

MINUTES OF THE SENATE EDUCATION COMMITTEE

The meeting was called to order by Chairman Dwayne Umbarger at 1:42 p.m. on March 23, 2004 in Room 123-S of the Capitol.

All members were present:

Committee staff present:

Carolyn Rampey, Legislative Research
Kathie Sparks, Legislative Research
Theresa Kiernan, Office of the Revisor of Statutes
Judy Steinlicht, Committee Secretary

Conferees appearing before the committee:

Ron Hein, Kansas Restaurant & Hospitality Association
R. E. "Tuck" Duncan, Kansas Wine & Spirit Wholesalers Association
Neal Whitaker, Kansas Beer Wholesalers Association
Gordon Yetter, Edward's Retail Liquor
Phillip Gradley, Kansas License Beverage Association
Chris Courtwright, Legislative Research Department
Joan Wagon, Secretary of Revenue

Others attending:

See Attached List

Senate Leadership School Finance Plan

Ron Hein, representing Kansas Restaurant & Hospitality Association (KRHA), is neutral on the school finance proposal, however, they have concerns about some of the tax revenue sources. KRHA feels there are three areas that may adversely impact the hospitality industry. They are the revocation of alcohol licenses for non-payment of taxes; gallonage tax increase; and the elimination of the sales tax exemption for utilities consumed in production for some members of the industry. KRHA is concerned that the government in the last couple of years is focusing on targeted tax increases. (Attachment 1)

Tuck Duncan, Kansas Wine & Spirits Wholesalers Association, testified against any proposed increases in beverage alcohol taxes. He believes that excise taxes are regressive and discriminatory and that beverage alcohol already contributes significant federal, state and local taxes. He believes the proposed increases may not produce the anticipated revenues and that cross border purchasing will increase. (Attachment 2)

Neal Whitaker, Kansas Beer Wholesalers Association, testified against the targeted tax increases proposed in this school finance plan. In 1979, a Kansas drink tax of 10 percent of gross receipts was imposed; in 1987, the 4 percent enforcement tax for off-premise consumption was doubled to 8 percent and was broadened to include 3.2 percent beer; in 1990, the 10 percent drink tax was extended to more licensees; in 1991, Kansas consumers had the federal portion of their beer excise tax doubled; and in 2002, the Kansas sales tax was increased. Mr. Whitaker said that Kansas is the only state that taxes alcohol beverages three times before the beverage is purchased by the consumer. Mr. Whitaker said Kansas will continue to lose revenue by raising taxes on select items that people can easily buy out of state. They do not mind that taxes must be paid prior to issuing a state license, but it should apply to all state issued licenses. Funding education is every citizen's responsibility and every citizen should share the tax burden. (Attachment 3)

Gordon Yetter, Edwards Retail Liquor, Topeka, supports education and is a business owner and a full time economics and business professor at a community college. He stated that he understands the need of reliable funding for Kansas educational system. Mr. Yetter believes that increasing gallonage tax would cause extreme hardship and dead weight loss to this targeted industry. Referring to recent news coverage regarding obesity in children, Mr. Yetter suggest taxing pop, candy and fast foods. He believes something different needs to be done to help our educational system without destroying Kansas owned small businesses. (Attachment 4)

CONTINUATION SHEET

MINUTES OF THE SENATE EDUCATION COMMITTEE at 1:42 p.m. on March 23, 2004 in Room 123-S of the Capitol.

Dr. Phillip Bradley, Executive Director, Kansas Licensed Beverage Association (KLBA), testified that they are in support of education, but are against targeted taxes at only one industry. They believe that the funds needed for the state should come from taxes that all citizens pay. Targeting individual industries only makes that industry less competitive in the market place and drives consumers to other states or on-line sales outlets where Kansas receives no tax revenue. Dr. Bradley stated that KLBA supports the tax collection component to recover taxes rightfully owed the state of Kansas. In 2001/2002, KLBA testified that delinquent taxes in question must be those that apply directly to the business which holds the license and this was added to a bill. They also proposed that renewals of all licenses and permits be treated the same; and that if one stockholder in a corporation or business operating this license was delinquent that the entire business would not be penalized. KLBA asks that these proposals be included in this bill. (Attachment 5)

Senator Oleen passed out a memorandum prepared by Theresa Kiernan, Revisor's office, listing ten licensees that are already required to be current in their tax payments to do business in the state of Kansas. (Attachment 6)

Chris Courtwright, Legislative Research, came to the committee to answer questions that were raised yesterday regarding the tax proposals in the Senate Leadership School Finance Plan. Chris answered those questions and passed out information further explaining the tax provisions. (Attachment 7)

Secretary of Revenue, Joan Wagnon, provided information regarding several tax provisions from earlier introduced bills, which the Department strongly supports. (Attachment 8)

Senator Teichman made a motion to approve the minutes for March 15, 16, 17 and 18. Seconded by Senator Vratil. Motion carried.

Senator Umbarger announced that the committee would meet again tomorrow at 8:00 a.m., place to be announced. The meeting adjourned at 2:40 p.m.

SENATE EDUCATION COMMITTEE GUEST LIST

DATE - 3-23-04

NAME	REPRESENTING
Denise Apt	4.5 D # 500
Heather Grace	Damon & Associates
Julia Robinson	Gov. Office
Dustin Hardison	Little Government Relations
Kimbra Caywood	Keeney & Assoc.
BILL RUDY	Kr God't Consulting
MARK DEBETTI	KNEX
TERRY FOLS GTT	KWEA
Amy Campbell	KABR
Charles E. McBRIDE	WIAE INSTITUTE
GORDON YETTER	KABR
Jim Sullinger	KC STAR
Neal Whitaker	KBWA
Rebecca Rice	KBWA
PHILIP BRADLEY	KLBA
TICK DUNCAN	KS wine/spirit/wholesale Assn.
Nancy Niles Luke	concerned parent
Rayleen Mather	"
Jenna Brockmeyer	PTA Legislative Rep & parent concerned
TOM PALACE	FMCA OF KANSAS
Ron Herin	KS Restaurant & Hospitality Association
Jim Edwards	KASB
Dodie Weikman Johnson	Patrick Hurley & Co

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**Testimony Re: Senate School Finance/Tax Proposal
Senate Education Committee
Presented by Ronald R. Hein
on behalf of
Kansas Restaurant and Hospitality Association
March 22, 2004**

Mr. Chairman, Members of the Committee:

My name is Ron Hein, and I am legislative counsel for the Kansas Restaurant and Hospitality Association. The KRHA is the Kansas professional association for restaurant, hotel, lodging and hospitality businesses in Kansas.

KRHA is neutral on the school finance proposal which is being heard today. As an association, we have generally opposed targeted tax increases, and taken the position that broad based funding is preferable to targeted taxes when funding state programs which are aimed at the general government functions of the state. We include K-12 education within such a general government function category.

However, we have concerns about some of the revenue sources which have been proposed to fund this education plan. Some of our concerns may be mitigated or eliminated when we actually see the bill draft. However, from the written proposal that was distributed, we have identified three areas which might impact adversely on the hospitality industry.

Revocation of Alcohol License for Non-Payment of Taxes

The KRHA has no objection to revocation of licenses as long as the bill is applicable for taxes that are due by the business which operates a club or drinking establishment alone. We have testified before regarding our concerns about the situations which could arise where a minority stockholder, or certain other individuals tied to the business could be delinquent in paying taxes, and the majority stockholder or the individual facility could be penalized for actions over which they have no control. For example, we would be concerned if the legislation permits the Department of Revenue to reject or not renew a license if a minority stockholder of a corporation seeking a license owed taxes for another business.

SB 465 as it passed the Senate in 2002 addressed our concerns.

*Senate Education
3-23-04
Attachment 1*

Gallonage Tax Increase

KRHA has opposed legislation in the past which increases the gallonage tax. Since there are three liquor taxes layered one upon each other, there is a compounding effect before the drink is finally sold at retail to the ultimate consumer.

Supporters of an increase in alcohol taxes have pointed to the gallonage tax and have said that it hasn't been increased since 1977. However, what is not pointed out is that in 1979, a new tax (the so-called drink tax) was imposed as a gross receipts tax at a rate of 10%. Likewise, in 1983, the enforcement tax was increased from 4% to 8%, a 100% increase. The enforcement tax and the drink tax are both based upon a percentage of the value, so although the rate has not been increased, the amount of tax paid per unit of sales has increased every year with inflation. Lastly, the compounding effect of these three pyramided taxes, which generate additional taxes by applying percentages of tax upon the taxes themselves, results in a very heavy burden of a targeted tax on restaurants, lodging facilities, and other hospitality businesses which serve alcohol..

Utilities Used In Production

KRHA earlier this session opposed HB 2681 because it eliminates for some members of our industries the sales tax exemption set out in K.S.A. 79-3606(n), which provides an exemption from sales tax for utilities consumed in production. In HB 2681, sales tax exemption for utilities consumed in production would only be applicable if the amount of usage on one meter was in excess of 50% of the meter usage.

Without seeing the bill, we cannot tell if there would be a similar elimination of the utilities used in production exemption in this school finance proposal. The KRHA does not necessarily object to requirement of an energy/utility usage study to qualify for the exemption, but state policy generally is not to double tax utilities used in production when the retail sales is to be taxed on the ultimate consumer of the product or service. Of greater concern is that the elimination of this exemption would hurt small businesses in general, but specifically to businesses that our association represents.

We also note that an individual business can get around the provisions of this type of legislation by simply using a separate meter for the utilities used in production which are actually exempt from sales taxation. Once again, this will be easier and more cost effective for a large business, and tends to be more of a burden on a small business. We simply wish to raise this as a concern that should be addressed by this committee. Even assuming that this is good policy, with the poor economy, now is not a good time to raise taxes on smaller businesses involved in the restaurant, lodging and hospitality industries.

General Comments

Although resources appear tight for the State right now, albeit with increasing revenues

available to the state. we acknowledge that the recovery is moving slowly, and the economy has not totally rebounded. However, our businesses are subject to the same economy. If our taxes are increased when the economy is moving slowly our options are to cut costs, increase the costs to our consumers if we can do so without affecting sales, or go out of business.

Of even greater concern to our industry is the fact that the government in the last couple of years has been focusing its attention on targeted tax increases to fund general government functions. If the public generally supports higher taxes to pay for increased governmental services or to make up for decreased revenues during economic downturns, then the general public would certainly support increases in general taxes, rather than attempting to impose taxes on selected individuals, selected businesses, or those who consume specific products.

Thank you very much for permitting me to testify and to raise these concerns as you address the funding issues involved in this school funding proposal. I will be happy to yield to questions.

Kansas Wine & Spirits Wholesalers Association

To: The Kansas Legislature

From: R.E. "Tuck" Duncan, Kansas Wine & Spirits Wholesalers Association

Re: Proposed increases in beverage alcohol taxes

Date: March 22, 2004

Our past is the prelude to the present. History: our teacher regarding tomorrow. The matters before you today must be viewed in the context of past lessons and how you respond will dictate the manner in which you undertake public policy in the future.

First I want to address the impact of increased beverage alcohol taxes. By any other name an excise tax is still a tax, excise taxes are regressive and discriminatory, and beverage alcohol already contributes significant federal, state and local taxes. Based on the federal experience the proposed increases may not generate the anticipated revenues, and cross border purchasing will be exacerbated.

Excise Taxes are Taxes - An increase in excise taxes is just as much a tax increase as an increase in the personal income tax or any other type of tax. This is the case whether they are argued for on the basis of so-called user fees or for program enhancement (such as for education). The fact is that excise taxes are taxes. Consumers will pay these taxes. The KCCI has stated in its Business Tax Policy: "Do No More Harm. The 2004 budget situation is not conducive to significant tax reforms. ...the Kansas Chamber will be on the front lines fighting to ensure Kansas' business tax position is not further eroded and Kansas remains competitive with its surrounding states." This proposal does harm.

Excise Taxes are Regressive - Excise taxes weigh most heavily on low and middle income families making the tax structure less progressive or fair. Studies by the Coalition Against Regressive Taxation (CART) show that increased excise taxes negated the benefit of the 1986 Tax Reform Act for lower income people.

Tax increases are contrary to voter's concerns - Ironically, at a time when 30% of Kansans say that the state of the economy is their most pressing concern, and when 23% of Kansans said slowing government spending, while 15% said reducing taxes were the ways to improve the economy, some in the Legislature want to take more money out of the pockets of consumers. 45% of Kansans say they pay too much in taxes, 49% say it's about right and only 4% say they don't pay enough. (source: www.kansaschamber.org)

Current Excise Taxes are Important to State and Local Government - The alcohol beverage industry now contributes significantly to state and local governments through excise taxes. Increases in beverage alcohol taxes may decrease current state revenue sources. The National Conference of State Legislatures released a study in March of 1989 which estimates that the states lost revenue in the amount of \$3.7 billion as a result of increases in federal alcohol, tobacco and gasoline taxes in 1983 and 1985.

Excise Taxes are Unfair and Discriminatory - An increase in the beverage alcohol taxes for the purpose of bridging the state's revenue shortfall or for supplementing education would be unfair and arbitrary. Whatever the merits of the particular outlays to be financed, it is clear that all Kansans have a stake in them, not just individuals who consume certain products. There is no justification for making one group of taxpayers finance government activities which affect everyone. Earmarking taxes is bad public policy. The Kansas Chamber of Commerce and Industry advised all Senators February 11, 2004 that it "adopted a position in 2002 that states that taxes should 'not be targeted toward any single industry or particular segment of our state's business community.'" In that communication the Senate was asked to, and did, remove the targeted liquor tax provisions from SB305.

Tax Burden and Incidence - As part of the overview of Kansas' state and local taxes, the Kansas Tax Review Commission in 1985 was interested in which taxpayers, by income group, actually bear the burden of Kansas taxes. That is, what is the economic incidence of the Kansas tax burden after all tax shifting and tax exportation are taken into account. Dr. Darwin Daicoff, Professor of Economics at the University of Kansas, had done considerable research in this area and presented some of this information to the Commission, extracted from his November, 1978 study, Who Pays Kansas Taxes? (A report to the Special Committee on Assessment and Taxation, Legislative Coordinating Council, State of Kansas; Darwin W. Daicoff and Robert H. Glass, Institute for Economic and Business Research, the University of Kansas. Lawrence, Kansas, November, 1978.) The following Table OR-5 contains effective tax rates for 1978 by

TABLE OR-5

EFFECTIVE TAX RATE BY INCOME CLASS, KANSAS LOCAL, STATE AND FEDERAL TAXES, EXPRESSED AS A PERCENTAGE OF INCOME, TRADITIONAL MODEL

Source	Income Class*												TOTAL
	Under 3,000	3,000- 3,999	4,000- 4,999	5,000- 5,999	6,000- 6,999	7,000- 7,999	8,000- 9,999	10,000- 11,999	12,000- 14,999	15,000- 19,999	20,000- 24,999	25,000 & Over	
Kansas Local Taxes													
Property	12.35	8.36	7.75	7.60	6.55	6.33	5.83	5.71	5.66	5.23	5.55	5.17	5.62
Inheritance	.01	.01	.01	.01	.01	.01	.01	--	--	.01	--	--	--
Sales	.39	.25	.22	.20	.18	.18	.17	.16	.15	.14	.12	.09	.14
Vehicle Registration	.03	.02	.02	.02	.02	.02	.01	.02	.01	.01	.01	.01	.01
Mortgage Registration	.12	.08	.08	.08	.07	.06	.06	.06	.06	.05	.06	.05	.06
Intangibles	.07	.09	.09	.08	.10	.08	.06	.04	.04	.04	.07	.11	.07
Other	--	--	--	--	--	--	--	--	--	--	--	--	--
Total Local Taxes	13.00	8.83	8.18	8.01	6.94	6.69	6.14	5.98	5.92	5.48	5.82	5.44	5.91
Kansas State Taxes													
Property	.21	.14	.14	.13	.11	.11	.10	.09	.09	.09	.09	.09	.10
Motor Carrier	.04	.03	.02	.02	.02	.02	.02	.02	.02	.02	.02	.02	.02
Individual Income	.20	.50	.69	.92	1.10	1.33	1.38	1.59	1.58	1.73	2.09	1.80	1.68
Corporate Income	.80	.71	.65	.64	.69	.61	.51	.43	.41	.43	.52	.69	.55
Financial Institutions	.07	.07	.06	.06	.07	.06	.05	.04	.04	.05	.05	.07	.06
Inheritance	.14	.17	.16	.16	.19	.15	.10	.07	.07	.08	.12	.05	.09
Sales and Use	7.45	4.77	4.01	3.93	3.51	3.34	3.13	2.94	2.76	2.52	2.33	1.71	2.50
Cigarette and Tobacco	.82	.73	.59	.53	.57	.53	.46	.40	.35	.26	.20	.12	.28
Motor Fuel	1.84	1.44	1.40	1.45	1.47	1.40	1.30	1.22	1.00	.94	.75	.54	.89
Vehicle Registration	1.10	.84	.80	.76	.65	.63	.54	.46	.41	.36	.36	.37	.43
Liquor and Beer	.35	.31	.23	.31	.20	.25	.27	.24	.22	.20	.21	.14	.20
Corporate Franchise	.03	.03	.03	.03	.03	.02	.02	.02	.02	.02	.02	.03	.02
Insurance	.37	.23	.22	.19	.20	.22	.23	.24	.24	.23	.23	.25	.24
Unemployment Compensation	.60	.62	.67	.82	.93	.90	.79	.66	.57	.47	.44	.40	.53
Other	--	--	--	--	--	--	--	--	--	--	--	--	--
Total State Taxes	14.05	10.60	9.69	9.97	9.76	9.60	8.93	8.45	7.79	7.41	7.45	6.31	7.59
Total State and Local Taxes	27.05	19.44	17.86	17.98	16.70	16.28	15.07	14.43	13.71	12.89	13.26	11.75	13.50

*Money Income - 1978

Source: Daicoff & Glass, Who Pays Kansas Taxes?, The University of Kansas, November, 1978

2.3

money income classes for each of the Kansas local and state taxes and fees. The effective tax rate represents total taxes paid divided by income. It serves as a measure of tax burden. If the effective rate increases as income increases, the tax structure is said to be "progressive." Conversely, if the effective rate decreases as income increases, the tax is said to be "regressive." An effective tax rate that is constant throughout the entire range of income is known as "proportional." As shown, alcohol taxes are very regressive.

The industry bears an exorbitant and totally discriminatory tax burden. The theory of diminishing returns threatens the industry. As Chief Justice John Marshall pointed out, "*The power to tax is the power to destroy.*"

Elasticity of Demand. The Kansas Legislative Research Department during previous discussions of beverage alcohol taxes has stated: "Increases in prices will, other things remaining equal, decrease the quantity sold. Increases in taxes which lead to increases in prices of goods or services, may as a result of a decrease in the base, lead to less than proportional increases in receipts...thus, proposals to increase taxes by a substantial amount will probably result in significantly less revenue than might be projected on the assumption of zero elasticity of demand (that price will not effect demand)."

Experience tells us that when there has been an increase in the federal excise tax (FET), collections have not increased proportionally. Reference the following charts showing the federal experience following FET increases on wine and spirits.

Cross Border Purchases. We believe that higher taxes on beer, wine and spirits would result in an "elasticity of demand" dilemma as well as shift sales across the border (despite Sunday sales) to Missouri. Taxes are lower in Missouri. Missouri is a particular problem because of the metropolitan area on the state line. An increase in taxes will cause Kansans to go across the border to make purchases, reducing sales (but not necessarily consumption). And when people cross the border for one commodity they buy others. Kansans will pay Missouri its sales taxes on groceries they buy, and its excise taxes on gasoline they purchase while there. Currently spirits are taxed at \$2.50 per gallon in Kansas. Missouri is at \$2.00. This plan proposes increasing spirits to \$5.50 as well as significant increases in beer and wine gallonage taxes thus aggravating the difference. In addition to the tax per gallon, Kansas also imposes an 8 percent excise tax. According to the 2002 Beverage Marketing Directory, which tracks U.S. consumption, Kansas is in the lower half of consumption in all categories.

EXCISE TAX COLLECTIONS

DISTILLED SPIRITS

YEAR	TAXES COLLECTED	\$ INCREASE/ DECREASE	% INCREASE/ DECREASE	100 PROOF GALLONS	INCREASE/ DECREASE	% INCREASE/ DECREASE
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*Tax rates on distilled spirits: \$10.50 per 100 proof gallon from November 1, 1951 through September 30, 1985

1984	\$3,566,482,000			339,664,952		
1985	\$3,520,697,000	(\$45,785,000)	-1.28%	335,304,476	(4,360,476)	-1.28%

*Tax rates on distilled spirits: \$12.50 per 100 proof gallon from October 1, 1985 through December 31, 1990

1986	\$3,731,368,000	\$210,671,000	5.98%	298,509,440	(36,795,036)	-10.97%
1987	\$3,799,226,000	\$67,858,000	1.82%	303,938,080	5,428,640	1.82%
1988	\$3,844,421,000	\$45,195,000	1.19%	307,553,680	3,615,600	1.19%
1989	\$3,862,326,000	\$17,905,000	0.47%	308,986,080	1,432,400	0.47%
1990	\$3,850,266,000	(\$12,060,000)	-0.31%	308,021,280	(964,800)	-0.31%

*Tax rates on distilled spirits: \$13.50 per 100 proof gallon from January 1, 1991

1991	\$3,764,405,000	(\$85,861,000)	-2.23%	278,844,815	(29,176,465)	-9.47%
1992	\$3,889,720,000	\$125,315,000	3.33%	288,127,407	9,282,593	3.33%
1993	\$3,797,200,000	(\$92,520,000)	-2.38%	281,274,074	(6,852,973)	-2.38%

— The Tax Collection figures are for the fiscal years ended September 30

— Source of information: U.S. Department of Treasury — Bureau of Alcohol, Tobacco and Firearms

EXCISE TAX COLLECTIONS

WINE

YEAR	TAXES COLLECTED	\$ INCREASE/DECREASE	% INCREASE/DECREASE	WINE GALLONS	INCREASE/DECREASE	% INCREASE/DECREASE
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*Tax rates on Table Wine: \$0.17 per wine gallon from November 1, 1951 through December 31, 1990

1984	\$319,920,000					
1985	\$305,966,000	(\$13,954,000)	-4.36%			
1986	\$415,196,000	\$109,230,000	35.70%			
1987	\$316,457,000	(\$98,739,000)	-23.78%			
1988	\$299,819,000	(\$16,638,000)	-5.26%			
1989	\$270,061,000	(\$29,758,000)	-9.93%			
1990	\$259,969,000	(\$10,092,000)	-3.74%			

*Tax rates on Table Wine: \$1.07 per wine gallon from January 1, 1991

1991	\$500,597,000	\$240,628,000	92.56%			
1992	\$615,696,000	\$115,099,000	22.99%			
1993	\$578,013,000	(\$37,683,000)	-6.12%			

— The Tax Collection figures are for the fiscal years ended September 30

— Source of information: U.S. Department of Treasury — Bureau of Alcohol, Tobacco and Firearms

The beverage alcohol industry in Kansas with the combination of federal and state excise taxes now levied plus the 10 per cent drink tax in addition to all other business taxes paid, cannot bear the proposed \$22 million tax increases.

PUBLIC POLICY ISSUES

I also want to address the process of the making of public policy, and specifically as it relates to budgetary and taxation policy. I am suited to address these issues having served as a public official and as having been an observer in this building for nearly a quarter of century. I can empathize with the difficulty of attempting to satisfy numerous interest groups, with wrestling with your own conscience as to what is right and with the job of having to meet the needs of those who sent you here.

However, I do question the necessity of enacting revenue increases before the Legislature has established its FY2005 priorities. At this point of the session we know not whether you will need the additional taxes nor do we know how much. With the exception of the inventory taxes included in any increase legislation, the tax increases proposed will not bring significant revenues into the state treasury until the next fiscal year.

And let me digress for just a moment, the inventory (floor) tax would result in my segment of the industry in having to write checks to the State in just a few months in an amount most likely in excess of \$1 million. Additionally, we would incur significant costs in programming and labor to do the inventory. I have no way at this time of ascertaining the cost to Kansas retail liquor dealers. Nonetheless, we most likely would have to finance this one time tax payment (in essence re- capitalize our businesses) in order to pay these taxes. Floor tax payments should be spread over time.

With respect to the current fiscal year the Legislature has multiple choices. I am not sure any of us know what the ending balance requirement will be, or closer to the point of this debate, available funds for education, or, whether or not the Supreme Court will require an overhaul of the education funding system. I suggest that pumping more money into this system pending the outcome of the Court's review is foolish.

The Topeka Housing Authority of which I am Chairman was confronted with a fiscal crisis several years ago. THA was nearly \$1 million in debt. As of the close of business last year we restored our reserves to just shy of \$1 million. We did this by significantly reducing staff, reorganizing our management structure, privatizing certain functions and implementing many private sector business practices. And we now are providing better housing services to more families than we were before we undertook this restructuring. It was a painful process, but it was the right thing to do. So when I suggest that you should look at areas by which to reduce spending and apply efficiency practices before you raise more revenues, I speak from experience. It can be done.

Some are suggesting that these new revenues are necessary to fund education. This Legislature has had before it a post audit report regarding K-12 education expenditures. I told a House committee in 2001, and I repeat to you this year, that the solution is not to continue to pour money into the educational pipeline until you have addressed structural issues such as consolidation, reduction of administration, cooperative agreements and shifting resources to the frontlines in the classroom. As a former school board member I know that that can be done as well. Do not ask my industry to extract more taxes from its consumers until you have made every effort to ascertain whether those additional revenues are really required. And inasmuch as education is the responsibility of all Kansans, then all Kansans should be asked to contribute. .. not just one segment.

In the 1986 work KANSAS POLICY CHOICES, edited by H. Edward Flentjie. it was stated that:

"Excise taxes on alcohol, tobacco, and motor fuel constitute relatively minor sources of revenue for most states and have major disadvantages: They have little growth potential; fall heavily upon low-income persons, and are susceptible to tax evasions. . . State and local governments should use restraint in setting excise tax rates. Tax rates that are substantially higher than in neighboring states will encourage tax evasion."

That work also challenged the Legislature as follows: "Other issues in state and local finance, often related to the major themes discussed above, will face Kansas in the years ahead. Among these are the following:

1. What percentage of total revenue should come from each of the major taxes - property, income, and sales?

2. By what criteria should tax exemptions be judged? How should low- income people be protected against unreasonable tax burdens?

3. How should financial responsibility be divided among state and local governments? Should changes be made in the organization and structure of local governments? In the way the state deals with local governments?

4. What should be the role of the "minor" taxes? Should specific unit rates be changed to ad valorem rates? To what extent should the state promote the lottery, if approved, as a revenue source?

5. Should user fees be expanded as a means of raising revenue or discouraging consumption of government services? ...

Obviously, these questions are not exhaustive. Answering them would provide a good start toward defining the kind of revenue structure that would maintain a reasonable level of services, prevent undue discouragement of economic growth, and not impose unreasonable burdens on any taxpayer."

I respectfully that in the 17 years hence the Legislature has not examined in detail these questions of budgetary and tax policy. I suggest that enacting annual budgets rather than two-year budget has created the potential for an ongoing fiscal crisis, such as the one you believe you now are confronted with, susceptible to economic swings. In short you have much work to do before you decide to raise taxes, whether it be on my industry, on another industry or a general tax increase. Adam Smith, the 18th century philosopher and founder of modern economics told us that all economic growth blossoms in a political environment that protects private property, free exchange, and the justly deserved fruits of labor. Countries reap despair Smith said, when they discourage business and punish productive activities. At a time when the economy is already suffering, do not shackle consumers and business with more taxes. It is tantamount to punishment.

And do not be fooled that because your proposals raises liquor gallonage taxes that you are not increasing the "sales" taxes on beverage alcohol. As the base price increases due to this \$22 million dollar cost to the system, then consumers will pay more in real dollars of liquor enforcement taxes (a tax on the retail sale of liquor) and of the liquor drink tax. *Those who say they do not favor increasing sales taxes, but vote for these increases, will be doing that which they abhor.*

Reasons NOT to increase liquor taxes

“A tax on a tax on a tax!”



Taxes\$ generated

on an average \$10.49 liter now & PLUS increase after tax plan @ \$11.29 (up7%)

Today at \$2.50 and at \$5.50
Spirits gallonage tax

Federal excise taxes \$13.50 proof gal. 80 proof liter \$10.80 x .264172	2.85	2.85
State Gallonage Tax	.66	1.46
Enforcement (sales) Tax 8%	.84	.90
TOTAL TAX	4.35 (41.5%)	5.21 (46%)
10% Drink Tax 33 drinks/bottle at \$3.50 drink today = \$115.50 x 10%	11.55	
with 7% cost increase @ \$3.75 = \$123.75 x. 10%		12.37
TOTAL FEDERAL & STATE TAXES	\$15.90	\$17.58

This proposal, by some who have vowed for three sessions now to increase liquor taxes because, for whatever reason, they do not believe that the over \$80 million dollars in liquor taxes currently paid is enough, constitutes what I term the **M&M** method of budgetary' policy. (Yes I have used this analogy before.) I have a granddaughter, and if I put a bowl of M&Ms out she will eat all the "nummies" in the bowl. If I refill the bowl, she will eat as many more as I place in it. As a good grandfather I have to know when not to refill the bowl and sometimes I have to know when to remove some of the **M&Ms** from the bowl, otherwise my granddaughter might get ill from over-consumption.

I challenge you to address the public policy issues first. To establish budget priorities first, to make appropriate reductions, structural and organizational changes first, and not to keep filling the bowl with M&Ms - - otherwise Kansans might develop a stomach ache that they can only cure themselves of in November.

Thank you for your attention to these matters.



Mr. Duncan is the Executive Secretary and General Counsel, Kansas Wine and Spirits Wholesalers Association (KWSWA). University of Kansas, B.S., Journalism '73; Washburn University J.D. '76. Secretary and Chief Counsel, Kansas Board of Tax Appeals '76-'78; Assistant Attorney General, Kansas Alcoholic Beverage Control, '79-'81; Assistant City Attorney, City of Topeka, KS, '81-'83. Private practice 1983 to present. Admitted to practice in Kansas, Federal District Court, Circuit Courts of Appeal, and the United States Supreme Court. Mr. Duncan has made numerous presentations to regional and national NCSLA conferences on beverage alcohol law, and is a frequent speaker for server training programs. Mr. Duncan currently sits as a Judge *Pro Tem*, Shawnee County District Court for Domestic Violence matters. Mr. Duncan represents the KWSWA, the Kansas Occupational Therapy Association and American Medical Response before the Kansas Legislature. Previous activities include: President Topeka Friends of the Zoo, Member and Vice-Chairman Topeka Public Schools Board of Education; Chairman Kansas Expocentre Operating Board; President Voluntary Action Center (a United Way agency); Member, Topeka and Kansas Bar Associations; Life Member Washburn Law School Association; Life Member, University of Kansas Alumni Association; Life Member Topeka/Shawnee County Friends of the Library; 2004 President Shawnee County Historical Society; 2002-2003 Chairman Topeka Postal Service Customer Advisory Council; and Chairman, Topeka Housing Authority 1999-2004. Senior Warden, St. David's Episcopal Church. Married 29 years to Kathleen Allen Duncan, father two adult sons and proud grandfather to granddaughter Tessa, age 5.



800 SW JACKSON STE 1017, TOPEKA, KANSAS 66612

TESTIMONY OPPOSING THE SENATE REPUBLICAN LEADERSHIP SCHOOL FINANCE PLAN 3-22-04

We appear today in opposition to the targeted tax increases proposed by the Chairman of this committee and other republican leaders. Part of this tax increase is targeted to more than 800 businesses that can - by law - only be owned by Kansans.

BEER TAXES HAVE GONE UP SINCE 1977:

- IN 1979 -- A KANSAS DRINK TAX OF 10 PERCENT OF GROSS RECEIPTS IS IMPOSED ON CONSUMERS FOR ALCOHOL PURCHASES. FURTHER, BECAUSE IT IS A PERCENTAGE OF THE PRICE, THE TAX BURDEN RISES EVERY YEAR.
- IN 1987 -- THE 4 PERCENT ENFORCEMENT TAX FOR OFF-PREMISE CONSUMPTION **WAS DOUBLED** TO 8 PERCENT, AND WAS BROADENED TO INCLUDE SALES OF 3.2% BEER TO DRINKING ESTABLISHMENTS, CLUBS, ETC. WHILE OTHER BUSINESSES AND PRODUCTS ARE RECEIVING TAX BREAKS AND EXEMPTIONS, CONSUMERS OF A SPECIFIC PRODUCT WERE TARGETED FOR INCREASES -- AGAIN.
- IN 1990 -- THE 10% DRINK TAX WAS EXTENDED TO MORE LICENSEES (E.G., THOSE WITH TEMPORARY PERMITS WHICH ARE MOSTLY CHARITIES).
- IN 1991 -- KANSAS CONSUMERS HAD THE FEDERAL PORTION OF THEIR BEER EXCISE TAX DOUBLED RESULTING IN A "WINDFALL" FOR KANSAS DUE TO OUR RELATIVELY *UNIQUE SYSTEM OF TAXING TAXES*.

IN 2002, THE KANSAS SALES TAX WAS INCREASED. BECAUSE GALLONAGE TAXES ARE INCLUDED IN THE COST OF CMB WHICH IS SUBJECT TO SALES TAX, THIS CREATES A TAX BEING LEVIED ON A TAX.

KANSAS IS THE ONLY STATE THAT TAXES ALCOHOLIC BEVERAGES 3 TIMES BEFORE THE BEVERAGE IS PURCHASED BY THE CONSUMER. AND, BASED ON THE PERCENTAGE TAXES THAT ARE APPLIED THE EFFECTIVE TAX RATE IN THIS PROPOSAL FOR BEER IS \$.50/ GALLON, WINE \$1.07 / GALLON, AND SPIRITS \$6.53 / GALLON.

DESPITE EFFORTS TO HIDE THE TAX, THIS IS NOTHING MORE THAN A LARGE TAX INCREASE ON KANSAS CONSUMERS.

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AND, WHAT HAPPENS WHEN THE KANSAS LEGISLATURE CHOOSES ONE PRODUCT TO OVER-TAX? CONSUMERS SHOW THEIR LOYALTY "WITH THEIR FEET" AND SHOP OUTSIDE THE STATE. MORE THAN 50% OF THE ALCOHOLIC BEVERAGES SOLD IN KANSAS ARE SOLD WITHIN 50 MILES OF THE GREATER KANSAS CITY AREA.

CURRENTLY, THERE IS SUBSTANTIAL CROSS BORDER MIGRATION TO PURCHASE LOWER TAXED PRODUCTS. THIS LEGISLATION WILL ONLY SOLIDIFY THOSE BUYING HABITS. DESPITE KANSAS' BEST EFFORTS TO RAISE TAXES AND FORCE ITS CITIZENS TO PAY THEM, SHORT OF BORDER CROSSING CHECKPOINTS - KANSAS WILL CONTINUE TO LOSE SUBSTANTIAL REVENUE BY RAISING TAXES ON SELECT ITEMS THAT PEOPLE CAN EASILY BUY ELSEWHERE.

WE DON'T MIND THE REQUIREMENT THAT ONE'S TAXES NEED TO BE PAID PRIOR TO ISSUING A STATE LICENSE, BUT IT SHOULD APPLY TO ALL STATE ISSUED LICENSES. NOT JUST ALCOHOLIC BEVERAGES. IF THAT CANNOT BE DONE BECAUSE OF GERMANENESS PROBLEMS THEN ADD A PROVISIO THAT THE REQUIREMENTS WILL BECOME EFFECTIVE WHEN LEGISLATION IS PASSED COVERING ALL STATE ISSUED LICENSES.

FUNDING OF EDUCATION IS EVERY CITIZEN'S RESPONSIBILITY. TAX EVERY CITIZEN IF YOU NEED ADDITIONAL MONEY FOR THIS ONE YEAR PLAN. TAXING EVERYONE TO RAISE THIS AMOUNT WOULD NOT BE ONEROUS. PLACING A PERMANENT TAX INCREASE ON ONE INDUSTRY TO FUND EDUCATION IS BOTH ONEROUS AND APPEARS PUNITIVE. AS WAS STATED ON THE HOUSE FLOOR, IF YOU WANT TO STOP DRINKING, RE-ENACT PROHIBITION. IF YOU WANT TO LOSE BUSINESS AND TAX REVENUE, ADOPT A TAX INCREASE THAT IS EASILY AVOIDED.

NEAL WHITAKER,

KANSAS BEER WHOLESALERS ASSOCIATION

SENATE EDUCATION COMMITTEE

March 22, 2004

Gordon Yetter, Edwards Retail Liquor
5341 S. Topeka, Topeka, Kansas 66619

Mr. Chairman and Members of the Committee, I am speaking to you today regarding the Senate Education Plan on behalf of myself as a retail liquor store owner and a member of the Kansas Association of Beverage Retailers.

I would like to thank you for allowing me this opportunity to speak before this committee. I understand that time is important and shall keep my statement short. My name is Gordon Yetter, my wife Deb and I own Edwards retail liquor store, located here in Shawnee County. I am also a full time economics and business professor at a community college.

There are three points that I would like to present.

First; I understand the need of our educational system for reliable funding, specifically out elementary and high school teachers are shamefully underpaid and some need to live off of state and federal subsidies to survive. However, what this committee is proposing to do by increasing the gallonage tax would cause extreme hardship and dead weight loss to this targeted industry.

- The instant inventory tax would require nearly every liquor store to borrow money to pay the State up front for tax increases that become effective on June 1. If this proposal is written like the one in Senate Bill 305, I would have to come up with that money in a couple of weeks. Even with my additional job, I do not have the cash to pay that tax on my inventory.
- The more than doubled gallonage tax would slow business to a crawl and further destroy Kansas businesses' ability to compete with our border states.
- Dead weight loss is the difference between what the market was (product sold), compared to what the market would be (losses of sold product), after the tax is imposed on the industry. We need to realize that 70% of Kansas' population lives on our borders. This population is already jumping the borders buying cigarettes, gasoline and liquor.

Loffler's curve would be a true example of this effect, showing that an increase in a tax would cause the collection of less money than it did before the new tax. **For example, right now we sell a 30 package of Busch for about \$16.50, in Missouri, it is selling for \$13.50 or less.**

Second; Kansas children are in trouble. Obesity in children has increased 35% in the last decade. Diabetes in children under the age of 16 has increased 26% during this same time. I was watching the TV news the other day and saw a clip about this same problem and the schools answer was to give the children more activities to do in school. I am sorry, but this is not the answer. If you are truly looking for ways to help schools and children, you could entertain the idea of taxing fast foods, pop, candies, cakes and ice cream. Call it the Twinky tax. There may be 1000 times more Coke, Pepsi, and other brands of pop sold in this state than liquor. Suppose you put a five cent tax per bottle/can on every pop sold. You could raise five times the money and no one will be going to Missouri to buy pop - meaning the moneys would be kept in our state.

Third; we need to look outside the old paradigm of target taxing fuel, cigarettes, and liquor. Do something different that would help our educational system and our children without destroying our Kansas owned small businesses - the 700 state licensed liquor stores.

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*Kansas
Licensed
Beverage
Association*

*President
Tom Intfen*

*Secretary/Treasurer
Tammy Davis*

*Vice Presidents
Robert Farha
Glenda Dewey
Jim Hendricks
James Fager
Curt Melzer
Richard Markle
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*Testimony on Senate Leadership Plan, March 22, 2004
Senate Education Committee*

Chairman, and Senators of the Committee,

I am Philip Bradley representing the Kansas Licensed Beverage Assn., a group of men and women, in the hospitality industry, who own and manage bars, clubs, caterers, restaurants and hotels where beverage alcohol are served. Thank you for the opportunity to present testimony today.

We appear in opposition to the Tax increases targeted at only one industry.

Although we support the funding of education, we oppose targeted taxes. We believe that the funds the state needs for general state needs should come from the taxes that all citizens pay; sales, property and income, (which we pay as well). Targeting individual industries only makes that industry less competitive in the market place and drives consumers to other states or on-line sales outlets where Kansas receives no tax revenue. This year the legislature is considering many roll backs and tax benefits to individual industries for just that reason. We ask that you apply consistent reasoning here as well.

These taxes – like most sales taxes - are regressive. These taxes will unfairly burden lower wage earners while having little impact on the highest income households. Excise taxes on beverages are among the most regressive revenue sources, placing the greatest burden on lower and middle-income consumers.

“Excise taxes on alcohol, tobacco, and motor fuel constitute relatively minor sources of revenue for most states and have major disadvantages. They have little growth potential, fall heavily upon low-income persons...State and local governments should use restraint in setting excise rates. Tax rates that are substantially higher than neighboring states will encourage tax evasion.” From, Kansas Policy Choices 1986.

This won't change the consuming habits of those that can afford to buy bulk and will drive a few more minutes to Missouri to buy case wine or cases of beer. It will just encourage the consumer to drive that extra 2 miles form KC or few minutes from Lawrence to eat out in KC, MO where they can already get a bottle of wine for less or their favorite microbrew for less. What is likely is that the consumer that has a limited budget will consider getting his beer at the Liquor store instead of at the local grill/restaurant and the hospitality industry gets another hit.

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And the hospitality businesses can ill afford this now as they have finally reached the bottom of the slide and a few people are starting to once again go out to spend a few of their discretionary dollars on a meal out.

Kansas is the only state that taxes these beverages 3 times before they get to the consumer.

Gallonage Tax – Wholesaler;
Enforcement Tax – Retailer;
Drinks Tax – Club and Drinking Establishments.

These taxes were adopted and increased BECAUSE of the multiplier affect: a tax on a tax on a tax. And increases in Gallonage Taxes are multipliers for the largest impact at the consumer level. This is the WORST tax for the consumer.

Tax Collection component

The tax collection component has a worthy purpose; to recover taxes rightfully owed our State. The KLBA supports that goal. In fact, SB-345 was introduced in the 2001/2002 Session to accomplish this very purpose. In our associations testimony at that time we raised 2 points that the Senate Federal and State Affairs committee found to have merit and acted upon.

First, that the delinquent taxes in question must be those that apply directly to this business which holds this license;

Second, that this condition for renewal of licenses and permits, controlled by the state, should apply to all of the businesses and individuals that the state issues licenses/permits to, and further that these should be treated equally, enacted at the same time and in the same manner.

A third concern was raised and the Committee determined it to also have merit; that if only one stockholder in a corporation operating this license, was delinquent that he not penalize the entire business.

The remedies that the Senators adopted follow;

For the First they added this clause,

The provisions of paragraph (1) of this subsection shall apply only to taxes related directly to the business for which the license is issued.

For the second they requested that a new bill be drafted to include all businesses or individuals that receive licenses/permits from the State. That bill did not appear in the last session. We ask you to include these in one bill.

And third they adopted this language.

If the licensee is a corporation, partnership, trust or association, the individual officers, directors, stockholders, partners, managers or other individual members shall not be required to be current in the payment of the taxes specified in paragraph (1) of this subsection.

We support these corrections and would ask the committee to do the same. We support all taxes owed being paid on time and in full by all of our citizens. In the hearing on HB-2860 the DOR endorsed these amendments and interest in combining all of the 6 bills proposed this year to make sure permit holders and licensees are current before renewal.

Other Bills on this topic this year that should be combined before passage to assure equal treatment; SB-414, SB-468, HB-4648, HB-2776 and HB-2860

From testimony in Senate Assessment & Taxation, on SB-468 February 16, 2003, "In conclusion, she called attention to a list of the licensing agencies and professions affected by the bill attached to her written testimony, noting that it would affect almost 118,000 licensees. In addition, she called attention to the last paragraph of her testimony, which lists states which currently have professional license tax clearance programs. She noted that states with these programs uniformly report them as very effective in achieving tax compliance." Secretary of Revenue, Joan Wagon.

We urge you not to pass the targeted tax or the solo enforcement component.

As always I will make myself available for questions. Thank you for your time.

Dr. Philip B. Bradley
Executive Director



COPY FOR YOUR INFORMATION

Senate Assessment and Taxation- SB-468
Chairman, Senators and Staff,

March 23, 2004

*Kansas
Licensed
Beverage
Association*

President
Tom Intfen

Secretary/Treasurer
Tammy Davis

Vice Presidents
Robert Farha
Glenda Dewey
Jim Hendricks
James Fager
Curt Melzer
Richard Markle
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SB-468 has a worthy purpose; to recover taxes rightfully owed our State. The KLBA supports that goal. As you know the Department of Revenue has introduced several bills to accomplish this goal. We ask that all businesses be treated the same. The DOR has agreed at your hearing on SB-414. Further they endorsed the amendments that we suggested from the work done in the 2002 session. We believe they would be appropriate for all businesses.

First that the delinquent taxes in question must be those that apply directly to this business which holds this license or permit.
Second, that this condition for renewal of licenses and permits, controlled by the state, should apply to all of the businesses and individuals that the state issues licenses/permits to, and further that these should be treated equally, enacted at the same time and in the same manner. A third concern was raised and the Committee determined it to also have merit; that if only one stockholder in a corporation operating this license, was delinquent that he not penalize the entire business.

The remedies that the Senators adopted follow;
For the First they added this clause,

The provisions of paragraph (1) of this subsection shall apply only to taxes related directly to the business for which the license is issued.

For the second we ask you to include all businesses/professional licenses and permits into one bill.

And third they adopted this language.

If the licensee is a corporation, partnership, trust or association, the individual officers, directors, stockholders, partners, managers or other individual members shall not be required to be current in the payment of the taxes specified in paragraph (1) of this subsection.

We further believe the 90 day notice in this bill should be applied to all.

We ask for current tax compliance percentages for all businesses and professions. It would be beneficial to know the extent of the challenge and where to begin.

We support these corrections and would ask the committee to do the same. We support all taxes owed being paid on time and in full by all of our citizens. In the hearings on HB-2860 and SB-414 the DOR endorsed these amendments and combining SB's 414, 468 & HB's 2860, 2648, 2776. With those changes we could support this proposal. I have attached the bill and supplemental from 2001/2002 session for your convenience.

Thank you for your time.

Philip Bradley
Executive Director

Sen. Oleen

MEMORANDUM

To: Senator Oleen
From: Theresa M. Kiernan
Subject: Licensees/Tax Payments
Date: May 2, 1998

K.S.A. 74-8708
(g)(4) Requires lottery retailers to be current in filing and payment of all taxes, interest and penalties owed to the state and to any taxing subdivision of the state.

K.S.A. 74-8813
(c)(7) Requires each director and officer of an organization licensee under the Kansas parimutuel racing act to be current in any monetary or tax obligation owed to the federal, state or local government, whether or not relating to the conduct or operation of a race meet held in this state or any other jurisdiction.

K.S.A. 74-8815
(f)(8) Requires applicants for a facility owner license or facility manager license under the Kansas parimutuel racing act to be current in any monetary or tax obligation owed to the federal, state or local government, whether or not relating to the conduct or operation of a race meet held in this state or any other jurisdiction.

K.S.A. 74-8816
(e)(8) Requires occupation licensees under the Kansas parimutuel racing act to be current in any monetary or tax obligation owed to the federal, state or

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local government, whether or not relating to the conduct or operation of a race meet held in this state or any other jurisdiction.

K.S.A. 74-8817

(d)(5)

Requires concessionaire licensees under the Kansas parimutuel racing act to be current in any monetary or tax obligation owed to the federal, state or local government, whether or not relating to the conduct or operation of a race meet held in this state or any other jurisdiction.

K.S.A. 74-8837

(d)(5)

Requires racing or wagering equipment or services licensees under the Kansas parimutuel racing act to be current in any monetary or tax obligation owed to the federal, state or local government, whether or not relating to the conduct or operation of a race meet held in this state or any other jurisdiction.

K.S.A. 79-3228

Provides that the signing of a fraudulent income tax return is a felony. Under most licensing statutes, a felony conviction is grounds for denial, revocation or suspension of a license.

K.S.A. 79-3309

Provides that a violation of the cigarette and tobacco products act is grounds for suspension or revocation of a license. K.S.A. 79-3392 imposes the sales tax act on the sale of cigarettes, therefore, failure to be current in the payment of sales taxes would be grounds for suspension or revocation of a license under the cigarette and tobacco products act.

Multi-Year Fiscal Notes for Selected Revenue Provisions

1. The current liquor gallonage tax would be increased on June 1, 2004, as follows: The per gallon tax on cereal malt beverage and strong beer would increase from \$.18 to \$.42; the per gallon tax on wort or liquid malt would increase from \$.20 to \$.468; the per gallon tax on malt syrup or malt extract would increase from \$.10 to \$.233; the per gallon tax on light wine would increase from \$.30 to \$.90; the per gallon tax on "fortified" wine would increase from \$.75 to \$2.25; and the per gallon tax on alcohol and spirits would increase from \$2.50 to \$5.50. **SGF Revenue Enhancements: FY 2005: \$21.74 million; FY 2006: 22.10 million; FY 2007: \$22.19 million.**
2. Policy would be changed regarding exemptions for sales tax paid on utilities (gas, water, and electricity) to require persons who seek refunds on sales taxes paid on utility purchases that pass through only one meter to conduct a usage study and provide it to the utility provider. The provider also would have to be presented with the exemption certificate or claim. Currently, no verification or documentation is required for individuals who claim utility exemptions for that portion of the utility that passes through one meter when most of the usage is taxable. **SGF Revenue Enhancements: FY 2005: \$8.60 million; FY 2006: \$8.88 million; FY 2007: \$8.16 million.**
3. The timeframe for claiming an income tax refund after filing the original return or paying the tax and for claiming a sales tax refund or credit would be reduced from three years to one year. **SGF Revenue Enhancements: FY 2005: \$16.5 million (\$12.0 income tax and \$4.5 million sales tax); FY 2006: \$12.25 million (\$9.0 million income tax and \$3.25 million sales tax); FY 2007: \$9.0 million (\$7.0 million income tax and \$2.0 million sales tax).**
4. A policy would be implemented relating to refundable tax credits and net operating loss to modify the existing provisions in various income tax credit statutes to provide that any excess credit, instead of being refunded, would be carried forward and used as a credit against income tax liabilities in subsequent years. Credits that would be affected by the change are the telecommunications credit, disabled access credit, child daycare assistance credit, small employer health insurance credit, and business machinery and equipment credit. **SGF Revenue Enhancements: FY 2005: \$9.0 million; FY 2006: \$9.0 million; FY 2007: \$9.0 million**
5. A policy would be implemented to amend the sales tax law to provide that, in the case of isolated sales of motor vehicles or trailers, the tax would be charged on the greater of the stated selling price or the valuation of the motor vehicles or trailers pursuant to the motor vehicle tax law. **SGF Revenue Enhancements: FY 2005: \$1.906 million; FY 2006: \$2.137 million; FY 2007: \$2.111 million.**



K A N S A S

JOAN WAGNON, SECRETARY

DEPARTMENT OF REVENUE
OFFICE OF THE SECRETARY

KATHLEEN SEBELIUS, GOVERNOR

Testimony to the Senate Education Committee Joan Wagon

March 23, 2004

Senate Substitute for 2003 House Bill 2004

Chairman Umbarger and Members of the Committee:

The Senate education finance plan, Senate Substitute for 2003 House Bill 2004, includes several provisions from earlier introduced bills, which the Department strongly supports. These are explained below:

Shorten Statute of Limitations on Sales Tax and Income Tax Refunds to 1 Year

Sections 15 (income tax refunds statute of limitations) and Section 23 (sales tax refunds statute of limitations) are based on provisions in House Bill 2430, introduced last year, which proposed to reduce the statute of limitations on income tax and sales tax refund claims from three years to one year. Had this change been in place at the time of the military retirement case, *Barker v. Kansas*, 503 U.S. 594 (1992), the fiscal note in resolving that matter would have been much lower. In recent years, sales tax refund "consultants" working for contingent fees have gleaned the countryside for clients, conducting reverse audits, and then filing hundreds of sales tax refund claims with the Department covering the prior three years. Many of the claims are of questionable validity and are poorly documented. However, they are filed en masse in hopes that at least some of them may have settlement value. The Department must then devote its limited resources to handling refund claims, instead of conducting audits or collecting taxes. We estimate that this change, which would be prospective, could reduce income tax refund payments by \$12 million and sales tax refund payments by \$4.5 million.

Refundable Tax Credits To Become Carryforwards

Sections 8 (employer health care premium tax credit), 16 (net operating loss), 17 (disabled access tax credit), 18 (child day care facility tax credit), 19 (community service organization contribution tax credit), 20 (business machinery and equipment tax credit) and 21 (telecommunications tax credit) are based on House Bill 2449. This proposal will save the State of Kansas substantial money. The bill identifies the following refundable tax credits and modifies them to become nonrefundable: the business machinery and equipment credit, K.S.A. 79-32,206; the telecommunications credit, K.S.A. 79-32,210; the disabled access credit, K.S.A. 79-32,175, et al.; the child day care assistance credit, K.S.A. 79-32,190; the community service contribution credit, K.S.A. 79-32,196, et al.; and the small employer health insurance credit, K.S.A. 40-2246. It also clarifies existing tax treatment of farm net operating losses. The positive

cal impact of this bill for FY 05 is estimated to be \$9 million, with that same amount expected in the out years.

If a tax credit is refundable, the taxpayer can claim it, whether the taxpayer has any tax liability to apply the credit against or not. If the taxpayer has insufficient tax liability to apply the credit against, the taxpayer is entitled to receive a refund of the unused amount of credit. Refundable tax credits do not simply reduce a taxpayer's tax liability. They require that tax revenue collected from somewhere else must be used to fund the refundable credits. With a nonrefundable credit, the taxpayer must have sufficient tax liability to apply the credit against in order to claim the credit. Typically, if there is unused credit left over after applying the credit against the outstanding tax liability and reducing that liability to zero, the unused credit can be carried over to the next tax year and claimed on that year's return. This process will continue until the credit is fully used up, unless the law provides that the credit must be used within a certain time period.

Changing the above tax credits from refundable to nonrefundable does not mean that those credits cannot be claimed. It only means that tax liability must exist for the credit to be applied against. We will not be taking revenue away from somewhere else to fund them.

Broaden Liquor License Tax Clearance Process

Sections 9 and 12 of the bill are based on language from Senate Bill 414, heard in Senate Committee on Assessment and Taxation. The Department recently concluded a successful tax amnesty program; Phase II brought in \$31 million in past due taxes, \$11.5 million above the projected \$19.5 million. With completion of the amnesty program, we are stepping up our compliance efforts, in order minimize the amount delinquent tax liability. Senate Bill 414 is one of several Department proposals to accomplish that objective.

First, Section 9 amends K.S.A. 2003 Supp. 41-311 to require a liquor licensee to be current in payment of withholding, sales and liquor taxes relating to the liquor-licensed business before the license can be issued or renewed. Current law requires liquor licensees be current only in liquor tax payment. Requiring liquor licensees to remain current in payment of withholding and sales tax will significantly improve tax compliance, increase tax revenue, and enable the Department of Revenue to maintain a more level playing field among liquor licensees.

At the hearing on the House version of this bill, House Bill 2680, in the House Federal and State Affairs Committee on February 9, representatives of the liquor industry raised concerns that under the bill as introduced, a disputed or erroneous tax liability could trigger license revocation. They also raised the question whether delinquent tax liability of a minority shareholder or officer of a liquor licensee could trigger license revocation. We are open to any amendment to address those concerns. Our proposal focuses on collecting delinquent sales and withholding taxes owed by businesses with liquor licenses. If the tax liability is in dispute and under appeal or subject to a current payment plan, the license non-renewal provisions are not triggered. We are also not interested in triggering the license non-renewal provisions simply because an individual associated with the business has an outstanding individual tax liability.

Sales tax is a trust tax. For the privilege of making retail sales in this state, businesses must register with the Department to collect on behalf of the state sales tax from purchasers and remit it on the 25th day following the month of the sale. Similarly, businesses are required to withhold a percentage of their employees' wages and remit those employer withholding taxes to the state on behalf of their employees. Licensees that pocket the sales tax collected from consumers or wages

withheld from their employees rather than remitting it to the Department of Revenue are not only misappropriating money from the state. They give themselves an artificial competitive advantage over compliant liquor licensees.

Our recently concluded tax amnesty program highlighted the need for strong tax compliance efforts, in order to keep downward pressure on delinquent tax liability. This proposal addresses tax compliance for liquor licensees. The licensing statute currently does not allow denial of liquor licenses based on noncompliance with sales or withholding tax.

While the Division of Taxation has other ways to collect delinquent taxes, the license renewal process is by far the most cost-effective and least intrusive for the liquor licensee. Our collection efforts include phone calls, letters, assessment notices, tax warrants, bank account levies, garnishments, seizure of money from cash registers and, in some circumstances, seizure and sale of inventory and other property. We have in the past seized retail liquor store inventory. Collecting delinquent taxes through the license renewal process gives the licensee a clear, simple choice: either pay your tax obligations to the state or close your liquor business.

At least 16 states require some sort of tax clearance before issuing or renewing liquor licensees.

Similar successful tax compliance requirements are currently in place in Kansas for:

- Lottery retailers
- Cigarette retailers
- Each director and officer of an organization licensed under the Kansas Pari-mutuel Racing Act
- Pari-mutuel facility owner and facility manager Occupation Pari-mutuel licensees
- Pari-mutuel Concessionaire licensees
- Racing or wagering equipment or services Pari-mutuel licensees

While this proposal will address tax compliance for the liquor licensees, the Department is working to address tax compliance in other areas as well. Legislative Post Audit (LPA) recently audited the Department on motor vehicle sales tax collections. In noting compliance issues with motor vehicle dealers delinquent in payment of sales and withholding taxes, the LPA recommended that the Department use the dealer license revocation procedure to encourage tax-delinquent dealers to become current on their tax obligations. The Department has followed through on that recommendation. We also support House Bill 2648, set for hearing in the House Tax Committee this week, which proposes mandating revocation of a motor vehicle dealer's license if the dealer is sufficiently delinquent in remitting sales tax. We have introduced legislation this session in both the House and Senate (Senate Bill 468, set for hearing in this Committee on February 16) proposing a tax clearance procedure for the renewal of professional licenses, such as for architects, engineers, accountants, doctors, nurses, pharmacists, real estate agents, insurance agents, veterinarians, among others. California, Oregon, Washington, Minnesota, and Missouri employ a tax clearance process for professional licenses. Those states indicate the tax clearance process for licenses is an excellent tax compliance tool.

At the House Federal and State Affairs Committee hearing mentioned earlier, liquor industry representatives suggested that this bill be combined with the other pending proposals for tax clearance processes for licenses. We support this as well.

Second, Section 12 amends K.S.A. 2003 Supp. 41-2623 in the Club and Drinking Establishment Act to add the sales tax and withholding tax clearance requirement for issuance or renewal of a club or drinking establishment license.

Third, Section 12 also eliminates the requirement that a corporate applicant for a club or drinking establishment license be a Kansas corporation. Under current law, if an out-of-state corporation, such as a large restaurant chain, wishes to obtain a club or drinking establishment license in order to serve alcoholic drinks with meals, the out-of-state corporation must set up a separate entity as a Kansas corporation to hold the club or drinking establishment license. The same restaurant business has to artificially exist as two entities, both with different FEIN's, with the food sales business holding one FEIN and the alcoholic drink business holding another FEIN. This creates needless complexity and opportunity for confusion and error for both the taxpayer and the Department. For example, the liquor entity might register for liquor taxes but not for sales tax, while the food business entity will register only for sales tax. One entity may be considered the employer and report the withholding taxes on the employees that are working for both entities.

The Kansas entity issue complicates the food sales requirement when a restaurant must set up two entities for liquor licensing purposes. For restaurant clubs, not less than 50% of their gross receipts must be from sales of food for consumption. For drinking establishments subject to the food sales requirement, not less than 30% of the gross receipts must be from sales of food for consumption. If a restaurant's food sales business and liquor business are separate entities with different FEIN's and reporting sales tax from food and liquor tax from drinks under different FEIN's, technically, it becomes impossible for the restaurant to meet the food sales requirements.

Having the liquor tax account and the sales tax account or withholding tax account for the same business under different FEIN's also makes it more difficult for the Department to determine the tax compliance status of the business. The liquor entity may be current in liquor taxes, but the food sales entity may be delinquent in withholding taxes, or vice versa.

A business could attempt to employ someone disqualified to work for a liquor licensee, but could pay the employee and file withholding taxes under another FEIN on the theory that the person technically is not employed by the entity that holds the liquor license.

The Department's goal is to reduce the number of separate FEIN's and tax accounts to a minimum, for administrative efficiency. Elimination of the Kansas Corporation requirement for a liquor license will simplify liquor and tax law administration for the licensee and the Department. An out-of-state corporate restaurant chain will no longer need to artificially create a separate Kansas entity for licensing purposes. All taxes (liquor, sales and withholding) can be reported under one FEIN number, the Department can track compliance easier, and there will be much less paperwork for everyone.

Use Property Tax Valuation for Private Car Sales Price

Section 22 is based on Senate Bill 372 (passed by the Senate, referred to House Taxation Committee), which amends K.S.A. 79-3603 concerning computation of sales tax on the sale of isolated or occasional sale of motor vehicles or trailers. The proposal sets the base for computing the sales tax as the stated selling price of the motor vehicle or trailer or the value pursuant to subsections (a), (b)(1) and (b)(2) of K.S.A. 79-5105, whichever amount is higher. K.S.A. 79-5105 defines the value of a vehicle and the assignment of a class code for vehicle property tax purposes. The actual selling price will be the base for computing the tax on the isolated or occasional sale of wrecked or damaged vehicles.

Legislative Post Audit issued a report on the collection of sales tax from motor vehicle sales in April 2003. LPA determined that the state may be losing several million dollars (LPA estimated this amount could be as much as \$7 to \$13 million) in sales tax paid on motor vehicles sold at private sales, due to the under-reporting to the County Treasurer of the sales price by the parties involved in private car sale transactions at the time the cars are registered. LPA's estimate was based on a sample of accounts reviewed, projecting the sample results to the approximate 126,000 isolated and occasional sales transacted yearly. The Special Committee on Assessment and Taxation studied the report last summer, recommending legislation to address the problem. A straightforward rule that County Treasurers could easily apply at the time cars purchased at private sales are registered would enhance collection of the correct amount of sales tax by an estimated \$2 million per fiscal year.

The LPA report found lack of adherence to K.A.R. 92-19-30(d), which requires the sales tax on private car sales to be computed by the County Treasurer or the Director of Taxation on the fair market value of the vehicle under either of the following circumstances:

- (1) The selling price of the vehicle is unknown; or
- (2) the stated selling price is not indicative of, and bears no reasonable relationship to, the fair market value of the vehicle or the average retail value as shown in the latest publication of the national automobile dealers' association official used car guide book.

The report indicated that County Treasurers had difficulty following the regulation, because they did not want to accuse purchasers of being dishonest, and they did not have any way of accurately determining the actual fair market value or whether the buyer simply made a great deal. This proposal would provide County Treasurers a simple "either" "or" rule to cite when determining the tax to charge: the price for sales tax computation purposes will be the higher of the stated selling price or the value for property tax purposes.

The property class value on vehicles that are 15 years or older will be zero and for those, the tax base would default to the selling price. K.S.A 79-5105, for the assignment of a vehicle class value, does not apply for several types of vehicles. Trucks over 16,000 pounds, recreational vehicles, manufactured homes, trailers, buses, electric, specialty, assembled, antique, homemade and some military vehicles would only be taxed on the purchase price, as these vehicles are not included under the class value statute.

Our I.S. staff has indicated that it should be possible to provide to County Treasurers through the VIPS/CAMA system the motor vehicle property tax value information, so that it can be looked up quickly and seamlessly.

Limits on Utilities Sales Tax Refunds

Section 24 of Senate Substitute for 2003 House Bill 2004 contains the language of House Bill 2681, heard in House Taxation Committee, which is intended to ensure that sales tax exemption claims for utilities furnished through a meter (such as gas, water or electricity) are valid and periodically verified by usage study. Under K.S.A. 79-3606(n), utilities "consumed in production" of taxable tangible personal property or services are exempt from sales tax. Last fiscal year, utilities "consumed in production" sales tax exemption claims reduced state sales tax collections by almost \$93 million. We are concerned about the accuracy and validity of many of these claims.

Section 24 requires a utility customer to submit an engineer study to the utilities provider verifying the portion of the utilities furnished through a meter claimed to be exempt from sales tax. The usage study must be renewed every 5 years (or sooner if operational changes have occurred). Although other states (Texas, Oklahoma, Missouri) have a renewal requirement, Kansas law currently does not require a utility customer to renew its sales tax exemption claim with the utility provider after any time period expires. The utility customer submits a sales tax exemption certificate claiming an exemption (such as electricity "consumed in production") to the utility for a specific utility meter. Once the utility customer obtains the sales tax exemption, the utility provider typically continues to honor it, unless the department determines in an audit of that business that the exemption was not proper. Later, the business may change, but no update or change is made to the exemption claim for that meter. A new business could improperly receive an exemption on utilities purchases that do not qualify. Utility providers do not require or ensure that the exemption is taken off a meter until or unless the Department notifies them to do so.

Section 24 further provides that no exemption would be allowed for consumed utilities unless the percentage of exempt use through the meter is more than 50%. This would decrease the number of erroneous refunds on utilities "consumed in production" and enable the Department to reallocate resources to other tasks. Currently, businesses can claim utility sales tax exemptions for any portion of the utilities running through one meter, even when the majority of the usage through that meter is taxable. Utilities providers and the Department spend considerable time and effort adjusting and amending returns, issuing refunds, and attempting to validate the exemption claims. This problem has increased as utilities sales tax exemption claims have expanded beyond the manufacturing and processing sectors. This proposal employs a common sense approach to limit the exemption to businesses in which the principal activity is in the production, manufacturing processing, mining, drilling, refining or compounding of tangible personal property.

Finally, Section 24 provides that refunds to a particular taxpayer account for amounts under \$5 per reporting period would not require payment. Currently, the refund will not be paid only if the amount due is under \$5 for the total owed on the taxpayer account. Likewise, if the taxpayer owes less than \$5, the taxpayer is not assessed. The bill changes the procedure for utility refunds, so that the "less than \$5.00 during any one reporting period" criteria will be used in determining whether a refund will be owed. We would also apply this criteria to determine whether an assessment should be made. This change would save significant refund processing time for the Department's staff.

We estimate that this proposal would result in \$9 million additional state sales tax revenue in fiscal year 2005. The state general fund would increase \$8.6 million and the highway fund \$400,000. The fiscal impact would come from two areas, fewer exemptions claimed on the utility provider returns and fewer refund requests received directly from utility customers or the utility providers on behalf of customers. If this proposal would affect 10% of the exemptions, it would result in the collection of \$9 million annually. Local sales tax receipts would also see an increase of \$2.25 million annually.