

MINUTES OF THE HOUSE TAXATION COMMITTEE

The meeting was called to order by Chairman John Edmonds at 9:00 a.m. on March 10, 2004 in Room 519-S of the Capitol.

All members were present except:

Representative Jeff Goering- excused

Committee staff present:

Chris Courtwright, Legislative Research Department
Martha Dorsey, Legislative Research Department
Gordon Self, Revisors of Statutes
Carol Doel, Committee Secretary

Conferees appearing before the committee:

Representative Tom Holland
Joan Wagnon, Secretary of Revenue
Melissa Wangemann, Office of the Secretary of State
Hal Hudson, NFIB
Ken Daniel, Midway Wholesale
Marlee Carpenter, KCCI
Matthew Goddard, Heartland Community Bankers Association
Chuck Stones, Kansas Bankers Assn.
Barb Hinton, Post Auditor
Leo Hafner, Deputy Post Auditor
Chris Cartwright, Legislative Research Department

Others attending:

See Attached List

Chairman opened the meeting requesting the introduction of a bill dealing with the mortgage registration tax.

With no objections, that is accepted for introduction.

There were no other bill introductions.

Barb Hinton from Legislative Post Audit was recognized and introduced Leo Hafner, Deputy Post Auditor who briefed the committee on the performance audit report on **HB 2882**. Mr. Hafner provided the committee with a copy of the performance audit which was done during the summer of 2002 as they were asked to look at various aspects of the Department of Revenue's tax processing. One of the issues was how the Department handled their review credits and the amount of scrutiny that the Department officials gave to credits. (Attachment 1)

Due to the similarities of **HB 2842** and **HB 2894** and the fact that many of the conferees are the same on both bills, Chairman Edmonds announced the two bills would be heard simultaneously. He then requested Chris Courtwright from Legislative Research Department give a brief overview of the two bills prior to starting the hearing. (Attachment 2)

First to address the committee in support of **HB 2842** was Representative Tom Holland. In his testimony, Representative Holland stated that this legislation will help to make Kansas a better environment for small business by reducing or eliminating the franchise tax for over 31,000 Kansas small businesses. He described the changes which the franchise tax legislation implements. (Attachment 3)

Chairman Edmonds recognized Joan Wagnon, Secretary of the Department of Revenue who came before the committee with testimony supporting both **HB 2842** and **HB 2894**. These bills propose to move administration of the corporate franchise tax to the Department of Revenue as well as requires that entities must file with their franchise tax balance sheets substantiating the determination of the amount of net equity subject to franchise tax. (Attachment 4 and Attachment 5)

CONTINUATION SHEET

MINUTES OF THE HOUSE TAXATION COMMITTEE at 9:00 a.m. on March 10, 2004 in Room 519-S of the Capitol.

Testimony from the office of the Secretary of State delivered by Melissa Wangemann also supported both **HB 2842** and **HB 2884**. Both bills would replace the franchise tax with a flat filing fee for the annual report submitted to the Secretary of State. Also, the bills would require the payment of a franchise tax to the Department of Revenue. The Secretary of State supports this concept because a flat fee for the annual report is consistent with the flat filing fees paid by customers for filings in their office; the flat fee is easily understood by customers and easily enforced by the Secretary's office; the tax that is based on capital is paid to, and reviewed by, the state agency that maintains the entity's tax records and that has accounting expertise, auditing powers and record confidentiality; and such a bifurcated system would make Kansas more uniform with other states.

They also offer the amendment that the amended franchise fee applies to "all tax years commencing after December 31, 2003." (Attachment 6)

Hal Hudson, Kansas State Director National Federation of Independent Business also support **HB 2842** and **HB 2884**. They NFIB has advocated reducing the franchise tax or fee since it was doubled in the 2002 session. Their position is supported by member response to a ballot survey before the 2003 session. They do not intend to gain a tax advantage for small business at the expense of large business, but state that small businesses have been paying a disproportionately higher franchise tax, based on their net worth, than larger businesses. (Attachment 7)

Giving an opinion in support of **HB 2842** and **HB 2894** for NFIB and Midway Wholesale was Mr. Ken Daniel. In his testimony he stated that the franchise tax is a highly unfair tax. It is levied whether a business is profitable or no. He also supplied charts showing the comparison of the two bills as well as franchise taxes in our region. He stated that rolling back the franchise tax will help small business, the only sector of the Kansas economy that is growing, to create jobs for Kansans and further stimulate our economy. (Attachment 8)

There was on other person wishing to testify in support of **HB 2842** and **HB 2894**.

Chairman Edmonds directed attention to the opponents and recognized Marlee Carpenter, KCCI (Kansas Chamber of Commerce and Industry) as an opponent of **HB 2842** and **HB 2894**. It is their opinion that lowering taxes is a much better formula for economic success than the shifting taxes from one business segment to another which these bills would do and they are extremely opposed to those measures. (Attachment 9)

Next to address the committee in opposition to **HB 2894** was Matthew Goddard, Heartland Community Bankers Association. In his testimony, Mr. Goddard related that this bill would have a negative impact on the cost of doing business in Kansas for banks and savings and loans. This increased cost will eventually be passed on to consumers in the form of lower interest rates on deposit accounts and higher interest rates on loans. (Attachment 10)

Testifying in opposition to **HB 2894** was Chuck Stones, Senior Vice President of The Kansas Bankers Associations. Mr. Stones related that **HB 2894** would create a whole new class of franchise tax payer and result in double, maybe triple franchise taxation for the banking industry. They would urge the committee to eliminate the double taxation potential of this bill by eliminating the reference to national and state banking associations in the bill. (Attachment 11)

There were no other conferees on **HB 2894** and Chairman Edmonds closed the hearing.

Being out of time, **SB 38** was canceled.

The Chairman adjourned the meeting at 10:27 a.m.



PERFORMANCE AUDIT REPORT

Corporate Income Taxes: Reviewing Factors Affecting the Recent Steep Drop in Those Tax Receipts

A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
August 2002

Corporate Income Tax Credits and Returns Receive Less Overall Scrutiny Now Than in the Past

When the new computer system was being implemented, the Department changed the way its staff processed tax returns. Staff were directed to place their emphasis on processing returns through the system and not on reviewing them—that task was to be left to the auditors. Those changes are summarized below:

	All Returns	Tax Credits Claimed on the Worklist	Other Returns on the Worklist
Before the New System	<ul style="list-style-type: none"> - Checked that tax form was filled out completely - Checked math - Checked for supporting schedules and required documentation 	<ul style="list-style-type: none"> - Checked schedules and supporting documentation for credits claimed 	<ul style="list-style-type: none"> - Checked information on the "problem" area - Could check entire return starting with line 1. - Could check that information on supporting schedules tied to information on the return
With the New System	<ul style="list-style-type: none"> - For pages 1-2 of the tax return, the computer checks math, and business rules. (See page 20 of this report for more information) 	<ul style="list-style-type: none"> - Check schedules and supporting documentation for credits claimed (except for Business Machinery & Equipment Credit). 	<ul style="list-style-type: none"> - Check information on the "problem" area only.

Under the new approach, the computer system has automated some checks for the first 2 pages of the corporate income tax return that were previously performed under a manual system. Tax returns may process more quickly now, but staff who review items on the worklist told us they don't deny as many tax credits as they used to, nor are tax returns scrutinized like they were in the past. As a result, this new process relies heavily on the audit staff to identify taxpayer non-compliance, but only about 25 of the approximately 30,000 corporate income tax returns filed each year are audited.

Staff also told us they thought being allowed to review more information from corporate income tax returns used to pay off, given the types of taxpayer errors they'd find, but no data are kept about the number and dollar impact of errors found in processing returns. However, an employee who recently found about \$77,000 in additional taxes due in examining the Business and Job Development Tax Credits a corporation had claimed over several years, told us she wouldn't have found this error if she had followed the regular, more superficial review policies now in place for that credit.

There's no longer any review of the Business Machinery and Equipment Tax Credits corporations claim. We found the following:

- **Beginning in fiscal year 2002, the Business Machinery and Equipment Tax Credit is no longer reviewed like the other tax credits.** Because this tax credit is on the tax return form itself, it's processed just like any other line item in the new computerized system. All other credits are flagged to be manually reviewed before being entered. That means one of the largest tax credits corporations use—it accounted for about \$13.7 million in credits claimed in 2001—is no longer reviewed for accuracy or eligibility.
- **Since tax year 2000, the Department hasn't required corporations to submit any documentation supporting their claims for a Business Machinery and Equipment Tax Credit.** This change was made because corporations were complaining about the amount of supporting documentation required for this credit. Even if this tax credit still kicked out to the worklist for a manual review, there would be nothing for Department staff to review. Corporations still are required to submit documentation supporting other tax credits.
- **Not reviewing these credit claims could result in corporations receiving credits they aren't eligible for.** We reviewed a sample of 20 returns for the 1998 and 1999 tax years that claimed a total of \$4.1 million in Business Machinery and Equipment Tax Credits (the Department still required documentation for these years). In all, 80% of the returns we reviewed had questionable documentation: 6 had incomplete documentation to support the tax credits claimed, 6 had no documentation, and 4 had documentation that appeared to be for the wrong time period. These credits, which were all allowed, may all have been legitimate, but Department staff couldn't know that unless they reviewed the claim and the documentation supporting it.

Because basic tax-return information from some corporations isn't entered into the computer, this information isn't subjected to the regular computer edits and checks. The Department's new computer system has most of the edits and checks you'd expect. These include things such as:

- checking all the math on the return
- verifying the amount listed by the taxpayer as "estimated tax paid" matches the amount shown in Department records
- ensuring that certain required fields for each return have an appropriate entry

However, corporations that file a tax return using the "combined method" provide certain basic information on a separate form that isn't

entered into the computer or manually checked for accuracy and reasonableness. For these taxpayers, lines 1-19 of their corporate tax form are blank. Information from these lines includes such key data as federal taxable income, non-business income, and the percent of the corporation's income apportioned to Kansas. As a result, this information can't be electronically checked for accuracy, and isn't stored electronically for future access or analysis purposes. In our sample of 80 corporations, about 75% filed this way in each year.

Non-business income is one of several criteria the Department uses to identify potential audit candidates. Because the Department doesn't record non-business income information for many corporations, any Department-generated reports listing corporations with large non-business income won't include corporations that use the "combined method" of filing. As a result, these corporations have no chance of being selected for potential audit, using this criterion.

Auditing Corporate Income Tax Returns

When this audit was requested, concerns were expressed that the Department wasn't devoting enough staff resources to auditing.

Essential Background Information: What Happens When a Corporation's Income Tax Return Is Audited?

- Audit staff have several different ways to identify corporations that are to be considered for audit. First, audit staff can query the Department's computer system to identify corporations meeting certain requirements, such as large amounts of non-business income or large tax credits. Second, staff can consider the results of previous audits. Third, staff can analyze a spreadsheet they maintain which contains historical information about the results of previous reviews of major corporations operating in Kansas.
- After identifying corporations for consideration, audit staff conduct a preliminary "file analysis" to determine whether the corporation may have underpaid its tax liability. Each file analysis consists of an examination of financial data for 3 consecutive years. In this analysis, Department staff look at things such as whether the amount of income apportioned to Kansas appears to be reasonable. The results of this work allow Department staff to select the corporations and fiscal years that will be audited.
- If a corporation is selected for audit, staff will perform one of two types of audits:
 - a. Field audit—an audit which involves travel to the taxpayer's place of business to examine financial records. The number and types of issues addressed can vary, but generally field audits address more complex tax issues.
 - b. Desk audit—generally a simpler audit which involves fewer and less complex issues. Department staff don't travel to the taxpayer's place of business, but the taxpayer may be asked to send copies of records to Department staff.
- Upon completion of the audit, Department staff issue a report which indicates whether the taxpayer is due a refund or owes additional money to the State. Corporations can appeal the outcome of any audit. Sometimes those appeals can take years to resolve, and may involve the efforts of the Department's legal staff as well.
- If an audit is appealed, Department staff attempt to resolve the dispute with the taxpayer. This is often a give-and-take process between the taxpayer and Department staff, and can include Department staff agreeing to reduce or dismiss the taxes, penalty, or interest owed to the State. If the taxpayer and Department staff can't resolve the issues, the audit may be appealed to the Board of Tax Appeals and the courts.

1-4

APPENDIX D

Corporate Tax Credit Information

The following two pages provide information about the various tax credits available to corporations operating in Kansas, along with a brief description of each credit. The table also includes Department figures regarding the number of corporations taking each credit, and the amount claimed (allowed and refunded) per credit as processed in calendar year 2001 by Department staff. As discussed in the body of the report, those amounts are potentially under-reported because they exclude tax credits based on poor data entry.

Definitions related to tax credits:

Refundable credit: A credit that can reduce the tax liability below zero, resulting in the Department paying the taxpayer the difference—a refund.

Non-refundable credit: A credit used to reduce the tax liability without the ability to reduce the tax liability below zero and without the ability to receive a refund from the Department. Generally, the portion of the credit that reduced the tax liability below zero can be “carried-over” by the taxpayer to the succeeding tax year.

**Information of Tax Credits Available to Corporations and Processed
By the Department in Calendar Year 2001**

Name of Tax Credit	Brief Description	Number of Corporations Receiving Tax Credits in 2001	Amount of Tax Credit Claimed
Refundable Credits			
Business Machinery and Equipment (enacted in 1998)	Allows corporations to claim personal property taxes paid on commercial and industrial machinery equipment as a credit against taxable income.	4,066	\$13,747,750
Child Care Assistance (enacted in 1989)	Allows corporations that pay for or provide child care services to their employees, or that provide facilities and necessary equipment for child day care services, to receive a tax credit.	10	\$148,123
Small Employer Health Insurance Contribution (enacted in 1999)	Allows an employer to receive a credit for amounts paid on health insurance or health care on behalf of an eligible employee.	6	\$13,090
Telecommunications (enacted in 2000)	Allows telecommunications companies to receive a credit for property taxes paid on property that had been acquired and placed into service in Kansas	0	\$0
Non-Refundable Credits			
Business & Job Development (enacted in 1976)	Allows corporations to claim a credit for creating new jobs by building new or expanding or renovating existing facilities. An enhanced credit is available for manufacturing, non-manufacturing, and retail businesses	624	\$13,399,339
High Performance Incentive Program (enacted in 1992)	<ul style="list-style-type: none"> • Encourages companies to expand their capital investment in Kansas plant and equipment by providing an investment tax credit and an exemption from sales tax for a specific project. • Encourages accelerated growth in a business, leading to related job creation, by making state funds available to reimburse 50% of the costs of approved consulting services. • Gives companies a tax credit for making a cash investment in the training and education of its employees 	24	\$6,174,827
Research and Development Credit (enacted in 1986)	Allows a taxpayer who makes expenditures in R&D activities in Kansas to claim an income tax credit.	42	\$915,023
Disabled Access (enacted in 1978)	Allows taxpayers to receive a credit for expenses resulting from modifying or adapting all or any portion of an existing facility to make it accessible to individuals with a disability.	21	\$162,076
Venture Capital (enacted in 1986)	Allows taxpayers who invest in stock issued by Kansas Venture Capital, Inc., a certified Kansas venture capital company, or in the technology-based venture capital company, Sunflower Technology Venture, LP, to claim a tax credit.	0	\$0

Name of Tax Credit	Brief Description	Number of corporations Receiving Tax Credits In 2001	Amount of Tax Credit Claimed
Non-Refundable Credits (continued)			
Historic Preservation (enacted in 2001)	Encourages corporations to pay for restoring and preserving a qualified historic structure by allowing a credit for a portion of those expenditures.	0	\$0
Oil and Gas Well Plugging (enacted in 1998)	Allows taxpayers to receive a credit for expenditures incurred from plugging any abandoned oil or gas well located on the taxpayers' land.	0	\$0
Seed Capital Credit (enacted in 1987)	Allows taxpayers to get a tax credit equal to 25% of the taxpayers' cash investments in a certified local seed capital pool.	0	\$0
Alternative-Fueled Motor Vehicle Property (enacted in 1995)	Allows taxpayers who make expenditures for a qualified alternative-fueled motor vehicle or alternative-fueled fueling station to receive a credit	1	\$0
Agricultural Loan Interest Reduction (enacted in 2000)	Allows production credit associations or agricultural credit associations to claim a credit for providing lower-than-normal rates on agricultural production loans. The loan rate must be at least one whole percentage point less than the lowest rate the association charges to other, equivalent borrowers.	0	\$0
Swine Facility Improvement (enacted in 1998)	Allows owners and operators of a qualified swine facility to receive a credit from making required improvements as required by the Department of Health and Environment	0	\$0
Refundable or Non-Refundable Credits			
Community Service Contribution (enacted in 1994)	Allows taxpayers who make a cash contribution to an approved community service organization to get a credit.	111	\$865,400
Habitat Management (enacted in 1997)	<ul style="list-style-type: none"> • Allows taxpayers to receive a credit equal to the ad valorem taxes and assessments for real property owned and used for habitat management of non-game and endangered species. • Allows taxpayers to receive a credit for costs incurred for habitat management or construction and maintenance of improvements of the land used for habitat management 	0	\$0
Total Tax credits processed in Tax year 2001		4,905	\$35,425,628

Source: Department internal data, analyzed by LPA

Note: the 2001 Legislature repealed 2 credits in 2001: First, the Oil Lease Working Interest credit, which allowed a credit for "working interest owners of an oil lease" a portion of their property tax expenses IF average daily production per well was 15 or fewer barrels. (According to Department data, this credit was claimed by 26 taxpayers and \$41,079 were refunded in 2001.) Second, the Solid Waste Management Credit, which allowed a credit for taxpayers who bought equipment that was used in creating products from recycled materials. (This credit wasn't claimed by any taxpayer in 2001.)

Franchise Tax Major Feature Comparison -- Current Law, HB 2842, and HB 2894

	<u>Current Law</u>	<u>HB 2842</u>	<u>HB 2894</u>
Rate	0.2%	0.1%	0.1%
Base	shareholder equity or net capital accounts attributable to Kansas	for only those entities with taxable equity or net cap accounts attributable to Kansas in excess of \$1 million (under \$1m exempt)	for only those entities with taxable equity or net cap accounts attributable to Kansas in excess of \$1 million (under \$1m exempt)
Application of Exemption Threshold	None	First dollar of taxable equity is \$1 for taxable entities	First dollar of taxable equity is \$1,000,001 (First \$1 million exempt)
Cap	\$5,000	\$20,500	None
Exemptions for banks, s & ls, ins companies	Yes	Yes	No (repeal exemptions)
Administered by	Sec of State	Dept of Revenue	Dept of Revenue
FY 2005 SGF	\$36 million	\$29.31 million	\$44.72 million
SGF Fiscal Note	n/a	(\$6.69 million)	\$8.72 million
Separate Franchise Fee Maintained by Sec of State for new Franchise Fee Fund	n/a	\$40 for for-profits \$40 for not-for-profits	\$40 for for-profits \$20 for not-for-profits
Franch Fee Revenues	n/a	\$3.91 million	\$3.80 million
All Funds F Note	n/a	(\$2.78 million)	\$12.52 million
Targeted Revenue Neutrality, Set Cap at	n/a	\$25,000	\$23,000

HOUSE TAXATION
Attachment 2
Date 3-10-04

TOM HOLLAND
 REPRESENTATIVE 10TH DISTRICT
 HOME ADDRESS: 961 E. 1600 ROAD
 BALDWIN CITY, KANSAS 66006
 (785) 865-2786
 tomholland23@hotmail.com



COMMITTEE ASSIGNMENTS
 MEMBER: EDUCATION
 HEALTH & HUMAN SERVICES
 SELECT COMMITTEE ON KANSAS SECURITY

OFFICE ADDRESS: STATE CAPITOL, 284-W
 TOPEKA, KANSAS 66612-1504
 (785) 296-7665
 E-mail: holland@house.state.ks.us
 1-800-432-2924

TOPEKA
 HOUSE OF
 REPRESENTATIVES

March 10th, 2004

Chairman Edmonds and Committee Members:

Good morning! Thank you for hearing my testimony in support of HB 2842. Kansas is one of 19 states that charges a franchise tax on business net worth in addition to income taxes and has perhaps the most regressive franchise tax of those 19 states. This bill is specifically designed to address the extremely regressive nature of Kansas's current corporate franchise tax structure. This legislation will help to make Kansas a better environment for small business by reducing or eliminating the franchise tax for over 31,000 Kansas small businesses.

This franchise tax legislation implements the following changes:

1. Any business with net worth of \$1,000,000 or less would pay no franchise tax.
2. Businesses with assets greater than \$1,000,000 would pay .1% (point 1 percent) up to a \$20,500 cap / the new cap would be the fifth LOWEST of the 19 states.
3. This legislation would exempt nearly 28,000 KS small businesses that paid franchise taxes in 2003 from paying ANY franchise tax.
4. This legislation would halve the franchise tax amount owed for over 4,400 businesses that paid franchise taxes in 2003.
5. This legislation would establish a \$40 franchise fee to be paid by both for-profit and non-profit entities to the Secretary of State and redirect the franchise tax monies to be paid to the Department of Revenue.
6. This legislation is intended to be revenue-neutral.

Nationally, small businesses represent more than 99.7% of all employers and account for 44.5% of the total private payroll in the U.S. In 1999-2000 (according to the most recent data), small businesses created three-quarters of U.S. net new jobs. Unfortunately, small businesses also pay the most in business-related taxes.

Kansas small business is the economic engine that drives our state's economic recovery. It's high time that we once and for all remove this onerous burden off the backs of Kansas small business.

Sincerely,


 Tom Holland

HOUSE TAXATION

Attachment 3

Date 3-10-04



K A N S A S

JOAN WAGNON, SECRETARY

DEPARTMENT OF REVENUE
OFFICE OF THE SECRETARY

KATHLEEN SEBELIUS, GOVERNOR

Testimony to the House Taxation Committee
Joan Wagon

March 10, 2004
House Bill 2842

Chairman Edmonds and Members of the Committee:

House Bill 2842, among other things, proposes to move administration of the corporate franchise tax to the Department of Revenue. In addition, it also requires that entities must file with their franchise tax returns balance sheets substantiating the determination of the amount of net equity subject to franchise tax. We strongly support these measures. The Secretary of State currently administers the corporate franchise tax. However, unlike the Department, the Secretary of State has not been granted audit authority over taxpayers. Also, under current law, franchise taxpayers are not required to file balance sheets with their returns. Therefore, the Secretary of State has no way to verify that the correct amount of franchise tax is being remitted. House Bill 2842 addresses both of those issues.

I would be pleased to answer any questions.

HOUSE TAXATION

Attachment 4

Date 3-10-04



K A N S A S

JOAN WAGNON, SECRETARY

DEPARTMENT OF REVENUE
OFFICE OF THE SECRETARY

KATHLEEN SEBELIUS, GOVERNOR

Testimony to the House Taxation Committee
Joan Wagnon

March 10, 2004
House Bill 2894

Chairman Edmonds and Members of the Committee:

House Bill 2894, among other things, proposes to move administration of the corporate franchise tax to the Department of Revenue. In addition, it also requires that entities must file with their franchise tax returns balance sheets substantiating the determination of the amount of net equity subject to franchise tax. We strongly support these measures. The Secretary of State currently administers the corporate franchise tax. However, unlike the Department, the Secretary of State has not been granted audit authority over taxpayers. Also, under current law, franchise taxpayers are not required to file balance sheets with their returns. Therefore, the Secretary of State has no way to verify that the correct amount of franchise tax is being remitted. House Bill 2894 addresses both of those issues.

I would be pleased to answer any questions.

HOUSE TAXATION
Attachment 5
Date 3-10-04

RON THORNBURGH
Secretary of State



Memorial Hall, 1st Floor
120 S.W. 10th Avenue
Topeka, KS 66612-1594
(785) 296-4564

TESTIMONY OF THE SECRETARY OF STATE
TO THE HOUSE TAXATION COMMITTEE
RE: 2842, 2894

MARCH 10, 2004

Mr. Chairman and Members of the Committee:

The Secretary of State appreciates the opportunity to appear today to brief the committee and to answer questions relating to the franchise tax, which is paid by business entities registered with our office.

General Information. A business entity such as a corporation, limited liability company, limited partnership, limited liability partnership, or business trust is created by filing organizational documents with the Secretary of State. Following its creation, the business entity must file an annual report with the Secretary of State to update the information on our records. A "franchise tax" which is calculated based on net worth, is paid at the time of filing the annual report. In 1972 when the general corporation code was adopted, the rate for calculating the tax was \$1 for each \$1,000 of net worth. This rate did not see any changes until 2002, when the Kansas legislature raised the rate to \$2 for each \$1,000 in net worth.

The revenue received from the franchise tax is deposited to the state general fund. This money does **not** support the operations of the Secretary of State's Office.

Quarterly data comparing FY 2002 and FY 2003 is given below. FY 2002 reflects the last fiscal year in which the franchise tax was \$1 per \$1,000 of net worth, and FY 2003 reflects the first year in which the rate was \$2 per \$1,000 of net worth. There has been an overall increase of \$12,264,970 in franchise taxes received.

FISCAL YEAR/QTRS	REVENUE FROM TAX
FY 2002 Quarter 1	3,215,579
FY 2002 Quarter 2	2,851,350
FY 2002 Quarter 3	4,845,583
FY 2002 Quarter 4	7,349,888
	FY 02 TOTAL: 18,262,400

HOUSE TAXATION

Attachment 6

Date 3-10-04

FY 2003 Quarter 1	3,708,309
FY 2003 Quarter 2	4,269,470
FY 2003 Quarter 3	9,273,577
FY 2003 Quarter 4	13,276,014
	FY 03 TOTAL: 30,527,370

Flat Fee versus Formula Fee

Because the Kansas franchise tax is based on an entity's net worth, the amount varies with each entity. The minimum tax is \$40 and the maximum tax is \$5,000. The majority of states (37) require a flat tax/fee when the business entity's report is submitted to the filing officer.¹ Most states that have a franchise tax based on a formula involving capital or net worth pay the tax to the taxing authority instead of the filing officer.² It is not unusual for states to require both a flat filing fee and a capital-value tax; fifteen states require a filing fee with the report submitted to the filing officer and a capital-value tax similar to the Kansas franchise tax.³

Consideration of HB 2842, 2894

Both HB 2842 and HB 2894 would replace the franchise tax with a flat filing fee for the annual report submitted to the Secretary of State. In addition, the bills would require the payment of a franchise tax to the Department of Revenue. The Secretary of State supports this concept for several reasons: a flat fee for the annual report is consistent with the flat filing fees paid by our customers for filings in our office; the flat fee is easily understood by customers and easily enforced by our office; the tax that is based on capital is paid to, and reviewed by, the state agency that maintains the entity's tax records and that has accounting expertise, auditing powers and record confidentiality; and such a bifurcated system would make Kansas more uniform with other states.

Suggested Amendments

Both bills include a provision for nonprofit corporations stating that the amended franchise fee applies to "all tax years commencing after December 31, 2003." No other section in the bill contains this wording, and we believe it creates a different effective date for nonprofits, which would be difficult to administer. We request that those words be deleted from the sentence so that all business entities have a uniform effective date.

Current law contains several provisions saying that an entity files an annual report "showing its financial condition." Because the annual report no longer lists any financial information, this obsolete statement should be deleted from the law.

¹ "All States Tax Handbook" by the Research Institute of America, 2003.

² Eighteen states out of twenty-five states pay a capital-value tax to the state's taxing authority. Id.

³ Id.

Lastly, the bills as written continue to allow an entity to file a copy of the entity's tax return extension with the Secretary of State, which grants a similar extension for the annual report. Generally, business entities file extensions so that they will have more time to prepare their financial statements and balance sheets for purposes of calculating both income taxes and the franchise tax. If the franchise fee paid to the Secretary of State is a flat fee and is no longer tied to the entity's net worth, the reason for an extension seems to disappear. The committee may wish to consider whether extensions should be permitted for annual reports.

I appreciate the opportunity to appear today and would be happy to answer questions.

Melissa A. Wangemann, Legal Counsel
Deputy Assistant Secretary of State

KANSAS

Statement by
Hal Hudson, Kansas State Director
National Federation of Independent Business
Before the
House Taxation Committee
Wednesday, March 10, 2004

Mr. Chairman and Members of the Committee:

Thank you for this opportunity to discuss with you House Bills 2894 and 2842.

As you may know, NFIB/Kansas has advocated reducing the franchise tax or fee, whichever name you choose to call it, since it was doubled in the 2002 session. Our position is supported by member response to our ballot survey before the 2003 session.

We asked: "Should legislation be adopted to repeal the increased doubling of the corporate franchise tax enacted in 2002, and return this tax to \$1.00 per \$1,000 of shareholder equity, perhaps with a higher maximum?" Our member responses was:

Yes 74.2% No 14.1% Undecided 10.7%

Most of our members are proprietorships, subchapter "s" corporations, or limited liability corporations. Of these, only proprietorships escaper payment of the franchise tax.

While it never has been our intent to gain a tax advantage for small business at the expense of large business, the reverse has been the effect of current law. Small businesses have been paying a disproportionately higher franchise tax, based on their net worth, than have larger businesses.

For example, a small-medium-size company with a net worth of \$2.5 million would pay exactly the same amount of franchise tax as a company with a net worth of \$250 million.

The part we like most about each of these two bills is language we interpret to mean a business with assets or less than \$1 million would pay only an annual fee of \$40.00 to the Secretary of State. This is the amount a representative of the Secretary of State's office has told this committee would be adequate to recover costs of administration of corporate records in that office. The \$1 million threshold in both bills would exempt at least 75% of NFIB/Kansas members from paying anything more than the \$40.00 franchise fee, payable to the Secretary of State.

Anything more than the \$40.00 fee must be construed as a tax on the privilege of doing business in the state. This tax was doubled in 2002 for only one purpose: to raise state revenues to help balance the General Fund Budget. But it was raised in a most regressive manner, with small-to-medium sized businesses paying as much as 90 percent of the new tax collected.

HB 2842 places a cap of \$20,500 on the franchise tax any business would pay. HB 2894 apparently has no cap. This is a policy decision for the Legislature to make. I would suggest only that you consider the income tax credits on property taxes paid on machinery and equipment in making your decision on the upper limit of this tax.

Thank your for your consideration of the concerns of Kansas small business.

HOUSE TAXATION

Attachment 7Date 3-10-04

**Kansas Franchise Tax
Presentation to the House Taxation Committee
March 10, 2004**

By Kenneth L. Daniel, Chairman and C.E.O., Midway Wholesale and 2003 Chairman, Kansas Leadership Council, National Federation of Independent Business.

Mr. Chairman and Members of the Committee:

My name is Kenneth Daniel of NFIB and Midway Wholesale.

I would like to speak in favor of both HB 2842 and HB 2894.

The Kansas Franchise Tax is extremely regressive. Many small businesses with 15 employees pay the same \$5,000 per year as Walmart, with its 22,000 Kansas employees.

This is primarily tax on small businesses¹. 90% to 95% of the \$31.1 million² is paid by small businesses. The 400 richest corporations in Kansas paid only \$2 million³.

The franchise tax is a highly unfair tax. It is levied whether a business is profitable or not. Identical businesses, organized differently, will pay widely varying amounts. For most small business owners, much or all of their personal net worth is invested in their business, so this tax is nothing more than a tax on their life savings.

In Kansas, the tax is levied on the net worth of corporations and limited liability partnerships. The "franchise" in the name of the tax refers to the right to operate in Kansas as a "limited liability" entity.

By paying this tax, an organization purchases indemnity for its owners, and to some extent, for its directors, officers, and employees. This indemnity shields the personal assets of these persons from lawsuits brought against the organization. It also shields the assets of parent companies from lawsuits against its subsidiaries⁴.

¹ The franchise tax is \$2 per \$1000 of net worth with a \$5,000 maximum. In FY2003, 79,747 Kansas businesses paid the tax¹. 47,473 paid the \$40 minimum (most were non-profits). 2,093 paid the maximum.

² The \$31.1 million was for FY 2003. Source: Kansas Tax Facts, 2003 Supplement to the Seventh Edition, October 2003.

³ 400 @ \$5000 equals \$2 million.

⁴ Senate Bills 29 and 38, which will bring Kansas back into compliance with the Delaware Corporation Code, the national standard, will eliminate most franchise taxes on subsidiaries unless the franchise tax provisions are stripped out.

HOUSE TAXATION

Attachment 8

Date 3-10-04

This tax was doubled in 2002 to provide funds for a mostly big-business property tax break⁵.

Only 19 states have a franchise tax:

<i>State</i>	<i>Highest Rate (per \$1000)</i>	<i>Maximum Tax</i>	<i>Comments</i>
West Virginia	\$7.00	No maximum	In addition, has license tax of \$.15 to \$.40 per \$1000.
Pennsylvania	\$6.99	No maximum	Phasing down to zero in 2010
Louisiana	\$3.00	No maximum	\$1.50 on first \$300,000 of net worth
Mississippi	\$2.50	No maximum	
Tennessee	\$2.50	No maximum	TN has no personal income tax.
Kentucky	\$2.10	No maximum	"Corporation License Tax"
Kansas	\$2.00	\$5,000	
New York	\$1.78	\$350,000	Alternatives reduce rate for most businesses
Alabama	\$1.75	\$15,000	Must have \$2.5 million in income to pay max. rate
North Carolina	\$1.50	No maximum	
Oklahoma	\$1.25	\$20,000	
Georgia	\$1.00	\$5,000	Rates go down to \$.02 for bigger businesses.
Illinois	\$1.00	\$1,000,000	
South Carolina	\$1.00	No maximum	
Missouri	\$0.33	No maximum	No tax on first \$1,000,000 in net worth
Arkansas	\$0.27	\$1,075,000	
Delaware	\$0.20	\$150,000	
Wyoming	\$0.20	No maximum	
Nebraska	\$0.12	\$11,995	

NFIB members voted by a 5 to 1 margin to ask you to roll back the rate to .1% (\$1 per \$1000) and increase the maximum if necessary.

Net Worth	Info Only			
	Present	HB 2842	HB 2894	HB 2025
Up to \$40,000	40	40	40	40
\$500,000	1000	40	40	500
\$999,999	2000	40	40	1000
\$1 million	2000	1000	40	1000
\$3 million	5000	3000	2000	3000
\$5 million	5000	5000	4000	5000
\$10 million	5000	10000	9000	10000
\$20 million	5000	20000	19000	10000
\$50 million	5000	20500	49000	10000
\$100 million	5000	20500	99000	10000
REVENUE	\$31.1 mm	\$31.1 mm	\$87 mm	\$27.6 mm
			(KD Est.)	(KD Est.)

⁵ The tax was doubled to provide funds for increasing the Machinery & Equipment income tax credit from 15% to 25%. In effect, small businesses were tapped for 90-95% of \$18 million to pay for a \$22 million tax break, 90-95% of which goes to big businesses.

- HB 2842 will eliminate the tax for 28,000 small businesses, cut it in half for another 4000, reduce it for another 400, and increase it for the largest 2100.
- HB 2896 will eliminate the tax for 28,000 small businesses, cut the tax by 50% to 100% for another 2200, reduce it for another 430, and raise it for the largest 1850.
- Although HB 2842, with its \$20,500 cap, is still regressive, we prefer it because we think it has the better chance of being enacted.
- House Bill 2896 is neither regressive nor progressive. It treats all limited liability businesses the same, no matter what size.
- House Bill 2025 is another franchise tax rollback bill which is included in the chart for your information.

Rolling back the franchise tax will help small business, the only sector of the Kansas economy that is growing, to create jobs for Kansans and further stimulate our economy.

Thank you. I will be happy to answer any questions.

COMPARISON OF HB 2842 AND HB 2894

FEE VS. TAX: Both bills split the Franchise Tax into a Franchise Fee and a Franchise Tax. The Franchise Fee must be paid by all limited liability entities. The maximum is \$40 per year, and must be filed and paid to the Secretary of State.

RATE: Both bills will roll back the Franchise Tax rate to .1% from .2%. This is absolutely the most important feature to NFIB. Any bill that has this feature will be acceptable to us, no matter what other features a bill might have.

UNDER \$1 MILLION NET WORTH: Both bills eliminate the Franchise Tax completely for all entities with less than \$1 million in net worth. This will eliminate the tax portion entirely for about 28,000 small businesses. HB 2842 also eliminates the paperwork for all 28,000. HB 2894 will require about 5,000 of them to file paperwork but pay no tax.

PROVIDE DOCUMENTATION WITH TAX FILING: Both of these bills would require all businesses that owe tax to furnish balance sheets with their filing. We have no problem with this as long as everyone has to do it.

Net Worth	Present	Info Only		
		HB 2842	HB 2894	HB 2025
Up to \$40,000	40	40	40	40
\$500,000	1000	40	40	500
\$999,999	2000	40	40	1000
\$1 million	2000	1000	40	1000
\$3 million	5000	3000	2000	3000
\$5 million	5000	5000	4000	5000
\$10 million	5000	10000	9000	10000
\$20 million	5000	20000	19000	10000
\$50 million	5000	20500	49000	10000
\$100 million	5000	20500	99000	10000

REVENUE	\$31.1 mm	\$31.1 mm	\$87 mm	\$27.6 mm
			(KD Est.)	(KD Est.)

FRANCHISE TAXES IN OUR REGION

Kansas, at \$2.00 per thousand, has by far the highest tax rate in the region. The tax is 6 times the average rate of the surrounding states.

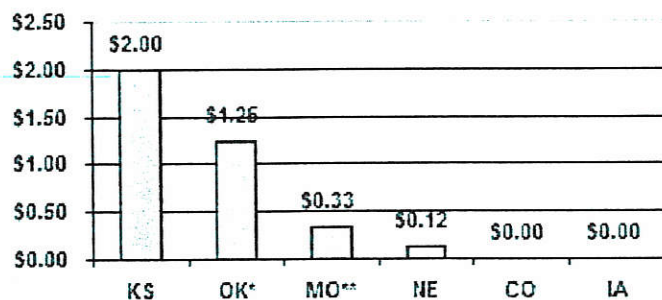
The Oklahoma version, at \$1.25 per thousand, is capped at \$20,000 of tax, which equates to a \$16,000,000 net worth. This at least spreads the misery to many large corporations, but it is still a highly regressive tax borne mostly by small businesses.

The Missouri version, at \$.33 per thousand, applies only to the portion of corporate net worth in excess of \$1 million, thereby eliminating this tax for most small businesses. It has no cap. The Missouri version is more of a tax on medium and large businesses.

The Nebraska version, at \$.12 per thousand, is capped at \$11,995 of tax (\$15,000 for out-of-state corporations) which equates to \$100,000,000 of net worth, making it the same percentage for almost all businesses in the state, and enabling the rate to be kept very low.

Colorado and Iowa, like many other states across the nation, do not have this tax at all.

Franchise Tax Rates Per \$1000 of Net Worth



* Oklahoma's tax is capped at \$20,000 per year.

** Missouri's tax applies only to the portion of net worth over \$1,000,000.

CORPORATION FRANCHISE TAXES (AND OTHER NET WORTH TAXES)

October, 2003

State	Highest Rate (per \$1000)	Maximum Tax	Comments
West Virginia	\$7.00	No maximum	In addition, has license tax of \$.15 to \$.40 per \$1000.
Pennsylvania	\$6.99	No maximum	Phasing down to zero in 2010
Louisiana	\$3.00	No maximum	\$1.50 on first \$300,000 of net worth
Mississippi	\$2.50	No maximum	
Tennessee	\$2.50	No maximum	TN has no personal income tax.
Kentucky	\$2.10	No maximum	"Corporation License Tax"
Kansas	\$2.00	\$5,000	
New York	\$1.78	\$350,000	Alternatives reduce rate for most businesses
Alabama	\$1.75	\$15,000	Must have \$2.5 million in taxable income to pay max. rate
North Carolina	\$1.50	No maximum	
Oklahoma	\$1.25	\$20,000	
Georgia	\$1.00	\$5,000	Rates go down to \$.02 for bigger businesses.
Illinois	\$1.00	\$1,000,000	
South Carolina	\$1.00	No maximum	
Missouri	\$0.33	No maximum	No tax on first \$1,000,000 in net worth
Arkansas	\$0.27	\$1,075,000	
Delaware	\$0.20	\$150,000	
Wyoming	\$0.20	No maximum	
Nebraska	\$0.12	\$11,995	

States With A Net Worth Alternative Calculation in Their Income Tax:

Ohio	\$4.00	\$150,000	Alternate income tax calculation—not a separate tax.
Connecticut	\$3.10	No maximum	Alternative calculation for income tax.
Massachusetts	\$2.60	No maximum	Alternative income tax calculation—not a separate tax.
Texas	\$2.50	No maximum	Plus tax on earnings, all in lieu of corp. income taxes
Rhode Island	\$0.25	No maximum	Capital Stock Tax—alternative to income tax

States with No Net Worth Taxes:

Alaska	None		
Arizona	None		
California	None		Their "franchise tax" is their income tax.
Colorado	None		
Florida	None		
Hawaii	None		
Idaho	None		
Indiana	None		
Iowa	None		
Maine	None		
Maryland	None		
Michigan	None		
Minnesota	None		
Montana	None		
Nevada	None		
New Hampshire	None		
New Jersey	None		
New Mexico	None		Has a flat \$50 "franchise tax" which is only a filing fee.
North Dakota	None		
Oregon	None		
South Dakota	None		
Utah	None		
Vermont	None		
Virginia	None		
Washington	None		
Wisconsin	None		Their "franchise tax" is just an income tax.

Legislative Testimony

HB 2842, HB 2894, SB 38

March 10, 2004

Testimony before the Kansas House Taxation Committee
By Marlee Carpenter, Vice President Government Relations

Mr. Chairman and members of the committee, I am Marlee Carpenter on behalf of the Kansas Chamber of Commerce. The Kansas Chamber has thousands of members who run businesses of varying sizes – small, medium and large – all across Kansas.

Most of our member companies employ 100 or fewer employees, but we also have the state's largest employers among our membership. The Kansas Chamber and our membership are committed to lowering the costs of doing business in Kansas thereby improving the business climate. Lowering taxes is a much better formula for economic success than shifting taxes from one group of business to another as proposed in HB 2842 and HB 2894.

The majority of our members are convinced that reducing the costs of doing business in Kansas is the path to economic recovery. HB 2842 and HB 2894 would have the effect of shifting taxes from one business segment to another and we are opposed to these measures. We support SB 38, which preserves the franchise fee cap, an extremely important concept for the health of our business community, especially in these difficult economic times. SB 38 also reduces the franchise fee rate, a measure that will significantly help small businesses.

Like the Kansas Chamber, the Kansas business community is a healthy mix of small, medium and large firms. Larger firms in the manufacturing, service, retail and construction industries generate demand for services and products from our smaller Kansas companies. These small businesses are invaluable partners to the larger businesses they support and the reciprocal is also true. Further, the employment provided by large firms increases the demand for consumer goods and services that allows many small firms to exist and thrive.

The fate of Kansas businesses of all sizes is intrinsically linked. The concepts put forward in these two House Bills attempt to pit one segment of our business community against another and this, too, is not an acceptable formula for the state's economic success. The Kansas Chamber urges this committee to the franchise fee measures in SB 38. Thank you and I am available for questions.

The Kansas Chamber is the statewide business advocacy group, with headquarters in Topeka. It is working to make Kansas more attractive to employers by reducing the costs of doing business in Kansas. The Kansas Chamber and its affiliate organization, The Kansas Chamber Federation, have nearly 7,500 member businesses, including local and regional chambers of commerce and trade organizations. The Chamber represents small, large and medium sized employers all across Kansas.

HOUSE TAXATION

Attachment 9

Date 3-5-04



**THE KANSAS
CHAMBER**

The Force for Business

835 SW Topeka Blvd.

Topeka, KS 66612-1671

785-357-6321

Fax: 785-357-4732

E-mail: info@kansaschamber.org

www.kansaschamber.org



Matthew S. Goddard, Vice President

700 S. Kansas Ave., Suite 512
Topeka, Kansas 66603
Office (785) 232-8215 • Fax (785) 232-9320
mgoddard@hcbankers.com

To: House Committee on Taxation
From: Matthew Goddard
Heartland Community Bankers Association
Date: March 10, 2004
Re: House Bill 2894

The Heartland Community Bankers Association appreciates the opportunity to appear before the House Committee on Taxation to share our opposition to **House Bill 2894**.

House Bill 2894 creates a new franchise tax that is to be collected by the Department of Revenue and changes the current franchise tax payable to the Secretary of State into a franchise fee. In addition, the bill will make banks, savings and loans and insurance companies subject to the new franchise tax. Current law exempts these types of businesses because they are chartered by federal or state agencies other than the Secretary of State and because they file reports and pay fees to those other agencies.

Since banks and savings and loans do not currently pay a franchise tax, House Bill 2894 represents an entirely new tax burden. Unlike the current franchise tax, the new tax created by HB 2894 does not contain a maximum tax liability. A sampling of HCBA members indicates that, for most savings and loans, HB 2894 would increase their state tax burden by approximately 15 to 20 percent and as an industry by nearly \$2 million annually. This new tax burden is based on net worth, not income, and must be paid regardless of whether or not the taxpayer actually makes a profit in a given year.

HCBA also believes there are certain inequities in HB 2894. We are concerned that a financial institution with all of its operations in Kansas may face a higher franchise tax burden than a large out-of-state institution with the same Kansas market share but just a small fraction of its overall operations in Kansas. The bill also applies the new tax to banks and savings and loans, but not our credit union competitors. The current franchise tax law in K.S.A. 17-7512 exempts banks, savings and loans, insurance companies and credit unions, so it would only seem fair that if the exemption is removed for one type of institution, it should be removed for all institutions, including credit unions. It should be noted that many savings and loans and insurance companies enjoy the same cooperative ownership structure as credit unions.

House Bill 2894 will have a negative impact on the cost of doing business in Kansas for banks and savings and loans. This increased cost will eventually be passed on to consumers in the form of lower interest rates on deposit accounts and higher interest rates on loans.

The Heartland Community Bankers Association respectfully requests the House Committee on Taxation not recommend House Bill 2894 favorable for passage.

Thank you.

HOUSE TAXATION

Attachment 10

Date 3-10-04



The Kansas Bankers Association

3-10-04

TO: House Taxation Committee
FROM: Chuck Stones, Senior Vice President

RE: HB 2894

Mr. Chairman and Members of the Committee,

The Kansas Bankers Association appreciates this opportunity to appear before you in opposition to HB 2894.

HB 2894 would create a whole new class of franchise tax payer and result in double, maybe triple, franchise taxation for the banking industry. Banks are specifically exempt from the current franchise tax because we already file reports and pay fees to the Office of the State Bank Commissioner. In addition, bank holding companies DO pay the current franchise tax through the Secretary of State's office. Banks are not corporations under Kansas code, but bank holding companies are and therefore currently subject to the franchise tax.

It is disturbing to us that the fee fund of the Office of the State Bank Supervisor is increasingly being used to subsidize the State's General Fund including this year when the fee funds are being raided to an even greater extent than in the past. The fee we pay in lieu of the franchise tax is substantial and used to, not only fund an entire State agency, but is, in ever increasing frequency, being used to prop up the General Fund.

We urge you to eliminate the double taxation potential of this bill by eliminating the reference to national and state banking associations in the bill.

I would also note that credit unions ARE on the list of exempted organizations in 17-7512, but are NOT included in the new list in HB 2894. If this bill does move forward, I urge you to rectify this oversight and move the whole list of exempted organizations to HB 2894.

Please allow me to briefly address the proposed change in the franchise tax formula with the following caveat, that bank holding company financial information is not as readily available to us and bank information was used in this analysis. If the proposed formula were put into the current law, it does appear, according to my quick calculations, that the total franchise tax liability for the banking industry would be reduced by about \$1.5 million, and the majority of bank holding companies would see a reduction in their franchise tax liability. I would be derelict in my duty, however, if I did not mention the 155 bank holding companies whose liability would increase. They would obviously oppose removing the cap in the franchise tax, as proposed in HB 2894. 84 bank holding companies would see their franchise tax burden at least double, 55 would see it triple, 14 would see their franchise tax liability increase by \$50,000 or more.

Thank you for the opportunity to appear before you and we urge you to oppose HB 2894.
HOUSE TAXATION
Attachment 11
Date 3-10-04