

Approved: February 2, 2006

Date

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE

The meeting was called to order by Chairman Barbara Allen at 10:45 A.M. on February 1, 2006 in Room 519-S of the Capitol.

All members were present except:

Derek Schmidt- excused

Committee staff present:

Chris Courtwright, Kansas Legislative Research

Martha Dorsey, Kansas Legislative Research

Gordon Self, Revisor of Statutes Office

Judy Swanson, Secretary

Conferees appearing before the committee:

Joan Wagon, Secretary, Kansas Department of Revenue

Others attending:

See attached list.

Senator Donovan made a motion to introduce a bill for sales tax exemption for Special Olympics. Senator Jordan seconded the motion, and the motion passed.

Joan Wagon, Secretary of Kansas Department of Revenue, made a presentation of sales tax exemptions in Kansas. (Attachment 1) She reviewed the list of organizations receiving tax exempt status. There are 17,012 nonprofit entities in Kansas that are non-exempt. She cautioned the Committee to be careful in making additional exemptions. She reviewed the 1970 Hodge Commission recommendations, which she thought were beneficial. The 2005 Interim Assessment & Taxation Committee study is included with Secretary Wagon's testimony. There is a study of sales tax base erosion in Kansas being conducted by Professor John D. Wong, Hugo Wall School of Urban and Public Affairs, Wichita State University. His report will outline feasible policy alternatives available to state and local policy makers in Kansas and will not make policy recommendations. (Attachment 2) Committee discussion followed.

SB 423, award of attorney fees to taxpayer in certain appeals by county of orders of board of tax appeals, was discussed. Senator Bruce said he thought the current civil law penalties provide for sanctions to be applied, including reasonable attorney fees. Senator Lee requested Research to find out if the Saline County taxpayer who had issues with the County Appraiser had ever requested his attorney fees be paid by the county. No action was taken on the bill.

SB 358, electronic filing of returns and electronic funds transfer for payments required in certain circumstances, was discussed. Richard Cram provided information on firms using electronic filing by number of employees. (Attachment 3) He also provided information on electronically filed and manually filed sales tax. (Attachment 4) **SB 358** would require 3,660 additional businesses to file electronically. No action was taken on the bill.

Senator Apple moved to approve the Minutes of the January 31 Committee meeting. Senator Jordan seconded the motion, and the motion passed.

Being no further business, the committee adjourned at 11:45 a.m.

SENATE
ASSESSMENT & TAXATION COMMITTEE

GUEST LIST

DATE: 02-01-06

1 of 2

NAME	REPRESENTING
Will Deer	Federico Consulting
John Donley	KS Lusk Assoc.
Martin Hawver	Hawver's Capitol Report
Rick Kready	Pioneer Group - Topeka
Bill Brady	C.S.
Derek Hein	Hein Law Firm
Tony A. Scott	KSCPA
Ronald Richey	ME
Madee Carpenter	KS Chamber
Sandy Braden	Grades, Braden, Barber & Assoc.
Sheryl McNair	Hodgeman County Farm Bureau Hodgeman County Economic Develop
Kathy Damron	Damron Assoc.
Mary Ellen Penlee	Via Christi Health System
Christy Caldwell	Topeka Chamber
Claudia Weaver	BioVancrum
Tony Folsom	KDOR
TERRY FOXS 4TH	KUEA
Tom Whitaker	KS Motor Carriers Assn.

SENATE
ASSESSMENT & TAXATION COMMITTEE

GUEST LIST

DATE: 02-01-06

2 of 2

NAME	REPRESENTING
Sharon Connors	Myself
BRAD HARRISON	KFBS
Steve Johnson	Kansas Gas Service / ONEOK
Jennifer Lyon	Pinger, Smith, and Associates
Dan Korber	Kansas, Inc
Ben Cleaves	DOJ
Larry R. Puse	LKM
Ed Muff	LGR
Chris Wilson	KBIA
Marta Jean Smith	KMHA
KEN DANIEL	KSSMBIZ.com
Mike Murray	Sprint
Dylan Shears	Sprint / Nextel
David R. Corbin	KDOR
M. Scott	KDOR
Richard Crum	KDOR
Joan Wagon	KDOR



K A N S A S

JOAN WAGNON. SECRETARY

KATHLEEN SEBELIUS. GOVERNOR

DEPARTMENT OF REVENUE
OFFICE OF THE SECRETARY

Testimony to Senate Tax Committee
Joan Wagon
Secretary of Revenue

February 1, 2006

Chairwoman Allen and Members of the Committee:

Goal: A sound, workable and fair system of taxation.

General Principles: The broader the base, the lower the rate can be.
Taxation is the rule; exemption should be the exception.
Taxation of services makes the tax less regressive and more elastic.
Taxes should be fairly and equitable applied.

In 1970 when the Hodge Commission studied the tax system they tried to examine the philosophy, equity, effectiveness of administration, and the relationship of the taxes to the goal of adequately financing governmental needs without adversely affecting economic growth. They recommended extensive revisions including

- o Expanding the sales tax base to include some labor services and sports participation charges;
- o eliminating all sales tax exemptions for purchases by religious, benevolent and charitable institutions; (committee found that the imposition of these taxes represented a reasonable contribution to the costs of government by the otherwise-exempt organizations.)
- o exempting "consumables" as a class rather than listing certain ones;
- o exempting prescription drugs and medical aids.

The cost of eliminating the charitable exemptions was \$697,000.

Today the list of charitable exemptions has grown to about \$26 million annually. Each year more and more organizations request exemption. It becomes difficult to "draw the line" and say yes to some, and not to others.

One of the most difficult things for a legislator or legislature to do is turn down requests for exemptions, particularly if the request is for a worthy cause or organization. It's a lot easier for the Department of Revenue to oppose the exemptions than for legislators. Yet, every narrowing of the tax base, no matter how small, added to the others soon becomes a large amount – and represents money that won't be available for other state priorities, like education, health care, etc.

Considering exemption requests piecemeal tends makes it harder to look at the larger picture, such as was done by the Hodge Commission. Having objective criteria to use in evaluating such a request is very helpful. The following are some suggested questions to ask, or criteria to use in evaluation of exemption requests.

1. Does this exemption help maintain the sales tax as a final tax on consumption, i.e., exempting component parts or consumables used in producing goods or services?
2. Does this exemption make the tax more easily administered, or would it lead to confusion over whether one organization is taxed and another similar organization is exempt?
3. Who is the principle beneficiary of the exemption? What will be lost if the exemption is not granted?
4. Does the exemption set up an unfair competitive advantage for this group with another group?
5. Is the exemption targeted to a broad class, or a narrow specific interest? Why should all members of the class not be included? If this exemption is granted, who else might also expect to be exempted?
6. What is the public benefit from granting the exemption? How does it outweigh the loss of revenue for the general activities of the state?



K A N S A S

JOAN WAGNON, SECRETARY

KATHLEEN SEBELIUS, GOVERNOR

DEPARTMENT OF REVENUE
OFFICE OF THE SECRETARY

Kansas Department of Revenue
Sales tax treatment for Not-for-Profit Entities
September 2005

The sales tax treatment for nonprofit entities has evolved over the years to include the entities as listed below. Certain exemptions were granted in the early years of the Kansas sales tax where others are recent additions. Requests to expand exempt status to specific nonprofit entities are a yearly activity in the legislature. Each legislative session there are several entities and organizations who have bills introduced that would provide their entity exempt status. In recent years, the greatest change in the exemptions occurred with the 1998 Legislature. In that year, exemptions for nonprofit zoos, religious organizations, habitat for humanity, medically underserved organizations, parent teacher associations/organizations and food distribution program organizations were enacted.

In 1970 an extensive review by the Joint Committee on the State Tax Structure (aka the Hodge Report) was completed. As a result of that study, the legislature amended the statutes to make purchases by religious, benevolent or charitable organizations subject to tax.

The information below provides a summary of the current exempt status of nonprofit entities, fiscal and administrative impacts and treatment of nonprofit entities by neighboring states.

Organizations receiving tax exempt status in Kansas

The following entities currently are exempt from sales tax.

<u>Cite</u>	<u>Organization</u>
79-3606 (b)	State of Kansas and its agencies, Kansas political subdivisions (cities, counties, townships school districts), Nonprofit hospitals, Nonprofit blood, tissue and organ banks
79-3606 (c)	Nonprofit educational institutions (colleges, universities, trade schools, etc. providing education above grade 12), Elementary and secondary schools
79-3606 (s)	Kansas groundwater management districts, Rural water districts and water supply districts
79-3606 (v)	Contractors preparing meals for the homebound elderly, disabled, indigent or homeless (such as Meals on Wheels)
79-3606 (z)	Port authority
79-3606 (hh)	Nonprofit nursing home, assisted living facility, interim care home for medical supplies and equipment
79-3606 (ii)	Nonprofit, nonsectarian, comprehensive youth development organizations
79-3606 (jj)	Community-based mental retardation facilities or mental health centers
79-3606 (ll)	Nonprofit public health corporations for educational materials
79-3606 (oo)	Community action groups/agencies for weatherization of low-income homes
79-3606 (qq)	Nonprofit museums and historical societies
79-3606 (rr)	Sale of personal property that will admit purchaser to an annual event sponsored by a nonprofit organization
79-3606 (ss)	Public broadcasting stations (radio and TV)
79-3606 (tt)	Nonprofit organization for constructing Kansas Korean War Memorial
79-3606 (uu)	Rural volunteer fire fighting organizations

- 79-3606 (vv) Kansas chapters of these Medical Education Organizations: American Diabetes Association - Kansas Affiliate, American Heart Association, Kansas Alliance for the Mentally Ill, Kansas Mental Illness Awareness Council, American Lung Association, Alzheimer's Disease and Related Disorders Assn., Inc., Parkinson's disease association, National Kidney Foundation (of KS and Western MO), The Cystic Fibrosis Foundation, Heart of America Chapter, Spina Bifida Association, Heartstrings Community Foundation
- 79-3606 (ww) Habitat for Humanity for housing project materials
- 79-3606 (xx) Nonprofit zoos
- 79-3606 (yy) Parent-Teacher Associations and Organizations
- 79-3606 (zz) Free-Access Radio and TV Stations – equipment used directly and primarily for producing broadcast signal
- 79-3606 (aaa) Nonprofit Religious Organizations
- 79-3606 (bbb) Nonprofit food distribution program organizations
- 79-3606 (ccc) Primary care clinics and health centers serving the medically underserved
- 79-3606 (ggg) Kansas Academy of Science
- 79-3606 (hhh) Domestic violence shelters as members of the Kansas Coalition against Sexual and Domestic Violence (KCSDV),
- 74-99b12 Kansas Bioscience Authority

Of the above organizations, all must be registered with the Internal Revenue Service (IRS) as a 501 (c) (3) nonprofit organization except for the entities below. Entities not required to be recognized as a 501 (c) (3) nonprofit organization to receive the sales tax exemption are:

- 79-3606 (ii) Nonprofit, nonsectarian, comprehensive youth development organizations
- 79-3606 (yy) Parent-Teacher Associations and Organizations
- 79-3606 (zz) Free-Access Radio and TV Stations – equipment used directly and primarily for producing broadcast signal (these would be privately)
- 79-3606 (oo) Community action groups/agencies for weatherization of low-income homes

When enacting some sales tax exemptions, there has been an allowance for purchases made "by or on behalf" of the entity to be exempt from tax. This allows individuals or contractors to make purchases on behalf of the organization without any real control over who is making the purchase. Prior to the use of the "by or on behalf" language, it had been the practice to include in the exemption the ability for indirect purchases by an organization through the use of project exemption certificates. Entities which have the "by or on behalf" language in their exemption are:

- 79-3606 (tt) Nonprofit organization for constructing Kansas Korean War Memorial
- 79-3606 (uu) Rural volunteer fire fighting organizations
- 79-3606 (ggg) Kansas Academy of Science
- 79-3606 (hhh) Domestic violence shelters as members of the Kansas Coalition against Sexual and Domestic

The following entities statutory language provides for indirect purchases through the issuance of project exemption certificates:

- 79-3606 (b) State of Kansas and its agencies, Kansas political subdivisions (cities, counties, townships school districts), Nonprofit hospitals, Nonprofit blood, tissue and organ banks (statute prohibits the state of Kansas from issuing project exemption certificates – materials purchased by contractors are subject to tax)
- 79-3606 (c) Nonprofit educational institutions (colleges, universities, trade schools, etc. providing education above grade 12), Elementary and secondary schools
- 79-3606 (aaa) Nonprofit Religious Organizations
- 79-3606 (ccc) Primary care clinics and health centers serving the medically underserved

The following entities' exemptions allows for indirect purchases without the need for a project exemption certificate:

- 79-3606 (s) Kansas groundwater management districts, rural and city water supply districts
- 79-3606 (z) Port authority

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In addition to the entity's purchases being exempt from sales tax, the following organizations also have sales of tangible personal property and services by the organization, or by or on behalf of the organization, exempt from sales tax.

- 79-3606 (ii) Nonprofit, nonsectarian, comprehensive youth development organizations
- 79-3606 (vv) Kansas chapters of these Medical Education Organizations: American Diabetes Association - Kansas Affiliate, American Heart Association, Kansas Alliance for the Mentally Ill, Kansas Mental Illness Awareness Council, American Lung Association, Alzheimer's Disease and Related Disorders Assn., Inc., Parkinson's disease association, National Kidney Foundation (of KS and Western MO), The Cystic Fibrosis Foundation, Heart of America Chapter, Spina Bifida Association, Heartstrings Community Foundation
- 79-3606 (yy) Parent-Teacher Associations and Organizations (note only sales of tangible personal property is exempt – sales of services are taxable)

501 (c) (3) Non-profit entities in Kansas

Data on the number and types of 501 (c) (3) non-profit organizations that exist in Kansas are available from the IRS in the form of a database of the organizations that the IRS makes available to the public. This information is extracted from the Business Master File (BMF) as maintained by the IRS. Table 1 (attached) lists the number of organizations who have 501 (c) (3) nonprofit status using the classification codes of the IRS.¹

Table 1 lists 17,012 nonprofit entities in Kansas by category. The categories shown on Table 1 with the largest number of organizations are:

Entity	Number
Charitable Organizations	5,796
Religious Organizations	2,241
Educational Organization	2,145
Fraternal Beneficiary Society, Order or Associations	1,019
Social Welfare Organizations	928
Post or Organizations of War Veterans	707
Civic Leagues	683
Pleasure, Recreational, or Social Clubs	628
Labor Organizations	480

The number of religious organizations recognized as nonprofit entities is misleading because religious organizations, integrated auxiliaries of churches, and associations of churches are not required to be registered with the IRS.

Other organizations not registered with the IRS are organizations that have gross receipts of not more than \$5,000 per tax year. In addition, most political subdivisions (government instrumentalities) would not be included in the IRS data.

Prior to 2005, the department did not have an accurate number of entities exempt from sales tax. To claim exemption, an entity needed only to print and complete a blank sales tax exemption certificate. A listing of entities submitting letters requesting exempt status was maintained, but this accounted for a small subset of the total number of exempt entities.

With the 2004 Legislature there was a significant change in how the department processed sales tax exemption certificates. The 2004 Legislature, in House Bill 2375, required the department to issue numbered sales tax exemption certificates to exempt entities. Table 2 (attached) lists the number of tax-exempt entity certificates issued by the department as of late August 2005, along with an estimated fiscal impact. Some key points

¹ For additional information on obtaining nonprofit status obtain Instructions for Form 1023 and publication 557 from the IRS.

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- A reason for the significantly larger number of religious organizations vs. the IRS is the difference in requirements. The department requires each church to have their own exemption certificate whereas the IRS may register them at the synod or diocese level.
- Organizations constructing a Kansas Korean War Memorial (79-3606(tt)) have been issued their own unique certificates, although not included in Table 2. There are two (2) such organizations in Kansas.
- Nonprofit organizations who sell tangible personal property that admits a purchaser into an annual event (79-3606(rr)) are thought to be less than 5. These were organizations that sold a button or wooden coin to a purchaser that would admit the purchaser into the event. An example was Railroad Days in Topeka.

When Tables 1 and 2 are reviewed in terms of the number of nonprofit entities that are subject to Kansas sales tax, it is estimated that there are 10,000 nonprofit 501 (c) (3) entities that are required to pay sales tax on their purchases. There may be thousands of more organizations, clubs, and groups who exist and operate as nonprofit entities but are not registered with the IRS.

Fiscal Impact

- Table 2 provides the fiscal impact for those entities that are currently exempt from sales tax. For fiscal year 2007, the loss of state sales tax revenue is estimated at \$398.14 million. The loss of local sales tax revenues is \$105.2 million. This amount includes political subdivisions and educational institutions.
- Non-profit entities (excluding political subdivisions and educational institutions) that are currently exempt have an impact of \$33.67 million in state sales tax. The loss of local sales tax would be \$8.9 million.
- The fiscal impact of exempting 501 (c) (3) nonprofit entities currently subject to sales tax is estimated to reduce state revenues by an additional \$25 million. The loss of local sales tax would be \$6.6 million. The estimate is based on the income revenue reported by the organizations to the IRS as part of their annual reporting. The methodology is provided at the end of this document.
- The fiscal note estimate on Table 2 for 79-3606 (s), groundwater management districts only includes the five-groundwater management districts. Water suppliers are exempt from sales tax on their purchases if they pay the clean drinking water fee and the payment of the clean drinking water fee replaces the amount of lost revenue from the sales tax exemption. Currently the fee is deposited into the state general fund but beginning January 1, 2006, the fee will be deposited into the state water fund, reducing sales tax receipts by \$2.75 million.

Neighboring States Tax Treatment for nonprofit organizations

As noted, Kansas limits sale tax exemptions to specific groups and activities. To apply for an exemption, an entity can submit a letter stating its purpose and may attach a copy of the IRS 501 (c) (3) nonprofit letter and bylaws or articles of incorporation. There is not a specific application form to complete. The department also provides an on-line application in which the organization provides information similar to what a letter would contain. No additional documentation is required, unless there is uncertainty as to the eligibility of the organization. Our neighboring states have the following exemptions and application requirements:

State	Exempt Entities	Application Requirements
Missouri	Exempts most 501(c)(3) organizations, including religious, civic, charitable, social, fraternal and service organizations, and educational institutions.	Requires the completions of a application and submission of IRS 501 (c) (3) nonprofit letter, certificate of incorporation (if applicable), copy of organizations bylaws and financial history for up to 3 years.
Nebraska	Similar to Kansas. Exemptions are limited to a few specialized organizations, such as 24-hour child caring services, services to the blind, health clinic, home health care, hospitals, nursing homes,	Requires the completions of a application and copy of license (if applicable), certificate of incorporation, and copy of organizations bylaws.

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	religious organizations and educational institutions.	
Colorado	Exempts most 501(c)(3) organizations, including religious, civic, charitable, social, fraternal and service organizations, and educational institutions	Requires the completions of a application and submission of IRS 501 (c) (3) nonprofit letter, certificate of incorporation, financial statement and copy of Colorado Certificate of Good Standing from Secretary of State's Office
Oklahoma	Similar to Kansas. Exemptions are limited to a few specialized organizations, such as religious institutions, educational organizations, museums, meals on wheels & food programs for the elderly, children's homes, boy/girl scouts youth camps, community based health clinics, blood banks, cultural organizations for disadvantaged children and federal qualified health care facilities.	Requires the completions of a application and submission of IRS 501 (c) (3) nonprofit letter, certificate of incorporation, financial statement and other documentation that may be applicable to the specific exemption.

Methodology: Calculation of fiscal impact for 501 (c)(3) organizations currently subject to tax.

Data is available on 501(c) (3) organizations from the Internal Revenue Service to develop an estimate. There are over 17,000 501(c) (3) organizations in the State of Kansas. The data from the IRS Statistics of Income report nonprofit 501(c) (3) organizations in Kansas had income of \$12.5 billion for 2004. Specific types of organizations that are currently exempt from sales tax are readily identifiable. When the income from religious and educational institutions, hospitals, and other organizations currently exempt from state sales tax is excluded, the income is reduced to \$8 billion. There are other organizations that can not be easily identified that also need to be excluded for the estimate. It is assumed these organizations represent 50% of the remaining income or \$4 billion. Nationally, expenditures account for 48% of the organization's income and 75% of the expenditures are for costs not subject to sales tax, such as wages and building rent. Therefore, 25% of the expenditures are subject to sales tax.

Based on the IRS data, it is estimated that nonprofit 501(c) (3) organizations have \$480 million in expenditures that are subject to sales tax, which would generate \$25 million in state sales tax. The IRS does not require organizations with gross receipts of less than \$5,000 to register. Although this may be a significant number of organizations, the dollar impact would be minimal. In addition to state sales tax, there would be a corresponding \$6.7 million in local sales tax impact.

Table 1
IRS Nonprofit Entities in Kansas

Subsection Code	Classification Code	Description	Count	Ks Exempt
1	1	Government Instrumentality	13	Yes
2	1	Title-Holding Corporation	69	
3	1	Charitable Organization	5,796	Partial
3	2	Educational Organization	2,145	Partial
3	3	Literary Organization	23	
3	4	Organization to Prevent Cruelty to Animals	45	
3	5	Organization to Prevent Cruelty to Children	6	
3	6	Organization for Public Safety Testing	9	
3	7	Religious Organization	2,241	Yes
3	8	Scientific Organization	23	
4	1	Civic League	683	
4	2	Local Association of Employees	84	
4	3	Social Welfare Organization	928	Partial
5	1	Agricultural Organization	196	
5	2	Horticultural Organization	8	
5	3	Labor Organization	460	
6	1	Board of Trade	251	
6	2	Business League	701	
6	3	Chamber of Commerce	148	
6	4	Real Estate Board	11	
7	1	Pleasure, Recreational, or Social Club	628	
8	1	Fraternal Beneficiary Society, Order or Association	1,190	
9	1	Voluntary Employees' Beneficiary Assn (Non-Govt. Emps.)	120	
9	2	Voluntary Employees' Beneficiary Association (Govt. Emps.)	13	
10	1	Domestic Fraternal Societies and Associations	247	
11	1	Teachers Retirement Fund Assoc.		
12	1	Benevolent Life Insurance Assoc.	11	
12	2	Mutual Ditch or Irrigation Co.	6	
12	3	Mutual Cooperative Telephone Co.	10	
12	4	Organization Like Those on Three Preceding Lines	21	
13	1	Burial Association	97	
13	2	Cemetery Company	68	
14	1	Credit Union	13	
14	2	Other Mutual Corp. or Assoc.		
15	1	Mutual Insurance Co. or Assoc. Other Than Life or Marine	10	
16	1	Corp. Financing Crop Operations		
17	1	Supplemental Unemployment Compensation Trust or Plan	2	
18	1	Employee Funded Pension Trust (Created Before 6/25/59)		
19	1	Post or Organization of War Veterans	707	
20	1	Legal Service Organization		
21	1	Black Lung Trust		
22	1	Multi-employer Pension Plan		
23	1	Veterans Assoc. Formed Prior to 1880		
24	1	Trust Described in Sect. 4049 of ERISA		

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Table 1
IRS Nonprofit Entities in Kansas continued

25	1	Title Holding Co. for Pensions, etc.	1
26	1	State-Sponsored High Risk Health Insurance Organizations	1
27	1	State-Sponsored Workers' Compensation Reinsurance	
40	1	Apostolic and Religious Org. (501(d))	
50	1	Cooperative Hospital Service Organization (501(e))	
60	1	Cooperative Service Organization of Operating Educational Organization (501(f))	
70	1	Child Care Organization (501(k))	
71	1	Charitable Risk Pool	
81	1	Qualified State-Sponsored Tuition Program	
92	1	4947(a)(1) - Private Foundation (Form 990PF Filer)	27
		Total	17,012

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Table 2
Kansas Exempt Entities and Fiscal Impact

Statute Cite (KSA 79-3606)	Exempt Entity	Count (a)	Estimated Fiscal Impact (FY 07 in Millions) (b)
b	Political Subdivisions, Hospitals, Blood Banks	2,391	\$ 308.89
c	Educational Institutions	1,907	\$ 54.58
s	Groundwater Management Districts, Rural Water and city water *	306	\$ 0.04
v	Meals on Wheels programs	52	\$ 0.78
z	Port Authority	2	Minimal
hh	Nursing Homes	190	\$ 0.97
ii	Nonsectarian Comprehensive Multidiscipline Youth Development Programs	1,032	\$ 2.45
jj	Community Mental Health Facility	97	\$ 2.25
ll	Public Health Educational Materials	17	\$ 0.08
oo	Weatherize low-income housing	52	Minimal
qq	Nonprofit Museum or Historical Society	365	\$ 0.37
ss	Public Broadcasting Stations	30	Minimal
uu	Rural Fire Fighting Organizations	419	Minimal
v v	Designated Health Organizations	16	\$ 0.09
ww	Habitat for Humanity	26	\$ 0.11
xx	Nonprofit Zoos	10	\$ 0.56
yy	Parent Teacher Organizations	396	\$ 0.53
zz	Free Access Radio or Television Stations	135	\$ 0.89
aaa	Religious Organizations	5,835	\$ 25.20
bbb	Food Distribution Programs	1	Minimal
ccc	Primary Health Clinic for the Medically Underserved	34	\$ 0.35
ggg	Kansas Academy of Science	1	Minimal
hhh	Domestic Violence Shelters	32	\$ 0.01
	Total	13,346	\$ 398.14

(a) As of August 23,2005

(b) from Sales Tax Exempt summary all funds Sept 2004

* the fiscal impact is only for the 5 groundwater management districts. Rural water districts and city water departments are exempt from sales tax on their purchases if they pay the clean drinking water fee. The clean drinking water fee is estimated to collect \$2.75 million in fiscal year 2007, which is estimated to be the value of the sale tax exemption they are receiving.

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Special Committee on Assessment and Taxation

ANALYSIS OF STATE AND LOCAL TAX POLICY

CONCLUSIONS AND RECOMMENDATIONS

The Committee encourages the Legislature to provide property tax relief by authorizing the restoration of sales tax demand transfers to local units of government. If it is determined that the demand transfer program need to be restructured, special emphasis should be placed on additional funds for local units in rural areas.

The Committee finds that the overall elasticity of tax receipts, especially State General Fund (SGF) tax receipts, appears to be declining. The Committee expresses its concern about legislation earmarking future sales, income, and property tax revenue streams from specific industries or businesses. The Committee therefore recommends that a more rigorous fiscal review be applied to future legislation seeking to earmark revenues historically placed in the SGF. The Committee further asks staff to develop a new monthly receipts report that disaggregates taxes and other receipts relative to the amount placed in the SGF compared to the amount placed in all other funds. The Committee also recommends that the 2006 Legislature memorialize Congress to minimize federal preemption of state taxing authority.

The Committee recommends that the Department of Revenue report to the standing tax committees on policy options regarding modernization and structural changes to the corporation income tax. The Committee further recommends that the Legislature attempt to provide a property tax exemption for commercial and industrial machinery and equipment.

The Committee recommends copies of a number of ongoing studies, including those on the implications of the expansion of state and local debt; and on sales and property tax base erosion, be made available to all appropriate committees when completed in June 2006. The Committee anticipates the need to give these reports in-depth review and therefore requests that a special committee on assessment and taxation again be established to study the same state and local tax policy topic during 2006.

Proposed Legislation: None.

BACKGROUND

During the 2004 and 2005 sessions, the House Taxation Committee frequently discussed a number of changes that had occurred in state and local tax policy over the last two decades. Included among those important changes were the 1992 school finance law and its impact on the overall tax burden; tax cuts enacted during the mid-1990s; the continued proliferation of tax exemptions; the elimination of demand

transfers to local units of government; and the 2002 tax increases.

The Legislative Coordinating Council in July therefore approved a request from Representative Wilk, chairman of the House Committee, and directed the Special Committee to review the current state and local tax structure, focusing on the shifts in reliance on sales, property, and income taxes since 1990. The Special Committee also was charged with studying the impact on the tax

structure of the ongoing shift in the Kansas economy to a more service sector-driven economy; and with reviewing the impact of: (1) property tax relief in the 1990s; and (2) the 2002 tax increases on the Kansas economy and tax structure. Finally, the Special Committee was asked to study the future of Kansas tax policy for the next 10 to 20 years, and recommend which tax structure components would be most equitable to the taxpayers of Kansas; and would improve Kansas' competitiveness with other states.

COMMITTEE ACTIVITIES

At the September meeting, staff reviewed Kansas Tax Facts with a particular emphasis on the previous 15 years. The presentation included a discussion of the composition (tax mix) of the Kansas state and local tax structure; revenue elasticity of the major tax sources; the progressivity of the major tax sources; and the extent to which economic development competition with surrounding states influences tax policy.

With respect to the elasticity of the sales tax, staff noted that while Kansas does apply the sales tax to more services than many states, one of the reasons the elasticity of the tax has been declining relates to the fact that as incomes go up, people tend to spend more of their disposable income on services which are exempt (such as tax-preparation, tanning-salon, and pet-grooming services).

Several committee members expressed concern about mill levy increases in rural areas and the impact of the elimination of demand transfer funds on property taxes. The Committee discussed the fact that many of the rural areas experiencing large property tax increases have very limited ability to provide any local property tax relief through the imposition of local sales taxes.

Secretary of Revenue Joan Wagon reviewed several major topics she said were imperative to consider when thinking about

the future of tax policy for the next 10 to 20 years. She said that if the erosion of the tax base were to continue into the future, the result would be higher tax rates and less equity among various groups of taxpayers; less competitiveness and more taxpayer discontent; and more special interest groups' requesting exemptions—creating a vicious cycle. She said that the Legislature may wish to look at some of the work of the "Hodge Committee" of the early 1970s and seek a return to the basic principle that "taxation is the rule, and exemption is the exception." Having a broader tax base means tax rates can be lower and taxes can be more equitable and competitive, according to the principle.

Secretary Wagon said that tax base erosion had been occurring because of the enactment of a number of exemptions and tax credits; and because of economic shifts in consumption and business practices, many relating to new technologies. She also said that the authorization of sales tax and revenue (STAR) bonds and the propensity of the Legislature to earmark future revenue streams threatened the elasticity of tax receipts relative to the State General Fund (SGF). She said that once a special practice or tax treatment had been established, it was often difficult for the Legislature to backtrack and stop that process. Faced with a similar situation more than three decades ago, the Hodge Committee formed a special commission to review tax policies and make decisions on which special exemptions, exceptions, and credits should be restructured or totally eliminated. She said the Department of Revenue was working on a number of the major tax policy issues in conjunction with the Kansas Advisory Commission on Intergovernmental Relations, Wichita State University, and the Department of Commerce. Major studies on sales and property tax base erosion currently are scheduled for completion in June 2006. She pointed specifically to a number of issues likely to be in front of the tax committees in upcoming years, including:

- Federal preemption of state taxing authority;
- Over-reliance on debt financing;
- Potential modernization of corporation income taxes;
- Deciding whether to exempt commercial and industrial machinery and equipment from property taxation;
- Potential elimination of a number of sales tax exemptions;
- Potential taxation of services;
- Whether to continue to allow withholding taxes to be earmarked;
- Whether to maintain a Kansas estate tax once the federal tax is eliminated; and
- Maintaining the uniformity of the local sales tax law as it relates to cities and counties.

At the October meeting, staff outlined statistics from the Kansas State Treasurer relating to the growth of Kansas state and local bonded indebtedness from \$7.581 billion in June, 1990 to \$21.138 billion in June 2004. Staff also reviewed the recently released FY 2005 version of Kansas Tax Facts. In comparison with all other states based on the latest federal statistics, Kansas had the 29th highest state taxes per capita and also the 29th highest state taxes as a percent of personal income. The recent rate of growth in local taxes, especially property taxes, rebounded somewhat in FY 2005 after coming off two years of more modest growth. Property taxes in FY 2005 increased by about 6.5 percent, or \$187 million, with schools accounting for \$120 million of the increase.

Secretary Wagon distributed eleven tax policy objectives recommended by the 1995 Governor's Tax Equity Task Force:

- Kansas should maintain its enviable reputation as a fiscally responsible state.
- A tax system should produce revenues that are adequate to finance an agreed-upon level of public services over time.
- A tax system should produce adequate revenue during economic downturns and also respond to economic growth.
- State and local taxing and spending decisions should be consistent with economic growth and development.
- Administration of the tax system should be fair and efficient.
- Fiscal accountability should be strengthened by making taxpayers aware of their true tax liabilities.
- Tax revisions should not unduly erode the tax base.
- State fiscal policy should advance the interests of the state as a whole, while facilitating the fiscal autonomy of local governments.
- Policymakers must recognize that tax policy influences economic behavior, and not always in the desired manner.
- Kansans should be able to rely upon a stable tax policy.
- The state and local tax system should be balanced and diversified.

She then asked how the rapid expansion of state and local debt over the last 15 years could be reconciled with these objectives, noting that a third major study on debt also was scheduled for completion in June 2006. The Committee asked that this latter study be made available to the Legislative Budget Committee as well as the tax committees once it is released.

1-12

The Secretary said that she hoped the Committee would strongly recommend that the Legislature in the future protect the withholding tax and not allow any other circumstances wherein major tax sources could be diverted from the SGF.

Dr. John Wong of Wichita State University made a presentation on the extent to which the elasticity of the major tax sources has declined over time. He said that one reason behind the declining elasticity relates to the fact that the economy today is much different than it was in the 1930s when the sales and income taxes were imposed. He said that as the economy and technology continue to change, government should keep an eye on those things generating economic activity and recognize the reallocation of resources in the private market. When the economy changes and the tax structure does not, a lag in revenues is likely to occur until the tax policies have been modified.

Dr. Wong also said that the declining elasticity of major taxes was indicative of the rapid changes occurring in the Kansas economy. He observed that Kansas was currently in a transitional period and was seeing agriculture and manufacturing become relatively less important while services were becoming more important. He also said that the ability of the tax structure to keep pace could be eroded even further as the next transition to a technology-based economy occurs. He said that states had not been able to adjust their sales tax structures to tax most services because of the potential mobility of services and because of the power of special-interest groups. If Kansas is unable to begin taxing more services, the elasticity of the sales tax is expected to continue to decline, based on the expectation that the relative economic contribution of services in comparison to goods is expected to continue to grow.

During the public hearings, a conferee representing the Wichita Metro Chamber of Commerce recommended that the

Legislature consider eliminating the property tax on commercial and industrial machinery and equipment, noting that eleven states already have such an exemption.

A conferee representing the Kansas Chamber encouraged the Legislature to develop a pro-growth business tax policy that would encourage capital investment and job creation.

A representative of the League of Kansas Municipalities asked for new consideration of three bills introduced during 2003 that would have allowed local units of government to diversify their revenue diversify portfolio and reduce reliance on property taxes.

Representative Wilk also distributed a chart on estimated growth in real Gross Domestic Product from 2004 through 2015 for twelve countries and observed that the forecasted rate of growth was much faster for China than it was for the United States.

CONCLUSIONS AND RECOMMENDATIONS

State and Local Tax Policy Linkage

The Committee recommends that the context within which the Legislature views state tax policy and potential changes should always include consideration of the implications on local tax policy, especially property taxes.

The Committee strongly encourages the 2006 Legislature to provide property tax relief by authorizing the restoration of sales tax demand transfers to local units of government. If it is determined that the demand transfer program need to be restructured, the Committee recommends that special emphasis be placed on providing additional funds for local units in rural areas.

The Committee also asks that the standing tax committees monitor the

Proposal: A Study of Sales Tax Base Erosion in Kansas

Principal Investigator: Professor John D. Wong, Hugo Wall School of Urban and Public Affairs, Wichita State University

We propose a study of the erosion of the Kansas sales tax base that assesses statutory sales tax exemptions from the perspective of sound tax policy, both state and local tax policy. The 70+ sales tax exemptions that have accumulated since the enactment of the state sales tax in 1937 through to the present day will be examined. The study will rely on estimates made by the Kansas Department of Revenue of the financial impact of statutory sales tax exemptions. To the extent feasible the impacts on sales tax rates, state and local sales tax revenues, taxpayer groups, and regions will be identified. The report will also provide an overview of factors contributing to the erosion of sales tax revenues in Kansas and nationally.

A working definition of tax base erosion will be developed, and a legislative history of the 70+ statutory sales tax exemptions in Kansas will be constructed. Any differences in exemptions between state and local sales taxes will be identified. Exemptions will be classified by purpose, by categories of recipients, and by other groupings determined to be useful to state and local policy makers. Additionally, the financial impact of the sales tax rebate program will be identified and included in the study.

State sales tax policy in selected states will be examined to identify primary features of sound tax policy, and Kansas policies will be reviewed from these perspectives.

With the assistance of the Kansas Department of Revenue, an assessment of the administrative procedures required to administer exemptions, including the costs incurred by state administrators and by retailers who collect and transfer sales tax revenues to the state.

The report will outline feasible policy alternatives available to state and local policy makers in Kansas and will not make policy recommendations.

This report will be completed no later than June 30, 2006. Periodic reports on the status of the study will be provided on request.

8/23/05

Assessment & Taxation
Date 2-1-06
Attachment # 22

Kansas Department of Revenue
Annual Withholding Reporting
W2 FILING Data

2006-01-31

ARK

#3

Assessment & Taxation
 Date 2-1-06
 Attachment # 3

Information Inquiry for Senate Bill 358

		Dollars <i>Withheld</i> from Employees Range - WH Tax							
W2s Submitted by Employer - Number of Employees Range		\$0 to \$500	\$501 to \$1,000	\$1,001 to \$5,000	\$5,001 to \$10,000	\$10,001 to \$50,000	\$50,001 and greater	W2s in Range	Distribution
	Employers	1 to 50	25,247	8,485	22,602	7,406	7,964	733	72,437
51 to 100		1,101	141	604	496	1,451	745	4,538	5%
101 to 200		587	53	209	236	730	1,081	2,896	3%
201 to 300		137	18	58	15	203	627	1,058	1%
301 to 400		195		23		122	373	713	1%
401 to 500		195	18	12		42	231	498	1%
501 to 1000		137		35		52	461	685	1%
1001 and above		-		23		38	443	504	1%
Total by \$ Range		27,599	8,715	23,566	8,153	10,602	4,694	83,329	
<i>Distribution</i>	<i>33%</i>	<i>10%</i>	<i>28%</i>	<i>10%</i>	<i>13%</i>	<i>6%</i>			

All Employers at 100 Employees and Above: 6,354
100 and Above *Already Electronically Filing*: 2,011

Additional Employers Affected by W2 filing change (new number): 4,343 *Not currently filing WH returns electronically*

Original testimony number => 50 employees: 6,067
+ / - Net Change between 50 and 100 employees: (1,724) -28.42 %

Assessment & Taxation
 Date 2-1-06
 Attachment # 3

Kansas Department of Revenue
 Annual Sales Tax FILING Data (Stats)
 Information Inquiry for Senate Bill 358

12-31-2006
 ARK

Assessment & Taxation
 Date 2-1-06
 Attachment # 4

Annual Sales Tax Paid		
\$0 to \$31,999	\$32,000 to \$99,999	\$100,000 and Greater

Sales Tax Filing - Submitted Manually at this time

Retailers' Sales	45,673	3,131	447
Retailers' Compensating Use	6,486	349	199
Consumers' Compensating Use	7,210	180	126
Totals	59,369	3,660	772

Sales Tax Filing - Submitted Electronically

Retailers' Sales	48,866	1,758	2,199
Retailers' Compensating Use	2,519	228	147
Consumers' Compensating Use	2,704	55	43
Totals	54,089	2,041	2,389

**Net Change of FILERS affected between
 \$32,000 and \$100,000:** 3,660

Assessment & Taxation
 Date 2-1-06
 Attachment # 4