Approved: April 29, 2004
Date

MINUTES OF THE HOUSE TAXATION COMMITTEE

The meeting was called to order by Chairman John Edmonds at 9:00 a.m. on March 18, 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:
Representative Ward Loyd
Representative Doug Patterson
Richard Cram, Department of Revenue
Linda Terrill, Legal Counsel for Meade County
Bill Waters, Kansas Department of Property Valuation
Larry Baer, Kansas League of Municipalities
Tom Fuhrmann, Morton county Appraiser
John Pinegar, Kasnas Legislative Policy Group
Dick Brewster, BP America Inc.
Ron Gaches, Northern Natural Gas, Southern Star Pipeline, El Paso
Tom Whitaker, Kansas Motor Carriers
Jack Glaves, Panhandle Energy
Chris Wilson, Kansas Building Industry
Wess Galyon, Wichita Area Builders Assoc
Bobbie Flory, Lawrence Home Builders Assoc
Bob Watson, City of Overland Park

Others attending:
See Attached List

Chairman Edmonds opened the meeting calling for any bill introductions. Representative Larkin wished to have a bill introduced which would repeal **SB 7**.

Hearing no objections, the Chairman accepted that bill for introduction.

He then turned the committees' attention to **HB 2897** and introduced Representative Ward Loyd as a proponent of the bill. This bill is intended to modify certain law regarding taxation of natural gas held in underground storage in Kansas. With the changes that have occurred in the way America does business in general, and those who engage in production, transmission, and delivery of natural gas in particular, and especially on the federal level, skillful lawyers have so narrowed and fashioned laws and regulations as to render no longer taxable a significant part of the traditional tax base. He urged the committee to act favorably on this bill. (Attachment 1)

Richard Cram, Department of Revenue stood to say that the Department was in support of **HB 2897**. (No Testimony)

The second proponent of **HB 2897** was Linda Terrill, Legal Counsel for Meade County. Meade County is trying to get back the tax base that they lost in the 2003 decision. Because of the way Kansas Funds schools, it is really an issue of statewide impact as we are all in the same boat when it comes to the issues affecting the tax base in Kansas. (Attachment 2) Ms. Terrill also submitted a copy of a case currently before the Supreme Court of Kansas regarding application of Central Illinois Public Services Company, et al., for exemption from Ad Valorem Taxation in Meade. (Attachment 3)

Bill Waters from the Department of Revenue, Division of Property Valuation addressed the committee in

support of **HB 2897** stating that this bill broadens the tax base by requiring the state assessment of stored natural gas owned by non-resident public utilities. (Attachment 4)

Assistant General Counsel for League of Kansas Municipalities, Larry Baer as its intent is to fix a condition that allows certain types of property to escape taxation. The League believes in fair and equal taxation of property. (Attachment 5)

Next to appear in support of **HB 2897** was Thomas Fuhrmann, County Appraiser for Morton County. Mr. Fuhrmann stated that he would hesitate to say how much money the passage of this bill would generate. Information at this time indicates the storage capacity ranging from 4 million cubic feet, provided by CIG, to 22 million cubic feet, estimated by the U.S. Department of Energy. (Attachment 6)

John Pinegar representing Kansas Legislative Policy Group strongly supports the preservation of the tax base for all counties and also encourages the elimination of all exemptions. Passage of **HB 2897** would be another step in this endeavor. (Attachment 7)

There were no more proponents and the Chairman opened the floor to opponents of **HB 2897** recognizing E.R. (Dick) Brewster, Government Affairs Director BP America Inc. The bill makes two changes in current law. The first change is in Section 1, (a) of K.S.A. 79-201f, and it is the repeal of the so-called "Freeport law," which specifically exempts from property taxes property moving in interstate commerce through, or over, the state. The second amendment of current law appears on page 2 of the bill, in lines 16 through 20. These changes modify the definition of "public utility". In his testimony Mr. Brewster provided information regarding the changes in the amendments which bring concern. (Attachment 8)

Ron Gaches representing El Paso, Northern Natural Gas, and Southern Central Pipeline, submitted comments in opposition to **HB 2897**. In his comments he stated that nobody is going to want to claim any gas that is stored in Kansas if we impose a new tax on gas stored here. Telling gas storage companies that they have to change the way they operate in Kansas for the purpose of identifying whose gas is stored where will only further drive up the cost of storage in Kansas and expand the negative impacts of this bill. (Attachment 9)

Addressing the committee in opposition of **HB 2897**, was Tom Whitaker, Executive Director of the Kansas Motor Carriers Association. Removal of this exemption would seem to allow Kansas to tax property moving through Kansas in interstate commerce on our trucks as well as property moving on the rail system or over our heads in airplanes. The US Commerce Clause prohibits the imposition of a state tax that discriminates or unduly burdens interstate commerce, thereby impeding free private trade in the national marketplace. Elimination of paragraph (a) of K.S.A. 79-201f would open the door to unfair taxation in Kansas and sends a bad message to businesses shipping goods through Kansas. (Attachment 10)

Jack Glaves testifying on behalf of Panhandle Energy in opposition to **HB 2897** stating that this bill would require the conclusion that natural gas held in federally-regulated storage facilities, which is"in interstate commerce", is subject to local ad valorem taxes, unlike all non-public utility merchants inventory, which is tax free under the Kansas Constitution. If every county through which that gas moves could tax it, the consumer would be a hapless victim of "the power to destroy. (Attachment 11)

Randall Allen, Kansas Association of Counties submitted written testimony in support of **HB 2897** (Attachment 12) as well as written testimony from Morton County Commissioners also in support of the bill (Attachment 13)

Chairman Edmonds closed the hearing on **HB 2897** and opened the hearing on **HB 2834**.

Representative Doug Patterson was recognized submitting testimony in support of **HB 2834.** In his testimony, Representative Patterson stated that the bill does the following:

1. Authorizes the imposition of a development excise tax.
2. Requires the development excise tax to be justified.
3. Projections on how the proceeds of the development excise tax will be used are required.
4. There will be accountability for the usage of this tax.

He further stated that this seems fair to him. (Attachment 14)

KBIA (Kansas Building Industry Association) was represented by Chris Wilson in favor of **HB 2834**. Ms. Wilson's related that the KBIA represents over 2600 members involved in the state's residential building industry. This bill would require that municipalities provide information regarding how excise taxes are calculated and how the funds collected are spent. Currently, excise taxes are collected and spent without such information available to the public. (Attachment 15)

Wess Galyon, President/CEO of the Wichita Area Builders Association also appeared before the committee in support of **HB 2834**. Mr. Galyon related not only what the bill does not do and what the bill does do, but also that they feel it is needed in order to keep municipalities consistently accountable with regard to the imposition of such taxes in accordance with claims made them they are justified and that the monies will be used for the purposes for which they are collected, and to prevent municipalities from using funds collected for some unrelated purpose at some future point subsequent to the imposition of such a tax. (Attachment 16) Mr. Galyon also submitted for committee review written testimony from Richard Standrich, Mayor of Derby, Kansas. (Attachment 17)

Next to come before the committee in support of **HB 2834** was Bobbie Flory testifying for Lawrence Home Builders Association. In her testimony she related that they support **HB 2834** because it will help limit the arbitrary nature of current excise taxes. It will mandate that municipalities provide a rationale for the tax amount other than what the community next door charge. (Attachment 18)

With no other person wishing to testify as a proponent, the Chairman recognized Larry Baer, Kansas League of Municipalities as the first opponent on **HB 2834**. He stated that the League does not know what problem or problems this bill addresses or proposes to fix. Adopting legislation where there is no specific need is not good policy. (Attachment 19)

As the final opponent to **HB 2834,** Robert Watson, City Attorney for the City of Overland Park gave testimony that related that the bill is a thinly disguised attempt to characterize cities' excise taxes as impact fees. It is their feeling that this bill is unnecessary and that the bill will confuse the law rather than clarify it because it is unclear exactly when a city would have to"prepare a document" (line 21): at the time it sets the tax rate or each time an activity triggers application of the tax rate? (Attachment 20)

With no other person wishing to address **HB 2834** the Chairman closed the hearing.

Due to lack of time, the Chairman will reschedule **HB 2540** which was also on the schedule.

A sub committee consisting of Representative O'Malley, Representative Brunk and Representative Flora was appointed to further study **HB 2834**.

The meeting was adjourned at 10:30 a.m.

HOUSE TAXATION COMMITTEE

Page ____ of ____

GUEST LIST

DATE March 18, 2004

NAME	REPRESENTING
George Petersen	KS Taxpayers Network
Ron Gaches	GBBA
Mark Lord	Meade Co
Robert J. Watson	City of Overland Park
Tom Whitaker	KS Motor Carriers Assn
Larry R Baker	UKM
Bobbie Flory	Lawr. Home Builders Assn.
Ann Durkes	DOB
Mark Schreiber	Westar Energy
Erik Sartorius	City of Overland Park

STATE OF KANSAS

WARD LOYD
123RD DISTRICT
"THE HEART OF GARDEN CITY"
E-MAIL: loyd@gcnet.com

TOPEKA

HOUSE OF
REPRESENTATIVES

COMMITTEES
CHAIR: CORRECTIONS & JUVENILE JUSTICE
JOINT COMMITTEE ON CORRECTIONS & JUVENILE JUSTICE OVERSIGHT
MEMBER: JUDICIARY
RULES AND JOURNAL
EXECUTIVE COMMITTEE, THE COUNCIL OF STATE GOVERNMENTS
CSG LEGAL TASK FORCE

TESTIMONY IN SUPPORT OF HOUSE BILL 2897

BY REPRESENTATIVE WARD LOYD

BEFORE THE HOUSE TAXATION COMMITTEE

March 18, 2004

Honorable Chairman Edmonds and Committee Members,

I appear in support of House Bill 2897, intended to modify certain law regarding taxation of natural gas held in underground storage in Kansas. Traditionally those companies which have engaged in this business, using much of our state lands in doing so, and constantly appearing before this body asking for favorable consideration of laws benefitting their conduct of business, including enactment of state criminal laws to protect their vast assets, have fallen under the umbrella of and been considered a public utility, and paid an appropriate share of taxes for the privilege of doing business in our state.

With the changes that have occurred in the way America does business in general, and those who engage in production, transmission, and delivery of natural gas in particular, and especially on the federal level, skillful lawyers have so narrowed and fashioned laws and regulations as to render no longer taxable a significant part of the traditional tax base.

Based upon the current court ruling, one local school district, USD #226, will be compelled to reimburse the state for back taxes in excess of $123,000 with the potential this amount will be approximately $300,000. And with a straight face, the utility will demand the refund, as a matter of right.

HOUSE TAXATION
Attachment 1
Date 3-18-04

RESIDENCE
1304 CLOUD CIRCLE
GARDEN CITY, KS 67846
(316) 276-7280

DISTRICT
118 W. PINE ST., BOX 834
GARDEN CITY, KS 67846
(620) 275-1415

ROOM 427-S STATEHOUSE
TOPEKA, KANSAS 66612-1504
(785) 296-7655

This is another critical year for local school districts for cash flow purposes and the required carryover in some fund budgets due to the affect of the accelerated tax collection enacted this past year. The loss of $8 to $10 million valuation will require an approximate 5 mills increase in Local Option Budget for the affected school district to maintain our current budget. The loss will also affect the amount of funds that can be raised by our 4 mill capital outlay and 1 mill recreation levies. We have a responsibility to avoid such draconian result.

To the extent the Legislature and this committee are able to address the recent court decision by favorably considering and acting on HB 2897, I would encourage doing so. Thank you.

Linda Terrill
Neill, Terrill & Embree, L.L.C.
7400 West 130th Street, Suite #130
Overland Park, Kansas 66213
Telephone: 913/814-8900
Facsimile: 913/814-8999
Email: Lterrill@ntelaw.com

HOUSE BILL 2897
TESTIMONY OF MEADE COUNTY

Mr. Chairman and members of the House Taxation Committee, thank you for this opportunity to testify in favor of HB 2897.

My name is Linda Terrill. I am a partner in an Overland Park, Kansas law firm that specializes in State & Local Tax matters. I am here representing the Meade County Board of County Commissioners.

This bill requires a short amount of background. In 1986, the Kansas Constitution was amended and provided the first constitutional exemption from property tax for merchants' and manufacturers' inventory. Public utilities were separately classified. In 1989, the Kansas Supreme Court held the merchants' and manufacturers' inventory exemption applied to public utilities as well. In 1992, the Kansas voters amended the Kansas Constitution to make it clear public utility inventories were taxable.

Ironically, it was the Federal Energy Regulatory Commission that caused the next detour from taxation of public utility inventory. FERC Order 636, in the name of deregulation, dictated that the pipeline company could no longer own the natural gas in the storage field or the pipeline. As such, title to the gas in the storage fields, such as the one in Meade County, Kansas changed from the public utility pipeline to the purchasers.

Some of the new owners of gas were in-state public utilities, some were out-of-state and some were marketing companies. The out-of-state public utilities filed for an exemption. In 2003, the Kansas Supreme Court found that public utilities inventories were taxable, but that the definition of a public utility was a "state assessed" public utility. PVD did not "state assess" the out-of-state public utilities. Because PVD did not assess them, the court exempted them under the general merchant and manufacturer exemption law.

We lost the revenue from the out-of-state public utilities and could lose the rest. The 2003 decision addresses the recognition of the court that the decision may present an

HOUSE TAXATION
Attachment 2
Date 3-18-04

"equal protection" issue to the in-state public utilities. In other words, the in-state public utilities could file in federal court for equal protection and request the exemption granted to the similarly situated public utilities by the Kansas Supreme Court.

Meade County met with the Department of Revenue to determine what language in K.S.A. 79-5a01 was needed to give them authority to assess the companies that we lost in the 2003 Supreme Court decision. With the assistance of Mr. William Waters, attorney, we were able to draft the language that you see in HB2897.

The issue of deregulation may cause other issues to arise that would warrant serious consideration of the overall policy of ad valorem taxation of public utilities. K.S.A. 79-5a01 defines a public utility to include, among others, anyone who controls, manages or operates a business of "transporting or distributing to, from, through or in this state natural gas, oil or other commodities in pipes or pipelines or engaging primarily in the business of storing natural has in an underground formation . . ." The taxpayers argued that they were not "in the business of transporting, distributing, etc.," they just owned the commodity that those companies moved through their pipelines or stored in their fields. HB2897 amends the definition of public utility to now include those companies that own the commodities and will begin taxing them as state assessed public utilities.

One opponent to HB2897 telephoned me to discuss the impact of this bill on the company that he works for. He said his main opposition was that his company was a "producer" of natural gas and that "producers" have not been state assessed as a public utility since the beginning of taxation. That caused me to pause to contemplate the overall tax policy in HB2897. Then I realized HB287 is not the "change." The "change" is that his company is no longer just a "producer" of natural gas. They now own the natural resources and control them just like the "public utilities" before FERC 636. It was the "producers" and the "marketing companies" entrance into this field that has caused a reexamination of what constitutes a public utility.

The bottom line for Meade County is that we were only trying to get back the tax base that we lost in 2003 decision. Because of the way Kansas funds schools, it is really an issue of statewide impact as we are all in the same boat when it comes to the issues affecting the tax base in Kansas, wherever situated.

Thank you. As always, it is an honor.

PROPERTY TAXATION OF STORED UNDERGROUND NATURAL GAS

TIME LINE AND BACKGROUND:

NOVEMBER 1986: Kansas voters approved an amendment to Article 11, § 1 of the Kansas Constitution. Providing a new exemption from property taxation for "merchants' and manufactures' inventories."

1989: In *Colorado Interstate Gas Co. v. Bd. of County Comm'rs of Morton County*, 247 Kan. 654, 802 P.2d 854 (1990), the Kansas Supreme Court concluded that "public utilities" were merchants as that term is commonly understood, stored natural gas of "public utilities." Underground gas owned by public utilities were exempted from taxation.

NOVEMBER 1992: Kansas voters approved such an amendment to Article 11, §1 and to reverse *Colorado Interstate* and to make it clear public utility inventories were not to be exempt. Stored gas was taxable.

FERC ORDER 636: Federal Energy Regulatory Commission Order 636 provides that pipeline companies, which are Kansas public utilities, could no longer own the gas stored underground. Title to the gas passed to the pipeline's customer at the point of extraction and not at point of delivery.

0CTOBER 2003: In *Central Illinois Public Service Co. vs. Meade Co.,* Case No. 02-89432-A, the Kansas Supreme Court held that since the gas was owned by a nonresident public utility which was not assessed by PVD as a state assessed public utility, the exclusion from the merchants' and manufactures' exemption does not apply. Once again the stored gas was exempted by the Court.

276 Kan. 612, *; 78 P.3d 419, **;
2003 Kan. LEXIS 593, ***

3 of 104 DOCUMENTS

In the Matter of the APPLICATION OF CENTRAL ILLINOIS PUBLIC SERVICES COMPANY, et al., for Exemption from Ad Valorem Taxation in Meade County, Kansas.

No. 89,432

SUPREME COURT OF KANSAS

276 Kan. 612; 78 P.3d 419; 2003 Kan. LEXIS 593

October 31, 2003, Opinion Filed

PRIOR HISTORY: [***1] Appeal from the Kansas Board of Tax Appeals.

DISPOSITION: Affirmed.

LexisNexis (TM) HEADNOTES - Core Concepts:

COUNSEL: Linda A. Terrill, of Neill, Terrill & Embree, of Overland Park, argued the cause, and Benjamin J. Neill, of the same firm, was on the brief for appellant.

S. Lucky DeFries, of Coffman, DeFries & Nothern, of Topeka, argued the cause, and Jeffrey A. Wietharn, of the same firm, was with him on the brief for appellee Village of Morton.

C. Michael Lennen, of Morris, Laing, Evans, Brock & Kennedy, of Wichita, argued the cause, and Richard D. Greene, of the same firm, was on the brief for appellees Central Illinois Public Service Company, Union Electric Company, and Missouri Gas Energy.

William E. Waters, of the Kansas Department of Revenue, argued the cause and was on the brief for appellee Kansas Department of Revenue.

JUDGES: The opinion of the court was delivered by LUCKERT, J.

OPINIONBY: LUCKERT

OPINION:

[**422] [*613] The opinion of the court was delivered by LUCKERT, J.:

Appellees, who are in the business of selling and distributing natural gas in states other than Kansas, own natural gas which is stored by a contractor in an underground [***4] facility in Meade County, Kansas. Appellees sought an exemption under Article 11, § 1 of the Kansas Constitution (2002 Supp.), which exempts merchants' and manufacturers' inventories from Kansas property tax. The State Board of Tax Appeals (BOTA) granted the exemption, ruling that the appellees' natural gas inventory stored in Kansas was merchants' inventory and that the appellees were [*614] not subject to the constitutional provision which denies public utilities the merchants' inventory exemption. BOTA applied the definition of "public utilities" found in K.S.A. 2002 Supp. 79-5a01, finding that appellees did not meet the definition because they do not transport, distribute, sell, trade, or otherwise dispose of natural gas within Kansas nor are they in the business of storing gas in Kansas. Meade County appeals.

We affirm BOTA.

The parties stipulated to many of the facts, which were accepted by BOTA and set out at length in its order. Highly summarized, the stipulated facts were as follows:

Appellees Central Illinois Public Service Company, Union Electric Company, and Missouri Gas Energy are public utilities operating in Illinois and/or Missouri where they [***5] are engaged in the business of selling and/or distributing natural gas. Appellee Village of Morton is an Illinois municipal corporation which operates a gas system for the benefit of its residents. Appellee Municipal Gas Commission of Missouri is a political subdivision of the state of Missouri which purchases and distributes needed natural gas supplies on behalf of its member cities, towns, and villages.

None of the appellees deliver, sell, trade, or otherwise dispose of natural gas within the state of Kansas; therefore, they are not state-assessed public utilities under K.S.A. 2002 Supp. 79-5a01. All of the appellees purchase natural gas from various producers and marketers and take title to the gas upon delivery to the interstate gas system owned and operated by Panhandle Eastern Pipe Line Company (Panhandle). Pursuant to contract, some of the gas purchased by the appellees is placed in storage in Meade County by Panhandle for withdrawal on a seasonal and scheduled basis. Under federal regulations, the appellees cannot designate the storage location and have no specific knowledge of the location.

When Meade County assessed and taxed appellees' stored [***6] natural gas inventories for the tax year 2000, appellees filed tax exemption applications and tax grievances with BOTA. The Director of Property Valuation (PVD) was joined in the actions as a necessary party. After a hearing, BOTA ruled that because appellees are not public utilities as defined by K.S.A. 2002 Supp. 79-5a01 their [*615] natural gas inventories are exempt from taxation under K.S.A. 79-201m as merchants' inventory. BOTA did not address the appellees' alternative arguments that their natural gas inventories were eligible for the "freeport" exemption pursuant to K.S.A. 79-201f or the municipalities' exemption pursuant to [**423] Article 11, § 1(b) of the Kansas Constitution (2002 Supp.).

BOTA denied Meade County's petition for reconsideration, and Meade County timely appealed. The appeal was transferred to this court on its own motion pursuant to K.S.A. 20-3018(c).

Did BOTA Err in Determining that Appellees Were Not Public Utilities and Therefore the Public Utility Exception to the Merchants' Inventory Exemption Did Not Apply?

Meade County argues that BOTA erroneously interpreted [***7] the public utility exception provided for in the merchants' and manufacturers' inventory property tax exemption provision of Article 11, § 1 (2002 Supp.). Specifically, Meade County argues that by applying statutory definitions of "public utility" to Article 11 of the Kansas Constitution (2002 Supp.) BOTA impermissibly limited the scope of the constitutional provision that denies the merchants' inventory exemption to public utilities. Instead of relying upon the statutory definition of "public utility," Meade County contends that a common understanding of "public utility" should be applied and that under this standard appellees would be viewed as public utilities since they distribute, sell, or trade natural gas in their home states. Further, Meade County argues that the legislators and voters intended for public utility inventory to be taxed, and BOTA's ruling contravenes this intent.

The standard of review this court must apply in considering these arguments is defined by the Kansas Judicial Review Act and Civil Enforcement of Agency Actions. K.S.A. 74-2426(c); see *In re Tax Application of Lietz Constr. Co.*, 273 Kan. 890, 896, 47 P.3d 1275 (2002). [***8] As applicable to this case, the KJRA provides that this court may grant relief from an order of BOTA only if it determines that BOTA has erroneously interpreted or applied the law, or that BOTA's action, or the statute upon which its action is based, is unconstitutional. K.S.A. 77-621(c)(1), (4).

[*616] This court has further stated: "BOTA is a specialized agency that exists to decide taxation issues, and its decisions are given great weight and deference when it is acting in its area of expertise. However, if BOTA's interpretation is erroneous as a matter of law, appellate courts will take corrective steps. [Citation omitted.]" *In re Appeal of Intercard, Inc.*, 270 Kan. 346, 349, 14 P.3d 1111 (2000).

When construing tax statutes, statutes that impose the tax are to be construed strictly in favor of the taxpayer. Tax exemption statutes, however, are to be construed strictly in favor of imposing the tax and against allowing the exemption for one who does not clearly qualify. *Presbyterian Manors, Inc. v. Douglas County*, 268 Kan. 488, 492, 998 P.2d 88 (2000).

The provision construed by BOTA and at issue in this case is Article 11, [***9] § 1 of the Kansas Constitution (2002 Supp.). Article 11, § 1 was amended in 1986 to create a new exemption from property taxation for merchants' and manufacturers' inventory. L. 1985, ch. 364, sec. 1. In 1988, the legislature enacted K.S.A. 1988 Supp. 79-201m to implement the exemption. At that time, the statute reiterated that merchants' and manufacturers' inventory was exempt from all property or ad valorem taxes and defined the terms "merchant," "manufacturer," and "inventory." There was no mention of public utilities. L. 1988, ch. 375, sec. 2.

The issue of whether the exemption applied to the inventory of public utilities reached this court in 1990 when we determined that natural gas owned by public utilities and stored for resale came within the exemption for merchants' inventory. *Colorado Interstate Gas Co. v. Board of Morton County Comm'rs*, 247 Kan. 654, 802 P.2d 584 (1990). This court found that the appellant public utilities were merchants under K.S.A. 79-201m because they were in the business of buying and selling natural gas and severed natural gas was tangible personal property. 247 Kan. at 661. [***10] Although we

recognized that the 1986 constitutional amendment was not intended to exempt public utility inventories from taxation, we nonetheless [**424] found that the clear language of the amendment had that effect.

"The problem here is that in enacting the proposed constitutional amendment the legislature determined the size of the mesh in the net and the requisite number [*617] of voters approved the mesh size. The mesh size is thus fixed in the constitution. The fact that unintended varieties of fish may pass through the mesh has little bearing on anything.

"Under the circumstances, this court can only apply the clear language of the amendment. . . .

"In the case before us, we are primarily concerned with the amendment itself and what persons of common understanding would imply from the words used therein." 247 Kan. at 662.

During the pendency of the *Colorado Interstate Gas* proceedings, the legislature amended K.S.A. 1988 Supp. 79-201m, effective December 8, 1989, to make the merchants' and manufacturers' inventory exemption inapplicable to the tangible personal property of a public utility as defined by K.S.A. 79-5a01 [***11] . We noted the amendment in reaching our decision in the *Colorado Interstate Gas* case, but because the case involved BOTA decisions which predated the statutory amendment, we did not address the validity or effect of the amendment. 247 Kan. at 658-59.

In 1992, Kansas voters approved another amendment to Article 11, § 1 of the Kansas Constitution (2002 Supp.). The amendment denied public utilities the merchants' and manufacturers' inventory exemption and, thus, made the constitution consistent with the previously adopted statute, K.S.A. 1988 Supp. 79-201m. The 1992 amendment read as follows:

"*(b)* All property used exclusively for state, county, municipal, literary, educational, scientific, religious, benevolent and charitable purposes, farm machinery and equipment, *merchants' and manufacturers' inventories, other than public utility inventories included in subclass (3) of class 2* . . . livestock, and all household goods and personal effects not used for the production of income, shall be exempted from property taxation." (Emphasis added to show amendment.) L. 1992, ch. 342, sec. 1.

Subclass (3) of class 2 consisted of "public utility [***12] tangible personal property including inventories thereof, except railroad personal property . . . ." At that time and today, the statute enabling the taxation upon the various classifications of property restated that subclass (3) of class 2 was public utility tangible property and added: "As used in this paragraph, 'public utility' shall have the meaning ascribed thereto by K.S.A. 79-5a01 and amendments thereto." K.S.A. 79-1439(b)(2)(C).

[*618] K.S.A. 2002 Supp. 79-5a01 defines "public utility" in relevant part as follows:

"(a) As used in this act, the terms 'public utility' or 'public utilities' shall mean every individual, company, corporation, association of persons, lessees or receivers that now or hereafter are in control, manage or operate a business of:

. . . .

"(4) transporting or distributing *to, from, through or in this state* natural gas, oil or other commodities in pipes or pipelines, or engaging primarily in the business of storing natural gas in an underground formation." (Emphasis added.) K.S.A. 2002 Supp. 79-5a01.

Panhandle met this definition of public utility [***13] and so paid the property tax on the stored natural gas until tax year 1999. Then, the Federal Energy Regulatory Commission (FERC) issued FERC Order 636 which unbundled the interstate pipeline industry and prohibited Panhandle from owning the stored gas. Under FERC Order 636, title to the severed natural gas passed to the customer upon delivery of the gas to the storage system. Consequently, Panhandle stopped paying tax on the stored gas.

Once FERC Order 636 was effective, title to the natural gas lay with the appellees, who are not public utilities as defined in K.S.A. 2002 Supp. 79-5a01. The parties stipulated that the appellees are not state-assessed public utilities pursuant to this statute. Additionally, based upon the stipulated facts regarding the appellees' business practices, [**425] BOTA found that none of the appellees met the statutory definition of public utilities contained in K.S.A. 2002 Supp. 79-5a01. The plain language of the statute requires that a company be engaged in the business of transporting or distributing natural gas to, from, or within the state of Kansas, or that a company be engaged in storing natural gas in [***14] an underground formation. Appellees did none of these things, their only connection with Kansas being that they contracted with Panhandle to store their natural gas.

Because the appellees did not meet the statutory definition of public utilities, the appellees sought application of the merchants' inventory exemption. After hearing the parties' arguments and considering the history of the provisions, BOTA concluded "that a construction of the term 'public utilities' contained within the constitutional [*619] amendment must be consistent with other statutes in effect at the time of the amendment's proposal and passage." BOTA concluded it would apply the definition of "public utilities" found in K.S.A. 2002 Supp. 79-5a01, stating that it "declines to

construe the term 'public utilities' as contained in the constitutional amendment in a manner inconsistent with well-established legislative definition."

In making its argument that BOTA should not apply the definition of "public utility" in K.S.A. 2002 Supp. 79-5a01, Meade County cites *Colorado Interstate Gas* wherein this court stated that the constitutional provision exempting merchants' [***15] and manufacturers' inventory from taxation is self-executing. The court quoted 16 Am. Jur. 2d, Constitutional Law § 139 *et seq.*, which states:

"'It is clear that legislation which would defeat or even restrict a self-executing mandate of the constitution is beyond the power of the legislature. Also, the legislature is neither required nor permitted to enact laws purporting to confer rights in excess of and different from those contemplated by the constitution. A liability imposed by a self-executing provision is absolute and not subject to legislative enlargement or lessening or restriction as to manner of enforcement.'" 247 Kan. at 659-60.

Relying upon this holding, Meade County argues the legislature could not limit the definition of "public utility" more narrowly than the meaning the term would have to people of common understanding. What this argument ignores is that, although the exemption of merchants' and manufacturers' inventory is self-executing, the exclusion of public utility inventories from the exemption refers to those "public utility inventories included in subclass (3) of class 2." Kan. Const. art. 11, [***16] § 1(b) (2002 Supp.); K.S.A. 79-201m. Article 11, § 1(a) provides that "tangible personal property shall be further classified into six subclasses, *shall be defined by law for the purpose of subclassification* and assessed uniformly as to subclass . . . ." (Emphasis added.)

Accordingly, the legislature does have some authority to define what constitutes "public utility tangible personal property." Even so, as we stated in *Colorado Interstate Gas*, the legislature's definition must conform to the commonly understood meaning of the term.

[*620] "A constitutional provision is not to be narrowly or technically construed, but its language should be interpreted to mean what the words imply to men of common understanding. [Citation omitted.] A constitution should not be interpreted in any refined or subtle sense, but should be held to mean what the words imply to the common understanding of men. [Citation omitted.] When interpreting the constitution, each word must be given due force and appropriate meaning. [Citation omitted.]" 247 Kan. at 660.

This court applied this rule of construction in *State ex rel. Stephan v. Parrish*, 256 Kan. 746, 762, 887 P.2d 127 (1994), [***17] in considering whether statutes creating "instant bingo" were unconstitutional. In 1974, Kansas voters adopted a constitutional amendment to permit games of bingo to be conducted by certain nonprofit organizations. The 1975 legislature then enacted enabling legislation defining the term "bingo." In 1993, the legislature enacted a bill authorizing "instant bingo."

[**426] The State argued that instant bingo was not a game of bingo as intended by voters in 1974; rather, it was merely another form of lottery prohibited under the Kansas Constitution. This court agreed, holding that the legislative definition of the constitutional term "games of bingo" must bear a reasonable and recognizable similarity to generally accepted definitions and the common understanding of the term by the people of Kansas. This court referred to the legislature's definition of bingo in the 1975 enabling legislation, stating:

"The legislature . . . defined bingo in 1975 in K.S.A. 1975 Supp. 79-4701(a), and in doing so carefully described traditional or call bingo. It is logical to assume that in doing so, the legislature, representing the people of Kansas, defined bingo as it was commonly understood [***18] by the voters when they approved Art. 15, § 3a of the constitution." 256 Kan. at 761.

Similarly, in this case the legislature, representing the people of Kansas, defined public utility to include only those entities doing business in Kansas. In contrast to the situation at issue in *Parrish,* such a definition was not an attempt to avoid a constitutional provision by defining a constitutional term in a manner different from the common understanding.

Other rules of constitutional construction applied in *Colorado Interstate Gas* also support BOTA's construction of the provision.

[*621] "'In ascertaining the meaning of a constitutional provision, the primary duty of the courts is to look to the intention of the makers and adopters of that provision.' Syl. P 2.

"'In interpreting and construing the constitutional amendment, the court must examine the language used and consider it in connection with the general surrounding facts and circumstances that cause the amendment to be submitted.' Syl. P 3." 247 Kan at 660 (quoting *Board of Wyandotte County Comm'rs v. Kansas Ave. Properties*, 246 Kan. 161, 786 P.2d 1141 [1990]).

In determining whether [***19] the term "merchants or manufacturers" as used in the 1986 constitutional amendment was intended to encompass

public utilities, this court stated: "Realistically speaking, it is highly unlikely that many 1986 Kansas voters spent much time meditating on whether public utilities could come within the term 'merchants or manufacturers.' The test is, however, what meaning people of common understanding would give to the words in question." 247 Kan. at 660.

Similarly, in this case, it is unlikely that many 1992 Kansas voters considered whether the term "public utilities" included only in-state companies or also out-of-state companies. It also seems unlikely that the legislature considered the issue. Nothing in the legislative history of the 1992 constitutional amendment indicates that the legislature considered the problem of whether nonresident public utility inventory stored in Kansas should be taxed. In fact, the problem was nonexistent until after that constitutional amendment was adopted. However, the legislature had consistently utilized the definition in K.S.A. 2002 Supp. 79-5a01.

Additionally, when we consider the language in connection with [***20] the general surrounding facts and circumstances that caused the amendment to be submitted we conclude that it was intended that the constitutional provision would be consistent with the statutes which defined "public utility."

Furthermore, "[a] statute and pertinent constitutional provisions must be construed together with a view to make effective the legislative intent rather than to defeat it." *Hunt v. Eddy*, 150 Kan. 1, 5, 90 P.2d 747 (1939). In this case, the only way of ascertaining legislative intent is to look at the statutes in existence at the time the constitutional amendment was proposed and adopted. As persuasively [*622] argued by appellee and concluded by BOTA, all of those statutes referred to public utilities as defined by K.S.A. 2002 Supp. 79-5a01.

Thus, the various rules of constitutional construction lead to the conclusion that Meade County's proposed construction should be rejected and the term "public utilities" [**427] found in Article 11 of the Kansas Constitution (2002 Supp.) should be construed in a manner consistent with K.S.A. 79-201m, K.S.A. 79-1439, and K.S.A. 2002 Supp. 79-5a01 [***21] . Thus, BOTA did not err in concluding that appellees were eligible for exemption relief pursuant to K.S.A. 79-201m and that the appellees' stored natural gas inventory is exempt from property taxation.

Does BOTA's Interpretation Result in an Equal Protection Violation?

Meade County next argues that BOTA cannot do by interpretation what the legislature could not do directly, that is, treat members of the same class differently. Under BOTA's interpretation of the law, the natural gas inventory of Kansas public utilities is taxed, while the natural gas inventory of non-Kansas public utilities is not taxed. Meade County argues that this unequal treatment violates the uniform and equal rate of assessment and taxation clause of Article 11, § 1 of the Kansas Constitution (2002 Supp.).

An initial question is whether Meade County has standing to raise an equal protection challenge. One who challenges the validity of state taxation as violating the Equal Protection Clause "cannot rely on theoretical inequalities, or such as do not affect him, but must show that he is himself affected unfavorably by the discrimination of which he complains." *Roberts & Schaeffer Co. v. Emmerson*, 271 U.S. 50, 55, 70 L. Ed. 827, 46 S. Ct. 375 (1926). [***22] Clearly, if an equal protection violation exists, it would be tax-paying Kansas public utilities that have standing to bring such a challenge. And, if such a challenge were to succeed, the remedy would be to relieve Kansas public utilities from paying the tax, not to impose a tax on nonresident utilities for which the statutory taxation scheme does not provide.

[*623] However, we also recognize that this court has a duty to construe a statute as constitutionally valid if there is any reasonable way to do so. *In re Tax Application of Lietz Constr. Co.*, 273 Kan. 890, Syl. P 8, 47 P.3d 1275 (2002). Therefore, we will consider the argument although we are hindered in doing so because, beyond citing *State ex rel. Stephan v. Parrish*, 257 Kan. 294, 891 P.2d 445 (1995), Meade County offers little analysis in support of this argument and appellees do not address the argument.

In *Parrish*, this court quoted *Topeka Cemetery Ass'n v. Schnellbacher*, 218 Kan. 39, 542 P.2d 278 (1975), as follows:

"'We have consistently held that where public property is not involved, a tax exemption must be based upon the use of the property and not on the basis of [***23] ownership alone. The reason for the rule is that a classification of private property for tax purposes based solely upon owners unlawfully discriminates against one citizen in favor of another and therefore is a denial of equal protection of the law.'" 257 Kan. at 303.

However, if there is a rational basis for the disparate treatment, other than simply ownership, classification of property based solely upon ownership would pass constitutional muster. See *Parrish*, 257 Kan. at 302-04. Furthermore, it is unnecessary to determine the actual legislative purpose; rather, "if any state of facts reasonably may be conceived to justify the alleged statutory discrimination, the statute will not be set aside as a violation of equal protection. [Citation omitted.]" *Leiker v. Gafford*, 245 Kan. 325, 364, 778 P.2d 823

(1989), *overruled in part on other grounds Martindale v. Terry,* 250 Kan. 621, 629, 829 P.2d 561 (1992).

There is no basis to discern the legislative purpose since, as previously discussed, there is no reason the legislature would have contemplated the distinction between Kansas and out-of-state utilities. Therefore, [***24] we consider whether any state of facts reasonably may be conceived to justify the alleged statutory discrimination.

One possible rational basis for favorable tax treatment of nonresidents was recognized by the United States Supreme Court in *Allied Stores of Ohio v. Bowers*, 358 U.S. 522, 3 L. Ed. 2d 480, 79 S. Ct. 437, 82 Ohio Law Abs. 312 (1959). This court cited to *Bowers* in *State ex rel. Tomasic v. Kansas City, Kansas Port Authority*, 230 Kan. 404, 636 [*624] P.2d 760 (1981), for a [**428] statement of the principles governing state taxation and equal protection.

"In [*Bowers*], an Ohio statute exempted from ad valorem taxation merchandise warehoused by nonresidents if it were held in a storage warehouse for storage only. Plaintiff, a resident who operated several department stores and maintained warehouses for his merchandise, claimed denial of equal protection. In rejecting the challenge, the Supreme Court noted the states are subject to the Equal Protection Clause in the exercise of their taxing power but enjoy wide discretion nonetheless. The court observed the Equal Protection Clause 'imposes no iron rule of equality, prohibiting the flexibility and variety that are [***25] appropriate to reasonable schemes of state taxation.' 358 U.S. at 526. The state taxation scheme must have a rational basis with classifications based on differences having a fair and substantial relation to the object of the legislation. In *Allied Stores of Ohio* the court found 'a statute which encourages the location within the State of needed and useful industries by exempting them, though not also others, from its taxes is not arbitrary and does not violate the Equal Protection Clause of the Fourteenth Amendment.' 358 U.S. at 528." 230 Kan at 425.

The *Bowers* rationale could be applied in Kansas. See *State ex rel. Tomasic v. City of Kansas City*, 237 Kan. 572, Syl. P 13, 701 P.2d 1314 (1985) (holding that the uniform and equal rate of assessment and taxation provision of Article 11, § 1 (2002 Supp.) "is, in principle and effect, substantially identical to the principle of equality embodied in the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution.")

Also, because the FERC regulations and appellees' contract with Panhandle give appellees little or no control over where the severed [***26] natural gas is stored or for how long, there is a rational basis to determine that it would be unfair and, at least arguably, a potential violation of the Commerce Clauseto tax the severed natural gas of a public utility that has no dealings with Kansas consumers.

Because we can conceive of several rational bases for the distinction between utilities regulated in Kansas and those which are not, we reject Meade County's argument.

The parties raise other arguments relating to the power of Meade County to assess the property, the application of the "freeport" exemption contained in K.S.A. 79-201f, application of the exemption for municipalities, and the constitutionality of the public utilities exclusion to the merchants' and manufacturers' exemption. [*625] However, because we affirm BOTA's ruling that appellees are not public utilities as defined by K.S.A. 2002 Supp. 79-5a01 and that their natural gas inventories are therefore exempt from taxation under K.S.A. 79-201m as merchants' inventory, none of the remaining arguments need be addressed.

Affirmed. [***27]

K A N S A S

JOAN WAGNON, SECRETARY

KATHLEEN SEBELIUS, GOVERNOR

DEPARTMENT OF REVENUE
DIVISION OF PROPERTY VALUATION

MEMORANDUM

TO: Representative John T. Edmonds, Chairman
House Committee on Assessment & Taxation

FROM: Mark S. Beck
Director of Property Valuation

DATE: March 17, 2004

SUBJECT: House Bill 2897

House Bill 2897 broadens the tax base by requiring the state assessment of stored natural gas owned by non-resident public utilities.

In the past, state-assessed natural gas pipelines generally owned the stored natural gas and; thus, the gas was subject to state valuation and assessment. Because the Federal Energy Regulatory Commission ("FERC") now prohibits pipelines from owning stored natural gas, the pipelines have divested themselves of its ownership. Resident power companies, which are state assessed, and non-resident power companies, which are not state assessed, now own the stored natural gas.

The Kansas Supreme Court, in *In re Tax Exemption Application of Central Illinois Public Services Co.,* 276 Kan. 612 (2003), found no statutory or constitutional authority for the assessment of stored natural gas owned by a non-resident power company. Resident power companies that are state-assessed pubic utilities remain unaffected by the Court's decision.

This bill amends K.S.A. 79-5a01 to encompass all companies that own natural gas within the definition of a "public utility" for property tax purposes, and requires its assessment by the state. Thus, if approved, this bill will require the state assessment of stored natural gas whether owned by a resident public utility or a non-resident public utility.

Art. 11, § 1 of the Kansas Constitution authorizes the legislature to define what property is to be included in the property tax subclasses established by the Constitution. In its opinion, the Kansas Supreme Court held that such definitions must conform to the commonly understood meaning of

HOUSE TAXATION
Attachment 4
Date 3-18-04

the term "public utility." In accord is Attorney General Opinion 99-21 ("The Legislature may under Article 11, Section 1 of the Kansas Constitution, define the term "public utility" for purposes of property tax classification, as long as the legislative definition remains consistent with the commonly understood meaning of the term.") This bill, in the opinion of the Department, comports with the commonly understood meaning of the term "pubic utility."

LKM
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Date: March 18, 2004

To: House Committee on Taxation

From: Larry R. Baer
Assistant General Counsel

Re: HB 2897 - Testimony in Support

Thank you for allowing me to appear before you today on behalf of the League of Kansas Municipalities and its member cities and present testimony in support of HB 2897.

As we understand HB 2897, its intent is to fix a condition that allows certain types of property to escape taxation. The League believes in fair and equal taxation of property. We do not believe that a taxpayer should be permitted to escape taxation because of either a loophole or an error in the tax law. To do so is an erosion of the property tax base for both the state and local governments.

The League supports HB 2897 and would encourage the Committee to pass the matter out favorably.

Again, thank you for allowing me to appear here today.

I will stand for question when appropriate.

HOUSE TAXATION
Attachment 5
Date 3-18-04

Testimony
on
House Bill No. 2897
By
Thomas J. Fuhrmann

Mr. Chairman and Members of the Committee:

Thank you for allowing me to appear before you in support of House Bill No. 2897.

My name is Tom Fuhrmann and I am the Morton County Appraiser.

Morton County has two underground gas storage facilities, the Richfield and the Boehm. My understanding is that the Richfield facility is not being used at this time. The Boehm facility generates no tax dollars on the gas stored in it. Based on conversation with an employee of Colorado Interstate Gas Company in Denver, most, if not all, of the gas stored in the Boehm facility is owned by public service companies in Colorado.

I hesitate to estimate the amount of tax dollars the passage of this bill may generate. Information available at this time indicates the storage capacity ranging from 4 million cubic feet, provided by CIG, to 22 million cubic feet, estimated by the U.S. Department of Energy. Estimated tax revenues from either end of this range would be beneficial to Morton County.

I will be glad to stand for questions.

Respectfully submitted,

Thomas J. Fuhrmann

Thomas J. Fuhrmann
County Appraiser
Morton County

HOUSE TAXATION
Attachment 6
Date 3-18-04

KANSAS LEGISLATIVE POLICY GROUP
P.O. Box 555 • Topeka, Kansas 66601 • 785-235-6245 • Fax 785-235-8676

TESTIMONY
BEFORE THE HOUSE COMMITTEE ON TAXATION
REGARDING
HOUSE BILL 2897
KANSAS LEGISLATIVE POLICY GROUP
By: John D. Pinegar

Mr. Chairman and Members of the Committee:

I am John Pinegar, representing Kansas Legislative Policy Group (KLPG). KLPG is an organization whose members are county commissioners from 35 western counties in Kansas.

In behalf of KLPG, I encourage your consideration and passage of House Bill 2897. Passage of this bill would be beneficial to those counties in which the underground gas storage facilities are located. At one time all the gas stored in these facilities was taxed, however through unintentional wording in legislation it became exempt.

KLPG strongly supports the preservation of the tax base for all counties and also encourages the elimination of all exemptions. Passage of this bill would be another small step in this endeavor.

Thank you for your time and consideration of this matter.

HOUSE TAXATION
Attachment 7
Date 3-18-04

Comments on House Bill No. 2897

Thursday, March 19, 2004

Before the:

Kansas House Committee on Taxation

Submitted by:

E. R. (Dick) Brewster
Government Affairs Director
For
BP America Inc.

Mr. Chairman, Members of the Committee, for the record I am Dick Brewster, Government Affairs Director for BP America Inc.

I appreciate the chance to comment on House Bill No. 2897, and appear before you today in opposition to passage of this proposed legislation.

The bill makes two changes in current law, and I'd like to review each of them, review the reasons we oppose each one, and then respond to any questions of comments.

The first change is in Section 1, (a) of K.S.A. 79-201f, and it's the repeal of the so-called "Freeport law," which specifically exempts from property taxes property moving in interstate commerce through, or over, the state.

Its been suggested that this provision is meaningless since, because of the commerce clause of the U.S. Constitution, property moving in interstate commerce is not subject to Kansas property taxation in the first instance. Frankly, we believe the issue is more complex than that. There are certain tests, which if met, will allow the taxation of property that might be in interstate commerce. And subsections (b) and (c) of the existing statute provide further definition of the Freeport law, and how it operates.

We urge you to leave this provision in current law, and not accept this change. If it doesn't matter, there is no need to repeal it. And repeal of this decades old provision will send unwelcome messages to the business community. Unless a person reading this bill were well versed in commerce clause law, this repeal would indicate that Kansas intended to at least attempt to levy a property tax on property moving in interstate commerce through or over the state.

The second amendment of current law appears on page 2 of the bill, in lines 16 through 20. These changes modify the definition of "public utility." While business inventories of merchants and manufacturers are exempt from property taxes by state constitutional provision, specifically, inventories of public utilities are not exempt. This change is an attempt to allow the property taxation of natural gas in storage in Kansas, regardless of who owns it, and it attempts to accomplish this effort by defining as a public utility, anyone who owns, controls and holds for resale, natural gas stored in Kansas.

We have a number of concerns about this amendment. First, the definition proposed by House Bill 2897 would include natural gas producers who have gas on pipeline systems with storage in Kansas. But in fact, natural gas producers are not utilities. Natural gas producers manufacture (produce), and merchandise natural gas to public utilities and other end users. What we do is much more akin to the activities of merchants and manufacturers than to the activities of utilities. We have no "territory," no rate of return, no right of eminent domain, no way to pass along taxes assessed against gas which might or might not be in a storage cavern in Kansas on any given date. We are

not regulated by state corporation commissions or similar regulatory agencies, and we are not regulated by FERC.

I realize that the legislature has the power to define terms. But with regard to a term used in the state's constitution, as the Supreme Court said in the case giving rise to this legislative proposal, the definition must bear "a reasonable and recognizable similarity to generally accepted definitions and the common understanding of the term...." The business of producing and marketing natural gas simply bears no reasonable similarity to the business of a utility. Producers and marketers don't walk like a duck, don't quack like a duck, and simply are not ducks. And the constitution of Kansas allows taxation of inventories held by utilities, or ducks, not anyone else. We submit that the definition of utilities in H.B. 2897 over reaches and is not consistent with the state's constitutional provisions.

In years past, in some ways, Kansas has had the best of all worlds. Pipelines purchased gas from producers at the wellhead. Gas in storage was clearly owned by one entity, the pipelines. Property taxes were paid on stored gas by the regulated pipelines and the taxes were passed along to users of the gas out of state, and with Kansas as a net gas exporter, users in other states paid much of the cost of these taxes. So, what has changed? Merely the ownership of the gas. But that is a significant change. This gas is now owned by a manufacturer, or merchandiser, it is no longer owned by a public utility. And it's the Kansas constitution that makes this difference important.

We believe there are other reasons Kansas should not attempt to tax this gas. Under the current scheme of gas transportation and delivery, these pipelines are subject to federal jurisdiction; regulation by FERC (Federal Energy Regulatory Commission). Under federal law, this jurisdiction rests exclusively with FERC, and FERC jurisdiction over transportation of natural gas includes storage. The federal law was enacted under authority of the commerce clause. A state tax violates the commerce clause if there is no substantial nexus with the taxing state. And, a substantial nexus requires something more than mere presence in a state due to interstate transportation. Quill Corporation v. North Dakota, 504 U.S. 298, 313 (1992). And gas stored in Kansas is an essential part of the interstate transportation of the gas. There is no substantial nexus of this gas in Kansas because the flow of gas from the wellhead to the consumer is considered a continual flow, even if interrupted by certain events. Maryland v. Louisiana, 451 U.S. 725, 755-56 (1981).

Perhaps we can look at storage facilities as a large bubble in the gas pipeline. And the ability to store gas is essential to providing adequate gas supplies to the nation during times of increased demand. The transportation pipelines essentially have a monopoly. The pipelines transport gas under rates subject to FERC approval, and the gas producer essentially has no control of where, or indeed, whether that gas is placed in a storage cavern in Kansas or any other state. We may nominate a certain volume of gas to a pipeline in, for example, southern Colorado. At the same moment, we may sell, and have the pipeline deliver the same volume of gas to a local distribution utility, or other end user. This delivery point could even be upstream from our production area. The gas

we're talking about then, will never enter the state of Kansas. Yet, if that pipeline has storage in Kansas, we may be "allocated" a share of the storage volume because we have volume in the pipeline system, and under the provisions of this bill, be taxed on that allocation of gas which never came close to the Kansas border.

FERC has stated that "Displacement of gas in the system is what effectuates transportation, not the actual movement of specific molecules of gas from receipt point to delivery point.... Any gas leaving the [interstate pipeline] system is not identifiable with any gas entering the system. There is no tracing of molecules from buyer to seller...." National Fuel Gas Distribution Corporation, 93 FERC P61 (FERC 2000). In short, there is simply no way to know who owns the gas in any specific storage facility in Kansas.

The transportation and storage of gas is exclusively under the jurisdiction of FERC, under the Commerce Clause of the U.S. Constitution. The Congress has found that this jurisdiction is in the public interest and essential to the nation's welfare. We submit that House Bill 2897 should not be passed, that taxing gas in storage will interfere with the authority of FERC in its regulation of natural gas transportation, and would therefore be void under the doctrine of federal preemption.

Mr. Chairman, members of the Committee, I appreciate the chance to review these points with you and will be glad to try to answer any questions.

Gaches, Braden, Barbee & Associates

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House Tax Committee
Regarding HB 2897: Tax on Interstate Natural Gas in Storage
Comments submitted by Ron Gaches
Gaches, Braden, Barbee & Associates
On behalf of El Paso, Northern Natural Gas,
and Southern Star Central Pipeline

Thank you Chairman Edmonds and members of the Committee for this opportunity to comment on behalf of my clients regarding the proposal to impose property tax on interstate natural gas held in storage in Kansas.

First, a quick overview of the underground natural gas storage industry in Kansas. There are seven firms that provide commercial underground storage of natural gas in Kansas and they operate a total of 19 storage fields. Almost all of these are porosity storage fields, areas that previously produced natural gas and are now used to store gas that is injected into the old production field. One storage field is in bedded salt. These fields typically occupy hundreds of acres but are unseen by the public because they are hundreds or thousands of feet beneath the surface.

As a general rule, the underground storage facilities in Kansas are engaged in storage of gas for both in-state and out-of-state users. The storage fields are located near major pipelines, which are used to bring the gas to the storage field and later deliver the gas to the shipper.

Gas storage firms do not own the gas stored in their fields except for some cushion or working gas, which is maintained to operate the field efficiently. Storage firms are common carriers like railroads or interstate trucking companies and are regulated by the Federal Energy Regulatory Commission (FERC). Storage firms holding gas for interstate commerce must file their tariffs for approval by FERC and work under a FERC regulatory scheme.

The changes proposed in HB 2897 are relatively simple in their language, but have implications that pose several complex policy issues.

The first change occurs on page one, lines 18-19 where the broad statement of property tax exemption for goods moving in interstate commerce is eliminated. I don't understand the full impact of this change. The deleted language leaves in place KSA 79-201(f)(b) & (c), which are generally referred to as the warehouseman exemption, but I have no idea how broad the exemption is in (a) that is being eliminated.

HOUSE TAXATION
Attachment 9
Date 3-18-04

The second change occurs on page two, lines 16-19 and would specifically declare as a "public utility" firms or individuals that "own, control and hold for resale stored natural gas in an underground formation in this state ..."

The obvious intent is to make stored gas held for resale to be subject to property tax as public utility property, which means it would be appraised at the highest assessment level of 33%.

Apart from the obvious windfall this would provide a few local units of government, I can't think of any reason why Kansas' lawmakers should think this is good public policy.

The primary effort here is to tax the gas that moves in interstate commerce. The device to levy the tax is to reclassify the interstate natural gas from tax-exempt interstate commerce to taxable public utility property.

Certainly its attractive to levy a tax that is only paid by taxpayers who reside out of state, but what does that do to our natural gas storage and production industries?

Kansas is surrounded by underground storage competitors. There is underground storage in Texas, Arkansas, Oklahoma, Colorado, Missouri, Iowa, Illinois and Minnesota, among others. Many of these storage facilities are interconnected to the same major pipeline systems and can be used to deliver gas to major markets throughout the Midwest. And most gas storage firms operate gas storage facilities in states outside of Kansas.

The Kansas underground storage industry is already dealing with substantial costs increases caused by compliance with the new underground storage regulations passed following the Reno County natural gas explosions of 2001. The new regulatory standards are the most rigorous in the country and are imposing millions of dollars of additional costs on the storage industry. At least two of the storage locations in Kansas are being closed due to the higher cost of regulatory compliance and the final costs are still not known because the regular permit requirements haven't been finalized by the KCC Oil and Gas Conservation Division.

Natural gas is a commodity, not a public utility. Much of the gas held in Kansas storage firms is not owned by investor owned public utilities. Instead it is owned by firms that are clearly not investor owned utilities. For example: one of my clients stores gas destined for interstate delivery for Cargill, City of Duluth, Conoco, Marathon Oil Company, Mobil Natural Gas, Texaco Natural Gas, and more than a dozen energy trading firms. None of these are public utilities and the gas they own is not public utility property. The gas is a commodity that is bought and sold across interstate boundaries. In addition, they store gas for municipal owned utilities in Nebraska and Minnesota.

It is a completely true statement to say that commodities sold across interstate borders is the lifeblood of the Kansas economy. Consider for a moment what some of those products are:

- Beef cattle
- Hogs and pork products
- Chickens
- Commercial airplanes

- General aviation airplanes
- Wheat
- Corn
- Milo
- Cotton
- Oil
- Propane
- Anhydrous ammonia, and
- Natural gas (among many others)

How competitive would these products be if we eliminated the interstate commerce property tax exemption and made them subject to the Kansas property tax, especially the property tax at a 33% assessment rate? Obviously, in an open marketplace the prices of such products would be less competitive and the sale of Kansas products would decline.

I expect that is exactly what will happen should we adopt HB 2897. Kansas natural gas will be less competitive in the interstate marketplace and less Kansas gas will be sold into interstate markets. That will have an adverse impact on Kansas natural gas production and an adverse impact on Kansas severance tax proceeds on gas production.

I'm not a commodity trader and I can't forecast the actual impact of the higher taxes and lower production, but it strikes me that it could be considerable and warrants careful study before we enact such a tax.

The bill will also have obvious impacts on the economics of storing natural gas in Kansas. If storing gas in Kansas becomes more expensive to shippers because of the added property tax, we'll have less gas stored in Kansas. Less gas stored in Kansas means that the economics of each Kansas storage field will change and the higher cost of compliance with the new KCC regulations will have to be recalculated against the lower return on the field.

It's worth noting that the cost of compliance with the new KCC regulations is driven not by the volume of gas stored but by the number of injection wells and fields you operate. Operators may decide that storage is not worth maintaining. And that decision could further impact the price of natural gas for Kansas public utilities, if there is less storage available to use as a hedge against price swings.

Now, I have noted that none of the Kansas public utilities are opposing this bill. I'm told that this is because they are allowed an automatic pass through of property taxes on their natural gas. I believe the higher cost of natural gas may also be passed on in most circumstance, so higher costs for storing gas may not be an issue for utility companies, but it could be an issue for gas consumers.

There are other objections to the bill, the most obvious of which is it probably violates the Commerce Clause of the U.S. Constitution (Article I, Section 8, Clause 3) or the Supremacy Clause (Article VI, Clause 2). Case law has consistently held that a state tax may be sustained if it (1) has a substantial nexus with the state, (2) is fairly apportioned, (3) does not discriminate

against interstate commerce, and (4) is fairly related to the services provided by the state. The tax must meet all four (4) prongs to be constitutional.

In the case of Maryland, et. al v. Louisiana, 451 U.S. 725 (1981) the United States Supreme Court struck down a Louisiana tax on gas produced in the federal Outer Continental Shelf (OCS), piped to processing plants in Louisiana, and eventually sold to out-of-state consumers. The tax was meant to equalize the severance tax imposed on Louisiana producers. The Supreme Court found that the tax violated both the Supremacy Clause and the Commerce Clause of the U.S. Constitution. The tax violated the Supremacy Clause because it interfered with the federal regulatory scheme for the transportation and sale of natural gas in interstate commerce. Part of the state tax legislation purported to restrict the pipelines' recovery of the tax, which the Court found to be within the exclusive jurisdiction of FERC under the Natural Gas Act. The Court also found that the tax violated the Commerce Clause because it unfairly discriminated against producers of gas moving through Louisiana in interstate commerce.

I don't know if this bill meets the four prong tests or not. Only the federal courts can tell us for sure. But I'm pretty certain that the economic impact on Kansas' gas producers and the underground storage firms would be significant if HB 2897 became law.

There is a final issue that Kansas storage firms will have to consider should HB 2897 be approved. As unusual as it may seem, storage companies can't tell you whose gas is in which storage field. Honestly, I didn't believe this at first. How can you not know whose gas is in your storage field?

The answer reflects the true commodity nature of natural gas. It is much like a farmer who takes his wheat to the local co-op for storage. When he sells his wheat the co-op doesn't ship exactly the same kernels of wheat the farmer brought in. Rather, it ships an equivalent amount of wheat out of its storage.

Another way to think about it is to envision a community bank. A person deposits his dollars in the bank on the east side of town and cashes a check on the west side of town. He's not withdrawing exactly the same dollars he put into the bank. In fact, the dollars he put in the bank are probably long gone by the time he cashes his check.

The same is true for natural gas storage. A shipper stores gas. The storage firm delivers gas to the shipper. It's not the same gas. But it is virtually identical gas, and it may come out of any one of several storage facilities.

Storage companies manage their gas storage supplies with a variety of tools that have names you and I don't understand: deferred delivery services, pipeline line-pack fluctuations, fuel retention volumes, operational balancing agreements with interconnection system operators, load swings, and contracted system balancing agreements. I don't know what they mean or how they work. But the practical application is nobody is going to want to claim any gas that is stored in Kansas if we impose a new tax on gas stored here. And telling gas storage companies that they have to change the way they operate in Kansas for the purpose of identifying whose gas is stored where

will only further drive up the cost of storage in Kansas and expand the negative impacts of this bill.

Asking out-of-state taxpayers to pay for our public schools and local government sounds like a great proposition. But there is no free lunch. Natural gas is a commodity in interstate commerce and the market for gas will respond if we find a way to impose property taxes on interstate gas stored in Kansas. The implications for our state as a whole will be negative, not positive. I urge you to oppose passage of HB 2897.

LEGISLATIVE TESTIMONY
BY THE
KANSAS MOTOR CARRIERS ASSOCIATION

In Opposition to House Bill No. 2897

Presented before the House Taxation Committee
Representative John Edmonds, Chairman
Thursday, March 18, 2004

MR. CHAIRMAN AND MEMBERS OF THE
HOUSE TAXATION COMMITTEE:

I am Tom Whitaker, executive director of the Kansas Motor Carriers Association. I appear here this morning representing our member companies in opposition to HB 2897.

Our opposition to the bill stems from the removal of language on Page 1, lines 18 and 19. That language reads: "(a) Personal property which is moving in interstate commerce through or over the territory of the state of Kansas,".

Removal of this exemption would seem to allow Kansas to tax property moving through Kansas in interstate commerce on our trucks as well as property moving on the rail system or over our heads in airplanes.

The US Commerce Clause prohibits the imposition of a state tax that discriminates or unduly burdens interstate commerce, thereby impeding free private trade in the national marketplace. Elimination of paragraph (a) of K.S.A. 79-201f would open the door to unfair taxation in Kansas and sends a bad message to businesses shipping goods through Kansas.

We ask the Committee to report House Bill No. 2897 unfavorably. We thank you for the opportunity to appear and would be pleased to respond to any questions you may have.

HOUSE TAXATION
Attachment 10
Date 3-18-04

STATEMENT OF JACK GLAVES
IN BEHALF OF
PANHANDLE ENERGY
ON
HOUSE BILL 2897
MARCH 18, 2004

House Bill 2897 results from a Court of Appeals decision affirming BOTA's ruling that gas stored by out of state utilities in Kansas is exempt from ad valorem taxation in Kansas as "merchants' inventory". The Court held that the owners of the gas did not fit the definition of a "public utility" that was exempted by the 1992 amendment to the Kansas Constitution, which is statutorily defined in KSA 79-5(a)01. Panhandle Energy's sister company, Missouri Gas Energy, was one of the applicants before BOTA. Pan Gas Storage, another Panhandle entity, also owns the Borchers field in Meade County, which is the storage facility containing gas held for resale owned by various entities. Pan Gas Storage paid ad valorem taxes on the storage field valuation and the "cushion gas" of $2,275,000.00 to Meade County in 2003. Panhandle Eastern paid $348,000.00 on its pipeline facilities.

The Court decision simply turned on the "public utility" definition contained in the statute and, hence, it was not required to get to the overriding constitutional issues of whether or not Article 11, Sec. 1 of the Kansas Constitution, which excludes public utility inventories from the merchants inventory exemption, violates the "equal protection" mandate of the US Constitution and whether or not the gas inventories were exempt because they were moving in interstate commerce. Presumably, the interstate commerce exemption argument in the Appellees Brief is responsible for the proposed deletion of Sec. 1(a) of KSA 79-201f in House Bill 2897 (page 1, lines 18 and 19). The removal of this exemption is of major concern to any business engaged in the movement of goods in interstate commerce in Kansas. This is a fatal flaw in the Bill, in our opinion.

KSA 79-201f has come to be known as the Kansas "freeport" exemption. ¶ The obvious intent is to exempt from local property tax, any goods "moving" in interstate commerce and it was argued by appellees in the BOTA appeal, that gas stored in Kansas, even if initially produced in Kansas, but destined for out of state transport, was exempt as interstate commerce.

As an historical footnote, it is useful to review the 1992 amendment to Article 11, Sec. 1 of the Kansas constitution, which excludes public utility inventories from the merchants' inventory exemption, which was motivated by a Supreme Court decision holding that public utilities could not be denied exemption of their "merchant inventories". ¶ The 1992 Legislature enacted Resolutions for a constitutional amendment which qualified the merchants and manufacturers inventory exemption by excluding public utility inventories. That constitutional amendment also increased the assessment rate for public utility property from 30% to 33%.

HOUSE TAXATION
Attachment 11
Date 3-18-04

I appreciate that it's late in the Session and given the skepticism of Constitutional arguments, I hesitate to suggest that the Kansas Constitution is unconstitutional. But, I believe the adoption of HB 2897 will ultimately lead to that judicial conclusion.

This bill would require the conclusion that natural gas held in federally-regulated storage facilities, which is "in interstate commerce", is subject to local ad valorem taxes, unlike all non-public utility merchants inventory, which is tax free under the Kansas Constitution. If every county through which that gas moves could tax it, the consumer would be a hapless victim of "the power to destroy". Suffice it to say, the Bill, as applied to the interstate movement of natural gas, is subject to serious constitutional challenges. Given FERC jurisdiction over the gas, the tax is arguably violative of the "supremacy clause" of the U.S. Constitution. Additionally, the taxation can be violative of the "commerce clause", as well as the "equal protection" clause. Blatantly striking the "freeport" exemption, obviously, extends the Bill's infirmity to all interstate business. Even if Sec.1(a) is stricken from the Bill, Sec. 2(a) is assured to keep the lawyers prosperous and the Courts busy. Yes, Panhandle's Pan Gas Storage, as the largest taxpayer in Meade County, will, in fact, pay higher taxes on its non-exempt facilities and on its "cushion gas", if the storage gas is not taxed. That is, however, the price to be paid for the free flow of interstate commerce, for the protection of the consuming public and business engaged in supplying the products.

We thus support our customers, the owners of storage gas and their customers, the ultimate consumers, in opposing HB 2897.

1st, ¶ Interstate pipelines were held to be merchants and that natural gas in storage was inventory, thus placing them within the clear meaning of the exemption. (Colorado Interstate Gas Company v. Board of County Commissioners, 247k659,802 P2nd 5 §4, (1990).

2nd, ¶ Kansas has recognized the interstate commerce exemption, statutorily, at least since 1955, KSA 79-304, '55 Supp, "... Provided further, that personal property moving through the state or consigned to a warehouse in the state from a point outside the state in transit to a final destination outside the state shall, for the purposes of taxation, acquire no situs in the state and shall be exempt from taxation." [G. S. 1949, §79-304; L. 1955, ch. 397, § 1; January 1, 1956.]

KANSAS
ASSOCIATION OF
COUNTIES

WRITTEN TESTIMONY
concerning House Bill No. 2897
Definition of Public Utility for Tax Purposes
Presented by Randall Allen
House Taxation Committee
March 18, 2004

Mr. Chairman and members of the committee, thank you for the opportunity to submit written testimony in behalf of the Kansas Association of Counties in support of House Bill No. 2897, concerning the definition of public utilities subject to property taxation.

The background of this bill goes back to 1986, when Kansas voters approved a constitutional amendment exempting merchants and manufacturers inventories from property tax assessment. The taxable status of underground, "stored" natural gas was clarified by a 1990 Kansas Supreme Court case, ***Colorado Interstate Gas v. Board of Morton County Commissioners*** , when the court concluded that "public utilities" are "merchants" as the term is commonly understood and that underground gas owned by public utilities is exempt from taxation.

However, in November, 1992, Kansas voters amended the Constitution to reverse the ***Colorado Interstate*** decision and make it clear that public utility inventories were not exempt, i.e. stored gas is taxable. A subsequent federal order (FERC Order 636) provided that pipeline companies, which are Kansas public utilities, could no longer own the gas stored underground. Title to the gas passed to the pipeline's customer at the point of *extraction*, and not at the point of *delivery*.

Later, in October, 2003, the taxable status changed once again as the Kansas Supreme Court held in ***Central Illinois Public Service Company v. Meade County***, that since the gas was owned by a nonresident public utility not assessed by the Property Valuation Division as a state-assessed public utility, the exclusion from the merchants from the merchants' and manufacturers' exemption does not apply, and therefore the stored gas is exempt from property taxation.

HB 2897 is a bill to include those who store natural gas in underground formations for resale within the definition of public utility for state assessment purposes. This has significant impact on the property tax base of several Kansas counties. In 1992, Kansas voters spoke to the issue of whether stored gas should be taxable. We urge the committee to report HB 2897 favorably, and return stored gas to the tax base as it should be. Thank you.

The Kansas Association of Counties, an instrumentality of member counties under K.S.A. 19-2690, provides legislative representation, educational and technical services and a wide range of informational services to its members. Inquiries concerning this testimony can be directed to Randall Allen or Judy Moler at the KAC by calling (785) 272-2585.

HOUSE TAXATION
Attachment 12
Date 3-18-04

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Testimony
On
House Bill No. 2897
By
Morton County Commissioners

Mr. Chairman and Members of the Committee:

Thank you for your consideration of our written testimony in support of House Bill No. 2897.

Morton County is a small rural county located in extreme southwest Kansas. The majority of our tax base comes from oil and gas and agricultural related industries. For your information we have included a brief history of the underground gas storage in Morton County.

UNDERGROUND GAS STORAGE TIMELINE

Prior to 1986, gas in underground storage was state assessed

In 1986, a constitutional amendment was passed, to take effect in 1989, which among other things exempted the inventories of merchants and manufacturers.

In 1988, the Kansas Legislature enacted K.S.A. 1988 Supp. 79-201m, which further defines the terms "merchants" and "manufacturer" and "inventory". They further stated that this shall apply to all taxable years commencing after December 31, 1988.

December 1988, then Director of Property Valuation (PVD) decided that stored natural gas qualified for the exemption.

In 1989, PVD allowed the exemption supported by Kansas Attorney General Opinion No. 89-85.

Board of Tax Appeals (BOTA) ruled against PVD stating that no public utility can be a merchant or manufacturer. This ruling then placed the gas in underground storage back on the tax roll.

BOTA's decision was then appealed through the court system ending up at the Supreme Court of the State of Kansas, case # 64,669 filed by Colorado Interstate Gas Company and Northern Natural Gas Company vs. the Board of County Commissioners of Morton and Pratt Counties. They also

combined case # 64,701 including the Board of County Commissioners of Meade County.

Supreme Court ruled that stored underground gas was inventory and therefore exempt. This decision was applied to tax years 1989, 1990, 1991 and 1992.

In 1992 a new constitutional amendment was passed which included a provision specifically placing inventories of public utilities on the tax roll as state assessed property. This amendment took effect for 1993.

1993 – Federal Energy Regulatory Commission (FERC) Order 636 deregulated the natural gas industry.

From the timeframe since the Supreme Court ruling in 1990 till current, Morton County has determined that gas stored in underground facilities was a function of the Kansas State Public Utilities Division and that there was nothing to be locally assessed.

We support the broadening of our tax base whenever possible and view mandated exemptions as an erosion of local control of our assets. We feel that passage of this bill would reinstate the unintentional exemption of a unique type of property.

Thank you for your attention to this matter.

Bob Boaldin

Bob Boaldin, Chairman

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REPRESENTATIVES

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HEALTH AND HUMAN SERVICES
JT. COMMITTEE ON STATE
INDIAN AFFAIRS
HOUSE RULES COMMITTEE

DOUG PATTERSON
MAJORITY WHIP

March 18, 2004

Rep. John Edmonds, Chair
and Members of the House Taxation Committee

Re: Supportive of 2834

Dear Mr. Chairman and Members:

Within the real estate development industry, there has been no small amount of confusion and frustration over what appears to be a loop-hole in the law concerning the ability of a municipality to impose an excise tax on local development activities.

Please make no mistake about our position; Real Estate development should and must pay its own way. Developer's should construct or pay for the burdens on the community infra-structure development brings with it. There is no argument about that.

However, we believe there should be a rational basis, i.e., connection between land development and the needed infrastructure improvement. We have seen that cities and counties have created numerous excise taxes for any number of purposes, not to finance infrastructure burdened by development, but rather excise taxes which go to the general budget without any form of connection with development or accountability. We feel as if locals are using excise taxes as a loop-hole to create an unauthorized sales tax to increase general revenues.

Accordingly, HB 2834 does the following:

1. Authorizes the imposition of a development excise tax.

2 Requires the development excise tax to be justified.

3. Projections on how the proceeds of the development excise tax will be used are required.

4. There will be accountability for the usage of this tax.

This seems more than fair to me.

By: Doug J. Patterson

HOUSE TAXATION
Attachment 14
Date 3-18-04

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McPherson
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Wichita

PAST PRESIDENTS
Richard Standrich 2003
Jeff Schrock 2002
David Reynolds 2001
John Young 2000
Michael Stibal 1999
John Samples 1998
Roger Schultz 1997
R. Neil Carlson 1996
Tom Ahlf 1995
James D. Peterson 1994
Gilbert Bristow 1993
Vernon L. Weis 1992
Elton Parsons 1991
Jim Miner 1990
Robert Hogue 1989
M.S. Mitchell 1988
Richard Hill 1987
Jay Schrock 1986
Joe Pashman 1985
Harold Warner, Jr. 1984
Frank A. Stuckey 1983
Donald L. Tasker 1982
John W. McKay 1981
Richard H. Bassett 1980

KANSAS BUILDING INDUSTRY ASSOCIATION, INC.

STATEMENT OF THE KANSAS BUILDING INDUSTRY ASSOCIATION

TO THE HOUSE TAXATION COMMITTEE

REPRESENTATIVE JOHN EDMONDS, CHAIR

REGARDING H.B. 2834

Mr. Chairman and Members of the Committee, I am Chris Wilson, representing the Kansas Building Industry Association. KBIA represents over 2600 members involved in the state's residential building industry. We appreciate the opportunity to comment in support of H.B. 2834.

This bill would require that municipalities provide information regarding how excise taxes are calculated and how the funds collected are spent. It is about simple accountability. Currently, excise taxes are collected and spent without such information available to the public.

The excise tax differs from impact fees. According to a 2000 study on "Alternativew Financing Opportunities for County Roads in Johnson County, Kansas," "Where impact fees' purpose is to regulate, the excise tax's purpose is to raise revenue." The excise tax is being touted more and more as a great way to raise revenue without voter approval. The excise tax is not subject to additional legal constraints; doesn't have to be related to costs generated by the person or business being taxed; there is greater flexibility regarding the use of the funds raised; excessive funds can be raised; funds raised do not have to be earmarked for specific projects.

Excise taxes have increased in popularity because of their ease and lack of legal constraint. With H.B. 2834, not much in the way of legal constraint would be imposed, but it would require municipalities to provide some level of information to the public about the rationale for the tax and intended use of the funds collected. Further, there would be information available in the future as to how much was collected and how it was spent.

We urge your favorable consideration of H.B. 2834 and would respond to questions.

HOUSE TAXATION
Attachment 15
Date 3-18-04

CHRISTINA M. WILSON, Execut
212 S.W. 8th Avenue, Suite 201 • Topeka, Ks 66603 • (.

Testimony on HB 2834
By: Wess Galyon, President/CEO
Wichita Area Builders Association

Mr. Chairman and members of the Committee.

I'm Wess Galyon, President/CEO of the Wichita Area Builders Association. We are a trade association consisting of 1300 members engaged in all facets of residential and light construction in Sedgwick, Butler, Harvey, Sumner, Cowley, Harper and Kingman counties. The majority of our members are small business owners but collectively employ approximately 18,000 people in our area according to the most recent census data.

I am appearing today to request your support of HB 2834. In so doing I wish to point out to the Committee what this bill does, and does not, do.

What the bill does not do:

- It does not weaken the home rule authority of any municipality and does not prevent local elected officials from imposing excise taxes as a means of generating revenue for the municipality
- It has not been structured in such a fashion so as to prevent any municipality from imposing a development excise tax upon any development activity that might be taking place in their respective jurisdiction as a condition of development approval

What the bill does:

- It imposes a duty on any municipality that may decide to impose such a tax to prepare a document detailing the costs of development to be paid for by the development excise tax funds generated
- It requires the preparation of a statement of the need for and rationale used in determining the amount of the development excise tax
- It requires the preparation of a projection of how funds generated by the tax will be expended
- It requires the municipality to, annually, prepare a report detailing the funds generated by the development excise tax and how those funds were expended

Why the bill is needed:

- It is needed in order to keep municipalities consistently accountable with regard to the imposition of such taxes in accordance with claims made them that they are justified and that the monies will used for the purposes for which they are collected, and to prevent municipalities from using funds collected for some unrelated purpose at some future point subsequent to the imposition of such a tax. At the present time municipalities imposing such a tax can switch gears at a future date and spend monies generated from such a tax on unrelated activities. Some, not all, representatives of municipalities know they can do this and argue that they should not be limited in their capacity to do so. We argue that if they make a commitment they should be expected to keep it. Our experience has been that if those who are opposed to what this bill requires truly intended to keep their commitment in this regard they would be imposing impact fees which would require them to be much more accountable than they know they have to be with excise taxes.

To factually outline for you what can happen if something isn't done to prevent such occurrences in the future, I have included a copy of the testimony of Richard Standrich, former Mayor of the city of Derby, Kansas which was presented to legislators a couple of years ago when the legislature was giving consideration to setting forth requirements municipalities should be expected comply with in this regard. I urge you take a couple of minutes to read his remarks, and ask for your consideration and support of HB 2834.

It would be greatly appreciated by our industry.

Thank you.

Testimony for Richard Standrich regarding Excise Tax Legislation..

Good Morning…
I'm Richard Standrich, Mayor of Derby, Kansas

I am appearing here this morning on behalf of myself and the City of Derby to voice our support of Senate Bill 474, which, if enacted into law would require our City and others in the State to justify the imposition of any such tax or fee.

This issue has been recently dealt with in our city and the voters of Derby voted down the imposition of an excise tax on the privilege of developing or building in the City of Derby by a vote of 58% to 42%. The issue was sent to the voters via a mail-in ballot and 5347 of the 10,300 registered voters voted.

The basis for this tax and the manner in which it was imposed by the previously seated City Council is, perhaps, the best argument that can be made as to why this legislation ought to be supported. The following is what happened in our city and had the tax not been repealed, I think it is very likely other small cities in Sedgwick County would have followed suit.

The story…

In March, 1999 the Derby City Council began looking for ways to generate more revenue due to the fact that they had passed a budget that included aggressive capital improvement spending, which they later admitted they could not fully fund without finding a source of additional revenues.

The first attempt they made was to impose an "infrastructure equity buy-in fee" on new development. Local developers and business leaders challenged the City as to the "equity" of the proposal that was made at that time and, after much discussion, the proposal was not approved. However, once Pandora's Box was opened, it appeared inevitable that some type of fee or tax was going to be imposed and it was just a matter of time until the Council and staff figured out how to get the money they wanted from the segment of the community that would offer the least resistance. What they ultimately settled on was the imposition of an excise tax on the privilege of developing and building in the City of Derby. After a couple of attempts to impose the tax, the council succeeded via a vote cast by the Derby Mayor on a 5 to 3 split by the Council which was not the super majority. The City Attorney interpreted this split as a tie vote and the Mayor cast the vote necessary to get the super majority. The City was subsequently sued and the court ruled that the Mayor had voted illegally and the action at this point in time was nullified. When the imposition of the tax was finally approved, the Councils action to impose it took place the night of the general election. The Mayor and Council members who were up for re-election were all defeated for re-election by substantial margins.

HOUSE TAXATION
Attachment 17
Date 3-18-04

- Approximately $18 million in future planned capital expenditures was purportedly needed to upgrade current infrastructure and accommodate projected future growth and expansion of the city's tax base. (Note: There was not a breakdown ever presented that identified those expenditures that would have to be made solely to accommodate new growth. In fact, there appeared to be no justification for charging new growth any additional fees or taxes in view of an analysis that was done by the Derby City Manager that showed that new residential development, alone, generated approximately 5 ½ times more revenue to the city than it cost to provide needed services. The to "buy in" to what was already existing and what others who lived in the city prior to them moving there had already paid for. (Note: The costs of building infrastructure improvements necessitated by new residential subdivisions and other such projects are repaid to the city, with interest, in the form of special assessments assessed against the property. Any investment the city might choose to make when infrastructure is being built, such as paying for the over sizing of pipe for water and sewer lines, are paid for by the city at large. However, the surplus revenues received, as above referenced are more than enough to pay for any shortfall the city might experience, initially, over time. Additionally, it was determined that the majority of people who were buying homes in Derby were not newcomers, but already existing residents of the city.)

- The estimated $400,000 per year budget shortfall was actually determined to be $100,000 at best when more carefully examined and it was determined that they could have handled it via the rescheduling of several capital improvement projects. (Note: During the discussion held in this regard, numerous persons who learned that the city has passed a budget that they knew they could not fund and later searched for a way to cover the budgeted deficit, were puzzled as to what motivated them to do it in the first place.)

- The tax was imposed with an adopted protocol as to how the monies would be spent. However, the Council was made aware that the protocol could be changed at any time and the monies collected could be spent on any project or program they chose regardless of whether the project or program was related to the tax charged. (Note: Discussion had during the time consideration was being given to this issue focused on how the council might give credibility to their proposal while discussion was being given to this issue focused on how the council might give credibility to their proposal while discussion was being had as to how and when the protocol in the ordinance could be changed if the Council decided to spend the monies collected for some other purpose.

- An impact fee was not imposed because the council felt that "it would be pretty hard to justify such a fee and the amount of it" and "it was doubtful the

city could withstand a legal challenge if one were advanced. (."(Note: Local developers and builders doing business in the city told the city that "if new growth wasn't paying it's way, they would like to know what the actual shortfall was and, if there was a legitimate shortfall, they would support the imposition of an impact fee and the establishment of a program that assured the monies collected would be spent to build the specific improvements the monies were collected for. They wanted to see a plan as to what expenditures would be made and in what time frame. The city was not willing to commit to such a program. In fact, the comment was made by one council member that the city could forego the charging of such a fee or tax, but felt that it might be needed in the future and that the city ought to start charging a tax now while times were good.)

- In summary, I would like to point out that we are not questioning governments authority to assess fees and taxes, and this legislation does not do that. What we are suggesting is that we think that our units of government ought to held to a higher standard that they presently are and they ought to be expected to economically justify what they do and fiscally assess the impact of their actions on communities before they do it. This will make for better government and a more responsive government for us all.

Thank you. I would he glad to stand for any questions you might have.

Lawrence Home Builders Association

P.O. Box 3490
Lawrence, Kansas 66046
(785) 748-0612
fax (785) 748-0622

STATEMENT OF THE LAWRENCE HOME BUILDERS ASSOCIATION

TO THE HOUSE TAXATION COMMITTEE

REGARDING H.B. 2834

MARCH 18, 2004

Mr. Chairman and Members of the Committee, I am Bobbie Flory, Executive Director of the Lawrence Home Builders Association (LHBA.) The LHBA is the local trade organization of the building industry in Douglas County, with approximately 250 members.

The LHBA supports House Bill 2834.

Residential development is an integral part of a growing dynamic community. New homes contribute new revenue to city governments, which is used to finance the delivery of city services and build new public infrastructure to serve new neighborhoods.

The LHBA believes growth should pay its own way.

There are many costs involved in the development process:

On-site development costs such as water, sewer, stormwater, cable TV, electric, telephone, streets, sidewalks, bike paths, street signs, and street lights are paid for by the developer.

One-time governmental costs are paid for through permit, tap, and impact fees.

These development costs, like all other costs in the building process, are passed on to the homeowner through the purchase price of the home.

On-going community costs such as police, fire, library, and parks are paid for through an expanded tax base resulting from additional property taxes paid by each new home or business.

Now local governments are beginning to impose Excise taxes. Excise taxes are typically intended to fund off-site transportation improvements. However, no regulation exists to limit the scope of the Tax. Local governments can impose Excise taxes without any knowledge of the costs of local development in comparison to the revenue generated by that development.

HOUSE TAXATION
Attachment 18
Date 3-18-04

member NAHB

Recently, the Eudora City Council considered the establishment of Excise Taxes. Throughout the entire discussion among Council Members, not once did any Council Member ask how much the needed improvement would cost, what share of the total cost of the improvement should be the responsibility of the new residents, or if the new residents of the City had a positive or negative impact on the City. They had no idea what to charge per square foot because they haven't done a cost/benefit analysis of new development in their community. The only information that they were provided by their City Manager was the amount per square foot neighboring communities were charging. Such comparisons had no bearing on the circumstances in Eudora. Therefore, Council Members went through an exercise of expressing uninformed opinions. **Without regard to the costs and benefits new development brings, any imposed Excise tax is ARBITRARY.**

The Lawrence Home Builders Association supports House Bill 2834 because it will help limit the arbitrary nature of current Excise Taxes. It will mandate that municipalities provide a rationale for the tax amount other than what the community next door charges.

LKM
League of Kansas Municipalities

300 SW 8th Avenue
Topeka, Kansas 66603-3912
Phone: (785) 354-9565
Fax: (785) 354-4186

Date: March 18, 2004

To: House Committee on Taxation

From: Larry R. Baer
Assistant General Counsel

Re: HB 2834 - Testimony in Opposition

Thank you for allowing me to appear before you today on behalf of the League of Municipalities and its member cities to testify in opposition to HB 2834.

HB 2834 poses concerns to the League. We do not know what problem or problems it addresses or proposes to fix. Section 1(c) is unclear as to when it must be complied with and what, if anything, happens if a city should not comply with it. However, a bigger concern is the mixing of the terms "tax" and "fees". The Kansas appellate courts have very clearly drawn a distinction between the two terms. More importantly the courts have specifically found and held that the "development excise tax" is a tax and is not a fee. The mixing of these terms raises a concern that HB 2834 is an attempt to turn an excise tax into an impact fee.

Development excise taxes are generally levied to help defray costs associated with greater use of local facilities, such as major traffic ways. The greater use generally is caused by growth coming from new housing developments. Internal infrastructure (streets and utilities within the development) can be dealt with by agreement with the developer or benefit district (special taxes). However, the need to enhance the external infrastructure (such as major traffic ways to get heavier traffic flows in and out of the area of the development) would fall solely upon local government. Thus, the need for development excise taxes.

Most if not all cities that are using development excise taxes are already doing the analysis and calculation that would be required by this proposal. HB 2834 appears to be an attempt by the State to micro-manage local government. If there is a problem here, it is one of local concern. Local issues should be handled at the local level and are best addressed at the level of government closest to those directly impacted.

The final concern is the lack of clarity or purpose within the proposal. It is possible for one to envision regular and reoccurring litigation over the validity of a city's formulas or other means of calculating the tax to be imposed. I think that we can all agree that there is a far better use of the time, talents and treasures of a city than being tied up in constant litigation – litigation that is the result of unnecessary legislation.

Adopting legislation where there is no specific need is not good policy. Therefore, the League stands in opposition to HB 2834 and requests that the matter be rejected.

Thank you for allowing me to appear before you. I will stand for questions at the appropriate time.

HOUSE TAXATION
Attachment 19
Date 3-18-04

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TESTIMONY IN OPPOSITION TO HOUSE BILL NO. 2834

TO: The Honorable John Edmonds, Chair
Members of the House Taxation Committee
Room 519-S

Date: March 18, 2004

RE: House Bill No. 2834 -- Proposed legislation pertaining to excise taxes.

Ladies and Gentlemen:

The City of Overland Park strongly opposes HB 2834 for many reasons:

- HB 2834 is a thinly disguised attempt to characterize cities' excise taxes as impact fees. The City of Overland Park does not want its excise tax to be characterized as an impact fee. If the City of Overland Park had wanted to enact an impact fee, it would have done so.

- There are differences between a "tax" and a "fee." HB 2834 confuses the terms "tax" and "fee." In fact, it explicitly and erroneously states "...tax' means a fee..." in Section 1(a)(2) at line 16.

- The home rule authority of cities to levy excise taxes by enactment of an ordinance pursuant to K.S.A. 12-137 *et seq.* was upheld by the Kansas Court of Appeals in *Homebuilders Association et al. v. City of Overland Park*, 22 Kan. App. 2d 649 (1996). The decision of the Court of Appeals has been left undisturbed by the Kansas Supreme Court.

- The City of Overland Park regularly prepares reports, solicits input from the development community, holds public meetings, and otherwise justifies its excise tax rate. It also regularly reports on its receipts of and expenditures of excise tax revenues in the normal budgeting process. Nothing is broken.

- The original enactment and each subsequent re-enactment of Overland Park's excise tax have included an opportunity for a city-wide referendum on each enactment.

HOUSE TAXATION
Attachment 20
Date 3-18-04

- The City of Overland Park has never abused its excise tax authority.

- The authority of cities to enact excise taxes is a local issue that should be left to local officials and their constituents to deal with. HB 2834 runs counter to the spirit and intent of the Constitutional Home Rule provision.

- The bill is unnecessary. Keeping records of receipts and expenditures of excise tax revenues is required by the existing budget laws anyway.

- The bill will confuse the law rather than clarify it because it is unclear exactly when a city would have to "prepare a document" (line 21): at the time it sets the tax rate or each time an activity triggers application of the tax rate?

Yours very truly,

Robert J. Watson

Robert J. Watson
City Attorney

RJW/rjw