counties on the subject of property tax exemptions for independent living centers. He called attention to the results of the survey which were attached to his written testimony, noting that the not-for-profit adult care retirement communities were identified through a directory provided by the Kansas Association of Homes and Services for the Aging (KAHSA). The League found that there are 63 retirement facilities of this type spread over 31 counties. He explained the methodology used to determine the estimated tax loss per year per facility and noted that the total estimated tax loss for the 31 counties is $2.5 million per year. He informed the Committee that the issue will be discussed further during the League's annual conference in October.

A representative of the KAHSA testified in opposition to SB 479, contending that the current law is good public policy. At the outset, he noted that approximately 14,000 older people reside in not-for-profit retirement communities in Kansas. After describing the typical resident, he listed the benefits that not-for-profit communities provide for their residents, state government, and local communities. He emphasized that not-for-profit facilities must meet strict requirements in order to obtain a tax exemption. He noted that, to address the concerns of some communities regarding the exemption, KAHSA helped create the Good Neighbor Program which provides the framework for local negotiation of voluntary payments by not-for-profit senior housing providers to local units of government and schools. In addition, he noted that, although the Harvey County Commission has rejected the program, several KAHSA members are moving ahead with the program. In conclusion, he discussed the reasons he believes that quality of construction should not be a factor in determining the tax exempt status of independent living units for the elderly.

A representative of Presbyterian Manors of Mid-America, Inc., testified in opposition to SB 479 on the grounds that it would adversely affect not only elderly Kansas residents but also the dedicated not-for-profit organizations providing services to older adults. He argued that SB 479 is not necessary because the Legislature clarified the law which creates the tax exemption for not-for-profit providers, and the Kansas Supreme Court reaffirmed the Legislature's interpretation. For the Committee's information, he said that he has found that residents of independent living facilities do not elect to live there to avoid property tax but enter upon a life changing event. He explained that Presbyterian Manors, Inc., builds independent living units upon demand, and the type of unit built reflects the needs of the community. As the construction of the unit progresses, the applicant begins to make payments but may leave at any point. Generally, the total of the monthly charge and the interest earned from the deposit is what drives the operation of the continuing care retirement community. When individuals can no longer live independently and move to assisted living, the family often receives a 70 to 90 percent refund or the refund is applied to the cost of assisted living arrangements. He noted that, for this year alone, Presbyterian Manors, Inc., will write off over $650,000 due to residents' inability to pay, and over $750,000 will be spent to help support residents. In his opinion, the benefits Presbyterian Manors provides to communities through reinvestment far outweighs the tax revenues that might be generated.

A representative of the City of Inman echoed the opinion of other conferees that KSA 79-201b, *Fifth*, creates a tax loophole and should be amended or repealed. He noted that BOTA's decision to grant a tax exemption for the 88 independent living units owned by Pleasant View Home, Inc., of Inman adversely affected the city's 2003 budget preparation. He further noted that, although Pleasant View Home has made voluntary contributions to pay for city services, the payments do not equal the total that property taxes would produce and cannot be used in the budgeting process because they may be discontinued at any time. He expressed his concern that a sizeable population of affluent people who are not paying property taxes can vote on tax issues affecting the city and the school district. He also reviewed Internal Revenue codes and rulings applicable to Pleasant View Home.

Several residents of Newton expressed their opposition to the property tax exemption for not-for-profit retirement homes. They opined that the county would not need to raise taxes if the statutory loophole allowing not-for-profit independent living facilities a property tax exemption was closed.

The Mayor of McPherson commented that a blanket property tax exemption for all elderly housing operated by charitable organizations is a gross injustice to other elderly citizens who continue to live in their homes and pay property taxes. He contended that the language in KSA 79-201b, *Fifth*, should be amended because it does not adequately address the issue of fairness. He urged the Committee to support an amendment which would require taxation of all elderly independent living units and revoke all exemptions currently granted.

The Vice Mayor of Newton noted that the City of Newton currently has three not-for-profit retirement communities with independent living units off the tax roles. As a result, the City of Newton has experienced a tax loss of $78,514. He complained that, as the number of tax-exempt independent housing units increase each year, it is becoming increasingly difficult for the City of Newton to provide the same high level of service to its citizens.

The Mayor of Hesston urged the Committee to take a stand for tax fairness by permanently eliminating the property tax exemption for independent living units in not-for-profit retirement centers. In this regard, he discussed Showalter Villa, which he described as an upscale, broad range, not-for-profit retirement center with a current appraised value of $15,685,960. He emphasized that Showalter Villa is a tremendous asset to the City of Hesston. However, he believes it is unfair that local property taxpayers living in nonexempt housing provided the funding for a $1 million upgrade of the wastewater treatment plant and sewer line which became necessary due to the development of Showalter. In addition, he discussed Showalter's impact on the city's Emergency Medical Services budget.

A Harvey County Commissioner contended that the demands of funding the infrastructure of the county, city, and schools currently is borne by an unfair and unequal application of the property tax. He observed, "Infrastructure belongs to all, benefits all, and should be supported by all."

A Reno County Commissioner sent written testimony indicating that independent housing units should be subject to full property taxation as a matter of fairness to all property owners.

Written testimony also was submitted by the Kansas Association of Counties, stating that the Association does not question the exempt status of nursing and adult care health facilities but urges the Legislature to amend the law with regard to the issue of duplexes and single family homes for the elderly which escape property taxation.

The Committee discussed the topic at the October meeting and developed recommendations on the topic for the 2003 Legislature.

CONCLUSIONS AND RECOMMENDATIONS

The Committee recommends the formation of a working group to study the issue of the property tax exemption for independent living units owned by not-for-profit nursing homes. This working group will be bipartisan and members will be appointed by the chairmen of the Senate Committee on Assessment and Taxation and the House Committee on Taxation. The working group will use 2002 SB 479 as a basis to develop appropriate legislation by February 1, 2003.

SALES TAX PARITY ON THE SALE OF FIREARMS, WEAPONS, AND AMMUNITION

CONCLUSIONS AND RECOMMENDATIONS

After reviewing the issue of sales tax parity on the sale of firearms, weapons, and ammunition, the Committee concludes that no legislative action is necessary.

Proposed Legislation: None

BACKGROUND

The topic of sales tax parity on the sale of firearms, weapons, and ammunition was recommended by the Legislative Coordinating Council for study by the Committee. This issue was brought to the Legislature by a retailer expressing concerns that sales tax laws were not being followed uniformly in regard to gun and ammunition sales. In particular, a concern was expressed as to whether vendors at gun shows were collecting and remitting sales tax.

COMMITTEE ACTIVITY

The Committee held a hearing on the topic at the October meeting. At that time, a pawn shop owner from Ogden, Kansas offered written testimony. He described to the Committee a tax avoidance scheme by which a consumer purchases a gun or ammunition through a catalog or over the Internet, the item is shipped to a Kansas retailer, and then the consumer takes possession from the retailer without paying sales tax. He also expressed concern about the enforcement of Kansas sales tax laws at gun shows and in special sales. He noted that when Kansas consumers can purchase an expensive gun without paying sales tax, this takes business away from legitimate retailers who collect the sales tax, thereby allowing unfair competition.

A representative of the Kansas Department of Revenue also gave the Committee an overview of the current laws in regard to the sale of guns and related items at the October meeting. He noted that the retail sale of firearms, weapons, and ammunition in Kansas is subject to state and local sales tax, whether the sale occurs at a gun show or a store. He also explained that the federal Brady law, 18 USC section 922(t) applies to the sale of all firearms and effectively prohibits the remote sale of firearms. Under that law, a dealer of firearms must obtain a Federal Firearms License and cannot transfer possession of a firearm to any unlicensed person without that person first going through a criminal background check through the National Instant Criminal Background Check System, and without the dealer verifying the identity of that person through a government-issued photo identification. The Kansas Department of Revenue interprets this law to say that, subject to some narrow exceptions, the only legal sale by mail order or the Internet would be from one federal firearms licensee to another one. Consequently, for a licensed firearms dealer located in Kansas, the transfer of possession of a weapon to the ultimate

consumer in Kansas would be subject to sales tax, regardless of how the dealer obtained possession of the weapon (mail, Internet or otherwise).

The Committee also received information regarding the Kansas Department of Revenue's compliance program for gun shows, art fairs, trade shows, and similar events. It was noted that two revenue agents have primary responsibility for implementing the Department's statewide sales tax compliance program for vendors at miscellaneous events such as gun shows. The two agents are assisted by one or more additional agents when necessary. The procedure for compliance agents was described as follows. The agent contacts the coordinator of each miscellaneous event in order to request a list of participating vendors, addresses, and phone numbers at least two weeks in advance of the event. Once the agent has the list of participating vendors, the agent verifies sales tax registration. If a vendor on the list appears not to be registered, the agent will send registration materials to the vendor as soon as possible. Depending on the size of the event and the agent's schedule, the agent will attend the event, make contact with the vendors, check that vendors are registered with the Department, answer vendor sales tax questions, and follow up with vendors who have not registered with the Department.

CONCLUSIONS AND RECOMMENDATIONS

After reviewing the issue of sales tax parity on the sale of firearms, weapons, and ammunition, the Committee concludes that no legislative action is necessary.

To: Senator David Corbin, Chair
Senate Committee on Assessment and Taxation

From: Richard L. Cram, Director of Policy & Research, Department of Revenue
Jim Weisgerber, Tax Specialist

Date: January 14, 2003

ADMINISTRATIVE PROBLEMS CONCERNING ESTATE AND SUCCESSION TAXES

Background

From 1915 through 1978, Kansas had its own, stand-alone, inheritance tax. The state made a completely independent determination of what assets were to be included in the gross estate, the value of those assets, the type and amount of deductions, how the estate was to be distributed, and the amount of tax due from the estate.

During the 1978 Legislative Session it was decided Kansas law should "conform" to federal law. As a result, effective for dates of death occurring on or after January 1, 1979, the "old" inheritance tax act was repealed and a "new" inheritance tax act applied. Under the new act, although Kansas still had the authority to make independent determinations, it looked to federal law to decide what assets were to be included in the gross estate, the value of those assets and, to a large extent, the type and amount of deductions. For estates in excess of the federal filing level, federal figures were generally used. In addition to conforming to federal law, the new act imposed a "pick-up" tax in an amount equal to the federal credit for state estate taxes allowed on the federal estate tax return in addition to the direct inheritance tax.

The "new" inheritance tax act included some effective compliance and enforcement provisions. The act imposed a lien against all the property owned by a decedent at the time of death. It also provided for the issuance of a tax warrant. The lien clouded title to any asset, especially securities and real estate, and the tax warrant provision (although seldom used) was a substantial enforcement tool.

Under the inheritance tax act, compliance was seldom a problem. Small estates were either non-taxable (and so not required to file) or included real estate for which title clearance was necessary. Large estates (those over $600,000) were required to file in order to claim the federal credit for state inheritance or estate taxes and were otherwise identified by an information exchange agreement between the Department of Revenue and the Internal Revenue Service.

Similarly, auditing was not an issue. There was seldom any reason to question the composition or value of small estates, which was determined by reference to the federal estate tax return, subject to IRS adjustment.

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In addition, enforcement was usually not an issue. Small estates generally paid promptly because the tax was small and they wanted to get clear title to real estate. Large estates were also inclined to pay promptly not only to get clear title to real estate and securities, but also because they needed to provide the IRS with proof of payment of an amount at least equal to the federal credit for state inheritance or estate taxes to avoid disallowance of the credit.

The "Pick-Up" Tax

The 1998 Legislature replaced the inheritance tax and imposed only a tax equal to the federal credit for state inheritance or estate taxes; a "pick-up tax". Kansas law was brought into total conformity with federal law. The "pick-up tax" act required that all determinations as to assets included in the gross estate, the value of those assets, the type and amount of deductions, and the amount of tax due from the estate were made by reference to federal law. Because the Kansas Legislature cannot delegate its authority to the federal government, the act referred to federal law as it existed on December 31, 1997.

Under the "pick-up tax" act compliance was not a problem because only those estates filing a federal return were required to file a state return. Auditing was not a problem because the federal return was the base document on which the tax was computed. And, enforcement was not a problem because the IRS would not allow the federal credit for state inheritance or estate taxes unless the estate could provide proof of an amount at least equal to the federal credit for state inheritance or estate taxes.

As originally enacted, the "pick-up tax" act contained both a lien and a tax warrant provision. The need for these provisions was almost immediately a subject of debate. It was reasoned, compliance, auditing and enforcement would not be problems because of the close conformity to federal law and reliance on the actions of the IRS. A proposal to eliminate these provisions was submitted to the Legislature in 1999, and these provisions were retroactively repealed.

Changes in Federal Law – Summer 2001

During the summer of 2001 federal law was changed dramatically. The changes in federal law did not automatically mean a change in the manner in which the state "pick-up tax" is to be determined, because state law is based on federal law as it existed on December 31, 1997. In other words, the effect of the changes in federal law was that state and federal law are no longer in total conformity. And, as time goes on, the differences between the two laws increase.

The changes in federal law create two primary differences between state and federal law. First, the accelerated increase in the IRC §2010 applicable exclusion amount had the effect of increasing the federal filing threshold to $1,000,000 effective January 2, 2002. In accordance with federal law this amount will increase to $1,500,000 in 2004, $2,000,000 in 2006, and $3,500,000 in 2007. On the other hand, the 1997 federal law

that Kansas has incorporated by reference includes a provision that increases the filing threshold at a much slower pace. The state filing threshold is $700,000 in 2002 and 2003, $850,000 in 2004, $950,000 in 2005, and $1,000,000 in 2006 and thereafter.

Second, under the new federal law the federal credit for state inheritance and estate taxes found in IRC §2011 is phased out. In accordance with federal law, for deaths occurring in 2002 the amount of the credit is decreased by 25%, for 2003 by 50%, for 2004 by 75%, and for 2005 the credit is eliminated and replaced with a deduction. . On the other hand, the 1997 federal law that Kansas has incorporated by reference does not include a phase-out provision. Instead, 100% of the amount of the credit is to be paid.

The differences that now exist between federal and state law create several problems. These include problems of compliance, administration, auditing and enforcement. These problems will continue to grow with time, unless legislative change is made.

First, compliance. Undoubtedly, many practitioners believe Kansas law conforms to federal law and that the federal changes will automatically flow through to Kansas. As a result, many estates with a value between $700,000 and $1,000,000 will not file Kansas estate tax returns during or after 2002. This problem will get worse over time because the federal filing threshold increases faster than the Kansas filing threshold. Without any provisions in the law to ensure "voluntary" compliance, it will fall to the Department of Revenue to attempt to identify estates that exceed the state filing level and require them to file a return.

Second, administration. In order to obtain the information needed to make the state calculations, the estate must complete a *pro forma* federal return and file it with the Department of Revenue even if a federal return will not be filed with the IRS. Federal law is very complex, and the Department of Revenue has neither the staff nor the expertise to administer federal law. Nevertheless, the Department will be called upon more and more to do just that as the gap between the federal filing threshold and the state filing threshold increases.

Third, auditing. Take, for example, the estate of a decedent dying in 2007 that does not file a federal estate tax return. In the past, for estates of any substantial size, the Department relied on the IRS to determine what assets should be included in the estate, and the value of these assets. (The inclusion and valuation of assets in small estates was seldom if ever challenged.) Now the Department of Revenue will be responsible for this function.

Finally, enforcement. Present Kansas law was based on the notion that enforcement would be effected by the IRS, and does not include either a lien or a tax warrant provision. The only enforcement tool available to the Department is a suit against the estate. This is not a cost-effective approach to enforcement.

Kansas Succession Tax

The Kansas succession tax was passed during the closing days of the 2002 Legislative Session. It is found in New Section 5 of Senate Bill 39.

The principle problems facing the Department of Revenue with regard to the succession tax come from its extreme brevity. The provisions of the succession tax simply say that there is a tax on the privilege of a remote heir succeeding to the ownership of property, and that the tax is imposed at one of three rates. The entire "act" is comprised of seven sentences.

The Conference Committee Report on Senate Bill 39 describes the new succession tax as a "Class C Inheritance Tax Reimposition." However, it is clearly not a reimposition of the inheritance tax. There is a vast difference between the new succession tax and the inheritance tax act.

The Kansas inheritance tax act is comprised of approximately 50 statutes. These statutes provide detailed instructions concerning the valuation of assets; what assets to include in the gross estate; how to calculate the composition and value of the adjusted gross estate; how to calculate the composition and value of the distributable estate; how to distribute the assets of the estate to the various distributees; and how to compute the tax on each share and the total tax liability of the estate. The act provides a great deal guidance as to how to report and pay the tax to the state of Kansas.

In the absence of detail such as that provided by the inheritance tax act, the Department of Revenue has been struggling with how to administer the succession tax. Based on the terms of the statute, the Department can require the identification of the remote heirs, verification of their relationship to the decedent, a statement as to the value of the assets they received, and a statement of the tax due on the value of these assets. However, the statute does not specify how the value of assets is to determined, the size or composition of the gross estate, the specifics of the assets to which the remote heir(s) succeeds, or the authority by which they succeed. The Department has developed an instruction booklet for the current Kansas estate and succession taxes, which is attached.

Staffing Needs

In addition to the problems presented by the current law, the Department of Revenue will need to rebuild an administrative unit in order to administer the "pick-up tax" and the succession tax. Under the inheritance tax, the Department of Revenue had a staff of between 12 and 15 people. When the "pick-up tax" was enacted, this staff was all but eliminated and, at present, only one person works with the estate and succession tax for the Department. Obviously, there is no way one person can handle this load.

Fiscal Impact of New Succession Tax

At the time the Legislature passed Section 5 of 2002 Senate Bill 39, the Department had provided a positive fiscal impact estimate of $15 million in tax revenue for FY 2003, based on the assumption that this legislation would be a reimposition of the inheritance tax on Class C heirs, and that it would have been in effect soon enough for an entire year of receipts from it to have been received in FY 2003. As passed, the succession tax applies only to estates of decedents passing away on or after June 6, 2002. To date, the Department has received only a few returns and insignificant revenue from the new succession tax. Given that succession tax returns would not be due until nine months after the date of death, the Department does not expect to receive significant revenue until March, 2003, at the earliest. As previously discussed, the language in Section 5 of Senate Bill 39 is not an inheritance tax, as none of the needed administration and compliance tools were included in the legislation.

At the November 2002 Consensus Estimating Group meeting, the FY 2003 fiscal impact estimate for the succession tax was reduced from $15 million to $5 million, based upon the anticipated administration and compliance problems that will be encountered with this new tax, and the fact that receipts from this tax are not expected to be received until March 2003. Receipts for the succession tax in FY 2004 are projected to be $10 million. The Consensus Estimating Group forecast for receipts from the Kansas estate tax remains flat, $50 million in FY 2003 and $50 million in FY 2004.

Future Action

The Department is involved in discussions with several estate tax attorneys in private practice who are working on drafting a legislative proposal (to be presented this session as soon as it is ready) for an alternative to the succession tax and existing Kansas estate tax, that would address the administrative problems discussed above.

Kansas Department of Revenue
www.ksrevenue.org

KANSAS

Estate and Succession Tax Booklet

Kansas Estate and Succession Tax

For Deaths Occurring On or After June 6, 2002

The State of Kansas imposes both an estate tax and a succession tax on the estates of persons who died on or after June 6, 2002.

The estate tax is a tax on the value of the decedent's estate, and is equal to the federal credit for state death taxes computed on the basis of 1997 federal law. The succession tax is imposed on the privilege of succeeding to the ownership of property by someone who is not a spouse, sibling, lineal ancestor or lineal descendant of the decedent.

Estates of persons who died before June 6, 2002 are subject to an estate tax and estates of persons who died before July 1, 1998 are subject to an inheritance tax. Please contact the Department of Revenue for more information about these taxes.

Pub. KS-1950 (Rev. 10/02)

For questions about the Kansas Estate and Succession Tax, contact:

Kansas Department of Revenue
Customer Relations – Estate Tax
915 SW Harrison St.
Topeka, KS 66625-2222

Outside Topeka:
1-877-526-7738
In Topeka:
(785) 368-8222
Fax:
(785) 296-4993
Hearing Impaired TTY:
(785) 296-6461

To obtain forms, publications and other information, please visit our Web site:

www.ksrevenue.org

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Kansas Estate Tax

The Kansas estate tax is based on federal law. By statute, Kansas has incorporated by reference federal law as it existed on December 31, 1997.

Federal law as it existed on December 31, 1997 provides that when estate taxes are paid to a state, a credit for that tax is allowed against the federal tax shown on the United States Estate (and Generation Skipping Transfer) Tax Return, federal Form 706. The Kansas estate tax is equal to 100% of the maximum federal credit allowable for state death taxes paid. In effect, the Kansas estate tax return picks up the maximum allowable credit amount. This is why the Kansas estate tax is referred to as a "pick-up tax".

Recent Changes In Federal Estate Tax Law

A major feature of the federal tax package adopted in June of 2001 is the phasing down and eventual elimination of the federal estate tax. Under this law, the federal estate tax will be gradually reduced over the next decade until it is eliminated in calendar year 2010.

The recent changes in federal law fall into two primary categories. First, the accelerated increase in the Internal Revenue Code §2010 applicable exclusion amount will have the effect of increasing the federal filing threshold to $1,000,000 effective January 2, 2002. In accordance with federal law this amount will increase to $1,500,000 in 2004, $2,000,000 in 2006, and $3,500,000 in 2007.

Second, under the new federal law the federal credit for state death taxes found in Internal Revenue Code §2011 is phased out. In accordance with federal law, for deaths occurring in 2002 the amount of the credit is decreased by 25%, for deaths occurring in 2003 by 50%, and for deaths occurring in 2004 by 75%. For deaths occurring in 2005 the credit is eliminated and replaced with a deduction.

Recent Changes In Federal Estate Tax Law Do Not Affect The Kansas Estate Tax

Many believe the Kansas estate tax is in total conformity with federal law, and that the recent federal law changes will automatically flow through to Kansas. This is not the case. By statute, Kansas has incorporated by reference federal law as it existed on December 31, 1997. Therefore, under current law, the Kansas estate tax will not be affected by the recent changes to federal law.

The 1997 federal law Kansas has incorporated by reference does not recognize the accelerated filing thresholds found in current federal law. Instead, the state filing threshold is $700,000 for deaths occurring in 2002 and 2003, $850,000 for deaths occurring in 2004, $950,000 for deaths occurring in 2005, and $1,000,000 for deaths occurring in 2006 or thereafter.

Similarly, the 1997 federal law Kansas has incorporated by reference does not include a provision that provides for a phase-out of the credit for state death taxes. Instead, 100% of the amount of the credit is to be paid.

Recalculation of Federal Credit For State Death Taxes By Estates Filing Federal Form 706

The 1997 federal law Kansas has incorporated by reference does not recognize either the accelerated filing thresholds or the phase-out of the credit for state death taxes found in current federal law. As a result, the amount of the federal credit for state death taxes shown on the federal Form 706 filed for the estate of a decedent dying on or after June 6, 2002, will not be correct for Kansas estate and succession tax purposes. To determine the correct amount, the estate must recalculate the amount of the federal credit for state death taxes.

To recalculate the federal credit for state death taxes, the estate should use the applicable Internal Revenue Code §2010 exclusion amount allowed for the year of death under federal law as it existed on December 31, 1997. The amount determined should not be reduced by any percentage. Instead, 100% of the amount of the recalculated credit should be used in determining the amount of Kansas tax due.

Proration of Kansas Estate Tax

Kansas law provides that when the estate of a resident decedent shall consist of property within and property without the state, or in the case of the estate of a nonresident decedent who died holding an interest in property with a Kansas tax situs, the tax must be prorated. The Kansas estate tax is the same percentage of the federal credit for state death taxes that the total value of the

decedent's Kansas property is of the total value of their federal gross estate.

For a **resident decedent**, property taxable by Kansas includes real property and tangible personal property located in Kansas, and intangible personal property wherever located.

For a **nonresident decedent**, property taxable by Kansas includes real property and tangible personal property located in Kansas.

Kansas Succession Tax

The Kansas succession tax is in addition to the Kansas estate tax. It is imposed on the privilege of succeeding to the ownership of any property, corporeal or incorporeal, and any interest therein within the jurisdiction of Kansas by any person who is not a spouse, brother or sister, lineal ancestor, lineal descendant, step-parent, step-child, adopted child, lineal descendant of any adopted child or step-child, spouse or surviving spouse of a son or daughter, or spouse or surviving spouse of an adopted child or step-child of the decedent. Generally, any estate that includes property passing to a "remote heir" (i.e. any person who is not a spouse, brother or sister, lineal ancestor, lineal descendant, step-parent, step-child, adopted child, lineal descendant of any adopted child or step-child, spouse or surviving spouse of a son or daughter, or spouse or surviving spouse of an adopted child or step-child of the decedent) will be subject to the succession tax, regardless of the size of the estate.

Property passing to a charity is not subject to the Kansas succession tax. For purposes of the Kansas succession tax, an organization will be considered a charity if it qualifies as a charity for federal estate tax purposes.

General Information

Kansas Filing Requirements

Estates of decedents dying on or after June 6, 2002 that include property passing to a "remote heir" must file an estate and succession tax return.

Estates of decedents dying on or after June 6, 2002 that do not include property passing to a "remote heir" must file an estate and succession tax return if the value of the estate exceeds the filing threshold found in the 1997 federal law Kansas has incorporated by reference. The thresholds established by that law are exceeded if:

- The decedent's death occurred during 2002 or 2003 and the value of the gross estate is $700,000 or more;
- The decedent's death occurred in 2004 and the value of the gross estate is $850,000 or more;
- The decedent's death occurred in 2005 and the value of the gross estate is $950,000 or more; or
- The decedent's death occurred in 2006 or after and the value of the gross estate is $1,000,000 or more.

If the estate of a decedent dying on or after June 6, 2002 does not exceed the filing threshold found in the 1997 federal law Kansas has incorporated by reference, and does not include property passing to a "remote heir", the estate is <u>not</u> subject to estate or succession tax. Estates of decedents dying on or after June 6, 2002 are <u>not</u> subject to a lien for taxes, and no release of lien or consent to transfer is required prior to transferring either real estate or securities from the decedent's estate. Therefore, since the estate is not subject to tax, and no release of lien or consent to transfer is required, the estate does not need to file an estate and succession tax return. The estate may, however, file a return to request a determination of no Kansas estate and succession tax liability.

Kansas Returns

If the gross value of the estate is in excess of the filing threshold established by the 1997 federal law Kansas has incorporated by reference for the year of the decedent's death, use Form K-707. If the estate filed a federal Form 706, a copy must be attached. If the estate was not required to file a federal Form 706, a *pro forma* federal Form 706 must be completed and attached. Use the version of Form 706 dated July, 1998.

If the gross value of the estate is below the filing threshold established by the 1997 federal law

Kansas has incorporated by reference for the year of the decedent's death, but includes property passing to a "remote heir", use Form K-708. Neither a federal Form 706 nor a *pro forma* federal Form 706 need be submitted.

If the estate is filing a return to request a determination of no Kansas estate and succession tax liability, use Form K-708.

Who Must File A Return

The personal representative of the estate must file a return. For purposes of the Kansas estate and succession tax, the term "personal representative" means the executor, administrator or deemed executor of the decedent. A "deemed executor" is any person in actual or constructive possession of any property of the decedent. A deemed executor must act if no executor or administrator is appointed, qualified and acting within the United States.

When To File

When the estate is required to file a federal estate tax return, a complete Kansas Estate and Succession Tax Return, Form K-707, must be filed on or before the due date of the federal estate tax return. This date is within nine months of the decedent's death unless an extension of time to file has been granted.

When the estate is required to file a *pro forma* federal Form 706, a Kansas Estate and Succession Tax Return, Form K-707, must be filed within nine months of the date of the decedent's death.

When the estate is not required to file a federal estate tax return, a Kansas Estate and Succession Tax Return, Form K-708, must be filed within nine months of the date of the decedent's death.

A return is deemed filed upon delivery to the Kansas Department of Revenue. When mailed, a return is deemed filed as of the postmark date.

Extensions of Time to File

Extensions of time to file a federal estate tax return that have been granted by the Internal Revenue Service will be accepted for Kansas estate and succession tax purposes. Attach a copy of the federal extension(s) to your Kansas return and check the box for an extension. An extension of time to file is not an extension of time to pay.

Payment of Tax

Tax is due nine months following the decedent's date of death. If not paid when due, interest will accrue.

Interest

If the tax is not paid by the due date, interest will be charged on the unpaid tax from the due date until the time it is paid. The rate of interest is the underpayment rate prescribed and determined under section 6621 of the federal Internal Revenue Code, as in effect on Septmeber 1, 1996, and which rate is in effect thereunder on July 1 of the year immediately preceding the calendar year for which the rate is being annually fixed, plus 1% if computed annually. For a specific rate, please contact the Estate Tax Section.

Closing Letter

Upon being satisfied that there has been a final determination of all taxes due and that payment has been received, the Director of Taxation will issue a closing letter to the personal representative. A copy of the closing letter will also be issued to the preparer of the return.

IRS Adjustments

Any adjustment by the Internal Revenue Service must be reported by the personal representative to the Director of Taxation within ninety (90) days of the date of such adjustment. Failure to comply will cause the statute of limitations to be tolled.

Additional Forms

To obtain additional Estate and Succession Tax forms or for other state tax assistance contact the office shown below. Forms can also be downloaded from the Department of Revenue's Web site: http://www.ksrevenue.org

Topeka Assistance Center
Docking State Office Building, First Floor
915 SW Harrison
Topeka, KS 66612-1588
Outside Topeka: 1-877-526-7738
In Topeka: (785) 368-8222
Hearing Impaired TTY: 1-785-296-6461
Forms Order Line: (785) 296-4937
Forms Fax Line: (785) 296-2736

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1997 Tables for Recalculation of Federal Credit for State Death Taxes

Kansas Table A - Unified Rate Schedule

Column A Taxable amount over	Column B Taxable amount not over	Column C Tax on amount in Column A	Column D Rate of tax on excess over amount in Col. A
			(percent)
0	10,000	0	18
10,000	20,000	1,800	20
20,000	40,000	3,800	22
40,000	60,000	8,200	24
60,000	80,000	13,000	26
80,000	100,000	18,200	28
100,000	150,000	23,800	30
150,000	250,000	38,800	32
250,000	500,000	70,800	34
500,000	750,000	155,800	37
750,000	1,000,000	248,300	39
1,000,000	1,250,000	345,800	41
1,250,000	1,500,000	448,300	43
1,500,000	2,000,000	555,800	45
2,000,000	2,500,000	780,800	49
2,500,000	3,000,000	1,025,800	53
3,000,000	----------	1,290,800	55

Kansas Table B -

Computation of Maximum Credit for State Death Taxes

(Based on Federal adjusted taxable estate computed using worksheet B)

(1) Adjusted taxable estate equal to or more than:	(2) Adjusted taxable estate less than:	(3) Credit on amount in column (1)	(4) Rate of credit on excess over amount in column (1):
			(percent)
0	40,000	0	None
40,000	90,000	0	0.8
90,000	140,000	400	1.6
140,000	240,000	1,200	2.4
240,000	440,000	3,600	3.2
440,000	640,000	10,000	4.0
640,000	840,000	18,000	4.8
840,000	1,040,000	27,600	5.6
1,040,000	1,540,000	38,800	6.4
1,540,000	2,040,000	70,800	7.2
2,040,000	2,540,000	106,800	8.0
2,540,000	3,040,000	146,800	8.8
3,040,000	3,540,000	190,800	9.6
3,540,000	4,040,000	238,800	10.4
4,040,000	5,040,000	290,800	11.2
5,040,000	6,040,000	402,800	12.0
6,040,000	7,040,000	522,800	12.8
7,040,000	8,040,000	650,800	13.6
8,040,000	9,040,000	786,800	14.4
9,040,000	10,040,000	930,800	15.2
10,040,000	----------	1,082,800	16.0

Kansas Table C - Unified Credit

Year	Unified Credit	Applicable Exclusion Amount
2002	229,800	700,000
2003	229,800	700,000
2004	287,300	850,000
2005	326,300	950,000
2006 and after	345,800	1,000,000

Kansas Table B - Worksheet

Federal Adjusted Taxable Estate

1. Federal taxable estate $ _____
(from Tax Computation, Form 706, line 3)

2. Adjustment 60,000

3. Federal adjusted taxable estate _____
Subtract line 2 from line 1. Use this amount to compute maximum credit for state death taxes in Table B.

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K-707

(Rev. 8/02)

Kansas Estate and Succession Tax Return

For estates of decedents filing federal Form 706, or a *pro forma* Form 706. For deaths occurring on or after June 6, 2002.

Decedents Information

First Name	Initial	Last Name		
County and State of Domicile at Date of Death	Date of Death	Age	Social Security Number	
Personal Representative (Name and Address)			Social Security Number	Telephone Number
Attorney for the Estate (Name and Address)				Telephone Number
Co-Representative (Name and Address)			Social Security Number	Telephone Number
Preparer of Return - Other than Personal Representative or Attorney (Name and Address)				Telephone Number

Check the box if an extension is attached. ☐ Amount paid with extension _____ Check the box if this is an amended return. ☐

Please attach a copy of Federal Estate Tax Return Form 706

1. Total state death tax credit allowed for federal estate tax purposes — 1.

Proration of Federal Credit

2. Total federal gross estate (From federal Form 706, pg.1, line 1) — 2.
3. Gross value of non-Kansas property (See instructions) — 3.
4. Gross value of Kansas property (Subtract line 3 from line 2) — 4.
5. Percentage of estate located in Kansas (Line 4 divided by line 2) — 5.

Kansas Estate and Succession Tax

6. (a) Estate Tax Due (Line 1 times line 5)	6a.	(b) Succession Tax Due (From Succession Tax Schedule) 6b.
7. (a) Estate Tax Interest (See Instructions)	7a.	(b) Succession Tax Interest (See Instructions) 7b.
8. (a) Total Estate Amount Due (Line 6a plus line 7a)	8a.	(b) Total Succession Amount Due (Line 6b plus line 7b) 8b.

9. Total Tax and Interest (Line 8a plus line 8b) Make check payable to: **Kansas Estate and Succession Tax** — 9.

Under penalty of perjury, I declare that I have examined this return, including accompanying schedules and statements and to the best of my knowledge and belief it is true, correct and complete. Declaration of preparer other than personal representative or person in possession of property is based on all information of which preparer has any knowledge.

Signature of Personal Representative _____ Date _____ Signature of Preparer Other than Personal Representative _____

Signature of Co-Representative _____ Date _____ Signature of Preparer Other than Personal Representative _____

Mail to: Kansas Department of Revenue, Customer Relations-Estate Tax
915 SW Harrison Street, Topeka, KS 66625-2222

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Federal Credit For State Death Taxes

Line 1. If the estate is required to file a federal Form 706, recalculate the credit for state death taxes on the Recalculation Schedule, page 9, and enter the amount here.

If the estate is not required to file a federal Form 706, enter the amount of the credit for state death taxes reported on the *pro forma* federal Form 706.

Proration Of Federal Credit for State Death Taxes

Kansas law provides that when the estate of a resident decedent consists of property within and without the state, or in the case of the estate of a nonresident decedent who died holding an interest in property with a Kansas tax situs, the federal credit for state death taxes must be prorated.

Resident Decedent. For a resident decedent, property taxable by Kansas includes real property and tangible personal property located in Kansas and intangible personal property wherever located.

Nonresident decedent. For a nonresident decedent, property taxable by Kansas includes real property and tangible personal property located in Kansas.

Line 2. Enter the gross value of the decedent's estate as reported on the federal Form 706 or *pro forma* federal Form 706.

Line 3. Enter the gross value of the decedent's non-Kansas property as reported on the federal Form 706 or *pro forma* federal Form 706. Please identify these assets on the attached copy of the federal estate tax return by highlighting them in some manner or by attaching a separate schedule of these assets.

Line 4. Subtract line 3 from line 2.

Line 5. Divide line 4 by line 2. Enter the result as a percentage. If the decedent was a resident decedent whose estate consists entirely of Kansas property, the result is 100 percent.

Kansas Estate and Succession Tax

Line 6a. Multiply line 1 by line 5. This is the Kansas estate tax.

Line 6b. Enter the amount of succession tax determined on the Succession Tax Schedule, page 11.

Line 7. If the tax is not paid by the due date, interest will be charged on the unpaid tax from the due date until the time it is paid. The rate of interest is the underpayment rate prescribed and determined under section 6621 of the federal Internal Revenue Code, as in effect on September 1, 1996 and which rate is in effect thereunder on July 1 of the year immediately preceding the calendar year for which the rate is being annually fixed, plus 1 percent if computed annually. For a specific rate, please contact the Estate Tax Section.

Line 7a. Enter the amount of interest due on the Kansas estate tax shown on line 6a.

Line 7b. Enter the amount of interest due on the Kansas succession tax shown on line 7b.

Line 8a. Enter the sum of line 6a and line 7a.

Line 8b. Enter the sum of line 6b and line 7b.

Line 9. Add line 8a and line 8b. This is the total amount due to the State of Kansas. Please make your check or money order payable to "Kansas Estate and Succession Tax".

For questions about the Kansas Estate and Succession Tax, contact:

Kansas Department of Revenue
Customer Relations – Estate Tax
915 SW Harrison St.
Topeka, KS 66625-2222

Outside Topeka:	1-877-526-7738
In Topeka:	(785) 368-8222
Fax:	(785) 296-4993
Hearing Impaired TTY:	(785) 296-6461

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Recalculation of Federal Credit for State Death Taxes

1.	Total gross estate less exclusion (From federal Form 706, page 1, line 1)	1.
2.	Total allowable deductions (From federal Form 706, page 1 line 2)	2.
3.	Taxable estate (Subtract line 2 from line 1)	3.
4.	Adjusted taxable gifts (From federal Form 706, page 1, line 4)	4.
5.	Add lines 3 and 4	5.
6.	Tentative tax on the amount on line 5 from Table A (Page 6)	6.
7.	Total gift tax payable (From federal Form 706, page 1, line 7)	7.
8.	Gross estate tax (Subtract line 7 from line 6)	8.
9.	Maximum unified credit (applicable credit amount) against estate tax (See Kansas Table C, page 6)	9.
10.	Adjustment to unified credit (From federal Form 706, page 1, line 10)	10.
11.	Allowable unified credit (applicable credit amount) (Subtract line 10 from line 9)	11.
12.	Subtract line 11 from line 8 (But do not enter less than zero)	12.
13.	Credit for state death taxes. (Do not enter more than line 12. Figure the credit by using the amount on line 3 less $60,000. See Kansas Table B, page 6. Enter here and on Form K-707, line 1.)	13.

2-14

LINE INSTRUCTIONS FOR RECALCULATION SCHEDULE

The 1997 federal law Kansas has incorporated by reference does not recognize either the accelerated filing thresholds or the phase-out of the credit for state death taxes found in current federal law. As a result, the amount of the federal credit for state death taxes shown on the federal Form 706 filed for the estate of a decedent dying on or after June 6, 2002, will not be correct for Kansas estate and succession tax purposes. To determine the correct amount, the estate must recalculate the amount of the federal credit for state death taxes.

To recalculate the federal credit for state death taxes, the estate should use the applicable Internal Revenue Code §2010 exclusion amount allowed for the year of death under federal law as it existed on December 31, 1997. The amount determined should not be reduced by any percentage. Instead, 100% of the amount of the recalculated credit should be used in determining the amount of Kansas tax due.

Line 1. Enter the amount of the total gross estate less exclusion shown on line 1, page 1, of the federal Form 706.

Line 2. Enter the amount of the total allowable deductions shown on line 2, page 1, of the federal Form 706.

Line 3. Subtract line 2 from line 1 and enter the result. This should be the same as the amount shown on line 3, page 1, of the federal Form 706.

Line 4. Enter the amount of adjusted taxable gifts shown on line 4, page 1, of the federal Form 706.

Line 5. Add lines 3 and 4. This should be the same as the amount shown on line 5, page 1, of the federal Form 706.

Line 6. Enter the tentative tax on the amount on line 5 from Kansas Table A on page 6 of these instructions. This should be the same as the amount shown on line 6, page 1, of the federal Form 706.

Line 7. Enter the amount of total gift tax payable shown on line 7, page 1, of federal Form 706.

Line 8. Subtract line 7 from line 6. This is the gross federal estate tax and should be the same as the amount shown on line 8, page 1, of the federal Form 706.

Line 9. Enter the amount of the maximum unified credit from Kansas Table C on page 6 of these instructions. This amount **will not** be the same as the amount shown on line 9, page 1, of the federal Form 706.

Line 10. Enter the amount of the adjustment to the unified credit shown on line 10, page 1, of federal Form 706.

Line 11. Subtract line 10 from line 9 and enter the result here. This is the allowable unified credit and **will not** be the same as the amount shown on line 11, page 1, of the federal Form 706.

Line 12. Subtract line 11 from line 8 and enter the result here (but do not enter less than zero). This amount **will not** be the same as the amount shown on line 12, page 1, of the federal Form 706.

Line 13. Enter the amount of the federal credit for state death taxes from Kansas Table B on page 6 of the instructions. Do not enter more than the amount on line 12. This amount **will not** be the same as the amount shown on line 13, page 1, of the federal Form 706. This amount should also be entered on line 1 of the Form K-707.

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Succession Tax Schedule

List relatives and strangers in the blood, other than a spouse, brother or sister, lineal ancestor, lineal descendant, step-parent, step-child, adopted child, lineal descendant of any adopted child or step-child, spouse or surviving spouse of a son or daughter, or spouse or surviving spouse of an adopted child or step-child of the decedent, who succeeds to the ownership of any property of the decedent, corporeal or incorporeal, and any interest therein within the jurisdiction of Kansas.

	(a) Name Address	(b) SS#	(c) Relationship	(d) Value of Interest Received	(e) Total Tax
1.					
2.					
3.					
4.					
5.					
6.					
7.					
8.					
9.					
10.					
11.					
12.					
13.					
14.					
15.					
16.					

Total Tax: Add all amounts listed in column (e). Enter Total Tax here and on line 6b of Form K-707 or on Line 3 of Form K-708.

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Instructions for Succession Tax Schedule

Column (a). Name and Address. Enter the name and address of any relative, or stranger in the blood, of the decedent other than the spouse, brothers and sisters, lineal ancestors, lineal descendents, step-parents, step-children, adopted children, lineal descendants of any adopted child or step-child, the spouse or surviving spouse of a son or daughter, or the spouse or surviving spouse of an adopted child or step-child of the decedent who succeeds to the ownership of any property, corporeal or incorporeal, or any interest therein within the jurisdiction of Kansas.

Column (b). Social Security Number. Enter the social security number of the person named in Column (a).

Column (c). Relationship. State the relationship between the decedent and the person named in Column (a).

In the case of any adopted child or step-child, a spouse or surviving spouse of an adopted child or step-child or the lineal descendant of any adopted child or step-child of the decedent, such person shall file with the Department of Revenue an affidavit setting forth the relationship of such person to the decedent. The affidavit can be in any form adequate to establish the relationship, and should be attached to the return.

Column (d). Value of Interest Received. Enter the value of the interest received from the decedent by the person named in Column (a). This includes all property to which the person succeeds in any manner recognized under Kansas law.

Column (e). Tax. Compute the amount of tax due for the person named in Column (a), and enter the amount here.

Tax is charged upon the value of the property being succeeded to in an amount equal to the following percentages:

On any amount up to $100,000	10%
On any amount in excess of $100,000 up to $200,000	12%
On all sums in excess of $200,000	15%

Total Tax. Add the amounts of tax listed in Column (e) for all of the persons named in Column (a). Enter the total here, and on line 6b of Form K-707 or line 3 of Form K-708.

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K-708 KANSAS SUCCESSION TAX RETURN

(Rev. 10/02)

For estates of decedents not filing federal Form 706, or *pro forma* Form 706. For deaths occurring on or after June 6, 2002.

Decedents Information

First Name	Initial	Last Name		
County and State of Domicile at Date of Death	Date of Death	Age	Social Security Number	
Personal Representative (Name and Address)			Social Security Number	Telephone Number
Attorney for the Estate (Name and Address)				Telephone Number
Co-Representative (Name and Address)			Social Security Number	Telephone Number
Preparer of Return - Other than Personal Representative or Attorney (Name and Address)				Telephone Number

Check the box if this is an amended return. ☐

Check the box if this is a request for determination of no Kansas estate and succession tax. ☐

1. Was the estate required to file a federal Form 706? ☐ Yes ☐ No

   If the answer to question 1 is "Yes" **DO NOT** complete this form. Use Kansas Form K-707.

2. Enter the value of the gross estate, as determined for federal estate tax purposes. 2. _____

   You must determine the actual value based on the IRS rules for federal estate tax before filing this form. **Do not** estimate this amount.

3. Enter the amount of succession tax determined from the Succession Tax Schedule. 3. _____

4. Interest (See instructions) 4. _____

5. Total tax and interest (Add line 3 and line 4) 5. _____

Make check payable to: **Kansas Estate and Sucession Tax**

Under penalty of perjury, I declare that I have examined this return, including accompanying schedules and statements and to the best of my knowledge and belief it is true, correct and complete. Declaration of preparer other than personal representative or person in possession of property is based on all information of which preparer has any knowledge.

Signature of Personal Representative _____ Date _____ Signature of Preparer Other than Personal Representative _____

Signature of Co-Representative _____ Date _____ Signature of Preparer Other than Personal Representative _____

Mail to: Kansas Department of Revenue, Customer Relations-Estate Tax
915 SW Harrison Street, Topeka, KS 66625-2222

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Line Instructions for Form K-708

Line 1. Indicate whether the estate is required to file a federal Form 706 or *pro forma* federal Form 706 by checking the appropriate box. If the answer is "Yes", **do not** complete this form. Use Kansas Form K-707 instead.

Line 2. Enter the value of the gross estate, as determined for federal estate tax purposes (i.e. the value determined in deciding whether the estate would be required to file a federal Form 706 or *pro forma* federal Form 706. You must determine the actual value based on the Internal Revenue Service rules for estate tax. **Do not estimate this amount.**

Line 3. Enter the amount of succession tax determined on the Succession Tax Schedule.

Line 4. If the tax is not paid by the due date, interest will be charged on the unpaid tax from the due date until the time it is paid. The rate of interest is the underpayment rate prescribed and determined under section 6621 of the federal Internal Revenue Code, as in effect on September 1, 1996 and which rate is in effect thereunder on July 1 of the year immediately preceding the calendar year for which the rate is being annually fixed, plus 1% if computed annually. For a specific rate, please contact the Estate Tax Section.

Line 5. Add line 3 and line 4. This is the total amount due to the State of Kansas. Please make your check or money order payable to "Kansas Estate and Succession Tax".

Request for Determination of No Kansas Estate and Succession Tax

If the estate of a decedent dying on or after June 6, 2002 does not exceed the filing threshold found in the 1997 federal law Kansas has incorporated by reference, and does not include property passing to a "remote heir", the estate is <u>not</u> subject to estate or succession tax. Estates of decedents dying on or after June 6, 2002 are <u>not</u> subject to a lien for taxes, and no release of lien or consent to transfer is required prior to transferring either real estate or securities from the decedent's estate. Therefore, since the estate is not subject to tax, and no release of lien or consent to transfer is required, the estate does not need to file an estate and succession tax return. The estate may, however, file a return to request a determination of no Kansas estate and succession tax liability.

If you file a return to request a determination of no Kansas estate and succession tax, check the appropriate box. Follow the instructions for line 1 and line 2, above. Enter zero (-0-) on line 3, line 4, and line 5.

2-19

To: Senator David Corbin, Chair
Senate Committee on Assessment and Taxation

From: Richard L. Cram, Director of Policy and Research
Kansas Department of Revenue

Re: Sales Tax Imposition on Custom Computer Software in 2002 Senate Bill 39

Date: January 14, 2003

Summary

At Section 6 of 2002 Senate Bill 39, the Legislature imposed Kansas and local retailer's sales tax on the sale of custom computer software and the services of modifying, altering, updating or maintaining custom software, effective July 1, 2002. Under prior law, sales tax was imposed only on the sale of canned computer software, and the services of modifying, altering, updating or maintaining canned computer software. Sales of both custom and canned software are now subject to sales tax, as are the services of modifying, altering, updating or maintaining software.

Canned software includes, among other things, prepackaged word processing programs, game programs, educational programs, spreadsheet programs including bookkeeping and payroll programs, and video game cartridges. Custom programs are those developed from scratch or those uniquely designed and custom tailored to meet the customer's specific requirements.

The Department published Notice 02-10 (copy attached; available electronically on the Department's website) in order to answer anticipated questions concerning this new sales tax imposition. We have received private letter ruling requests raising additional questions about this new sales tax imposition, which we are in the process of responding to.

Fiscal Estimate for Custom Computer Software Sales Tax Revenue

During the course of the 2002 Legislative Session, at the request of the Legislature, the Department provided a FY 2003 fiscal estimate of $14.8 million in increased sales tax revenues to be received from imposition of sales tax on custom computer software. This estimate increases to $16.7 million for FY 2004. Steve Brunkan, economist with the Department, developed this estimate from the 1997 Economic Census data for Kansas, which provides specific breakdown for NAICS code 541511, Custom Computer Programming Services, with receipts of $258 million, assuming a 3% annual growth rate from 1997.

The Department is working on a methodology for tracking the amount of sales tax revenue received from the custom software imposition, but reliable numbers are not yet available. As soon as we have such numbers, we will provide them.

Historical Background

The Legislature first imposed sales tax on the sale of computer software at L. 1981, ch. 391, § 1, by adding subparagraph (s) to K.S.A. 79-3603. This imposition was not limited to canned software. In 1988, at L. 1988, ch. 386, § 1 and 2, the Legislature limited the sales tax imposition to canned software only, but added to the imposition the services of modifying, altering, updating or maintaining canned software. The Legislature also expressly included canned software in the statutory definition of "tangible personal property" at K.S.A. 79-3602(f).

Computer Software—Tangible or Intangible Property?

Under Kansas law, computer software is expressly defined as tangible personal property. K.S.A. 79-3602(f). In states that do not expressly define computer software as tangible personal property, the question has arisen as to whether the general sales tax imposition on the sale of

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Attachment 3

tangible personal property would include computer software. Earlier cases held that computer software was an intangible and therefore not subject to sales tax. See, *e.g.*, *Commerce Union Bank v. Tidwell*, 538 S.W.2d 405 (Tenn. 1976). In *Appeal of AT&T Technologies, Inc.*, 242 Kan 554, 749 P2d 1033 (1988), the court construed the 1981 version of K.S.A. 79-3603(s) [L. 1981, ch. 390, §1] and determined that software purchased outside of Kansas but used in Kansas was not subject to Kansas use tax. The court noted that computer software was not statutorily defined as "tangible personal property," and the use tax only applied to tangible personal property sold outside the state but used in Kansas. [Note: The 1988 legislative changes, discussed above, which included adding computer software to the statutory definition of "tangible personal property," have rendered the *AT&T* decision obsolete.] Courts in more current cases have determined that computer software is tangible personal property subject to sales tax. See, *e.g.*, *South Central Bell Telephone Co. v. Barthelemy*, 643 So.2d 1240 (La. 1994); *Wal-Mart Stores, Inc. v. City of Mobile*, 696 So.2d 290 (Ala. 1996).

Other States

According to the RIA All States Tax Guide, ¶ 259-A, of the 45 states (plus the District of Columbia) that impose sales tax, all include canned software in their sales tax bases. Ten of those states (plus the District of Columbia) also include custom software in the sales tax base. Those states, besides Kansas, imposing sales tax on custom software are: Arkansas, Connecticut, Hawaii, Mississippi, Nebraska, South Carolina, South Dakota, Tennessee and Texas.

For those states taxing canned but not custom software, attempting to distinguish between canned and custom software can be troublesome for both taxpayers and tax administrators. Regarding the policy of taxing canned software but exempting custom software, Hellerstein criticizes drawing this distinction in *State Taxation*, ¶ 13.06:

> There is no doubt that most purchases of customized software are made by businesses whereas most household purchases of software for personal use are purchases of canned software. Nevertheless, the distinction between customized and canned software is an indirect and imperfect proxy for the distinction between purchases by business and purchases by individuals for personal consumption, since many businesses purchase canned software (e.g., spreadsheets and word processing programs). If a state really wanted to implement a sound rule of retail sales tax policy that would exempt business purchases and tax only purchases for personal consumption, it could do so directly. [footnote 310]
>
> Wholly apart from the fact that the distinction between canned and custom-made software finds no support in normative sales tax policy, unless it is viewed as an indirect means of distinguishing purchases by businesses from purchases by households, a rule taxing canned software but leaving customized software tax-free tends to favor larger over smaller businesses. Larger businesses are generally able to afford customized software programs created for their specific needs, while smaller businesses often must rely on canned programs that require only minor, if any, adaptations.
>
> Moreover, there is an element of delusion in categorizing any but the simplest and most standardized types of software as "canned." In many of the decided cases, both those holding software nontaxable and those holding software taxable, some modifications were made in the programs to adapt them to the taxpayer's particular needs. Indeed, even standardized software purchased by larger businesses is frequently modified in some respects. Consequently, the line between customized and canned programs is so vague and imprecise that a rule taxing canned but not customized software is difficult to administer and tends to encourage tax avoidance through minor adaptive modifications. The result is an

erosion of the sales tax base for software programs that can often be quite costly to the states. [¶13.06(3)]

Kansas has avoided Hellerstein's policy criticism by imposing sales tax on both canned and custom software.

Notice

Notice Number:	02-10
Tax Type:	Kansas Retailers' Sales Tax
Brief Description:	Imposition of sales tax on sale custom computer software and services of modifying, altering, updating or maintaining such software.
Keywords:	
Approval Date:	07/01/2002

Body:

Office of Policy & Research

July 1, 2002

Notice 02-10
Imposition of sales tax on sale custom computer software and services of modifying, altering, updating or maintaining such software

Summary

Beginning July 1, 2002, Kansas and local retailer's sales tax is imposed on the sale of custom computer software and the services of modifying, altering, updating or maintaining custom software. Under prior law, sales tax was imposed only on the sale of canned computer software, and the services of modifying, altering, updating or maintaining canned computer software. Sales of both custom and canned software are now subject to sales tax, as are the services of modifying, altering, updating or maintaining software.

Canned software includes, among other things, prepackaged word processing programs, game programs, educational programs, spreadsheet programs including bookkeeping and payroll programs, and video game cartridges. Custom programs are those developed from scratch or those uniquely designed and custom tailored to meet the customer's specific requirements.

Under prior law, the sale of any custom computer program originally developed for the exclusive use of a single end user, as well as the sale of modification services when developed exclusively for a single end user (if charges for such modification were separately stated on the invoice), were expressly excepted from the imposition of sales tax on computer software and the sale of services of modifying, altering, updating or maintaining computer software. See K.S.A. 2001 Supp. 79-3603(s). Section 6 of 2002 Senate Bill 39 amended 79-3603(s) by removing the exception for custom computer software.

Definition of Computer Software

"Computer software" is defined at Section 6, 2002 Senate Bill 39 as follows:

> information and directions loaded into a computer which dictate different functions to be performed by the computer. Computer software includes any canned or prewritten

program which is held or existing for general or repeated sale, even if the program was originally developed for a single end user as custom computer software.

Computer software is defined as "tangible personal property" under Kansas sales tax law at K.S.A. 79-3602(f), which provides:

> "Tangible personal property" means corporeal personal property. Such term shall include any computer software program which is not a custom computer software program, as described by subsection (s) of K.S.A. 79-3603, and amendments thereto.

Because Section 6, 2002 Senate Bill 39 deletes the description of custom computer software formally contained in K.S.A. 79-3603(s), custom computer software is also included in the term "tangible personal property" as of July 1, 2002.

K.A.R. 92-19-70 provides:

> Computer software. (a) Sales tax shall be imposed on the gross receipts received from the sale of computer software. Computer software includes all software or computer programs, whether contained on tapes, discs, cards or other devices or materials which direct a computer or hardware to perform different functions, and includes customized software, canned software, operational software, application software, systems software and other forms of software or computer programs.
> (b) Sales tax shall be imposed on the total cost to the consumer without any deduction or exclusion for the cost of:
> (1) The property or service sold;
> (2) labor or services used or expended, including:
> (A) Program development, problem definition;
> (B) analysis, design, coding, testing; and
> (C) implementation, evaluation, maintenance and documentation;
> (3) materials used;
> (4) losses;
> (5) overhead or any other costs or expenses; or
> (6) profit, regardless of how any contract, invoice or other evidence of the transaction is stated or computed, and whether separately billed or segregated on the same bill.
> (c) The principal line of business of the seller is not material when determining the taxability of sales of computer software. Each bank, savings and loan or other thrift institution, accounting firm, computer program developer, dealer and other person is deemed to be a retailer when selling computer software at retail to the final user or consumer. Each retailer shall collect sales tax on the gross receipts received from the retail sale of computer software.

Under K.S.A. 79-3602(c), a sale includes "the sale of the use of tangible personal property by way of a lease, license to use or the rental thereof regardless of the method by which the title, possession or right to use the tangible personal property is transferred." These provisions make sales of licenses to use computer software subject to tax, regardless of whether the software is transferred to the buyer by floppy disc, CD-ROM, telephone modem, or via the

Internet or other electronic media. Sales of computer software are taxable regardless of how possession or the right to use the software is transferred.

Charges for performing the following activities, whether separately stated or not, are subject to sales tax when part of the sale of computer software: (a) designing and implementing computer systems (determining equipment and personnel required and how they will be utilized); (b) designing storage and data retrieval systems (determining what data communications and high-speed input-output terminals are required); (c) consulting services (study of all or part of a information management or data processing system); (d) feasibility studies (studies to determine what benefits would be derived from a software project); (e) evaluation of bids (studies to determine which manufacturer's proposal for computer equipment would be most benficial); (f) providing technical help, analysts and programmers, usually on an hourly basis; (g) training services; (h) software set up; and (i) maintenance of software.

Sales by Kansas software retailer to in-state customers

Sales by a Kansas retailer of computer software to an in-state customer are considered a Kansas retail sale of tangible personal property, subject to state and local sales tax.

For purposes of determining which local sales tax applies to the sale of computer software, the situs or location of the sale must be identified. The general rule is that local sales tax is situsued to the retailer's place of business. K.A.R. 92-21-7 provides:

> 92-21-7 Place of sale. For the purposes of local sales tax, all retail sales occur at the place of business of the retailer unless delivery is made by the retailer or his agent to an out-of-state destination, or to a common carrier for delivery to an out-of-state destination or unless otherwise specified by Kansas statutes or regulations. For the purpose of this provision it is immaterial that title passes to the purchaser at a place outside of the local taxing jurisdiction in which the retailer's place of business is located, or that property sold is never within the local taxing jurisdiction in which the retailer's place of business is located.
>
> If a retailer has more than one location in Kansas and if two or more of such locations participate in the sale, the sale occurs at the place of business where the principal negotiations are carried on. If this place is the place where the order is taken, it is immaterial that the order must be forwarded for acceptance, approval of credit, shipment or billing. For the purposes of this rule, an employee's activities will be attributed to the place of business out of which he works.

Local sales tax should be charged based on the location of the retailer making the sale. This rule applies when the retailer orders something from an out-of-state manufacturer or distributor to be delivered to the retailer's business or when the retailer orders something from an out-of-state manufacturer or distributor to be delivered to the customer's location.

Sales by Kansas software retailer to out-of-state customers

Sales by a Kansas retailer of computer software to an out-of-state customer would be considered a sale in interstate commerce. K.A.R. 92-19-29 provides:

> 92-19-29. Sales in interstate commerce. When tangible personal property is sold

within the state and the seller is obligated to deliver it to a point outside the state or to deliver it to a carrier or to the mails for transportation to a point without the state, the retail sales tax does not apply: *Provided*, The property is not returned to a point within this state. The most acceptable proof of transportation outside the state will be:

(a) A waybill or bill of lading made out to the seller's order calling for delivery; or

(b) An insurance or registry receipt issued by the United States postal department, or a post office department's receipt; or

(c) A trip sheet signed by the seller's delivery agent and showing the signature and address of the person outside the state who received the delivered goods.

However, where tangible personal property pursuant to a sale is delivered in this state to the buyer or his agent other than a common carrier, the sales tax applies, notwithstanding that the buyer may subsequently transport the property out of this state.

If computer software sold by a Kansas retailer is delivered to the out-of-state customer in Kansas, then the transaction would be considered a Kansas sale, subject to sales tax. If delivery to the out-of-state customer occurs outside the borders of Kansas, then the transaction would not be considered a Kansas sale and would not be subject to Kansas tax. Computer software delivered to the out-of-state customer electronically and downloaded at the customer's out-of-state location will be considered a sale in interstate commerce, not subject to Kansas sales tax. If delivery outside of Kansas is by the US Postal Service, common carrier such as UPS, or the retailer's or retailer's agent's vehicle, the sale is regarded as taking place in the state of delivery and is not subject to Kansas tax. Delivery in Kansas to a contract carrier makes the sale Kansas taxable when the carrier is acting as the buyer's agent.

Sale of Computer Software by Out-of-State Retailer to Kansas Customer

Sale of computer software by an out-of-state retailer to a customer located in Kansas is subject to Kansas compensating use tax. If the out-of-state retailer has sufficient nexus with Kansas, the out-of-state retailer is obligated to collect the use tax from the customer and report and remit it to the Department. If the out-of-state retailer does not have nexus with Kansas, then the customer is obligated to accrue Kansas use tax on the purchase and report and remit it to the Department.

Nexus refers to the presence or contacts that an out-of-state business has with a state. A state can impose use tax collection duties on an out-of-state business only if the business has sufficient contacts or presence in the state. Presence in the taxing state of owned or leased personal or real property, offices, facilities, or agents, representatives or employees can establish nexus. If the out-of-state business has no property, offices, employees, or agents who operate in Kansas, then it will have no legal duty to collect use tax on sales of computer software to Kansas customers. Nexus would not be achieved if the only activity in Kansas is delivery of software, by shipment of a disk by mail, UPS, common carrier or by downloading from the Internet.

Nexus would be created if the out-of-state business sends employees into Kansas, pays independent contractors or agents to operate here, regularly delivers into Kansas using its own vehicles, appears at trade shows here, employs Kansans to perform service work here, or conducts similar activities here. If an out-of-state business, as lessor, leases computer hardware or software in Kansas, it would have nexus and would be required to collect and remit use tax on

leases to Kansas lessees. See K.S.A. 79-3702(c); K.S.A. 79-3702(g).

Computer Software Modification and Maintenance

K.S.A. 2001 Supp. 79-3603(s), as amended by Section 6 of 2002 Senate Bill 39, imposes sales tax on the sale of services of modifying, altering, updating or maintaining computer software. K.S.A. 79-3603(q) specifies that alteration, repair and maintenance services done to tangible personal property are subject to Kansas sales tax. Computer software is defined as "tangible personal property." K.S.A. 2001 Supp. 79-3602(f)(1). K.S.A. 79-3603(r) imposes a sales tax upon: "the gross receipts from fees or charges made under service or maintenance agreement contracts for services, charges for the providing of which are taxable under the provisions of subsection (p) or (q). . ." The sale of computer hardware and software maintenance agreements are taxable, pursuant to K.S.A. 79-3603(r).

The services of modifying, altering, updating or maintaining computer software are presumed to be performed at the location of the software being used by the customer at the customer's premises. Kansas sales tax would apply to such services performed in Kansas. Fees charged to diagnose a computer software problem for a customer are considered part of service of modifying, altering or maintaining the software and are part of the taxable gross receipts.

Software that modifies or alters existing software is considered separate from the existing software and is taxable.