

MINUTES OF THE HOUSE TAXATION COMMITTEE

The meeting was called to order by Chairman John Edmonds at 9:00 a.m. on March 16, 2004 in Room 519-S of the Capitol.

All members were present.

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:

Joan Wagnon, Secretary of Revenue  
David Allison, CPA

Others attending:

See Attached List

Chairman Edmonds opened the meeting for bill introductions. Hearing none, he opened a public hearing on **HB 2924**. With no one wishing to testify as a proponent on the bill, the Chairman recognized Richard Cram from the Department of Revenue as an opponent. Under **HB 2924**, contractors would be allowed to claim the resale exemption when they buy the materials they will use in completing the project. Also under this bill when the labor is exempt, the contractor must break out the materials price on the billing and would need to collect sales tax on the full amount billed to the customer for the materials, including any mark-up. The Department suggests an amendment to the bill and have submitted a balloon as part of their testimony. **HB 2924** would eliminate the project exemption certificate requirement, since all contractors would be treated as retailers, and their purchases will be regarded as for resale and thus exempt from sales tax until used in a project. This raises several concerns for the Department. It is their estimate that this proposal would require an additional 5,000 contractors/subcontractors/repairpersons to register as retailers and begin filing sales tax returns. (Attachment 1)

Next to submit testimony to the committee was David Allison, CPA, Director CBIZ Accounting, Tax & Advisory Services who also is an opponent to **HB 2924**. It is their belief that our modern-day, multi-faceted construction businesses already have a flexible sales and use tax system from which to select the correct taxing method to match the transaction. **HB 2924** will take away that flexibility, affect the allocation of tax revenues between state and local taxing jurisdictions, and require most contractors to spend significant amounts of dollars and time to develop and implement sophisticated systems to comply with the law at a time when their businesses are suffering. (Attachment 2)

There was no other person wishing to testify on **HB 2924** and the Chairman closed the hearing.

Chairman Edmonds recognized Representative Jack to address the committee.

He stated that on March 15<sup>th</sup> he made a motion on **HB 2842** which was ruled out of order and he requested that the Chair reconsider the ruling.

The Chairman explained that we had three hearings on that date that looked as if they were going to consume the entire meeting and there would not be adequate time for the hearings and hear his motion as well, however, he has withheld filing the committee report so his motion will be considered. He also explained that the rules of the House do not require a second to the motion, therefore he will not require a second in the committee. The rules of the House do provide for time limits which he also will not enforce.

Representative Jack thought there was good debate on **HB 2842** on March 12<sup>th</sup>. He felt it was pretty clear that he was in favor of rolling the franchise tax back to where it was two years ago and there was an amendment made to that effect which failed. We finally ended up with what currently is **HB 2842**. Representative Jack made a motion that the committee reconsider the motion to roll the franchise tax back to where it was two

CONTINUATION SHEET

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years ago.

Representative Powers offered the comment that this motion was probably going to keep the bill.

Representative Jack countered saying that he understood that all kinds things can happen. There is the possibility that it would kill the bill.

Representative Powers said he would have to vote no to reconsider **HB 2842**.

Representative Larkin also stands in opposition to reconsider. The bill that was passed out last week was a fair decision. This bill as it stands no will reduce or limit taxes for 94% of the corporations in the State of Kansas. That is the back bone of Kansas economy.

The Chair wished to express some points of view to the committee.

If this motion succeeds, the result will be to return **HB 2842** to that point where the motion recommending it for passage would be the next logical step.

If this motion succeeds, the bill will be removed from consideration. There will not be another discussion on franchise tax in this committee this year.

Facts to consider:

Last year in Kansas there were 79,747 businesses exactly that paid franchise tax.

Of those, 75,261 of the had equities less than \$1 million and, therefore, paid no tax under the current terms of **HB 2842**

Further, 3,306 had between \$1 million and \$6 million and therefore would pay a tax, but a smaller one than they currently pay.

The remaining 1,180 businesses with equities above \$6 million would, in fact, pay more tax than they paid, although they still would not pay there full proportional share.

**HB 2842** benefits 78,567 companies and costs money for 1,180 companies. The benefits 98-1/2%.

Consider that if you vote for the motion, make a few phone calls to people and explain yourself to them. The Chairman listed businesses that could be contacted and it could be explained to them why they should pay a higher percentage on his equity than Boeing.

This vote is a vote to continue the unfair practice of requiring disproportionately higher rates from small businesses than from large businesses. It is a vote to continue status quo. The Chairman further advised the committee that if they are so beholden to the big firms that they can turn their back on 98-1/2% of the businesses in the state of Kansas then so be it.

Representative Jack countered that he did not feel it was a vote to continue status quo. This is a vote to reconsider because he believes there is another alternative that has not been reconsidered. He states that he is not beholden or influenced by the larger companies as he has no large companies in his district. He stated again that he did not like the franchise tax and felt that it was a double tax. The amendment that will be made if the bill is brought back for reconsideration is to put the State back where they were two years ago before the cap was doubled, put the State back to 1% and reduce the cap down to \$2500 and make this effective a year from now so that it doesn't affect the current years' budget and the Governor and the Legislature will have a year to find additional money. He would prefer and be willing to support corporate income tax or some other more "honest" tax.

Representative Jack closed and moved his amendment.

Vote was taken to reconsider **HB 2842**. Motion failed with a vote of 11 to 10.

With no further business before the committee, the meeting was adjourned at 10:25 a.m.





# K A N S A S

JOAN WAGNON, SECRETARY

DEPARTMENT OF REVENUE  
OFFICE OF POLICY AND RESEARCH

KATHLEEN SEBELIUS, GOVERNOR

## Testimony to the House Taxation Committee Richard Cram

March 16, 2004  
**House Bill 2924**

Chairman Edmonds and Members of the Committee:

House Bill 2924 proposes a fundamental change to the way contractors are treated under Kansas sales tax law, raising several concerns for the Department. Currently, contractors are considered consumers of the tangible personal property they buy to incorporate into construction projects. Contractors pay sales tax when they purchase materials. If the labor on the construction project is taxable (such as for a commercial remodeling project), the contractor will collect sales tax on the total amount billed for the project, less tax-paid materials. If the labor is not taxable (such as for original construction or a residential remodeling project), then the contractor pays sales tax to the supplier on the purchased materials and would not need to collect any sales tax from the contractor's customer.

Contractors are different from retailers. A contractor applies skill and labor to convert material into real property. Contractors cut, bend, hammer and otherwise transform materials into real property as the construction project progresses. Once a project is complete, there is no longer any tangible personal property to be taxed under the current law. Nearly every state treats contractors as consumers. This has been the result of both case law and legislation. Kansas first codified this treatment in 1947. *See 1947 Kan. Sess. Laws, Chap. 463, Sec. 1(m).*

Courts historically have recognized that contractors are consumers of the building materials. See *Duham v. State Tax Commission*, 65 Ariz. 268, 179 P.2d 252, 259 (1947) ("When a contractor fabricates his materials for the contractee, and the completed structure is erected on the owner's land, it is as much real property as the land itself. The constituent elements of tangible personal property have been destroyed by their incorporation into the completed structure. And such a contractor, therefore, is not making a sale of tangible personal property to his contractee."); *J. W. M. Eadors & Co. v. State*. 89 Ga. App. 86,80 S.E.2d 86. 87 (1954) ("A contractor when fabricating personalty into realty neither sells, resells, sells at retail, nor can he be considered a retailer."); *State v. J. Watts Kearny & Sons*, 181 La. 554, 160 So. 77, 78 (1935) ("A contractor who buys building material is not one who buys and sells --a trader. . . . The contractor has not resold but has consumed the materials. Sales to contractors are sales to consumers."); *Craftman Painters & Decorators. Inc. v. Carpenter*, 111 Colo. 1, 137 P.2d 414, 416 (1953) ("[W]hen [contractors] purchased the several items of personal property and built them into the structure as an integral part of their entire contract, and then disposed of the completed work to the owner,

they were users and consumers and not retailers to the owner of each item.”); *Harding v. Oklahoma Tax Commission*, 275 P.2d 264-7 (Okla. 1954); *Townsend Electric Company v. Evans*, 193 Tenn. 536, 246 S.W.2d 907 (1952); *Yolk v. Evatt*. 142 Ohio 335, 52 N.E.2d 338 (1943).

Under House Bill 2924, contractors would be allowed to claim the resale exemption when they buy the materials they will use in completing the project. The taxable retail sale of the materials to the party contracting for the construction project would be deemed to occur at the time payment was due to the contractor, presumably after the materials had been installed in the project. The contractor must then collect sales tax from the party who has contracted for the work (usually the owner or another contractor) on the total amount billed for the project (which would include the materials, as well as other items). If the labor on the project is exempt from sales tax, then the contractor must break out separately in the billing to the party contracting for the work the amount for materials, which would be taxable, and the amount for the labor, which would not be taxable. Otherwise, if the billing is not broken out, the entire billed amount will be attributed to the sale of tangible personal property and therefor taxable.

When a contractor bills a property owner for work done (especially on projects when bids are solicited), the job price often is a lump sum that does not distinguish between material costs, labor costs, overhead costs, and profit. Some contractors mark up the cost of the construction materials on their billing. Under House Bill 2924, when the labor is exempt, the contractor must break out the materials price on the billing and would need to collect sales tax on the full amount billed to the customer for the materials, including any mark-up. Under current law, the supplier will collect sales tax only on the amount paid by the contractor for the materials—which would not include any contractor mark-up. Contractors may also be tempted to charge artificially low prices on the materials (even below the contractor’s own costs for the materials), in order to reduce the amount of sales tax they would have to collect. This could have a substantial negative fiscal impact. If the Committee wishes to consider this bill favorably, the Department suggests an amendment to add the following sentence to the end of subparagraph (ii) on page 7, line 19:

“The retail selling price of any materials shall not be less than the contractor’s, subcontractor’s, or repairperson’s own costs for such materials.” See the attached balloon amendment.

#### Project Exemption Certificates

House Bill 2924 would eliminate the project exemption certificate requirement, since all contractors would be treated as retailers, and their purchases will be regarded as for resale and thus exempt from sales tax until used in a project. Elimination of the project exemption certificate requirement, although a convenience for the contractor and exempt entity and a reduction in paperwork, raises several concerns.

Currently, materials purchased for use in a construction project are taxable to the contractor. The only exception is when the contractor has a project exemption certificate. When that occurs, the contractor may purchase materials for a construction project exempt from sales tax. Certain entities, such as governmental entities, nonprofit hospitals, public and private schools, religious organizations, nonprofit zoos, or certain primary care clinics serving the medically underserved, are exempt from sales tax on their direct purchases when the purchased items are to be used for exempt purposes. When one of these entities contracts for building construction/repair/modification work, the materials would be exempt from sales tax if purchased directly by the exempt entity. In order for the contractor to avoid paying sales tax when purchasing materials for a construction project for one of the above exempt entities, the exempt

entity must, before any materials are purchased, apply for (by fax) and obtain a project exemption certificate from the Department. If the Department determines that the exemption claim is proper, based on the information submitted, the Department will approve the application and issue a project exemption certificate to the exempt entity. The contractor then obtains the project exemption certificate from the exempt entity and presents it to the supplier when the materials are purchased. Attached for reference is a copy of the current project exemption certificate application form.

Project exemption certificates are also required for construction projects in which the "enterprise zone" sales tax exemption (K.S.A. 79-3606(cc)) is claimed on the materials. A business seeking this exemption must apply to the Department in advance and provide the information needed to show that the business qualifies for the exemption.

K.S.A. 79-3606(cc) provides an exemption from sales tax on all sales of tangible personal property or services purchased for the construction, enlarging or remodeling of a business or retail business meeting certain qualifying criteria. The sale and installation of purchased machinery and equipment at the qualifying business is also exempt from sales tax. For example, a manufacturing business qualifies if it hires 2 additional full-time employees and has Department of Commerce approval, if relocating to another city or county. A non-manufacturing business qualifies if it hires 5 additional full-time employees and has Department of Commerce approval, if relocating to another city or county. A retail business qualifies if it hires 2 additional full-time employees and the expansion occurs in a city with population under 2,500 or outside a city in a county with population under 10,000.

The Department has established an application process for a business to request a project exemption certificate prior to the expansion project starting. The business must provide documented evidence of the type of business and the job expansion involving the employment of the required number of additional full-time employees. The application enables the Department to make an initial determination that the exemption is being correctly used. The application information can also later be verified by audit. Attached for reference is a copy of the enterprise zone project exemption certificate application.

If the project exemption certificate under K.S.A. 79-3606(cc) is eliminated, the Department will not determine whether a particular business meets the criteria to qualify for the exemption, before the exemption is claimed on material purchases for a project. Improper exemption claims would be discovered only if the business is audited. The Department currently tracks and reports the amount of enterprise zone sales tax exemptions, based on the applications approved for project exemption certificates. An estimated \$37 million in enterprise zone sales tax exemptions were allowed in the past fiscal year. The Department will lose the ability to track this if the project exemption certificate process is eliminated. The State of Kansas will not know the impact of this "incentive."

The Department will be much less likely to discover an improper exemption claim in an audit, than through the project exemption certificate application process.

#### Fiscal Cost and Administrative Issues

This proposal moves the sales tax collection point downstream from the building materials supplier (building supply center, lumberyard, appliance or hardware store) to the contractor/subcontractor/repairperson. When the tax collection point is moved from few

materials suppliers to many service-providing businesses (contractors, etc.) using those materials, tax noncompliance will increase.

Suppliers tend to be more reliable than contractors when it comes to collecting and remitting sales tax. See Due & Mikesell, *Sales Taxation*, Johns Hopkins Press, 1983 ("The states have found through experience that it is better not to register . . . contractors as vendors, since many of them are very small and keep poor records, and the rate of turnover of firms is high. Therefore, their suppliers collect tax on sales to them, and they do not bill the tax separately to their customers, regardless of the legal nature of the contract.")

Suppliers are a smaller group than contractors/subcontractors/repairpersons. Businesses in the construction trades have a history of going into and out of business in short time periods. A subcontractor doing construction work as a part-time occupation may not be aware of this new tax collection and remittance obligation and may not collect or remit the tax, or may be willing to accept the risk of being audited by the Department for noncompliance. A trap for the unwary may exist on labor-exempt projects, when a contractor who fails to separately break out on the invoice charges for taxable materials versus nontaxable labor under-collects the tax that is due.

The ability to track and ensure payment of all the tax becomes increasingly difficult as taxable materials move through more entities. Currently, contractors/subcontractors/repairpersons who only do original construction or residential remodeling or repair work currently do not need to register as retailers, because none of their labor would be taxable, and they currently pay sales tax to their suppliers on the materials purchased. They would have no further obligation to collect or remit sales tax or file returns. We estimate that this proposal would require an additional 5,000 contractors/subcontractors/repairpersons to register as retailers and begin filing sales tax returns. State sales tax collections in fiscal year 2003 attributed to the construction industry are estimated at \$150 million. If the increased risk of noncompliance reduced these receipts by 10%, this would mean a loss of \$15 million in state sales tax revenue.

1 erecting structures, or building on, or otherwise improving, altering or  
 2 repairing real or personal property such purchases shall be considered  
 3 purchases for resale. When a contractor, subcontractor or repairperson  
 4 uses such purchased tangible personal property in erecting structures, or  
 5 building on, or otherwise improving, altering or repairing real or personal  
 6 property, such purchased tangible personal property shall be considered  
 7 sold at retail at the time payment is due under the contract to the person  
 8 contracted with by the contractor, subcontractor or repairperson. If such  
 9 contract is part of a multi-contract project, the labor and materials fur-  
 10 nished pursuant to such a contract shall be subject to sales tax only once.  
 11 When the labor services for any contractor, subcontractor or repairperson  
 12 project are exempt from sales tax and the materials for the project are not,  
 13 the contractor, subcontractor or repairperson shall separately state on  
 14 the invoice or billing to the purchaser the sales price of all tangible per-  
 15 sonal property purchased for resale by the contractor, subcontractor or  
 16 repairperson for the project and the selling price of all labor services  
 17 furnished for the project. Otherwise, the entire sales price billed by the  
 18 contractor, subcontractor or repairperson for the project shall be deemed  
 19 attributable to the retail sale of tangible personal property.

20 (jj) "Retail sale" or "sale at retail" means any sale, lease or rental for  
 21 any purpose other than for resale, sublease or subrent.

22 (kk) "Sale" or "sales" means the exchange of tangible personal prop-  
 23 erty, as well as the sale thereof for money, and every transaction, condi-  
 24 tional or otherwise, for a consideration, constituting a sale, including the  
 25 sale or furnishing of electrical energy, gas, water, services or entertain-  
 26 ment taxable under the terms of this act and including, except as provided  
 27 in the following provision, the sale of the use of tangible personal property  
 28 by way of a lease, license to use or the rental thereof regardless of the  
 29 method by which the title, possession or right to use the tangible personal  
 30 property is transferred. The term "sale" or "sales" shall not mean the sale  
 31 of the use of any tangible personal property used as a dwelling by way of  
 32 a lease or rental thereof for a term of more than 28 consecutive days.

33 (11) (1) "Sales or selling price" applies to the measure subject to  
 34 sales tax and means the total amount of consideration, including cash,  
 35 credit, property and services, for which personal property or services are  
 36 sold, leased or rented, valued in money, whether received in money or  
 37 otherwise, without any deduction for the following:

- 38 (A) The seller's cost of the property sold;
- 39 (B) the cost of materials used, labor or service cost, interest, losses,  
 40 all costs of transportation to the seller, all taxes imposed on the seller and  
 41 any other expense of the seller;
- 42 (C) charges by the seller for any services necessary to complete the  
 43 sale, other than delivery and installation charges;

The retail selling price of any materials shall not be less than the contractor's, subcontractor's, or repairperson's own costs for such materials.



# REQUEST FOR PROJECT EXEMPTION CERTIFICATE

Kansas Department of Revenue  
Office of Policy and Research  
915 SW Harrison St.  
Topeka, Kansas 66612-1588

Date \_\_\_\_\_

Telephone: (785) 296-3081  
FAX: (785) 296-7928

It is requested that a Certificate of Exemption be issued to the Petitioning Authority for the following described project if it is determined by the Department of Revenue that the proposed project qualifies for exemption from sales tax under the provisions of K.S.A. 79-3606(d), (e), (xx), (aaa), or (ccc).

(A) Type of project: \_\_\_\_\_  
Describe Work to be Done

A. Present use of facility: \_\_\_\_\_

B. Proposed use of facility after project: \_\_\_\_\_

(B) Project location: \_\_\_\_\_  
Building Number, Street Address, City, State, and Zip

(C) Is this project being constructed as part of a business enterprise whose sales are subject to sales tax (e.g., municipal water, electric or gas companies)? Yes  No

(D) Is the Petitioning Authority authorized to levy ad valorem taxes on tangible property? Yes  No   
If so, under what statute? \_\_\_\_\_

(E) A. Is this project being totally financed by industrial revenue bonds? Yes  No

B. Is this project being partially financed by industrial revenue bonds? Yes  No

Amount of bonds being issued for project: \_\_\_\_\_

If you answered "Yes" to A or B, you must complete the agreement on the back of this form and **attach a copy of the letter of intent or resolution of intent to issue bonds.**

If you answered "No" to A and B, how is the project being financed (explain type of tax, bonds, etc.)?  
\_\_\_\_\_

(F) Name of claimant owner of project: \_\_\_\_\_

(G) Starting date: \_\_\_\_\_ (H) Estimated completion date: \_\_\_\_\_

(I) Estimated project cost: \_\_\_\_\_ (J) List names and addresses of prime contractors:

(K) Contract date: \_\_\_\_\_

(L) Contract number: \_\_\_\_\_

(M) Project number: \_\_\_\_\_

\_\_\_\_\_  
Petitioning Authority

\_\_\_\_\_  
Mailing Address

\_\_\_\_\_  
Signature of Authorized Representative

\_\_\_\_\_  
City, State & Zip Code

\_\_\_\_\_  
Type or Print Name

\_\_\_\_\_  
Title

\_\_\_\_\_  
Phone Number



ONLY COMPLETE THIS PAGE IF YOU ANSWERED YES TO (E) ON PAGE 1.

This agreement is made and entered into between and by the \_\_\_\_\_  
\_\_\_\_\_ (name of political subdivision), hereinafter referred to as  
Exempt Entity; and \_\_\_\_\_ (name of beneficiary of industrial revenue  
bond proceeds), hereinafter referred to as Beneficiary.

It is hereby agreed by all parties to this agreement that the construction project for which the request for an exemption certificate is being made would be exempt from sales tax solely due to the fact that it is being financed by industrial revenue bonds. It shall be the duty of the Exempt Entity to notify the Kansas Department of Revenue when the industrial revenue bonds have actually been issued.

Whereas, the Kansas Department of Revenue deems it necessary to ensure that sales or compensating tax is paid should the project not be financed by industrial revenue bonds, it is hereby further agreed by the Beneficiary that if the industrial revenue bonds have not been issued by the time the project is completed then the Beneficiary will remit to the Kansas Department of Revenue the sales or compensating tax and applicable interest on tax which is due based upon the cost of tangible personal property or services used or consumed in the construction of the project. It is agreed, that the Secretary of Revenue shall determine when the project has been completed.

The Director of Policy and Research shall have the right to demand from the Beneficiary payment of the sales and compensating tax and applicable interest due the state should the Kansas Department of Revenue not receive such payment within thirty (30) days after the project has been completed.

Any and all notices required herein shall be mailed and addressed as follows:

- A. Notices to the Department of Revenue shall be addressed to: Director of Policy and Research, Kansas Department of Revenue, 915 SW Harrison St., Room 230, Topeka, Kansas 66612-1588;
- B. Notices to the Exempt Entity shall be addressed to: \_\_\_\_\_  
\_\_\_\_\_;
- C. Notices to the Beneficiary shall be addressed to: \_\_\_\_\_  
\_\_\_\_\_.

This agreement shall be binding upon all parties hereto and any and all their successors.

IN WITNESS WHEREOF, the parties hereto have caused this instrument to be executed by persons authorized to do so lawfully and with full corporate authority.

POLITICAL SUBDIVISION

BENEFICIARY OF INDUSTRIAL REVENUE BOND  
PROCEEDS

\_\_\_\_\_  
Authorized Signature

\_\_\_\_\_  
Authorized Signature

\_\_\_\_\_  
Type or Print Name and Title

\_\_\_\_\_  
Type or Print Name and Title

DATED: \_\_\_\_\_

DATED: \_\_\_\_\_

3. **NONMANUFACTURING**

Type of nonmanufacturing business:

- Commercial enterprise other than a manufacturing business or a retail business
- Business headquarters
- Ancillary support (Please attach statement from Department of Commerce & Housing)
- Enterprise designated under SIC code 5961 (Catalog & Mail Order Houses)
- Enterprise designated under SIC code 7372 (Prepackaged Software)

Does your business make retail sales? Yes  (Provide Kansas retailers' sales tax number) \_\_\_\_\_ No

Is your business primarily engaged (more than 50%) in the service of installing or applying tangible personal property in connection with the original construction of a building or facility; the original construction, reconstruction, restoration, remodeling, renovation, repair or replacement of a residence; or the construction, reconstruction, restoration, replacement or repair of a bridge or highway? Yes  No

Will the expansion of the nonmanufacturing business, (commercial enterprise other than a manufacturing business or a retail business) involve the hiring and addition of at least five employees to your total Kansas employment? Yes  No

Will the expansion of the nonmanufacturing business, (business headquarters, ancillary support, enterprise designated under SIC code 5961 or 7372) involve the hiring and addition of at least twenty new full time positions to your total Kansas employment? Yes  No

4. **RETAIL**

Will the expansion of the retail business involve the hiring and addition of at least two employees to your total Kansas employment and be located or expanded in a city with a population of 2,500 or less or outside a city in a county having a population of 10,000 or less?

Yes  No

5. **LESSOR/LESSEE**

Will the facility (construction, expansion, or renovation) be leased for a period of five years or more?

Yes  (Please enclose a copy of the lease.) No

Would the lessee qualify for the sales tax exemption if the lessee requested the exemption directly with the department?

Yes  (If yes, provide the lessee's classification below.) No

Lessee's classification:

- Certified HPIP Business: Certified by the Department of Commerce and Housing;
- Manufacturing: SIC \_\_\_\_\_ with hiring of two (2) additional employees;
- Nonmanufacturing: Commercial enterprise other than a manufacturing business or a retail business. Describe business \_\_\_\_\_ and business will hire five additional employees;
- Business headquarters, ancillary support, SIC 5961 or SIC 7372 with hiring of at least 20 additional full time employees;
- Retail: Hiring and addition of at least two employees and will be located or expanded in a city with a population of 2,500 or less outside a city in a county having a population of 10,000 or less?

(H) Is this project a result of working with officials of the state, county, or city government? Yes  No

If yes, provide the name of the agency and contact: \_\_\_\_\_

What will be the average annual wage for new (non-managerial) employees? \_\_\_\_\_

(I) List the name(s) and address(es) of the general contractor(s): \_\_\_\_\_

(J) Estimated project costs: Total \_\_\_\_\_ Construction costs: \_\_\_\_\_

Machinery and equipment costs: \_\_\_\_\_

(K) Contract date: \_\_\_\_\_ (L) Contract No.: \_\_\_\_\_

(M) Estimated completion date (not to exceed two years): \_\_\_\_\_

\_\_\_\_\_  
Taxpayer (please type or print)

\_\_\_\_\_  
Name of Authorized Representative (please type or print)

\_\_\_\_\_  
Signature of Authorized Representative

\_\_\_\_\_  
Title

\_\_\_\_\_  
Phone Number

## INSTRUCTIONS

An exemption from sales tax is allowed on all sales of tangible personal property or services purchased for the construction, enlarging or remodeling of a business or retail business. The sale and installation of machinery and equipment purchased for the installation at the business or retail business shall also be exempt from sales tax.

Line (A) Enter the name of the entity that will operate the business facility and claim the sales tax exemption and associated income tax credit, and check the appropriate box identifying the business type.

Line (B)(1) Enter the doing business as (DBA) name of the business, if it is different than line (A), above, and check the appropriate box identifying the business type.

Line (B)(2) Enter the location, including the county of the business facility where the investment is going to be made.

Line (B)(3) Enter the complete mailing address of the taxpayer who will own and/or operate the above referenced business facility.

Line (C) A manufacturing business located within the state of Kansas that has documented evidence of job expansion involving the employment of at least two additional full time employees which relocates in another city or county within the state of Kansas must receive approval from the Secretary of Commerce & Housing prior to qualifying for the sales tax exemption (K.S.A. 74-50,115(a)(2)). Approval by the Secretary of Commerce & Housing is not required if the manufacturing business relocates within the same city.

A nonmanufacturing business located within the state of Kansas that has documented evidence of job expansion involving the employment of at least five additional full time employees which relocates in another city or county within the state of Kansas must receive approval from the Secretary of Commerce & Housing prior to qualifying for the sales tax exemption (K.S.A. 74-50,115(b)(2)). Approval by the Secretary of Commerce & Housing shall not be required if the nonmanufacturing business relocates within the same city.

Line (D) Check the applicable box(es) that describe the project and attach required documentation.

Line (E) Purchases of materials, machinery, equipment, and services must be directly related to increased employment to qualify for exemption from retailers' sales tax. Therefore, you are required to describe each purchase you are contemplating and demonstrate how the purchase relates directly to increased employment at the facility.

Line (F) Describe specifically the type of business activity to be conducted by the taxpayer at the business facility.

Line (G) Indicate the type of business activity to be conducted at the business facility by the named taxpayer, and answer the corresponding questions. It should be noted that only **ONE** of the boxes under Line (G) should be checked in regards to the type of business activity conducted at the facility.

Line (G)(1) Certified business means a firm which is qualified by the Secretary of Commerce & Housing as meeting the eligibility criteria for the High Performance Incentive Program (HPIP) pursuant to K.S.A. 2000 Supp. 74-50,131. The firm must be entitled to the corporate tax credit established in K.S.A. 2000 Supp. 74-50,132 or must have received written approval for participation and has participated, during the tax year in which the exemption is claimed, in training assistance by the Department of Commerce and Housing under the Kansas industrial training (KIT), Kansas industrial retraining (KIR) or state of Kansas investments in lifelong learning program (SKILL).

Line (G)(2) Manufacturing business means all commercial enterprises identified under the manufacturing standard industrial classification codes (SIC), major groups 20 through 39.

Line (G)(3) Nonmanufacturing business means any commercial enterprise other than a manufacturing business or a retail business. Nonmanufacturing business shall also include the business headquarters of an enterprise, ancillary support of an enterprise and an enterprise designated under standard industrial classification (SIC) codes 5961 or 7372 regardless of the firm's classification as a retail business if that facility for which the sales tax exemption certificate is issued facilitates the creation of at least 20 new full time positions.

Business headquarters means a facility where principal officers of the business are housed and from which direction, management, or administrative support for transactions is provided for business or division of a business.

Ancillary support means a facility which is operated by a business and whose function is to provide services in support of the business, but is not directly engaged in the business' primary function. Attach the statement from the Department of Commerce and Housing.

Original construction means the first or initial construction of a new building or facility and includes the addition of an entire room or floor to any existing building or facility, the completion of any unfinished portion of any existing building or facility and the restoration, reconstruction or replacement of a building or facility damaged or destroyed by fire, flood, tornado, lightning, explosion or earthquake. Residence means only those enclosures within which individuals customarily live.

Line (G)(4) Retail business means (a) Any commercial enterprise primarily engaged in the sale at retail of goods or services taxable under the Kansas retailers' sales tax act; (b) any service provider set forth in K.S.A. 17-2707, and amendments thereto (licensed professional); (c) any bank, savings and loan, or other lending institution; (d) any commercial enterprise whose primary business activity includes the sale of insurance, and (e) any commercial enterprise whose primary business activity includes the sale of services such as, but not limited to, barber shops, beauty shops, photographic studios, and funeral services.

Line (G)(5) Lessor means any person constructing, reconstructing, remodeling, or enlarging a facility which will be leased for a period of five years or more to a business that would be eligible for a sales tax exemption if the business had constructed, reconstructed, enlarged, or remodeled the facility itself. Please attach a copy of the 5 year lease agreement.

As the lessor, you must determine whether the lessee qualifies for the sales tax exemption as a manufacturing, nonmanufacturing, retail or certified business. If the lessee does not qualify, a project exemption certificate cannot be issued.

If there are multiple lessees, each must qualify for the sales tax exemption and a lease agreement must be submitted for each.

Line (H) Check the applicable box and list the name of the organization and/or person you were contacted by and the average wage of the new (non-managerial) employees.

Line (I) List the name and address of the general contractor if available. If a general contractor does not exist for this project, please attach a list of all the contractors/subcontractors (if available) involved in performing labor services or supplying materials for the project. Include in this list, the estimated project costs, contract date, contract number, and the estimated completion date for each contract.

Line (J) Enter the estimated cost of the project.

Line (K) Enter the date of the contract.

Line (L) Enter the applicable contract number if available.

Line (M) Enter the estimated completion date for this project. The Department requests that this period not extend beyond two years from the application date.

Signature The name of the taxpayer as well as the authorized representative requesting the exemption should be typed or printed in the area provided. The authorized representative must also sign the request and provide a phone number where they can be reached during business hours.

# MANUFACTURING

## FOOD AND KINDRED PRODUCTS

- 201 Meat Products
- 202 Dairy Products
- 203 Canned, Frozen, and Preserved Fruits, Vegetables, and Food Specialties
- 204 Grain Mill Products
- 205 Bakery Products
- 206 Sugar and Confectionery Products
- 207 Fats and Oils
- 208 Beverages
- 209 Miscellaneous Food Preparations and Kindred Products

## TOBACCO PRODUCTS

- 211 Cigarettes
- 212 Cigars
- 213 Chewing and Smoking Tobacco and Snuff
- 214 Tobacco Stemming and Redrying

## TEXTILE MILL PRODUCTS

- 221 Broadwoven Fabric Mills, Cotton
- 222 Broadwoven Fabric Mills, Manmade Fiber and Silk
- 223 Broadwoven Fabric Mills, Wool (Including Dyeing and Finishing)
- 224 Narrow Fabric and Other Smallwares Mills: Cotton, Wool, Silk, and Manmade Fiber
- 225 Knitting Mills
- 226 Dyeing and Finishing Textiles, except Wool, Fabrics and Knit Goods
- 227 Carpets and Rugs
- 228 Yarn and Thread Mills
- 229 Miscellaneous Textile Goods

## APPAREL AND OTHER FINISHED PRODUCTS MADE FROM FABRICS AND SIMILAR MATERIALS

- 231 Men's and Boys' Suits, Coats, and Overcoats
- 232 Men's and Boys' Furnishings, Work Clothing, and Allied Garments
- 233 Women's, Misses', and Juniors' Outerwear
- 234 Women's, Misses', Children's, and Infants' Undergarments
- 235 Hats, Caps, and Millinery
- 236 Girls', Children's, and Infants' Outerwear
- 237 Fur Goods
- 238 Miscellaneous Apparel and Accessories
- 239 Miscellaneous Fabricated Textile Products

## LUMBER AND WOOD PRODUCTS, EXCEPT FURNITURE

- 241 Logging
- 242 Sawmills and Planing Mills
- 243 Millwork, Veneer, Plywood, and Structural Wood Members
- 244 Wood Containers
- 245 Wood Buildings and Mobile Homes
- 249 Miscellaneous Wood Products

## FURNITURE AND FIXTURES

- 251 Household Furniture
- 252 Office Furniture
- 253 Public Building and Related Furniture
- 254 Partitions, Shelving, Lockers, and Office and Store Fixtures
- 259 Miscellaneous Furniture and Fixtures

## PAPER AND ALLIED PRODUCTS

- 261 Pulp Mills
- 262 Paper Mills
- 263 Paperboard Mills
- 265 Paperboard Containers and Boxes
- 267 Converted Paper and Paperboard Products, Except Containers and Boxes

## PRINTING, PUBLISHING, AND ALLIED INDUSTRIES

- 271 Newspapers: Publishing, or Publishing and Printing
- 272 Periodicals: Publishing, or Publishing and Printing
- 273 Books

- 274 Miscellaneous Publishing
- 275 Commercial Printing
- 276 Manifold Business Forms
- 277 Greeting Cards
- 278 Blankbooks, Loose-leaf Binders, and Bookbinding and Related Work
- 279 Service Industries for the Printing Trade

## CHEMICALS AND ALLIED PRODUCTS

- 281 Industrial Inorganic Chemicals
- 282 Plastics Materials and Synthetic Resins, Synthetic Rubber, Cellulosic and Other Manmade Fibers, Except Glass
- 283 Drugs
- 284 Soap, Detergents, and Cleaning Preparations; Perfumes, Cosmetics and Other Toilet Preparations
- 285 Paints, Varnishes, Lacquers, Enamels, and Allied Products
- 286 Industrial Organic Chemicals
- 287 Agricultural Chemicals
- 289 Miscellaneous Chemical Products

## PETROLEUM REFINING AND RELATED INDUSTRIES

- 291 Petroleum Refining
- 295 Asphalt Paving and Roofing Materials
- 299 Miscellaneous Products of Petroleum and Coal

## RUBBER AND MISCELLANEOUS PLASTICS PRODUCTS

- 301 Tires and Inner Tubes
- 302 Rubber and Plastic Footwear
- 305 Gaskets, Packing, and Sealing Devices and Rubber and Plastics Hose and Belting
- 306 Fabricated Rubber Products, Not Elsewhere Classified
- 308 Miscellaneous Plastics Products

## LEATHER AND LEATHER PRODUCTS

- 311 Leather Tanning and Finishing
- 313 Boot and Shoe Cut Stock and Findings
- 314 Footwear, Except Rubber
- 315 Leather Gloves and Mittens
- 316 Luggage
- 317 Handbags and Other Personal Leather Goods
- 319 Leather Goods, Not Elsewhere Classified

## STONE, CLAY, GLASS, AND CONCRETE PRODUCTS

- 321 Flat Glass
- 322 Glass and Glassware, Pressed or Blown
- 323 Glass Products, Made of Purchased Glass
- 324 Cement, Hydraulic
- 325 Structural Clay Products
- 326 Pottery and Related Products
- 327 Concrete, Gypsum, and Plaster Products
- 328 Cut Stone and Stone Products
- 329 Abrasive, Asbestos, and Miscellaneous Nonmetallic Mineral Products

## PRIMARY METAL INDUSTRIES

- 331 Steel Works, Blast Furnaces, and Rolling and Finishing Mills
- 332 Iron and Steel Foundries
- 333 Primary Smelting and Refining of Nonferrous Metals
- 334 Secondary Smelting and Refining of Nonferrous Metals
- 335 Rolling, Drawing, and Extruding of Nonferrous Metals
- 336 Nonferrous Foundries (Castings)
- 339 Miscellaneous Primary Metal Products

## FABRICATED METAL PRODUCTS, EXCEPT MACHINERY AND TRANSPORTATION EQUIPMENT

- 341 Metal Cans and Shipping Containers
- 342 Cutlery, Handtools and General Hardware
- 343 Heating Equipment, except Electric and Warm Air; and Plumbing Fixtures
- 344 Fabricated Structural Metal Products
- 345 Screw Machine Products, and Bolts, Nuts, Screws, Rivets, and Washers

- 346 Metal Forgings and Stampings
- 347 Coating, Engraving, and Allied Services
- 348 Ordnance and Accessories, Except Vehicles and Guided Missiles
- 349 Miscellaneous Fabricated Metal Products

## INDUSTRIAL AND COMMERCIAL MACHINERY AND COMPUTER EQUIPMENT

- 351 Engines and Turbines
- 352 Farm and Garden Machinery and Equipment
- 353 Construction, Mining, and Materials Handling Machinery and Equipment
- 354 Metalworking Machinery and Equipment
- 355 Special Industry Machinery, Except Metalworking Machinery
- 356 General Industrial Machinery and Equipment
- 357 Computer and Office Equipment
- 358 Refrigeration and Service Industry Machinery
- 359 Miscellaneous Industrial and Commercial Machinery and Equipment

## ELECTRONIC AND OTHER ELECTRICAL EQUIPMENT AND COMPONENTS, EXCEPT COMPUTER EQUIPMENT

- 361 Electric Transmission and Distribution Equipment
- 362 Electrical Industrial Apparatus
- 363 Household Appliances
- 364 Electric Lighting and Wiring Equipment
- 365 Household Audio and Video Equipment, and Audio Recordings
- 366 Communications Equipment
- 367 Electronic Components and Accessories
- 369 Miscellaneous Electrical Machinery, Equipment, and Supplies

## TRANSPORTATION EQUIPMENT

- 371 Motor Vehicles and Motor Vehicle Equipment
- 372 Aircraft and Parts
- 373 Ship and Boat Building and Repairing
- 374 Railroad Equipment
- 375 Motorcycles, Bicycles, and Parts
- 376 Guided Missiles and Space Vehicles and Parts
- 379 Miscellaneous Transportation Equipment

## MEASURING, ANALYZING, AND CONTROLLING INSTRUMENTS; PHOTOGRAPHIC, MEDICAL AND OPTICAL GOODS; WATCHES AND CLOCKS

- 381 Search, Detection, Navigation, Guidance, Aeronautical, and Nautical Systems, Instruments, and Equipment
- 382 Laboratory Apparatus and Analytical, Optical, Measuring, and Controlling Instruments
- 384 Surgical, Medical, and Dental Instruments and Supplies
- 385 Ophthalmic Goods
- 386 Photographic Equipment and Supplies
- 387 Watches, Clocks, Clockwork Operated Devices, and Parts

## MISCELLANEOUS MANUFACTURING INDUSTRIES

- 391 Jewelry, Silverware, and Plated Ware
- 393 Musical Instruments
- 394 Dolls, Toys, Games and Sporting and Athletic Goods
- 395 Pens, Pencils, and Other Artists' Materials
- 396 Costume Jewelry, Costume Novelties, Buttons, and Miscellaneous Notions, Except Precious Metal
- 399 Miscellaneous Manufacturing Industries

TESTIMONY TO THE HOUSE COMMITTEE  
ON ASSESSMENT AND TAXATION  
REGARDING H.B. No. 2924

Sales Tax Treatment of Contractors, Retailers and  
Contractor/Retailers

By

David N. Allison, CPA  
Director, CBIZ Accounting, Tax & Advisory Services  
and  
Shareholder, Mayer Hoffman McCann P.C.  
March 16, 2004

Chairman Edmonds and Members of the Committee:

I am David Allison, CPA and the Leader of the Midwest Construction Industry Group for CBIZ Accounting, Tax & Advisory Services. CBIZ is a publicly-traded integrated business services firm which, in conjunction with the related independent CPA firm of Mayer Hoffman McCann P.C., is currently the 9th largest accounting and business consulting firm in the United States.

In the six state region from which I serve from our Topeka office, CBIZ has over 200 contractors, architects and engineers for clients. Our contractor clients are general building contractors, road builders, mechanical contractors, electricians, home builders, HVAC service contractors, and other specialty contractors. Our clients perform original and remodel construction services and retail services for governments, nonprofit organizations and for-profit businesses.

Further, I am an associate member and former board member of the Associated General Contractors of Kansas, associate member of the Kansas Contractors Association, and a member and former board member of the Kansas Society of Certified Public Accountants.

INDIVIDUAL TRANSACTIONS SHOULD DETERMINE THE TAXING METHOD, NOT A  
STATUTORY CLASSIFICATION

As you will hear from others today, I too was a member of a special Construction Sales Tax Group which met numerous times in 1999 and afterwards to discuss what we believe was the proper solution to the sales and use tax issue involving "contractors" and "retailers." Our Construction Sales Tax Group consisted of construction industry members and organizations, business organizations, and representatives of the Kansas Department of Revenue. Our Group discussed the evolution of the present day "contractor/retailer" business, the need to have sales and use tax laws that were flexible to handle the situation when a business acted as a "retailer" in one transaction and as a "contractor" in another transaction. This discussion led our

HOUSE TAXATION

Attachment 2

Date 3-16-02



Group to suggest the framework for developing necessary clarifying legislation and regulations, which is our current law.

Upon review of the suggested changes in the sales and use tax law by H.B. 2924, I believe that the State will be taking a step backwards in not recognizing the necessity of a business to have an ability to have a "retailer", "contractor" and "contractor/retailer" category.

#### LOCAL TAXING JURISDICTIONS REVENUES WILL BE AFFECTED

Currently, if a contractor removes materials from inventory to be performed by his contracting business, the taxing jurisdiction is the location of the warehouse because the contractor is considered the end-user of the materials. Under H.B. 2924, the project owner (or prime contractor) will be considered the end-user of the materials. The extent to which sales and use tax revenue will shift from one government to another should be researched before passing this bill.

Further, local governments will lose out on sales and use taxes generated from State of Kansas projects. Currently, materials consumed by contractors in the construction project performed for the State of Kansas are subject to state and local sales and use taxes because contractors are considered the end-users of the materials. H.B. 2924 will change the law so that construction projects for the State of Kansas will no longer be subject to sales or use taxes because the State will be considered to be purchasing the materials directly as the end-user, exempt from tax.

Therefore, local governments will lose out on substantial amounts of sales and use tax revenue. For example, it is my understanding that the I-70 and I-635 interchange construction in Kansas City, Kansas generated in excess of \$400,000 in use tax revenue when the destination-based sales tax was implemented last year. This revenue will be forever gone to local governments. Conversely, the State and federal governments will save costs on these construction projects.

#### ADDITIONAL OVERHEAD COSTS FOR MOST CONTRACTORS; A FEW MAY SAVE

Most contractors currently pay tax on materials at the time they purchase them from a supplier. As a result, except for those few transactions where they provide taxable labor services, most contractors do not have to incur the cost of implementing a retail sales tax billing, collection and payment system for their businesses. Material suppliers have already borne the cost to develop elaborate retail sales systems as a result of implementation of the destination-based sales tax law change last year. H.B. 2924 will create an enormous overhead burden on most contractors during a time when many of them are fighting to keep their businesses in existence.

As noted on State of Kansas projects, only direct sales of materials to the State are exempt from sales and use tax. To take advantage of this exemption, some contractors have established separate companies to sell the materials directly to the State of Kansas, and then they have a separate construction business performs the labor and installation services. H.B. 2924 would eliminate the need of this separate materials supplier business on Kansas projects and some of its overhead costs. However, because we understand that the states surrounding Kansas still define the end-user of materials on construction contracts as the contractor, virtually all of the companies we are aware of with this business model will continue it, resulting in little to no cost savings to their business.

#### STATE OF KANSAS WOULD ESTABLISH CONTRACTING TERMS FOR CONTRACTORS

Contractors perform their work generally under lump-sum (one price for the entire project), time-and-material (labor and materials separately stated and marked up for overhead and profit), or guaranteed-maximum price (time-and-material billing, but the price may not exceed a certain lump-sum). Further, recent trends find more contractors and owners entering into design-build or design-build-maintain contracts. These various types of contracts and services are performed on projects where materials are subject to tax, and also when labor services may or may not be taxable.

A key issue in H.B. 2924 is that all billings must separately state the price of the materials sold to the owner. If not separately stated, the entire sales price billed by the contractor will be subject to sales and use tax. H.B. 2924 will impose a huge penalty for a contractor using any form of contract other than a time-and-material contract, as it will subject the entire contract to sales and use tax. Does the State really want to dictate the form of contract between an owner and a contractor?

#### SALES TAX BASE LEFT TO INTERPRETATION

Current law establishes the sales and use tax base on materials consumed by a contractor to be the contractor's cost to acquire them (a "contractor" sale). For materials sold directly to a customer from its inventory and separately stated on the billing, the tax base is the price billed to the customer (a "retail" sale).

H.B. 2924 only provides for the tax base to be the amount separately billed for the materials in the billing to the owner. Under H.B. 2924, it would be possible for one contractor to bill the owner at a marked-up retail price, another contractor to bill the owner at cost, and a creative contractor to bill the owner at below cost. Consideration should be given by this Committee to consider adding a minimum amount for determining the tax base (contractor's cost) to avoid abuse of the tax law.

## NO PROJECT EXEMPTION CERTIFICATE TO PROVIDE TO SUBCONTRACTORS

H.B. 2924 intends to eliminate the need for project exemption certificates because prime contractors will be selling their materials directly to owners who are exempt from sales and use tax. However, because the prime contractor (not the exempt project owner) is defined as the "owner" to which a subcontractor sells its materials, the subcontractor's purchases of materials will not be exempt from sales tax. Because project exemption certificates will not be available after passage of H.B. 2924, the cost of exempt construction projects will rise to the extent of any work that is subcontracted.

Further, subcontractors will be at a competitive disadvantage to prime contractors. Prime contractors that self-perform their work will not have to charge sales tax to the owner on the materials. Prime contractors who subcontract more of their work and subcontractors overall will have to lower their profits by the applicable sales and use tax rate in order to compete with the prime contractor who self-performs the work. With top-quality contractors currently generating only 0%-to-5% to the bottom line today, many small prime contractors and subcontractors will need to merge with large contractors to survive under the economic dynamic created by H.B. 2924.

Finally, in order for tax-exempt owners to minimize the sales and use tax cost on their construction projects, they may be forced to once again purchase materials directly from suppliers without tax and then have the materials installed by a contractor. This is what happened several years ago when churches had to purchase all of their materials directly to avoid sales tax because indirect purchases of materials were not tax exempt.

### CONCLUSION

I believe that our modern-day, multi-faceted construction businesses already have a flexible sales and use tax system from which to select the correct taxing method to match the transaction. H.B. 2924 will take away that flexibility, affect the allocation of tax revenues between state and local taxing jurisdictions, and require most contractors to spend significant amounts of dollars and time to develop and implement sophisticated systems to comply with the law at a time when their businesses are suffering most. I believe H.B. 2924 will be a step backwards, and I oppose the bill on behalf of our clients and friends.