Approved: 4-3-2007
Date

MINUTES OF THE HOUSE TAXATION COMMITTEE

The meeting was called to order by Chairman Kenny Wilk at 9:00 A.M. on March 7, 2007 in Room 519-S of the Capitol.

All members were present except:
Representative Kenny Wilk- E

Committee staff present:
Chris Courtwright, Legislative Research Department
Martha Dorsey, Legislative Research Department
Gordon Self, Office of Revisor of Statutes
Rose Marie Glatt, Committee Secretary

Conferees appearing before the committee:
Secretary Wagnon, KDOR
Denise Walsh, Hill's Pet Nutrition, Inc.
Christy Caldwell, Greater Topeka Chamber of Commerce
Shirley Sicilian, Multistate Tax Commission
Lucky DeFries, Coffman, DeFries & Northern, P.A.
Duane Simpson, Kansas Grain and Feed
Jim Hall, The American Council of Life Insurance (ACLI)
Bob Tomlinson, KS Insurance Department
David Hanson, KS Insurance Associations

Others attending:
See attached list.

The Vice- Chair called for bill introductions.

Representative Menghini made a motion to introduce a committee bill increasing the earned income tax credits to 20%. Representative Holland seconded the motion. The motion carried.

SB 240 - Apportionment of net income for income tax purposes for certain taxpayers.

The Vice-Chair opened the public hearing on **SB 240**.

Secretary Wagnon said that the Department of Revenue in concert with the Department of Commerce has brought forward **SB 240**, which provides a change in the apportionment formula for corporate tax. It would allow a company, that invests $100 million and meets specific criteria, to take advantage of using just the sales factor instead of all three factors, property, payroll and sales. The Department supports **SB 240** as it would allow Kansas to compete favorably against Missouri for, in this instance, a proposed plant. There is a precedent for this in Kansas as the single factor has been applied in several other scenarios.

Denise Walsh, Hill's Pet Nutrition, Inc. said **SB 240** would allow the state to grant single factor relief to manufacturers making significant investments in the state, hiring Kansans, and paying above-average wages. It would make Kansas competitive with other states in the Midwest, who have significant advantages on their corporate tax structures. This would have a long term positive effect on any potential expansions and investments Hill's considers for their current and proposed Kansas manufacturing facilities. She stated that the current plant is operating at capacity and the new plant must be operating by fourth quarter 2008. Therefore, the bill is time sensitive and she asked the Committee's cooperation (Attachment 1).

Christy Caldwell, Greater Topeka Chamber of Commerce, spoke in support of **SB 240**. She said a new Hill's Nutrition plant would have a tremendous economic effect on the community through labor, employment and service industries. She reminded the Committee that site selectors look very carefully at corporate tax rates when comparing locations in the United States or in deciding whether to move offshore and urged passage of the bill without any amendments (Attachment 2).

Seeing no other conferees, the Chairman closed the hearing on **SB 240**. There being no opposition

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

MINUTES OF THE House Taxation Committee at 9:00 A.M. on March 7 in Room 519-S of the Capitol.

to immediately working the bill, the Vice-Chair asked the wishes of the Committee.

Representative Holland made a motion to pass **SB 240** out favorably and be placed on the consent calendar. Representative Menghini seconded the motion. The motion carried.

HB 2495 - Decrease in the income tax surtax on corporations.

The Vice-Chairman opened the hearing on **HB 2495** and invited Shirley Sicilian, Multistate Tax Commission, to the podium as a proponent to the bill. She stated that the bill has three purposes: 1) to clarify that non-corporate income taxpayers are included in the combined group; 2) to expand the definition of "business income" that is subject to apportionment; and 3) to clarify that returns of principal from investment of short-term working capital are not included in the sales factor as a "gross receipt." She reviewed the details of each purpose. She said the bill is very timely as these same issues are currently being addressed by most other states and the proposals in the bill are being adopted in many of those states (Attachment 3).

Lucky DeFries, Coffman, DeFries & Northern, P.A. spoke to the Committee in opposition to **HB 2495**. He stated the business community has many concerns regarding the amendments and during a business group discussion convened by the Secretary of Revenue and the Governor during the fall the business group unanimously rejected those ideas. He explained why key points in the legislation are not in the best interest of Kansas businesses, and suggested there were alternative formulas available in existing legislation (Attachment 4).

Duane Simpson, Kansas Grain and Feed, testified that the Dillmore amendment creates a bill that could significantly raise corporate income taxes on some of their association's members. It defeats the intent of the Governor's tax package based on tax cuts that would spur economic growth. He requested the Committee reconsider the Dillmore amendment (Attachment 5).

Jim Hall, The American Council of Life Insurance, questioned the amendment in the final paragraph of Section 4 of the bill. That provision would grant sweeping authority to KDOR to force insurance companies to pay not only Kansas premium taxes but also Kansas income taxes through the insurers' non-insurance affiliates. Double taxing law abiding insurance companies is not an appropriate solution to a tax avoidance problem posed by non-insurers. He urged the Committee to carefully consider **HB 2495** (Attachment 6).

Bob Tomlinson, Kansas Insurance Department, testified that the amendment would impose a tax upon the Kansas taxable income of every corporation doing business within Kansas and the Department does not support the bill in its current form. He offered the Department's help in looking at the problem on both the state and national level and in the development of language that would prevent corporations from avoiding taxation and just as importantly, would not produce an unreasonable burden upon Kansas insurance companies (Attachment 7).

David Hanson, Kansas Insurance Associations said that the provisions in the proposed amendments to **HB 2495** would allow combined reporting of business income and taxation, thus would be contrary to the provisions in existing statute. Insurance companies pay premium taxes in other states at rates set by those states. This bill would increase the overall tax rate in Kansas and result in other states charging a higher retaliatory tax to our companies for any premiums written in those states, then costing our companies more and causing more tax dollars to flow to other states (Attachment 8).

It was noted that the following KDOR memorandums were distributed to the committee: 1) Analysis of Corporate Income Tax 2000-2002 (Executive Summary); 2) Update to Analysis of Kansas Corporate Income Tax Dated October 14, 2004 (Tax Year 2003); and 3) Update to Analysis of Kansas Corporate Income Tax Dated October 14, 2004 (Tax Year 2004)(Attachment 9).

Discussion continued until the Vice-Chair, due to time constraints, closed the hearing on **HB 2495** and advised they would return to the bill after the scheduled hearing tomorrow. At that time Representative Dillmore would have the floor.

The meeting was adjourned at 10:30 a.m. The next meeting is March 8, 2006.

TAXATION COMMITTEE

DATE: ~~MARCH 8~~ 7, 2007

NAME	REPRESENTING
Delbert Tomlinson	Kansas Depart. of Ins.
Deletria Nash	KID
Ron Gaches	GBBA
Ben Cleeves	DOB
REP STAN FROWNFELTER	31st DIST
TONY A. SCOTT	KSCPA
JOHN C CONLEY	KSCPA
Bill Thompson	Commerce
Denise Walsh	Hill's
TOM PALACE	PMCA of KS
Marlee Carpenter	KS Chamber
Sandy Braden	Hallmark Cards, KCPL, AIG
Mike Murray	Embarq
Ashley Sherard	Lenexa Chamber
Christy Caldwell	Topeka Chamber
John Peterson	Capitol Strategies
JOHN C. BOTTENBERG	BOTTENBERG & ASSOC.
Jim Maag	Spirit AeroSystems
JIM HALL	ACLI

TAXATION COMMITTEE

DATE: MARCH ~~8~~ 7, 2007

NAME	REPRESENTING
Natalie Haag	Security Benefit Corp.
Lori Church	KAPCIC
Joe Frederick	Boeing
Lucky DeFries	CD&W + Kan Chamber
Bernie Koch	Wichita Chamber
J Kent Eckles	O.P. Chamber of Commerce
Kathy Olsen	Ks Bankers Assoc.

Hill's Pet Nutrition, Inc. and Subsidiaries
P. O. Box 148
Topeka, Kansas 66601-0148
(785) 354-8523

March 7, 2007

Chairman and members of the Committee:

My name is Denise Walsh. I am the Director of Corporate Tax for Hill's Pet Nutrition here in Topeka. I am here today to express our support of the proposed bill which would allow certain manufactures making significant investments in the state to apportion their income taxable to Kansas based on only their sales factor as opposed to using the current three factor formula.

Kansas currently determines a company's corporate income tax liability by considering the company's payroll, property and sales within the state. This methodology effectively places a higher tax burden on companies that employ more Kansas workers and own more manufacturing facilities, and therefore have more assets within the state. This current method creates a disincentive to invest capital and employ Kansans. Eight Midwest states: Illinois, Indiana, Iowa, Michigan, Minnesota, Missouri, Nebraska and Wisconsin currently (some as recently as within the last 24 months) determine a corporation's tax liability by primarily considering the sales location of their customers. A company expanding its capital or employment in any of these states would not incur additional income taxes solely based on their decision to invest or expand their presence within these jurisdictions as is the case in Kansas.

The enactment of House Bill 2619 this past legislative session which revoked the imposition of personal property taxes on new machinery and equipment was a very positive movement towards making Kansas a competitive location for major manufacturing investments. Passing the current proposed bill which would allow the state to grant single factor relief to manufacturers making significant investments in the state, hiring Kansans and paying above-average wages would make Kansas competitive with other states in the Midwest, especially its neighboring states of Missouri and Nebraska which share many of the same available natural resources of the Midwest with Kansas but have a significant advantage on their corporate tax structure. Currently, just by locating manufacturing facilities outside of the state of Kansas a current Kansas company can lower its income tax liability and be taxed a fraction of what that same investment would be taxed in the state of Kansas.

The US government has recognized at the Federal Income Tax level the need for the US to become more competitive in order to secure manufacturing jobs within its borders. The Federal Manufacturing Deduction is a significant step in that direction and it will be a significant positive factor in US companies deciding to manufacturer in the US. By Kansas passing this proposed bill, the state will be in a positive position to partner with the Federal government to drive new manufacturing jobs within not only the US borders but also the State of Kansas.

While Kansas Investment tax credits can mitigate the single factor impact on a short-term basis it does not address the long-term effect of creating jobs and increasing investments in the state. This proposed Bill will have a long term positive effect on any potential expansions and investments we consider for our current and proposed Kansas manufacturing facilities as products produced here would be more price competitive as we analyze differences in the cost structures between locations.

Thank you for your consideration and I would be pleased to answer any questions you may have.

GREATER TOPEKA CHAMBER

GO TOPEKA

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Testimony: SB 240
House Taxation Committee
March 5, 2007
By: Christy Caldwell
Vice President Government Relations
Greater Topeka Chamber of Commerce
ccaldwell@topekachamber.org

Chairman Wilk and members of the Committee:

The Greater Topeka Chamber of Commerce would like to ask your support for SB 240 – regarding the method of apportionment of net income. This bill will allow a narrowly defined group of manufacturing taxpayers to utilize only the sales-factor, instead of the current three factor formula of property, payroll and sales, in determining net income for Kansas tax purposes.

The bill defines a qualified manufacturing company as one which has made an investment of $100 million in the construction of a new business facility, has added 100 new jobs to the Kansas economy, and pays employees a higher than average wage.

We believe this legislation will allow the state to determine if a change in policy to allow an election to utilize the sales factor only will create a positive outcome of growth in high-waged jobs and growth in business investment within the state. Current tax policy regarding the apportionment of income for Kansas is considered a disincentive for business growth; it penalizes a company's investment in new jobs and added capital. Other states have derived benefit by allowing a single factor to determine tax liability.

We realize this legislation is a departure from current tax practice in our state; however SB 240 will give Kansas the opportunity to "try out" this new tax strategy in order to determine its effect on the economy, job growth and state revenues.

In a 2006 study completed for Area Development Magazine on the factors manufacturers use to determine domestic and foreign site selections, their response indicates: "More significant is the movement of the corporate tax rate factor, which received a 90.8 rating [out of a possible 100] this year – up 5.8 percentage points over last year – and moved from sixth to third place in rankings. **Site selectors look very carefully at corporate tax rates when comparing locations in the United States or in deciding whether to move offshore.**" The respondents in this study are the top site location decision makers in their companies. This survey speaks to the desire we have for the Kansas Legislature to consider lowering the income tax rate, and in this instance to consider the positive outcomes that could result from allowing an election to utilize the sales factor only when determining a very limited number of corporations' income tax liability.

Kansas government leaders have embraced changes in tax policy over the last several years to position our state as more competitive in a global environment. Even with the narrow utilization of the tax change in this bill, we believe, it may lead to significant new investment in Kansas and be helpful in situating our state for future manufacturing expansions.

Chairman Wilk and Committee, we ask that you vote favorably for SB 240.

Attachment: 21st Annual Corporate Survey – Area Development Magazine, December 2006 (provided to the Topeka Chamber by Bernie Koch, Wichita Chamber of Commerce)

HS TAXATION COMMITTEE
3-7-2007
ATTACHMENT 2

21ST ANNUAL CORPORATE SURVEY

FIGURE 25

Combined Ratings* of 2006 Factors

SITE SELECTION FACTORS

Ranking		2005	2006
1.	Labor costs	87.9	95.0
2.	Highway accessibility	91.4	90.9
3.	Corporate tax rate	85.0	90.8
4.	State and local incentives	86.0	88.6
5.	Availability of telecommunications services	79.8	88.3
6.	Tax exemptions	83.6	86.7
7.	Occupancy or construction costs	83.7	85.5
8.	Availability of skilled labor	87.2	85.1
9.	Energy availability and costs	82.8	82.4
10.	Availability of high-speed Internet access	85.7	82.1
11.	Cost of land	79.1	79.2
12.	Low union profile	77.0	78.4
13.	Proximity to major markets	83.2	76.9
14.	Availability of land	75.0	73.3
15.	Environmental regulations	71.1	68.9
16.	Right-to-work state	69.7	67.1
17.	Availability of unskilled labor	50.6	65.3
18.	Raw materials availability	62.3	64.1
18T.	Availability of long-term financing	56.5	64.1
19.	Accessibility to major airport	50.0	61.4
20.	Training programs	59.6	56.0
21.	Proximity to suppliers	66.7	49.3
22.	Proximity to technical university	30.2	30.0
23.	Railroad service	28.9	20.8
24.	Waterway or oceanport accessibility	20.2	17.0

QUALITY-OF-LIFE FACTORS

Ranking		2005	2006
1.	Low crime rate	67.8	70.8
2.	Ratings of public schools	56.8	64.4
3.	Housing costs	60.0	63.9
4.	Health facilities	62.1	60.8
5.	Housing availability	59.3	54.4
6.	Climate	46.5	48.6
7.	Colleges and universities in area	46.0	44.6
8.	Recreational opportunities	44.8	43.7
9.	Cultural opportunities	48.8	41.4

*All figures are percentages and are the total of "very important" and "important" ratings of the *Area Development* Corporate Survey and are rounded to the nearest tenth of a percent.

MULTISTATE TAX COMMISSION

Working Together Since 1967 to Preserve Federalism and Tax Fairness

To: **Chairman Wilk,**
Members of the Kansas House Tax Committee

From: **Shirley Sicilian, General Counsel, Multistate Tax Commission**

Date: **March 7, 2007**

Subject: **House Bill 2495**

Chairman Wilk and members of the Kansas House Tax Committee, thank you very much for the opportunity to testify today on House Bill 2495. My name is Shirley Sicilian. I am General Counsel for the Multistate Tax Commission (MTC). The MTC is a governmental instrumentality. It was created in the 1967 by interstate compact, the Multistate Tax Compact, to which 20 states including Kansas are signatories. Another 26 states are also members of the Commission in various capacities.

I understand HB 2495 has three purposes: 1) to clarify that non-corporate income taxpayers are included in the combined group, 2) to expand the definition of "business income" that is subject to apportionment, and 3) to clarify that returns of principal from investment of short-term working capital are not included in the sales factor as a "gross receipt." All three of the proposed amendments address issues that have been or are being faced in many states in addition to Kansas, and all three would address these issues consistently with other states.

1. Inclusion of Non-Corporate Income Taxpayers in the Combined Group

A combined group is a group of affiliated entities that are engaged in a single, unitary business. The relevance of the combined group is that it delineates the entities whose income will be included in the pool of income subject to apportionment. When unitary affiliates are excluded from the combined group, there is always the potential for tax sheltering through intercompany transactions between members and non-members that have the effect of shifting income out of that pool of income subject to apportionment.

The question of whether to include non-corporate income taxpayers in a combined group did not really arise for states until a few years ago, when the federal government began loosening the barriers between different types of financial services industries.[1] One outcome of those federal changes was that banking and insurance companies, which typically pay a premiums tax in lieu of a corporate income tax, may now branch out and engage in a single unitary business with other companies that are subject to the corporate income tax.

[1] See *e,g,* Riegle-Neal Act and Gramm-Leach-Bliley Acts of 1994 and 1999.

HS TAXATION COMMITTEE
3-7-2007
ATTACHMENT 3

In combined reporting states, this has raised the question of whether unitary insurance companies must be included in the combined group. Exclusion of captive unitary insurance companies leaves open the potential for these companies to be used as tax sheltering devises. Objections were raised that including insurance companies would amount to subjecting the income of the company to the corporate income tax. But it is important to remember that including non-taxable entities in a combined group does *not* subject those entities, or their income, to a corporate income tax. It merely provides the base from which the taxable corporation's share is apportioned. The non-taxable corporations do not pay or become subject to the corporate income tax. Properly reflecting that total pool of income is simply a step in calculating the tax base for those corporations that *are* subject to the tax.

This concept was articulated in *State ex rel. Dept. of Revenue v. Penn Independent Corp.*[2], where the Oregon Tax Court found the apportionable income of a unitary group should include the income of an insurance company even though that company was not subject to Oregon's corporate income tax, but instead paid a gross premiums tax. The holding was recognized by Walter Hellerstein as "plainly correct."[3] And the Kansas Board of Tax Appeals has also recently recognized the concept – in *Appeal of Wendy's International*[4] – where it found "no *per se* bar against the combination of insurance company income …."[5]

In sum, all but one state that has taken a position on the issue has required inclusion. California, in part because certain of its insurance tax provisions are constitutional rather than statutory, has taken a position against inclusion in litigation where the insurance is arguing in favor of inclusion. Other states; including Alaska, North Dakota, New Mexico, Idaho, New Hampshire, Oregon and Kansas; have taken the position that these entities should be included. In Massachusetts, Governor Patrick has just introduced legislation that would adopt combined reporting and include captive insurance companies in the combined group.

Other states are also moving forward on the issue. This year, the member states of the MTC adopted a model uniform combined reporting statute that would allow non-corporate income taxpayers to be required to be included in the combined group by regulation.[6] After taking into account comments from the insurance industry, the Commission recognized there are certainly mechanical issues that must be worked out for inclusion to properly reflect activity in the state, but felt these mechanical issues can be adequately dealt with through regulations.

2. Expansion of the Definition of "Business Income"

Once the members of the combined group have been established, the next task is to determine, for each member, which items of income are business income, subject to apportionment, and which are non-business income that must be allocated to a particular state. The Uniform Division of Income for Tax Purposes Act (UDITPA), which Kansas and

[2] *State ex rel. Dept. of Revenue v. Penn Independent Corp*. 15 Or. Tax 68 (1999). http://www.publications.ojd.state.or.us/TC4321.htm.
[3] Hellerstein, State Taxation: 2001 Cumulative Supplement No. 1, ¶ 8.11[3][e].
[4] Docket No. 2006-3929-DT
[5] Id. p. 3.
[6] A copy of the model statute is available at: http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/Combined%20Reporting%20-%20FINAL%20version.pdf

approximately 38 other states have adopted in whole or in significant part, sets out a test for making that determination. Kansas case law has interpreted UDITPA as providing a "transactional" test.[7] But today the view of the clear majority is that this language provides two tests for identifying business income, a transactional test and a functional test and that an item of income is properly classified as business in nature if either test is met.[8] In states where the court found only a transactional test, the legislature often followed up with a statutory amendment clarifying the existence of the functional test.[9]

Inconsistent definitions of "business income" create a potential for duplicative or less than full taxation. To illustrate, consider a multistate business that is subject to tax in two states. If one state requires the taxpayer to allocate 100% of an item of income to it as the taxpayer's commercial domicile and the other state requires the same item of income to be apportioned at least in part to it, then more than 100% of the same item of income in the aggregate will be taxed. Similarly, if one state determines the item of income is non-business income allocable to an out-of-state commercial domicile, but the state of commercial domicile determines the item of income is apportionable across all states in which the taxpayer does business, then there will be less than full apportionment of the taxpayer's income.

The proposed amendment would bring Kansas back into uniformity with the other states insofar as it would re-establish the functional test as a second method for identifying business income. A number of states that had not incorporate the functional test, have added it recently: Mississippi (2001), Oregon (2004), Kentucky (2006).[10] In addition, the proposed amendment would allow for apportionment of income to the extent permitted by the U.S. Constitution. In *Allied Signal,* the U.S. Supreme Court recognized the UDITPA definition of business income as "compatible" with constitutional principles.[11] There has been a definite trend over the last few years for states to move in this direction as well: Minnesota (1999), Alabama, Pennsylvania (2001); New Jersey, North Carolina (2002); Illinois (2004); and Georgia (2005)[12]

3. Clarification that Returns of Principal from Investment of Working Capital is Not Included in the Sales Factor.

This portion of the proposal would clarify the apportionment formula used to determine the amount of that pool of business income that is attributable to a particular taxpayer's activities in the state. As you know, the Kansas formula is an equal weighted three factor formula based on the ratios of property, payroll and sales in the state to property, payroll and sales everywhere. This amendment addresses the sales factor. Specifically, it would exclude returns of principal from the sales factor.

This issue arises when taxpayers engage in the sale of a product that generates large sums of excess cash on a short-term basis. Rather than let these sums lay idle, even for brief

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[7] *In re Tax Appeal of Chief Industries, Inc.*, 255 Kan. 640, 647, 875 P.2d 278 (1994).
[8] See *Hoechst Celanese Corp. v. Franchise Tax Board,* 25 Cal.4th 508 (2001).
[9] See, e.g., Tenn. Code Ann. §67-4-2004, Ala. H.B. 7 (Dec. 28, 2001).
[10] Mississippi, A.B. 1695, 2001; Oregon, OAR 150-314.610(1)-(A)(2); Kentucky, 103 KAR 16:060E.
[11] *Allied Signal v. Dir. Div. of Taxation,* 504 U.S. 765 (1992).
[12] Minn. §290.17; Alabama, H.B. 7, 2001; Pennsylvania, H.B. 334, 2001; New Jersey, A.B. 2501, 2002; North Carolina, S.B. 1115, 2002; Illinois S.B. 2207, 2004; Georgia, H.B. 488, 2005.

periods, taxpayers often form a treasury division to efficiently employ the cash in various types of short-term, liquid investments. Some taxpayers have argued that the UDITPA sales factor should include, in addition to the income generated from these liquid investments, the repeated returns of the same principal.

The problem with a rule that includes the return of principal in the sales factor is its distortion of the apportionment of a taxpayer's income. A taxpayer, simply by engaging in short-term investment of its working capital, would increase many fold the denominator of the sales factor. This marked inflation of the sales factor denominator would reduce the apportionment to all states other than the state in which the treasury function is located.

The magnitude of potential distortion can be huge, as shown by the facts of a recent California case involving Microsoft, Corp. In that case, Microsoft invested on average approximately $480 million of working capital in marketable securities. Over 60 percent of these investments were held for seven days or less, and over 30 percent were held for just one day. Including these repeated returns of principal in the sales factor would have inflated the sales factor denominator by $5.7 billion. The consequence would have been a major reduction of the sales factor in California from 15.34% to 3.06%.

This magnitude of distortion, and the potential for further distortion through manipulation of the length of term of the investments of working capital, has prompted jurisdiction after jurisdiction to exclude the return of principal from the sales factor by court decision[13] or legislation.

Given this high level of uniformity across the states, if Kansas were to allow returns of principal in the sales factor, the result would be less than full apportionment for some Kansas taxpayers and duplicative taxation for others. This is because improperly including returns of principal in the sales factor would cause a larger share of a Kansas taxpayer's total multistate business income to be apportioned to its treasury function state. Such a formula, although incorrect, would not result in duplicate or less than full apportionment as long as both Kansas and the treasury function state were to adopt it. But if Kansas were to adopt a formula shifting income to a treasury function state, while the treasury function state has not adopted such a formula (and no states have), there would be less than full apportionment of the Kansas taxpayers income. By the same token, should Kansas adopt this position while other states have not, any multistate taxpayer whose treasury function is located in Kansas would be subject to duplicate taxation. And, as mentioned, the amount of double taxation or less than full apportionment could be significant.

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[13] See *Appeals of Pacific Telephone & Telegraph Company,* Cal. St. Bd. of Equal. (May 4, 1978) 78 SBE 028; *American Telephone & Telegraph Co.* v. *State Tax Appeal Board* (Mont. 1990) 787 P.2d 754; *American Telephone & Telegraph Co.* v. *Director, Division of Taxation* (Tax Ct. 1982) 4 N.J. Tax 638, aff'd and modified (N.J. Super. App. Div. 1984) 476 A.2d 800, cert. denied (1984) 97 N.J. 627; *Sherwin-Williams* v. *Indiana Dept. of State Revenue* (Ind. Tax 1996) 673 N.E.2d 849; *Walgreen Ariz. Drug Co. v. Ariz. Dept. of Revenue* (Ariz. Ct. App. 2004) 97 P.3d 896; *Microsoft Corporation v. Franchise Tax Board*, Ca. Sup. Ct. No. S133343 (2006);

SB 2495- as amended by committee
House Tax Committee
Wednesday, March 7, 2007
Lucky DeFries, Coffman, DeFries & Nothern, P.A.

Representative Wilk and members of the committee,

The business community has many concerns with the amendments that have been added to this piece of legislation some of them are listed below.

- These ideas were discussed by the business group convened by the Secretary of Revenue and the Governor during the fall. The business group unanimously rejected these ideas so they were struck from the Governor's proposal
- This undoes tax policy that was enacted in the mid-1990's and the definition of business income that put Kansas on a level playing field with other states
- These proposals affect companies domiciled in Kansas differently than companies domiciled in another state that have a presence in the state.

In terms of apportionment of income, the amendment states on page 3 that "income is apportioned to this state under the provisions of the Constitution of the United States and laws thereof".

- There are no federal laws dealing with state business income
- The bill on page 3 creates a higher standard ("**clear and convincing**") to overcome the presumption that all income is apportionable. This is a very different standard than is customarily used in tax law ("preponderance of the evidence")

Page 4 of the amendment re-defines the sales factor of the corporate income tax

- The redefinition of the sales factor will bring in the sale of anything other than inventory. In essence, the sale's factor will be calculated as net sales instead of gross sales
- This issue has been litigated many times in Kansas and the Secretary of Revenue has authority to deal with the issue administratively

Captive Insurance companies

- This requires that income from insurance companies or financial institutions come in as part of the unitary group for income tax purposes
- If this income is taxed as part of the unitary group instead of taxed under the privilege tax system, revenue generated in other states will come in and be taxed in Kansas. Other states that have imposed this type of tax have had a retaliatory tax assed against them
- The Department of Revenue has taken a contrary position to this proposal in litigation

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Kansas Grain & Feed Association
Kansas Agribusiness Retailers Association

Joint Statement in to HB 2495
House Taxation Committee
Kenny Wilk, Chair
March 7, 2007

Thank you Mr. Chairman and members of the House Taxation Committee; I am Duane Simpson, Vice President of Government Affairs for the Kansas Grain and Feed Association (KGFA) and the Kansas Agribusiness Retailers Association (KARA). KGFA is a voluntary state association with a membership encompassing the entire spectrum of the grain receiving, storage, processing and shipping industry in the state of Kansas. KGFA's membership includes over 950 Kansas business locations and represents 99% of the commercially licensed grain storage in the state. KARA's membership includes over 700 agribusiness firms that are primarily retail facilities that supply fertilizers, crop protection chemicals, seed, petroleum products and agronomic expertise to Kansas farmers. KARA's membership base also includes ag-chemical and equipment manufacturing firms, distribution firms and various other businesses associated with the retail crop production industry. On behalf of these organizations, I am testifying in opposition to House Bill 2495 as amended by this committee last week.

Our associations appreciated the Governor's proposal to reduce corporate income tax rates, but only a handful of our members would have benefited from the plan so we have not taken an active role on this issue until now. Instead, we have focused on a complete repeal of the state's franchise tax since it would the most benefit for our entire membership.

However, after the Dillmore amendment, HB 2495 is now a bill that could significantly raise corporate income taxes on some of our members. While the bill itself is "revenue neutral," it achieves that neutrality by increasing the amount of income that is taxable generating approximately $20 million in new corporate income taxes.

The Governor's tax package was based upon a series of meetings with businesses to determine which tax cuts would spur the most economic growth. During those meetings, the Dillmore amendment was suggested and rejected. The Governor was right to not include that amendment in her original package and we encourage this committee to reconsider its action and remove it.

According to Secretary Wagnon's previous testimony, the corporate income tax rate reduction was part of the Governor's package because it is believed that lowering corporate income tax bills will help create new jobs in the state. If that is true, then certainly the reverse is also true. Raising the corporate income tax bill of individual companies will certainly destroy jobs in this state.

Even though this bill is technically revenue neutral, we view it as a tax increase on some of our members. For that reason, we oppose it in its current form and respectfully request the committee to reconsider the Dillmore amendment.

HS TAXATION COMMITTEE
3-7-2007
ATTACHMENT 5

//ACLI
Financial Security. For Life.

James D. Hall
Regional Vice President, State Relations

STATEMENT OF THE AMERICAN COUNCIL OF LIFE INSURERS

KANSAS HOUSE TAX COMMITTEE

HOUSE BILL 2495

MARCH 7, 2007

The American Council of Life Insurers (ACLI) is a national trade association whose 373 member companies hold ninety percent of the life insurance and ninety-five percent of the annuities in force in America today. We have 312 member companies licensed to do business in Kansas. I am here today because of the recent amendment to HB 2495 that would adversely impact the life insurance industry.

The amendment in question is the final paragraph of Section 4 of the bill. This provision would grant sweeping authority to the Department of Revenue to force insurance companies to pay not only Kansas premium taxes but also Kansas income taxes through the insurers' non-insurance affiliates. Life insurers oppose being subject to such double taxation. We urge the Department of Revenue to work with both the insurance industry and the Kansas Insurance Department to clarify whether a tax issue exists that requires changing the tax laws relating to insurance companies. We also ask that if such an issue exists, the Department of Revenue allow the insurance industry to work with the Department to address the issue.

Double taxing law-abiding insurance companies is not an appropriate solution to a tax avoidance problem posed by non-insurers.

<u>The Insurance Tax System</u>

Insurance companies are taxed under a completely different system than non-insurers. Insurers are taxed on their gross premium received, not on their net income. Because of the heavy burden posed by the premium tax, insurers are exempt from the corporate income tax. Any attempt to combine these two tax systems presents myriad problems, not the least of which is the national retaliatory tax system which is unique to the insurance industry and which exists because the federal McCarran-Ferguson Act, 15 U.S.C. Sec. 1011 *et seq* excludes the business of insurance from Commerce Clause applicability. Moreover, insurers have a different accounting system than non-insurers (statutory vs. GAAP). The forced combination of insurance companies with unitary, affiliated non-insurance companies would, for both the insurance industry and the state –

- raise critical tax policy concerns;
- add tax burdens and uncertainties;
- create myriad administrative and substantive issues; and
- almost certainly lead to litigation

American Council of Life Insurers
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Economic Development Damage

Enacting the amendment in question into law will do considerable damage to the state's economic development opportunities. Creating a burdensome and complicated insurance tax environment will harm Kansas' ability to attract insurers to locate here. Moreover, both foreign and domestic insurers who are looking to locate a non-insurer affiliate will certainly avoid Kansas if the chance for double taxation exists here.

The ACLI strongly opposes the amendment in Section 4 of HB 2495 and we urge the committee to reconsider adoption of that amendment.

Thank you for the opportunity to comment on House Bill 2495.

Kansas Insurance Department

Sandy Praeger COMMISSIONER OF INSURANCE

COMMENTS ON
SB 2495 - Decrease in the income tax surtax on corporations
HOUSE TAXATION
March 7, 2007

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to speak on behalf of the Kansas Insurance Department. My name is Bob Tomlinson. I am the Assistant Commissioner. I am here today to offer testimony regarding House Bill 2495.

As you are aware, this Committee is considering language that will amend K.S.A. 2006 Supp. 79-32,110. This amendment, if passed, will impose a tax upon the Kansas taxable income of every corporation doing business within this state or deriving income from sources within this state. While the Department understands that some corporations are using captive insurance companies to hide corporate assets and thus, avoid taxation in this state, the Department does not support the bill in its current form.

Kansas currently has two captives that, to the knowledge of our Department, are not used by corporations to avoid taxation. However, HB 2495, as it is currently written, drastically will impact our captives, as well as every Kansas insurance company, as a result of retaliatory taxes that are imposed by at least twenty-four states.

Kansas insurance companies are required to pay premium taxes in every state in which business is written. If HB 2495 becomes law, these companies will be subject to both premium and income taxes in states where business is conducted regardless of the amount of premiums written.

As President-elect of the National Association of Insurance Commissioners, Commissioner Sandy Praeger has the unique opportunity to help us look at this problem on both the state and national levels. In light of her position, the Department is willing to help develop language that prevents corporations from avoiding taxation and just as importantly, does not produce an unreasonable burden upon Kansas insurance companies.

Thank you for the opportunity to speak and I would be happy to stand for any questions.

HS TAXATION COMMITTEE
3-7-2007
ATTACHMENT 7

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Kansas Association of Property & Casualty Ins. Cos.

Member Companies:

Armed Forces Insurance Exchange
Ft. Leavenworth

Bremen Farmers Mutual Insurance Co.
Bremen

Columbia Insurance Group
Salina

Farm Bureau Mutual Insurance Company
Manhattan

Farmers Alliance Mutual Insurance Company
McPherson

Farmers Mutual Insurance Co.
Ellinwood

Federated Rural Electric Insurance Exchange
Lenexa

Kansas Mutual Insurance Co.
Topeka

Marysville Mutual Insurance Co.
Marysville

Mutual Aid Association of the Church of the Brethren
Abilene

Mutual Aid eXchange
Overland Park

Upland Mutual Insurance Co.
Chapman

Kansas Life Insurance Association

Member Companies:

The American Home Life Insurance Company
Topeka

American Investors Life Insurance Company
Topeka

Blue Cross/Blue Shield of Kansas
Topeka

Employers Reassurance Corporation
Overland Park

First Life America Corporation
Topeka

Preferred Health Systems
Wichita

The Pyramid Life Insurance Company
Shawnee Mission

Security Benefit Life Insurance Company
Topeka

Testimony on House Bill 2495

March 7, 2007

TO: House Taxation Committee

RE: House Bill No. 2495

Mr. Chairman and Members of the Committee:

Thank you for this opportunity to appear before the Committee. I am David Hanson and am appearing on behalf of the Kansas Association of Property and Casualty Insurance Companies and the Kansas Life and Health Insurance Association, whose members are domestic insurers here in Kansas, as well as PCI, the Property Casualty Insurers Association of America, which has over 1,000 member insurance companies in the U.S., and whose member companies have a significant business presence in Kansas writing over 40% of the property-casualty premiums in Kansas.

In the latter part of 1997, representatives of several of our member companies were invited to join with legislative leaders, the Insurance Commissioner and business development leaders in a task force to explore ways to improve the business climate for insurance in Kansas. The task force recognized the positive impact that insurers have on the economy and sent a clear message to insurers that Kansas wants insurers to bring the jobs and other benefits that only an increased competitive environment in insurance, like any industry, can bring.

Consequently, we try to alert you to positive enhancements, as well as to unduly burdensome or unnecessary restrictions. We realize that this often entails a tough policy decision on your part. Insurers are also faced with difficult decisions in managing their businesses. The provisions contained in this Bill will affect decisions insurers need to be able to make without undue interference in order to be competitive. And, to be competitive in insurance means to be able to offer the best coverages at the best rates to consumers.

Insurance companies are generally taxed in Kansas on the basis of premium volume in Kansas and those premium taxes generally have been reported as the third highest revenue source for the State General Fund in recent years. K.S.A. 40-252b specifically provides that the fees, charges and premium taxes imposed under

K.S.A. 40-252 "shall be in lieu of all other...occupation taxes, income taxes, intangible property taxes, or other fees levied or assessed on the basis of income, premiums, gross receipts and intangible property by this state...." The provisions in the proposed amendments to House Bill 2495 allowing combined reporting of business income and taxation thereof would be contrary to the provisions of K.S.A. 40-252b.

Furthermore, our companies pay premium taxes in other states at rates set by those states. If those rates are higher than the Kansas rate, then Kansas charges a higher rate, a retaliatory rate for companies from that state doing business in Kansas. This bill would increase the overall tax rate in Kansas and result in other states charging a higher retaliatory tax to our companies for any premiums written in those states, then costing our companies more and causing more tax dollars to flow to other states.

We are not aware of any need for this drastic change in the tax treatment of our companies and would urge you not to support the amendment.

Respectfully,

DAVID A. HANSON

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JOAN WAGNON, SECRETARY

KANSAS

DEPARTMENT OF REVENUE
OFFICE OF POLICY AND RESEARCH

KATHLEEN SEBELIUS, GOVERNOR

Analysis of Corporate Income Tax 2000-2002

Executive Summary

October 15, 2004

Purpose of Study

The Kansas Department of Revenue recently completed an "Analysis of Corporate Income Tax 2000-2002." The purpose of the study was to provide historical information concerning the corporate income tax and the 4 largest business incentive tax credit programs (business and job development, high performance incentive program, research and development, and business machinery and equipment property tax credit). The study also examined where the corporate income tax burden falls by industry sector, and made limited comparisons of the employment performance of corporations claiming the largest amounts of tax credits to the employment performance of similar sectors of the Kansas economy as a whole in recent years.

The analysis focused specifically on tax years 2000, 2001 and 2002, which included the 2001 recession and the aftermath of 9/11. Unfortunately, these were the only years where data was readily available. The downturn in the economy following the events of 9/11 is clearly evident. This study should provide tax policy makers information for future decision-making. However, its scope did not encompass other taxes, such as individual income, sales, or property tax, nor did the scope include other business tax incentive programs, such as the enterprise zone sales tax exemption, STAR bonds, or local property tax exemptions. KDOR will update this document on an annual basis and continue to expand the study as more tax years are included, making it more useful to policy makers to see longer term trends.

DOCKING STATE OFFICE BUILDING, 915 SW HARRISON ST., TOPEKA, K
Voice 785-296-3081 Fax 785-296-7928 http://www.ksreve

Recent History of Corporate Income Tax Receipts

Despite a recent upturn, the long-term trend for corporate income tax receipts reflects significant shrinkage. Receipts for FY 2004 ($141 million) are below receipts for FY 1981 ($162 million) and half of the receipts for the peak year, FY 1998 ($281 million). Corporate income tax receipts are a smaller portion of total state taxes collected by the department and deposited in the state general fund than they were a decade ago. For FY 1991, corporate income tax receipts accounted for 8.4% of the total state taxes collected by the department and deposited in the state general fund. For FY 2003, corporate income tax receipts accounted for only 2.6% of total state taxes collected by the department and deposited in the state general fund. (Pages 1-2)

Distribution of Corporate Income Taxpayers

The largest 200 corporations account for almost three-fourths of the corporate income tax revenue. Most of the 25,000 to 30,000 corporate income tax returns received reflect zero tax liability. (Page 3)

Corporate Income Tax Credits

Rapidly expanding tax credit programs have decreased corporate income tax receipts. The most significant business income tax credit incentive programs in size are the business and job development (B&J) credit, high performance incentive program (HPIP) credit, research and development (R&D) credit, and business machinery and equipment property tax (B M&E) credit.

These credit programs favor capital-intensive, higher wage-paying businesses, such as manufacturers, as they were designed to do. The total credits allowed under these programs increased from $18.5 million in process year 1997 to $54.1 million in process year 2002, while corporate income tax receipts have declined. A relatively small number of corporations claim most of these credits. The B M&E credit, the only refundable credit of the 4 credit programs, had 4,450 corporate claimants in process year 2002, and $18.8 million in B M&E credits allowed. Of the 4 credit programs, HPIP, the largest in terms of fiscal impact, was claimed by the smallest number of corporate taxpayers. In process year 2002, $20.3 million in HPIP credits were allowed to 39 corporations. The B&J credit was claimed by 329 corporations, and the R&D credit was claimed by 59 corporations in process year 2002. (Table 1, Page 5)

9-2

Corporate Income Tax Burden

The study sample of 250 corporations included the largest 100 companies with Kansas corporate income tax liability in each of the three sample years (before credits) and the largest 100 Kansas employers in tax years 2000, 2001 and 2002. In this sample the manufacturing sector, as expected, reduced its income tax liability the most with tax credits. The whole sample averaged 27% reduction of Kansas income tax liability with tax credits. Manufacturers in the sample averaged 54% reduction of Kansas income tax liability with tax credits. (Table 2, Page 6)

Manufacturers also accounted for the largest portion (29%) of Kansas corporate income tax liability (and Kansas taxable income) during tax years 2000, 2001, and 2002 (liability measured before credits were taken) of any industry sector. The retail trade sector accounted for the largest portion (21%) of income tax receipts (measured after credits are taken). (Attached Charts 2 and 3)

Based on a group of 58 corporations included in the top 20 corporations claiming the most B&J credits during tax years 2000, 2001 and 2002, wide disparity exists between the average effective tax rate paid by those in the manufacturing/transportation/warehousing category vs. the retail/wholesale/other category. Wide disparity also exists in effective tax rates paid by individual corporations within each category. In tax year 2002, the 9 corporations in the manufacturing/transportation/warehousing category had an average effective tax rate of 2.59%, although within that category, the effective tax rates ranged from –1.8% to 6.34%, with 4 either receiving refunds or with zero net tax liability. Of the 11 corporations in the retail/wholesale/other category in tax year 2002, the average effective tax rate was 4.14%, although within that category, the effective tax rates ranged from .02% to 6.13%. (Page 7)

The study compared the manufacturing firms (13) and retail firms (9) within the group of 58 corporations included in the "top 20" in B & J credit claimants for tax years 2000, 2001 and 2002. Manufacturing firms offset 76% of their Kansas income tax liability with credits, while retailers in this group offset only 20% of their income tax liability with credits. The manufacturing corporations in the group also claimed the largest amounts of refundable and non-refundable credits from the other tax credit programs. (Table 3, Page 8)

The Kansas Economy—Retail Sector Compared to Manufacturing Sector

Since 1998 and in particular since the 2001 recession and 9/11, Kansas manufacturing sector employment has significantly declined. Retail sector employment experienced only modest decline during 2001 to 2003. The gap between retail sector employment and manufacturing sector employment has narrowed: manufacturing sector employment exceeded retail sector employment by only 20,000 jobs in 2003. (Chart 5, Page 9)

Employment Data on Top 20 Business and Job Development Credit Claimants

Comparison of the percentage rate of change in the employment levels of manufacturers among the top 20 B&J tax credit claimants during tax years 2000, 2001 and 2002 to similar data for the entire Kansas manufacturing sector from 2000 through 2003 shows that employment levels of manufacturers claiming the largest B&J credits performed worse than employment levels of the Kansas manufacturing sector as a whole during much of this time period. No correlation could be found between the tax credit programs and improved employment performance for manufacturers claiming the largest amounts of those credits when compared to the employment performance for the Kansas manufacturing sector as a whole. (Chart 7, Page 11) Caution in drawing conclusions must be exercised because of the severe dislocation in the aircraft industry in the aftermath of the 2001 recession and the 9/11 attacks, which dominated the sample period.

Employment performance of retailers claiming the largest B&J credits in tax years 2000, 2001 and 2002 was somewhat better than employment performance of the Kansas retail sector as a whole during much of this time period, although retailers claimed a much smaller portion of the credits than manufacturers. (Chart 8, Page 11)

The aggregate employment level of corporations included in the group of top 20 B&J credit claimants in tax years 2000, 2001 and 2002 performed worse than the aggregate employment level in the private sector as a whole in Kansas during most of this time period. (Chart 9, Page 12)

Conclusions

Manufacturers have utilized the business tax credit incentive programs and have claimed the largest amounts of the credits. This result is consistent with state economic development policy that has been in effect for 10 years. Some larger claimants have used the credits to eliminate their corporate income tax liability entirely—even obtaining refunds.

Because tax credits are used to lower tax burden, the effective tax rate varies greatly within industry groups of all types.

Generally, the manufacturing sector bears a smaller share of the corporate income tax burden than other sectors of the economy, compared to the taxable income generated by those sectors. The tax credit programs do not appear to have shielded manufacturers claiming the largest amounts of B&J credits from the economic downturn experienced by the Kansas economy in the 2001 recession, and in the aftermath of 9/11.

The retail sector contributes the largest portion of the corporate income tax receipts, although the manufacturing sector generated the largest amount of Kansas taxable income in tax years 2000, 2001 and 2002. The retail sector is less able than the manufacturing sector to benefit from the tax credit programs, typically bears a higher share of the corporate income tax burden, and pays higher effective tax rates. Retailers in the group of top 20 B&J credit claimants showed stronger employment performance in the aftermath of the 2001 recession and 9/11 than the Kansas retail sector as a whole.

In general, corporations claiming the most tax credits did not show employment performance matching that of the Kansas private sector economy during most of the 2000-2003 time period. This result should be tracked and measured over a longer period of time before conclusions are reached because of the recession during the sample years.

JOAN WAGNON, SECRETARY

KANSAS

DEPARTMENT OF REVENUE
POLICY AND RESEARCH

KATHLEEN SEBELIUS, GOVERNOR

October 15, 2004

Analysis of Kansas Corporate Income Tax 2000-2002

This Analysis focused on the Kansas corporate income tax during tax years 2000, 2001 and 2002 and the impact of the 4 largest business income tax credit incentive programs on corporate income tax receipts, in an effort to determine how the corporate income tax burden falls within various industry sectors. It also examined employment data concerning the largest tax credit claimants, in order to determine whether any correlation exists between improved employment performance and tax credits, in comparison to employment data for the Kansas economy as a whole during 2000 to 2003. The 2001 recession and aftermath of 9/11 dominated this time period. The Analysis did not consider other taxes, such as individual income, sales or property tax, or other business tax incentive programs, such as STAR bonds, local property tax exemptions, or the enterprise zone sales tax exemption.

Historical Background

The Kansas corporate income tax has been in place since 1933, initially at a rate of 2% of Kansas taxable income. The rate has been increased several times over the years, and was last raised in 1992, when the current rate structure was adopted: the 4% rate on Kansas taxable income, with a surtax of 3.35% on Kansas taxable income above $50,000. This 7.35% marginal rate on Kansas taxable income above $50,000 is typical of rates in many states, but higher than the corporate income tax rates in three neighboring states, including: Colorado (4.63%); Missouri (6.25%); and Oklahoma (6%). It is lower than the corporate income tax rate in Nebraska (5.58% on first $50,000; 7.81% marginal on income above $50,000).

Most states impose some type of corporate income tax. Only Nevada, South Dakota, Washington, and Wyoming do not (although Washington imposes a "business and occupations" tax).

Recent History of Corporate Income Tax Receipts

Annual Kansas corporate income tax receipts (by fiscal year) since 1981 are shown below:

Fiscal Year	Amount Collected	Percent Change
1981	$161,967,709	
1982	$146,823,052	-9.4%
1983	$122,831,287	-16.3%
1984	$120,993,044	-1.5%

1985	$141,957,298	17.3%
1986	$135,818,461	-4.3%
1987	$104,632,665	-23.0%
1988	$171,437,706	63.8%
1989	$172,927,488	0.9%
1990	$167,600,876	-3.1%
1991	$185,319,680	10.6%
1992	$169,118,247	-8.7%
1993	$169,118,153	0.0%
1994	$211,953,103	25.3%
1995	$229,421,376	8.2%
1996	$218,586,552	-4.7%
1997	$263,573,332	20.6%
1998	$281,651,300	6.9%
1999	$227,369,923	-19.3%
2000	$250,122,826	10.0%
2001	$211,906,919	-15.3%
2002	$93,958,484	-55.7%
2003	$105,222,316	12.0%
2004	$141,173,000	34.2%

Although the bottom fell out of corporate income tax receipts in FY 2002, the recent trend is encouraging. FY 2004 corporate income tax receipts exceeded the April 2004 Consensus Revenue Estimate ($125 million) by 12.9% and were 34.2% above the prior year's receipts. Thus far in FY 2005, corporate income tax receipts of $52.9 million through the end of September are 62.8% above the April 2004 Consensus Revenue Estimate and 45.9% above actual corporate income tax receipts for this same time period last year.

Despite the recent upturn, the long term trend for corporate income tax receipts reflects significant shrinkage of the tax base—even though tax rates have remained unchanged since 1992. Receipts for FY 2004 are below receipts for FY 1981 and are barely half of the receipts for the peak year, FY 1998.

Corporate income tax receipts account for a much smaller portion of total state taxes collected by the department and deposited in the state general fund than they did even a decade ago. For FY 1991, corporate income tax receipts accounted for 8.4% of the total state taxes collected by the department and deposited in the state general fund. For FY 2003, corporate income tax receipts accounted for only 2.6% of total state taxes collected by the department and deposited in the state general fund.

The pie graphs at Chart 1 (attached) (comparing state and local tax revenue by source for FY 1998 to the same for FY 2003) show that income (individual and corporate) and privilege taxes have become a smaller portion of total state and local tax base in recent years. For FY 2003, property and vehicle taxes accounted for 34.7 percent of state and local tax revenues; sales and use taxes, 27.8 percent, and income and privilege taxes, 21.8 percent. As noted in 2003 Supplement to Kansas Tax Facts:

> The relative balance in the big three sources of state and local tax revenue—sales, income, and property—that Kansas had achieved for a number of years after the 1992 school finance law appears to be eroding. . . . As recently as

FY 1998, the figures were much more closely balanced: 30.9 percent for property and vehicles; 28.1 percent for sales and use; and 28.0 percent for income and privilege.

Economists generally believe that with a diversified revenue portfolio not relying too heavily on a single source, Kansas state and local governments are better able to withstand economic downturns.

Distribution of Corporate Income Taxpayers

The department receives approximately 25,000 to 30,000 corporate income tax returns per year. Most of those returns reflect zero tax liability. The largest 200 corporations account for almost three-fourths of the corporate income tax revenue, as shown below (statistics taken from the department's Annual Reports for FY 2001, FY 2002 and 2003). As shown below, this distribution pattern has remained fairly consistent over many years.

Corporate Income Tax Liability By Taxable Income Bracket

Tax Year 2001 Returns Filed In Calendar Year 2002

Taxable Income Brackets	Number Returns	Percent of Total Returns	Tax Liability	Percent of Total Liability
No Taxable Income	13,975	60.3%	$ 0	0.0%
$0 - $75,000	7,834	33.8%	$ 6,051,308	8.7%
$75,000.01 - $100,000	371	1.6%	$ 1,704,346	2.4%
$100,000.01 - $500,000	743	3.2%	$ 9,917,859	14.3%
$500,000.01 - $1,000,000	112	0.5%	$ 5,475,153	7.9%
$1,000,000.01 - Over	125	0.5%	$46,438,219	66.7%
Total	23,160	100.0%	$69,586,885	100.0%

Tax Year 2000 Returns Filed In Calendar Year 2001

Taxable Income Brackets	Number Returns	Percent of Total Returns	Tax Liability	Percent of Total Liability
No Taxable Income	18,025	60.4%	$ 0	0.0%
$0 - $75,000	9,550	32.0%	$ 7,437,981	4.3%
$75,000.01 - $100,000	466	1.6%	$ 2,162,361	1.2%
$100,000.01 - $500,000	1,226	4.1%	$ 17,989,315	10.3%
$500,000.01 - $1,000,000	230	0.8%	$ 11,676,780	6.7%
$1,000,000.01 - Over	329	1.1%	$135,700,416	77.6%
Total	29,826	100.0%	$174,700,416	100.0%

Tax Year 1989 Returns Filed in Calendar Year 1990

Taxable Income Brackets	Number Returns	Percent of Total Returns	Tax Liability	Percent of Total Liability
No Taxable Income	20,022	58.3%	$ 0	0.0%
$0 - $25,000	8,219	25.2%	$ 2,775,067	2.2%
$25,000.01 - $50,000	2,036	6.3%	$ 3,834,025	3.1%
$50,000.01 - $75,000	1,097	3.1%	$ 3,880,877	2.9%
$75,000.01 - $100,000	561	1.7%	$ 2,929,035	2.4%
$100,000.01 - $500,000	1,178	3.8%	$ 16,367,577	13.6%
$500,000.01 - Over	468	1.5%	$ 93,003,841	75.8%
Total	33,581	100.0%	$ 122,790,422	100.0%

Corporate Income Tax Credits

"Both tax exemptions and tax-deductibility are a form of subsidy that is administered through the tax system. A tax exemption has much the same effect as a cash grant to the organization of the amount of tax it would have to pay on its income. Deductible contributions are similar to cash grants of the amount of a portion of the individual's contributions." *Regan v. Taxation With Representation of Washington*, 461 U.S. 540, 544 (1983). Tax credits, like exemptions and deductions, are also a form of subsidy. During the 1990's, several business-oriented tax credit programs were either expanded or created, the most significant in size being the business and job development (B&J) credit, high performance incentive program (HPIP) credit, research and development (R&D) credit, and business machinery and equipment property tax (B M&E) credit. The first three tax credits listed are non-refundable (i.e., the taxpayer must have sufficient tax liability to offset the credit claim), and the last, the business machinery and equipment property tax credit, is refundable—even when there is no tax liability. Non-refundable credits exceeding the taxpayer's liability can be carried forward and claimed in future years, subject to certain constraints and time limits. The tax credit programs are described in Appendix A.

These credit programs were designed to favor capital-intensive, higher wage-paying businesses, such as manufacturers. Corporations availing themselves of these credits must make significant capital investments, hire additional employees, pay higher wages, or all of the above.

Table 1 shows that total corporate credit claims for the largest 4 tax credit programs have increased dramatically in recent years. It provides data on the amount of and number of corporate taxpayers claiming the B&J credit, HPIP credit, R&D credit, and B M&E credit claimed from process year (calendar year during which the return was processed, which is generally the calendar year following the tax year of the return) 1994 through process year 2002. The total credits allowed increased from $18.5 million in process year 1997 to $54.1 million in process year 2002. Corporate income tax receipts declined significantly during much of this time period.

9-9

Table 1

HPIP TAX CREDIT CLAIMED BY CORPORATE INCOME TAX FILERS

HPIP	Filers	Credit Allowed
PY 1994	*confidential	
PY 1995	5	$163,733
PY 1996	6	$345,755
PY 1997	12	$884,455
PY 1998	13	$2,919,924
PY 1999	20	$4,814,076
PY 2000	29	$11,019,194
PY 2001	33	$10,770,156
PY 2002	39	$20,297,734
Total	**157**	**$51,215,027**

BUSINESS & JOB DEVELOPMENT TAX CREDIT CLAIMED BY CORPORATE INCOME TAX FILERS

B&J	Filers	Credit Allowed
PY 1994	392	$9,737,422
PY 1995	515	$9,972,855
PY 1996	619	$11,910,471
PY 1997	633	$16,384,465
PY 1998	630	$24,981,586
PY 1999	508	$14,757,102
PY 2000	404	$11,261,171
PY 2001	392	$13,286,971
PY 2002	329	$14,076,006
Total	**4,422**	**$126,368,049**

BUSINESS MACHINERY & EQUIPMENT TAX CREDIT CLAIMED BY CORPORATE INCOME TAX FILERS

M&E	Filers	Credit Allowed
PY 1994		
PY 1995		
PY 1996		
PY 1997		
PY 1998		
PY 1999	2,509	$3,784,307
PY 2000	3,486	$10,453,217
PY 2001	4,156	$14,464,830
PY 2002	4,450	$18,771,538
Total	**14,601**	**$47,473,892**

RESEARCH & DEVELOPMENT TAX CREDIT CLAIMED BY CORPORATE INCOME TAX FILERS

R&D	Filers	Credit Allowed
PY 1994	61	$3,199,219
PY 1995	68	$704,701
PY 1996	58	$846,025
PY 1997	57	$1,243,004
PY 1998	58	$2,428,084
PY 1999	52	$1,354,640
PY 2000	48	$1,061,975
PY 2001	47	$3,597,764
PY 2002	59	$997,203
Total	**508**	**$15,432,615**

TOTAL CREDIT ALLOWED - CORPORATE INCOME TAX FILERS

	HPIP	B&J	M&E	R&D	Total
PY 1994	*confidential	$9,737,422		$3,199,219	12,936,641
PY 1995	$163,733	$9,972,855		$704,701	10,841,289
PY 1996	$345,755	$11,910,471		$846,025	13,102,251
PY 1997	$884,455	$16,384,465		$1,243,004	18,511,924
PY 1998	$2,919,924	$24,981,586		$2,428,084	30,329,594
PY 1999	$4,814,076	$14,757,102	$3,784,307	$1,354,640	24,710,125
PY 2000	$11,019,194	$11,261,171	$10,453,217	$1,061,975	33,795,557
PY 2001	$10,770,156	$13,286,971	$14,464,830	$3,597,764	42,119,721
PY 2002	$20,297,734	$14,076,006	$18,771,538	$997,203	54,142,481
Total	**51,215,027**	**$126,368,049**	**47,473,892**	**$15,432,615**	**240,489,583**

9-10

The B M&E credit, the only refundable credit of the 4 credit programs, has a large number of corporate claimants: 4,450 corporate claimants in process year 2002, with $18.8 million in B M&E credits allowed during process year 2002. The B M&E credit is not the largest corporate tax credit program. In process year 2002, $20.3 million in HPIP credits were allowed to 39 corporations. Of the 4 credit programs, HPIP, the largest monetarily, was claimed by the smallest number of corporate taxpayers. The B&J credit was claimed by 329 corporations, and the R&D credit was claimed by 59 corporations in process year 2002. Depending on the circumstances, a corporation may claim several, if not all 4 of these credits in one tax year.

Corporate Income Tax Burden

In order to determine how much impact these tax credit programs have on the corporate income tax burden, the department reviewed corporate income tax returns for tax years 2000, 2001 and 2002 and developed a sample database containing taxpayer information extracted from actual returns of corporations. Corporations in the top 100 in Kansas income tax liability (measured before credits are applied) in each of those three tax years were included. Based on information received from the Department of Commerce, corporations among the top 100 employers in Kansas (based on number of employees) were also included in the database. The total amount of companies included in the sample was 250. These large corporations account for approximately three-fourths of the corporate income tax base. The North American Industry Classification System (NAICS) code, Kansas taxable income, Kansas corporate income tax liability before credits, credits claimed, and the net tax receipts after credits for tax years 2000, 2001 and 2002 for each of these corporations were captured in the database.

Table 2 summarizes the results by NAICS code categories (using the first 2 digits of the NAICS code). The number of corporations included in each NAICS code category is shown in parenthesis in the first column. According to NAICS, the manufacturing sector comprises establishments engaged in the mechanical, physical, or chemical transformation of materials, substances or components into new products. The retail trade sector comprises establishments engaged in retailing merchandise, generally without transformation, and rendering services incidental to the sale of merchandise.

Table 2. Tax and credits Statistics by Industry from a Sample of Top 200 Corporations from Tax Year 2000 to Tax Year 2002.

Industry (# of corporations)	Total Tax Liability	Total NR Credits	B&J	R&D	HPIP	Property Tax Refund	Total Other Ref Credits	Net Receipts	Payment Percentage
Mining (8)	$18,112,767	$11,000	$0	$0	$0	$132,917	$0	$17,968,850	99.21%
Utilities (5)	$11,067,425	$287,225	$0	$0	$231,725	$12,588	$46,024	$10,721,588	96.88%
Manufacturing (58)	$106,017,045	$43,477,139	$15,534,381	$6,426,435	$22,151,467	$13,460,663	$732,800	$48,346,443	45.60%
Wholesale Trade (44)	$42,696,065	$5,275,178	$4,279,126	$627,929	$265,623	$2,152,127	$76,065	$35,192,695	82.43%
Retail Trade (40)	$67,150,276	$9,121,169	$5,076,413	$0	$1,334,017	$2,513,120	$189,306	$55,326,681	82.39%
Transportation and Warehousing (7)	$16,799,674	$1,102,070	$841,938	$0	$224,632	$1,551,930	$81,250	$14,064,423	83.72%
Information (16)	$30,981,962	$1,117,749	$545,699	$61,548	$500,502	$5,339,965	$1,228,587	$23,295,661	75.19%
Finance and Insurance (16)	$18,601,663	$1,339,593	$32,000	$0	$0	$45,545	$1,250	$17,215,275	92.55%
Professional and Technical Services (11)	$6,764,612	$49,281	$48,970	$311	$0	$118,724	$0	$6,596,607	97.52%
Management of Companies and Enterprises (10)	$17,947,926	$480,650	$242,550	$0	$0	$361,265	$0	$17,106,011	95.31%
Accommodation and Food Services (6)	$6,076,907	$432,019	$88,280	$0	$0	$97,752	$14,279	$5,532,857	91.05%
Others (29)	$15,320,818	$3,218,822	$1,465,082	$0	$1,280,577	$878,537	$700	$11,222,759	73.25%
Total (250)	$357,537,139	$65,911,895	$28,154,439	$7,116,223	$25,988,543	$26,665,133	$2,370,261	$262,589,850	73.44%

9-11

Table 2 shows wide disparity between the various industry sectors in net tax receipts (after credits are taken) vs. tax liability measured before credits are taken (directly proportional to Kansas taxable income). The "payment percentage" column shown above reflects the percent of tax liability (measured before credits are taken) actually paid after credits were applied to reduce tax liability. Manufacturers have by far the lowest tax payment percentage rate at 45.60%.

Charts 2 and 3 (attached) show that although manufacturers represent the largest portion of Kansas tax liability before credits (and Kansas taxable income) in the sample, retail trade represents the largest portion of net taxes paid after credits are taken. Manufacturers are clearly best situated to take advantage of the largest tax credit programs. Charts 2 and 3 graphically display the information in Table 2. Chart 2 shows the percentage of total Kansas income tax liability (measured before credits are taken) attributable to each industry sector in the sample.. Chart 3 shows the percentage of total net tax receipts (taxes paid after credits were taken) attributable to each industry sector in the sample.

Within this sample of 250, the Analysis looked at the group of top 20 corporations that claimed the most B&J credits during tax years 2000, 2001 and 2002. Some corporations appeared in the group of top 20 B&J credit claimants in more than 1 tax year. This group totalled 58 corporations. These corporations also claimed large portions of the other credits, but the ranking was based on the B&J credits claimed. The corporations in this group were divided into 2 broad categories by NAICS code: manufacturing/transportation/warehousing and retail/wholesale/other. The effective tax rate for each corporation was computed, as well as the average effective tax rate for each of the two categories. The results are shown below.

Top 20 B & J Credit Claimants

Tax Year 2000

5 in Manufacturing/Transportation/Warehousing
Total Taxable Income: $208.8 million
Total Net Tax: $4.375 million
Ave. Effective Tax Rate: 2.1%
Range: .88% to 5.44%

15 in Retail/Wholesale/Other
Total Taxable Income: $436 million
Total Net Tax: $24.4 million
Ave. Effective Tax Rate: 5.6%
Range: .27% to 7.07%

Tax Year 2001

10 in Manufacturing/Transportation/Warehousing
Total Taxable Income: $257 million
Total Net Tax: $3.19 million
Ave. Effective Tax Rate: 1.2%
Range: -1.3% to 5.16%
(5 with refunds or zero taxes)

10 in Retail/Wholesale/Other
Total Taxable Income: $281 million
Total Net Tax: $17 million
Ave. Effective Tax Rate: 6%
Range: -1.9% to 7%
(1 with refund)

Tax Year 2002

9 in Manufacturing/Transportation/Warehousing
Total Taxable Income: $169 million
Total Net Tax: $4.37 million
Ave. Effective Tax Rate: 2.59%
Range: -1.8% to 6.34%
(4 with refunds or zero taxes)

11 in Retail/Wholesale/Other
Total Taxable Income: $82 million
Total Net Tax: $3.385 million
Ave. Effective Tax Rate: 4.14%
Range: .02% to 6.13%

The results show a wide disparity between the average effective tax rate paid by the manufacturing/transportation/warehousing category vs. the retail/wholesale/other category. There is also wide disparity in effective tax rates paid by individual corporations within each category. For example, in tax year 2002, the 9 corporations in the manufacturing/transportation/warehousing category had an average effective tax rate of 2.59%, although within that category, the effective tax rate ranged from –1.8% to 6.34%, with 4 either receiving refunds or with zero net tax liability. Of the 11 corporations in the retail/wholesale/other category in tax year 2002, the average effective tax rate was 4.14%, although within that category, the effective tax rate ranged from .02% to 6.13%.

Table 3 compares the manufacturing firms and retail firms within this group of 58 corporations included in the "top 20" in B & J credit claimants for tax years 2000, 2001 and 2002. The amount of tax liability (measured before credits are taken), credits and net receipts for all three tax years for manufacturing and retail firms in the group are listed. Of the 58 corporations in the group, 13 were manufacturing corporations and 9 were retail trade corporations. The "total" row at the bottom sums the information not only for these 13 manufacturers and 9 retailers, but also the rest of the 58 corporations in the group.

Table 3. Summary information for the Corporations that claimed most B&J Credits in TY 2000, 2001 and 2002

Sector (# of sample)	Total Tax Liability	Total NR Credits	B&J	R&D	HPIP	B M & E	Total Ref. Credits	Net Receipts	Percent-age*
Manufacture (13)	$43,405,188	$29,235,951	$14,965,331	$5,990,066	$8,192,460	$3,567,459	$298,675	$10,303,103	23.74%
Retail Trade (9)	$25,096,141	$4,684,763	$4,684,763	$0	$0	$388,165	$0	$20,023,213	79.79%
Total (58)	$103,582,994	$42,709,553	$26,977,254	$6,543,973	$8,990,232	$5,347,514	$359,019	$55,166,908	53.26%

*Percentage = (Net Receipts/Total Tax Liability).

Table 3 shows that manufacturing firms succeeded in offsetting much of their tax liability with credits, owing only 24% of the amount of their tax liability measured before credits were applied, while retailers offset a much smaller portion of their tax liability, still owing about 80% of the amount their tax liability measured before credits. The average payment percentage for all 58 corporations in this group of largest B&J credit claimants is about 53%. The manufacturing corporations in the group also claimed the largest amounts of refundable and non-refundable credits from the other tax credit programs.

The Kansas Economy—Retail Sector Compared to Manufacturing Sector

As discussed above, based on the sample database of large corporations, the manufacturing sector enjoys a lower effective tax rate than other sectors of the economy, as a result of tax credits. In the last decade, and in particular since the 2001 recession and 9/11, the United States manufacturing sector has been shrinking. Kansas is no exception. The two charts below provide historical employment information for various sectors of the Kansas economy.

Chart 4 compares the Kansas civilian labor force to aggregate employment and private sector employment from 1990 through 2003. The civilian labor force represents persons either in the workforce or actively looking for work. The difference between the civilian labor force line and the aggregate employment line represents unemployment. The difference between the aggregate employment line and the private sector line reflects public sector employment. After steadily increasing during the 1990's and into 2000, the civilian labor force and aggregate employment experienced significant drop-offs beginning in late 2000 through early 2002 and then steadily increased. Private sector employment also steadily increased during the 1990's, but reached a plateau in 2000 and then declined through 2003.

Chart 4. Kansas Civilian Labor Force, Total Employment and Employment in Private Sector, 1990-2003

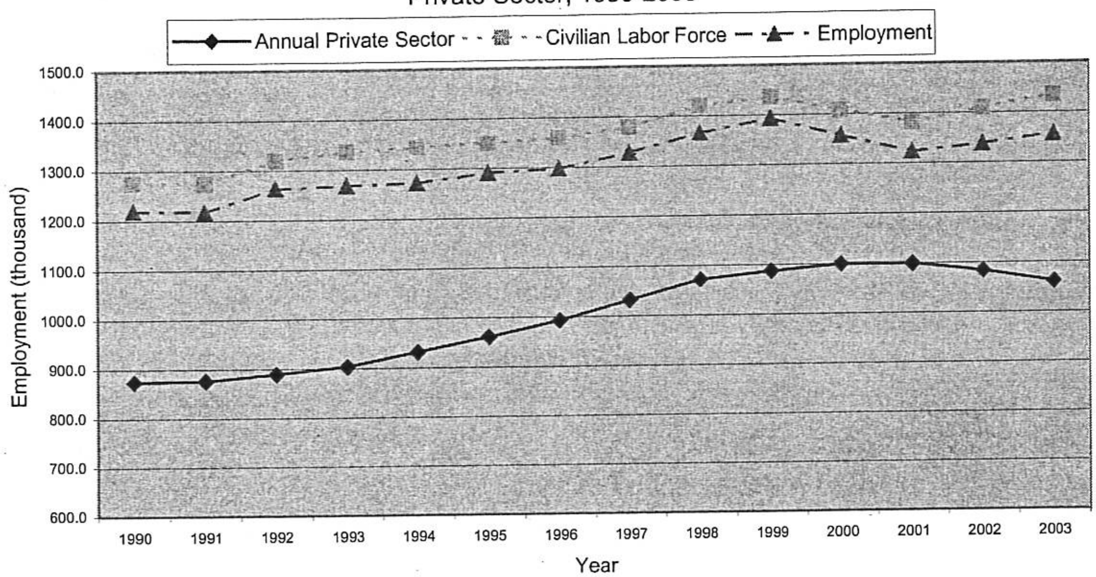

Chart 5 compares Kansas manufacturing employment and retail trade employment from 1990 through 2003. During most of the 1990's, both manufacturing and retail trade experienced steady growth, with dramatic growth in manufacturing in the late 1990's. Manufacturing sector employment was significantly larger than the retail sector throughout the 1990's, ranging from 40,000 to 60,000 employees higher. Since 1999, manufacturing sector employment has sharply declined. Retail sector employment experienced only modest decline during 2001 to 2003. The gap between retail sector employment and manufacturing sector employment has significantly narrowed: manufacturing sector employment exceeded retail sector employment by only 20,000 jobs in 2003.

Chart 5. Comparing Kansas Manufacturing and Retail Trade Sectors Employment: 1990-2003

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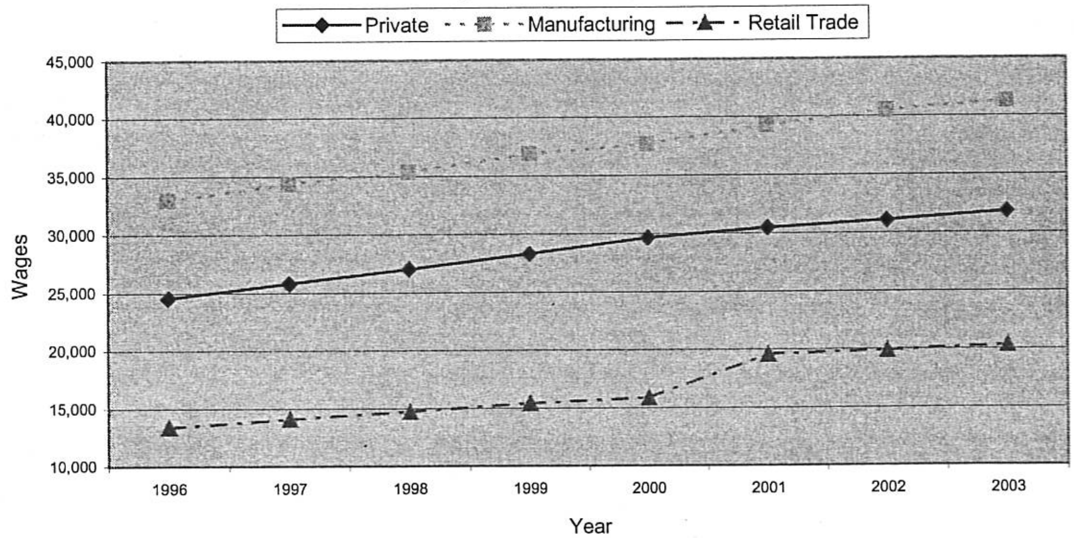
Chart 6 compares the average annual wages for the Kansas private sector, manufacturing sector and retail sector from 1996 through 2003. Manufacturing sector wages are higher than private sector wages, and retail wages are lower than private sector wages. Despite the 2001 recession, wage levels have increased throughout the time period shown.

Chart 6. Kansas Average Annual Wages in Different Sectors



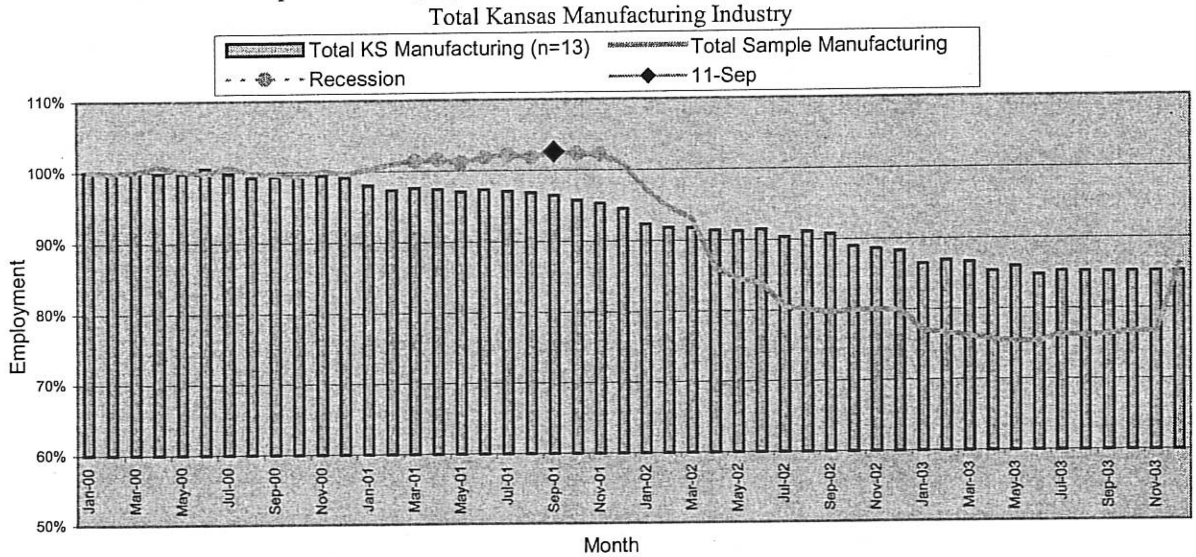
As the charts above show, the Kansas economy experienced a serious recession during 2001, and with the added impact of 9/11, experienced higher unemployment rates in many sectors for an extended time period.

Employment Data on Top 20 Business and Job Development Credit Claimants

The B & J tax credit program provides tax credits based on the number of net new employees and the amount of qualified capital investment. Corporations claiming large amounts of these credits could be expected to have a higher job growth than their industrial average. Employment data was obtained from the Department of Labor on the corporations included in the group of top 20 claimants of the B&J tax credit during tax years 2000, 2001 and 2002, in order to determine how well changes in the employment levels in these corporations compared with changes in employment levels in the Kansas economy.

Chart 7 compares the performance of employment levels of manufacturers (13 corporations) included in the group of largest B&J tax credit claimants with that of the entire Kansas manufacturing sector. The percentage rate of change in the employment levels of manufacturers among the largest B&J tax credit claimants are compared to similar data for the entire Kansas manufacturing sector from 2000 through 2003. Employment levels of manufacturers claiming the largest B&J credits performed worse than employment levels of the Kansas manufacturing sector during much of this time period. Chart 7 graphically notes the 2001 recession (March 2001 to November 2001, according to the National Bureau of Economic Research) and 9/11 on the time line for the group of largest B&J tax credit claimants. These events dominated this time period and severely affected the Kansas manufacturing sector.

Chart 7. Comparison of Employment Level Between the Sample Manufacturers (n=13) and the Total Kansas Manufacturing Industry



The Department of Labor employment information provides no correlation between the tax credit programs and improved employment performance for manufacturers claiming the largest amounts of those credits, during the aftermath of the 2001 recession and 9/11.

Chart 8 compares the performance of employment levels of retailers included in the sample (9) of largest B&J claimants with that of the entire Kansas retail sector. The percentage rate of change in the employment levels of retailers among the largest B&J tax credit claimants are compared to similar data for the entire Kansas retail sector from 2000 through 2003. Employment levels of retailers claiming the largest B&J credits performed somewhat better than employment levels of the Kansas manufacturing sector during much of this time period, although retailers claim a much smaller portion of the credits than manufacturers. The 2001 recession and 9/11 are noted graphically.

Chart 8. Comparison of Employment Level Between the Sample Retailers (n=9) and the Total Kansas Retail Trade Industry

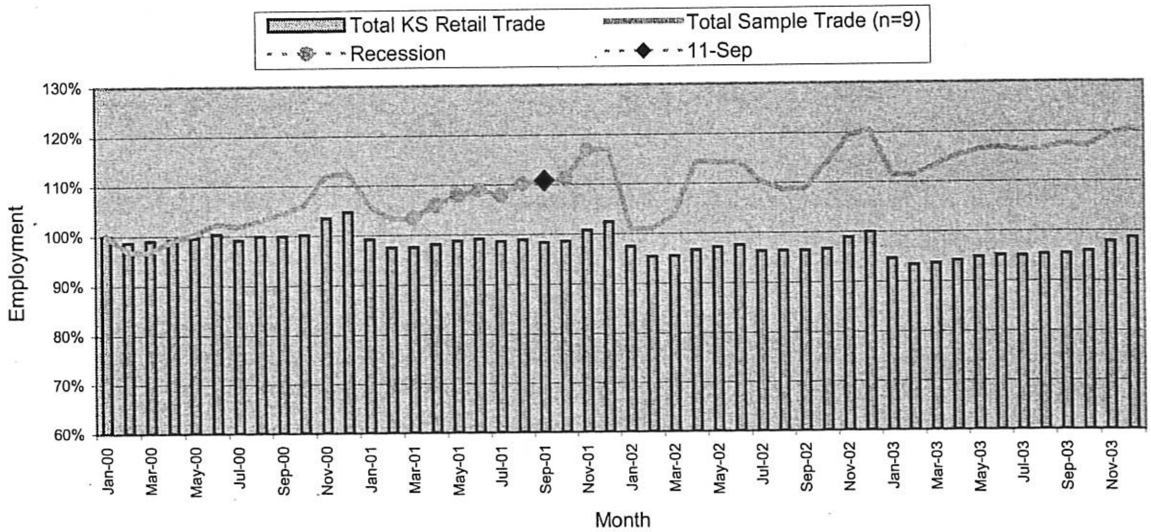


Chart 9 tracks the percentage rate of change in the aggregate employment level of corporations included in the group of top 20 B&J credit claimants from January 2000 through the end of 2003 and compares that to the percentage rate of change in the aggregate employment level of the Kansas private sector during the same time period. During most of this time period the rate of change in employment level of the corporations in the group claiming the largest B&J credits was worse than in the private sector as a whole in Kansas. The 2001 recession and 9/11 are also noted graphically.

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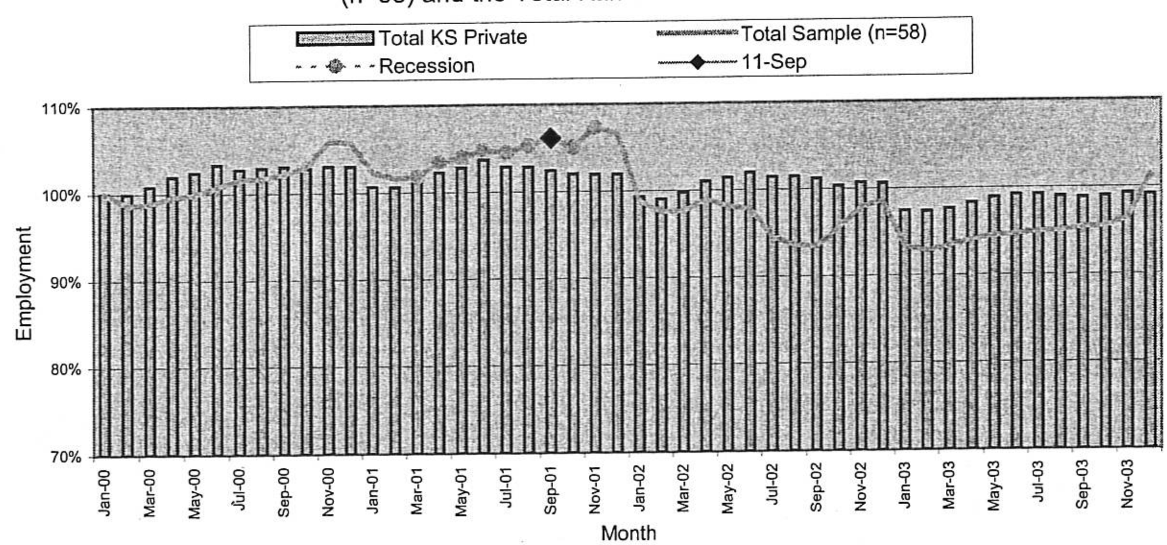
Chart 9. Comparison of Employment Level Between the Sample Corporations (n=58) and the Total Kansas Private Industries



Conclusions

Manufacturers have utilized the business tax credit incentive programs and have claimed the largest amounts of the credits. This result is consistent with state economic development policy that has been in effect for 10 years. Some larger claimants have used the credits to eliminate their corporate income tax liability entirely—even obtaining refunds.

Because tax credits are used to lower tax burden, the effective tax rate varies greatly within industry groups of all types.

Generally, the manufacturing sector bears a smaller share of the corporate income tax burden than other sectors of the economy, compared to the taxable income generated by those sectors. The tax credit programs do not appear to have shielded manufacturers claiming the

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largest amounts of B&J credits from the economic downturn experienced by the Kansas economy in the 2001 recession, and in the aftermath of 9/11.

The retail sector contributes the largest portion of the corporate income tax receipts, although the manufacturing sector generated the largest amount of Kansas taxable income in tax years 2000, 2001 and 2002. The retail sector is less able than the manufacturing sector to benefit from the tax credit programs, typically bears a higher share of the corporate income tax burden, and pays higher effective tax rates. Retailers in the group of top 20 B&J credit claimants showed stronger employment performance in the aftermath of the 2001 recession and 9/11 than the Kansas retail sector as a whole.

In general, corporations claiming the most tax credits did not show employment performance matching that of the Kansas private sector economy during most of the 2000-2003 time period. This result should be tracked and measured over a longer period of time before conclusions are reached because of the recession during the sample years.

Appendix A

Business and Job Development Credits - K.S.A. 79-32,153 and K.S.A. 79-32,160a
K.S.A. 79-32,153
A taxpayer that invests in a qualified business facility and hires at least two employees as a result of that investment may be eligible for a tax credit of $100 for every new qualified business facility employee and $100 for every $100,000 of investment made.

K.S.A. 79-32,160a
A taxpayer that invests in a qualified business facility and hires a minimum number of employees as a result of that investment may be eligible for the enhanced tax credit of at least $1,500 for every new qualified business facility employee and $1,000 for every $100,000 of investment made. To qualify for the enhanced credit, a manufacturing business must hire at least 2 qualified business facility employees as a direct result of the investment, a non-manufacturing business must hire at least 5 qualified business facility employees as a direct result of the investment, and a retail business must be considered a business headquarters, ancillary support operation (such as a warehouse), catalog house or prepackaged software operation and hire at least 20 qualified business facility employees as a direct result of the investment.

High Performance Incentive Program Credits - K.S.A. 74-50,132 and K.S.A. 79-32,160a(e)
Businesses must be certified in advance by Department of Commerce, in order to qualify for HPIP. The program applies only to businesses within certain specified NCAIS codes that pay wages higher than the prevailing wage within that industry.

Training and Education Tax Credit
A qualified firm making a cash investment in the training and education of its employees can receive a credit equal to the portion of the investment in the training and education that exceeds 2% of the businesses total payroll costs.

Investment Tax Credit
A credit is available for those qualified firms that make an investment in a qualified business facility. the investment tax credit is 10% of the qualified business facility investment that exceeds $50,000.

Business Machinery and Equipment Credit - K.S.A. 79-32,206

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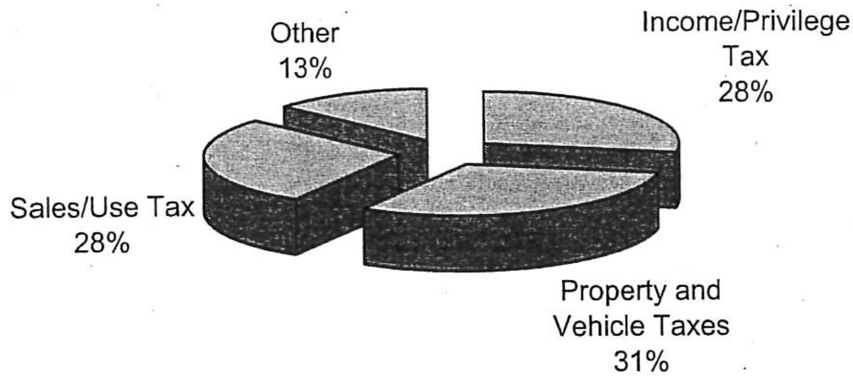
A credit may be allowed in an amount equal to 15% of the personal property tax levied and paid on commercial and industrial machinery and equipment classified for property taxation purposes pursuant to section 1 of article 11 of the Kansas Constitution in subclass (5) or (6) of class 2 and machinery and equipment classified for such purposes in subclass (2) of class 2. The credit amount will increase to 20% of the property tax levied for property tax years 2005 and 2006, and 25% of the property tax levied for property tax years 2007 and after. This credit is refundable.

Research and Development Tax Credit - K.S.A. 79-32,182a
A taxpayer with qualifying expenditures in research and development activities conducted within Kansas may be eligible to receive a credit of 6 1/2% of the amount expended for the research.

Chart 1

Fiscal Year 1998
State and Local Tax Revenues by Source



Fiscal Year 2003
State and Local Tax Revenues by Source

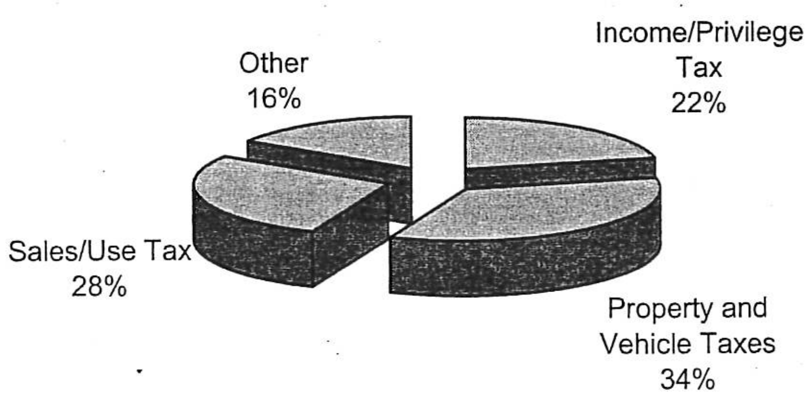


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Chart 2

Total Corporate Income Tax Liability by Sector Before Credits Are Taken

Tax year 2000, 2001 and 2002

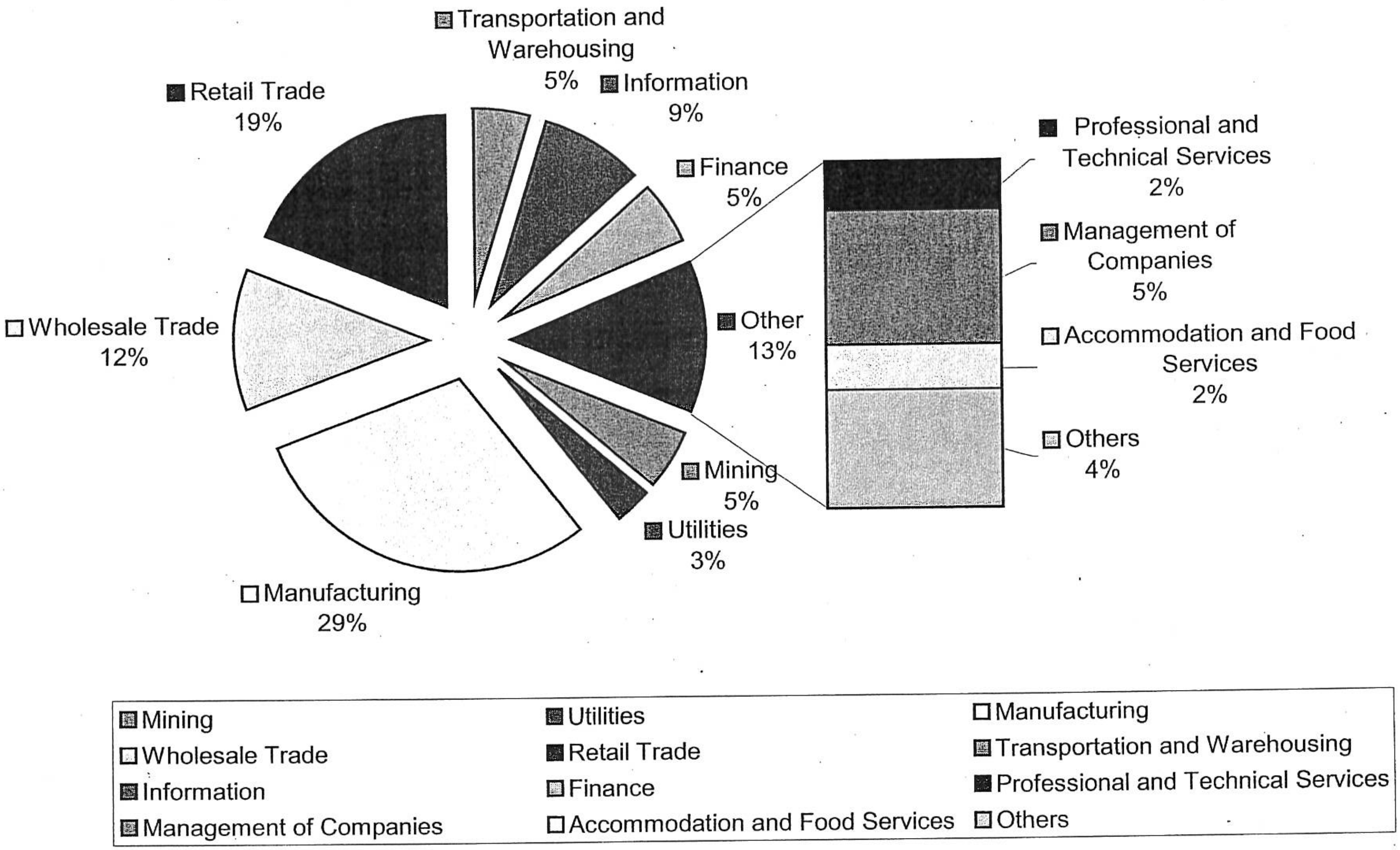

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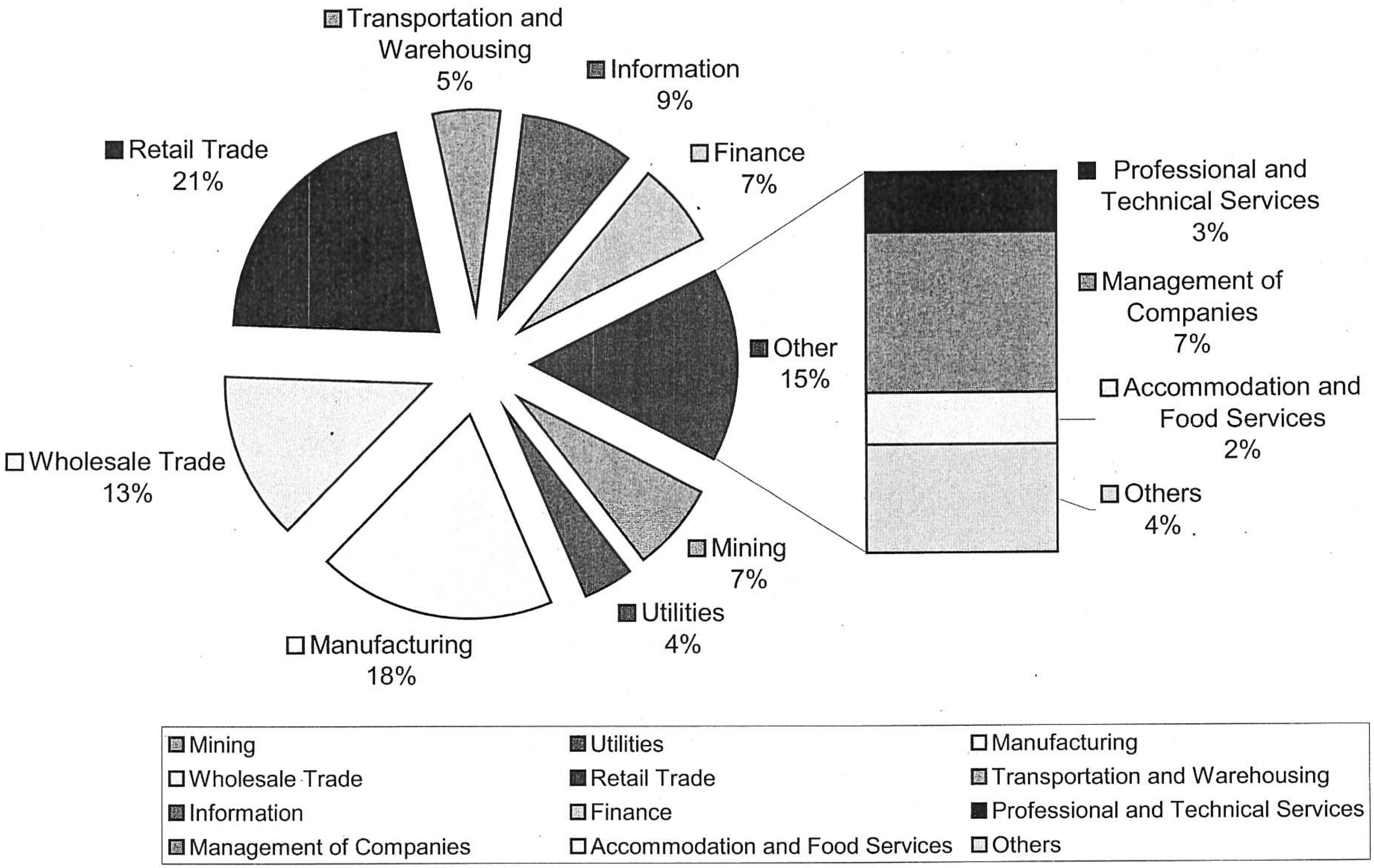
Chart 3
Total Corporate Income Tax Liability by Sector After Credits Are Taken
Tax Year 2000, 2001 and 2002.



KANSAS

JOAN WAGNON, SECRETARY

KATHLEEN SEBELIUS, GOVERNOR

DEPARTMENT OF REVENUE
POLICY AND RESEARCH

November 1, 2006

**Update to Analysis of Kansas Corporate Income Tax Dated October 14, 2004
To Reflect Tax Year 2004 Data**

The Analysis dated October 14, 2004 focused on the Kansas corporate income tax during tax years 2000, 2001 and 2002 and the impact of the 4 largest business income tax credit incentive programs on corporate income tax receipts, in an effort to determine how the corporate income tax burden falls within various industry sectors. Attached are updates to Tables 2 and 3 of the Analysis, to reflect the addition of tax year 2004 data. The discussion of the Top 20 claimants of the Business and Job Development (B&J) income tax credit is updated for tax year 2004 data. For comparison purposes, also attached are Analysis Tables 2 and 3, updated to include tax year 2003 data. Data on the Top 12 claimants of the High Performance Incentive Program (HPIP) tax credits for tax year 2004 is also discussed.

Recent History of Corporate Income Tax Receipts

Annual Kansas corporate income tax receipts (by fiscal year) since 1995 are shown below:

Fiscal Year	Amount Collected	Percent Change
1995	$229,421,376	
1996	$218,586,552	-4.7%
1997	$263,573,332	20.6%
1998	$281,651,300	6.9%
1999	$227,369,923	-19.3%
2000	$250,122,826	10.0%
2001	$211,906,919	-15.3%
2002	$93,958,484	-55.7%
2003	$105,222,316	12.0%
2004	$141,173,000	34.2%
2005	$226,071,634	60.1%
2006	$350,201,000	55.0%

Although the bottom fell out of corporate income tax receipts in FY 2002, the recent trend is very encouraging. Fiscal Year 2006 receipts set a new record. Thus far in FY 2007, corporate income tax receipts of $135 million through the end of October are 55% above the April 2006 Consensus Revenue Estimate of $306 million for FY 2007 and 50% above actual corporate income tax receipts for this same time period last year.

Corporate Income Tax Burden

In updating the Analysis dated October 14, 2004, tax returns from a sample of the largest 414 corporate taxpayers for tax year 2004 were reviewed in order to determine how much impact the business tax credit programs (Business & Job Development, High Performance Incentive Program, Research & Development, Business Machinery & Equipment) have on the corporate income tax burden. These corporations accounted for approximately 60% of the corporate income tax base for tax year 2004. The North American Industry Classification System (NAICS) code, Kansas taxable income, Kansas corporate income tax liability before credits, credits claimed, and the net tax receipts after credits for tax year 2004 for each of these corporations were captured in the database.

The update to Table 2 (attached) summarizes the results by NAICS code categories (using the first 2 digits of the NAICS code) for tax year 2004. The number of corporations included in each NAICS code category is shown in parenthesis in the first column.

Consistent with the Table 2 in the prior Analysis, the Update to Table 2 for tax year 2004 continues to show disparity between the various industry sectors in the proportion of tax liability that is reduced or eliminated by tax credits from participation in business incentive tax credit programs. The "payment percentage" column shown on the attached Update to Table 2 reflects the percent of tax liability (measured before credits are taken) actually paid after credits were applied to reduce tax liability. Manufacturers continue to experience a low tax payment percentage rate, 59.9% for tax year 2004, although higher than the 54.35% payment percentage rate for tax year 2003, and 45.60% tax payment percentage rate for tax years 2000 through 2002. The retail trade sector, now by far the largest in generating total tax liability before credits, as well as in the amount of net taxes paid (tax paid after credits are taken), had a higher tax payment percentage rate of 88.01% for tax year 2004, compared to 87.21% for tax year 2003, and the wholesale trade sector an even higher tax payment percentage rate than retail, 91.29%, although slightly lower than for tax year 2003, which was 94.61%.

While the Analysis dated October 14, 2004 (see Charts 2 and 3 of that document) indicated that manufacturers represented the largest portion of Kansas tax liability before credits (and Kansas taxable income) in the sample during tax years 2000 through 2002, the tax year 2003 data (see Update to Table 2 for tax year 2003) shows that retail trade represents the largest portion of Kansas taxable income, Kansas income tax liability generated before credits are taken, and net taxes paid after credits are taken. The 2004 tax year data continues that trend. As Update to Table 2 for tax year 2004 indicates, the retail sector's total corporate income tax liability before credits was $35.6 million and tax payments after credits (see "net receipts" column) were $31.3 million, while the manufacturing sector's total corporate income tax liability before credits was $31.2 million and tax payments after credits were $18.7 million.

B&J Credit Data

Within the sample of 414 corporations, the group of top 20 corporations that claimed the most B&J credits during tax year 2004 were identified. Corporations in this group were divided into 2 broad categories by NAICS code: manufacturing/transportation/warehousing and retail/wholesale/other. The effective tax rate for each corporation was computed, as well as the average effective tax rate for each of the two categories. The results are shown below.

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Top 20 B & J Credit Claimants Tax Year 2004

Tax Year 2004	
5 in Manufacturing/Transportation/Warehousing	15 in Retail/Wholesale/Other
Total Taxable Income: $99.9 million	Total Taxable Income: $323.14 million
Total Net Tax: $6.32 million	Total Net Tax: $19.45 million
Ave. Effective Tax Rate: 6.33%	Ave. Effective Tax Rate: 6.02%
Range: .69% to 6.78%	Range: -2.23% to 6.47%

This compares to the data for tax year 2003, shown below.

Top 20 B & J Credit Claimants Tax Year 2003

Tax Year 2003	
6 in Manufacturing/Transportation/Warehousing	14 in Retail/Wholesale/Other
Total Taxable Income: $40.96 million	Total Taxable Income: $247.77 million
Total Net Tax: $1.742 million	Total Net Tax: $15.69 million
Ave. Effective Tax Rate: 4.2%	Ave. Effective Tax Rate: 6.3%
Range: -.58% to 7.78%	Range: 3.51% to 6.59%

The tax year 2004 results show rough parity between the manufacturing/transportation/warehousing category and the retail/wholesale/other category in terms of effective tax rates. In fact, the manufacturing/transportation/warehousing category averaged a higher effective tax rate (6.33%) than the retail/wholesale/other category (6.02%), and the range of effective tax rates within the manufacturing/transportation/warehousing category is narrower than for the retail/wholesale/other sector. This contrasts with the tax year 2003 results, which continued to show a significant disparity between the average effective tax rate paid by the manufacturing/transportation/warehousing category vs. the retail/wholesale/other category and wide disparity in effective tax rates paid by individual corporations within the manufacturing/transportation/warehousing category. For example, in tax year 2003, the 6 corporations in the manufacturing/transportation/warehousing category had an average effective tax rate of 4.2% (compared to a lower effective tax rate of 2.1% for tax years 2000 through 2002), although within that category, the effective tax rate ranged from –.58% to 7.78%. Of the corporations in the retail/wholesale/other category in tax year 2003, the average effective tax rate was 6.3%, although within that category, the effective tax rate ranged from 3.51% to 6.59%, a much smaller variance.

The Update to Table 3 for tax years 2000 through 2004 (attached) compares the manufacturing firms and retail firms within the group of corporations included in the "top 20" in B & J credit claimants during tax years 2000 through 2004 (a sample size of 114 corporations). The amount of tax liability (measured before credits are taken), credits and net receipts (tax paid after credits were taken) for all four tax years for manufacturing and retail firms in the group are listed. Of the 114 corporations in the group, 34 were manufacturing corporations and 30 were retail trade corporations. The "total" row at the bottom sums the information not only for these 34 manufacturers and 30 retailers, but also the rest of the 114 corporations in the group.

The Update to Table 3 for tax years 2000 through 2004 shows that manufacturing firms that are large B & J credit claimants continue to succeed in offsetting significant tax liability with tax credits, owing only 32.75% of the amount of their tax liability measured before credits were applied, while retailers offset a much smaller portion of their tax liability, owing 81.52% of the

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amount their tax liability measured before credits. The average payment percentage for all 114 corporations in this group of largest B&J credit claimants is 61.23%. Comparing this table to Update to Table 3 for tax years 2000 through 2003, manufacturers owed only 24.14% of their tax liability measured before credits were applied, while retailers owed 81.38% of their tax liability measured before credits. The average payment percentage for all 78 corporations in this group of largest B&J credit claimants for tax years 2000 through 2003 was 56.95%.

HPIP Data

Within the sample of 414 corporations, the top 12 corporations claiming the most HPIP credits during tax year 2004 were identified. Corporations in this group were divided into 2 broad categories by NAICS code: manufacturing and other. The effective tax rate for each corporation was computed, as well as the average effective tax rate for each of the two categories. The results are shown below.

Top 12 HPIP Credit Claimants Tax Year 2004

Tax Year 2004

7 in Manufacturing
Total Taxable Income: $146.4 million
Total Net Tax: $2.548 million
Ave. Effective Tax Rate: 1.74%
Range: -1.35% to 4.07%

5 in Other
Total Taxable Income: $50.6 million
Total Net Tax: $2.423 million
Ave. Effective Tax Rate: 4.79%
Range: -2.23% to 6.6%

The tax year 2004 data indicates that manufacturers benefited the most from the HPIP program, with over half (7) of the "top 12" claimants being manufacturers, paying a low average effective tax rate of 1.74%. Some participants had negative effective tax rates, eliminating their corporate income tax liability entirely with credit offsets. The 5 non-manufacturer HPIP claimants in the "top 12" group succeeded in offsetting significant tax liability with tax credits, maintaining a low effective tax rate of 4.79% (although not as low as for manufacturers in HPIP), with some of these participants also eliminating their tax liability entirely. This data shows that large-scale participants in HPIP are able to offset most, if not all, of their corporate income tax liability with tax credits, the majority of large claimants being manufacturers.

Updated Conclusions

Many of the conclusions in the Analysis dated October 14, 2004 remain valid for the tax year 2004 corporate income tax data sample: manufacturers continue to utilize the business tax credit incentive programs heavily and have claimed the largest amounts of the credits. Because tax credits are used to lower tax burden, the effective tax rates continue to vary within industry groups of all types, although that disparity narrowed in tax year 2004, a year for strong corporate income tax receipts, and manufacturers were able to offset a lower percentage of their tax liability with credits than in prior years. Generally, the manufacturing sector bears a smaller share of the corporate income tax burden than other sectors of the economy, compared to the taxable income generated by those sectors. However, the tax year 2004 data indicates that the average tax payment percentage for manufacturers increased from 54.35% for tax year 2003 to 59.9% for tax year 2004, while the average tax payment percentage for all corporations in the sample decreased from 85.15% for tax year 2003 to 78.44% for tax year 2004. Also, among the top 20 B&J credit claimants for tax year 2004, the manufacturing/transportation/warehousing category average effective tax rate (6.33%) actually exceeded the average effective tax rate for the retail/wholesale/other category (6.02%). During years when the economy and tax receipts are strong (such as 2004), even manufacturers have a higher average tax payment percentage.

The tax year 2004 data, as did the 2003 data, continues to show that the retail sector is the most dominant portion of the corporate income tax base, generating the largest amount of Kansas taxable income and contributing the largest portion of the corporate income tax receipts. In tax years 2000, 2001 and 2002, the manufacturing sector generated the largest amount of Kansas taxable income (but not corporate income tax receipts). The retail sector has benefited somewhat less than the manufacturing sector from the tax credit programs. The retail sector typically bears a higher share of the corporate income tax burden, and pays higher effective tax rates, although that disparity did narrow in tax year 2004.

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Update to Table 2: Tax and Credits Statistics by Industry from a sample of 414 Corporations for Tax year 2004.

Industry (# of corporations)	Total Tax Liability	Total NR Credits	B&J	R&D	HPIP	CIME Credit	Total Ref. Credits	Net Receipts	Payment Percentage
Mining (10)	$10,164,775	$5,337,022	$0	$0	$0	$84,965	$0	$4,742,788	46.66%
Utilities (8)	$2,617,772	$0	$0	$0	$0	$4,814	$8,362	$2,604,596	99.50%
Construction (10)	$1,062,113	$436,967	$0	$0	$436,967	$25,456	$0	$599,690	56.46%
Manufacturing (75)	$31,200,763	$8,711,141	$764,439	$112,185	$7,380,319	$3,771,681	$30,000	$18,687,941	59.90%
Wholesale Trade (84)	$20,218,220	$597,101	$18,000	$216,734	$416,225	$1,133,930	$30,324	$18,456,864	91.29%
Retail Trade (59)	$35,563,751	$3,325,521	$3,326,251	$3,718	$2,599,171	$940,131	$0	$31,298,099	88.01%
Transportation and Warehousing (10)	$10,628,394	$519,233	$210,113	$0	$0	$313,500	$0	$9,795,661	92.17%
Information (25)	$8,717,709	$1,055,292	$23,800	$0	$1,028,986	$2,234,716	$2,502,520	$2,925,181	33.55%
Finance and Insurance (41)	$11,617,309	$1,123,859	$473,727	$0	$27,715	$79,849	$0	$10,413,601	89.64%
Real Estate and Rental and Leasing (8)	$842,259	$0	$0	$0	$0	$87,435	$0	$754,824	89.62%
Professional, Scientific, and Technical Se (21)	$5,509,049	$208,037	$15,760	$0	$0	$63,188	$0	$5,237,824	95.08%
Management of Companies and Enterprises (16)	$9,850,735	$179,062	$179,062	$0	$0	$206,854	$0	$9,464,819	96.08%
Administrative and Support and Waste Manag (1	$862,623	$24,000	$24,000	$0	$0	$47,204	$0	$791,419	91.75%
Health Care and Social Assistance (15)	1670376	0	0	0	0	1102	0	$1,669,274	99.93%
Accommodation and Food Services (10)	$2,140,856	$370,973	$365,477	$0	$0	$65,054	$0	$1,704,829	79.63%
Other Industries (12)	4826240.77	175608	175608	0	0	266212	0	$4,384,421	90.85%
Total All Industries (415)	$157,492,944	$22,063,816	$5,576,237	$332,637	$11,889,383	$9,326,091	$2,571,206	$123,531,830	78.44%

Other industries includes: Agriculture, Forestry, Fishing and Hunting, Educational Services, Arts, Entertainment and Recreation, and other service sectors not specified by the current codes

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Update to Table 3. Summary information for the corporations that claimed most B&J Credits from TY 2000 to 2004

Sector (# of sample)	Total Tax Liability	Total NR Credits	B&J	R&D	HPIP	BM&E	Total Ref. Credits	Net Receipts	Payment Percentage
Manufacturing (34)	$52,737,690	$30,965,768	$16,272,236	$6,140,317	$8,400,818	$4,199,955	$298,675	$17,273,292	32.75%
retail Trade (30)	$61,975,221	$10,362,521	$10,643,159	$0	$2,599,171	$1,091,391	$0	$50,521,310	81.52%
Total (114)	$160,070,038	$52,296,474	$36,265,460	$6,694,224	$12,430,647	$7,148,085	$2,013,593	$98,004,077	61.23%

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Update to Table 2: Tax and Credits Statistics by Industry from a sample of 244 Corporations for Tax year 2003.

Industry (# of corporations)	Total Tax Liability	Total NR Credits	B&J	R&D	HPIP	CIME Credit	Total Ref. Credits	Net Receipts	Payment Percentage
Agriculture, Mining and Utilities (10)	$12,487,012	$544,410	$0	$0	$544,410	$219,237	$0	$11,723,364	93.88%
Construction (6)	$666,750	$0	$0	$0	$0	$15,329	$16,256	$635,165	95.26%
Manufacturing (39)	$20,412,158	$7,894,827	$613,466	$283,740	$6,897,871	$1,378,092	$46,100	$11,093,139	54.35%
Wholesale Trade (51)	$16,840,931	$135,443	$96,000	$39,443	$0	$771,757	$0	$15,933,731	94.61%
Retail Trade (44)	$30,064,738	$3,170,582	$2,493,213	$12,165	$665,204	$673,794	$0	$26,220,362	87.21%
Information (12)	$7,102,178	$243,117	$900	$0	$0	$390,130	$19,952	$6,448,979	90.80%
Finance and Insurance (24)	$6,874,239	$0	$0	$0	$0	$17,780	$0	$6,856,459	99.74%
Real Estate and Rental and Leasing (5)	$979,887	$0	$0	$0	$0	$1,194	$0	$978,693	99.88%
Professional and Technical Services (17)	$4,715,392	$124,700	$99,700	$0	$0	$59,258	$0	$4,531,434	96.10%
Management of Companies and Enterprises (11)	$6,246,353	$0	$0	$0	$0	$234,429	$0	$6,011,924	96.25%
Health Care and Social Assistance (6)	$1,372,700	$0	$0	$0	$0	$19,756	$0	$1,352,944	98.56%
Accommodation and Food Services (7)	$2,086,084	$295,116	$222,956	$0	$0	$67,261	$0	$1,723,707	82.63%
Other Services (12)	$6,099,645	$590,426	$379,484	$0	$188,946	$287,194	$0	$5,222,025	85.61%
Total All Industries (244)	$115,948,066	$12,998,621	$3,905,719	$335,348	$8,296,431	$4,135,211	$82,308	$98,731,927	85.15%

Other services includes: Administrative and Waste Service, Educational Services, Arts, Entertainment and Recreation, Transportation and Warehousing, and other service sectors not specified by the current codes

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Update to Table 3. Summary information for the corporations that claimed most B&J Credits from TY 2000 to 2003

Sector (# of sample)	Total Tax Liability	Total NR Credits	B&J	R&D	HPIP	BM&E	Total Ref. Credits	Net Receipts	Payment Percentage
Manufacturing (17)	$45,169,004	$30,137,026	$15,507,797	$6,140,317	$8,400,818	$3,830,802	$298,675	$10,902,501	24.14%
retail Trade (18)	$41,517,023	$7,125,540	$7,125,540	$0	$0	$605,059	$0	$33,786,424	81.38%
Total (78)	$125,095,156	$46,969,073	$30,689,223	$6,694,224	$9,387,536	$5,917,080	$359,019	$71,242,175	56.95%

K A N S A S

JOAN WAGNON, SECRETARY

DEPARTMENT OF REVENUE
POLICY AND RESEARCH

KATHLEEN SEBELIUS, GOVERNOR

February 2, 2006

Update to Analysis of Kansas Corporate Income Tax Dated October 14, 2004
To Reflect Tax Year 2003

The Analysis dated October 14, 2004 focused on the Kansas corporate income tax during tax years 2000, 2001 and 2002 and the impact of the 4 largest business income tax credit incentive programs on corporate income tax receipts, in an effort to determine how the corporate income tax burden falls within various industry sectors. Provided below are updates to Tables 2 and 3 of the Analysis, to reflect the addition of tax year 2003 data. Also, the discussion of the Top 20 claimants of the Business and Job Development income tax credit is updated for tax year 2003 data.

Corporate Income Tax Burden

In updating the Analysis dated October 14, 2004, tax returns from a sample of the largest 244 corporate taxpayers for tax year 2003 were reviewed in order to determine how much impact the business tax credit programs (Business & Job Development, High Performance Incentive Program, Research & Development, Business Machinery & Equipment) have on the corporate income tax burden. These corporations accounted for approximately 82% of the corporate income tax base for tax year 2003. The North American Industry Classification System (NAICS) code, Kansas taxable income, Kansas corporate income tax liability before credits, credits claimed, and the net tax receipts after credits for tax year 2003 for each of these corporations were captured in the database.

The update to Table 2 (attached) summarizes the results by NAICS code categories (using the first 2 digits of the NAICS code) for tax year 2003. The number of corporations included in each NAICS code category is shown in parenthesis in the first column.

Consistent with the Table 2 in the prior Analysis, the Update to Table 2 continues to show wide disparity between the various industry sectors in the proportion of tax liability that is reduced or eliminated by tax credits from participation in business incentive tax credit programs. The "payment percentage" column shown on the attached Update to Table 2 reflects the percent of tax liability (measured before credits are taken) actually paid after credits were applied to reduce tax liability. Manufacturers continue to experience a low tax payment percentage rate, 54.35% for tax year 2003, although higher than the 45.60% tax payment percentage rate for tax years 2000 through 2002. The retail trade sector, now by far the largest in generating total tax liability before credits, as well as in the amount of net taxes paid (tax paid after credits are taken), had a much higher tax payment percentage rate of 87.21% for tax year 2003, and the wholesale trade sector an even higher percentage, 94.61%.

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While the Analysis dated October 14, 2004 (see Charts 2 and 3 of that document) indicated that manufacturers represented the largest portion of Kansas tax liability before credits (and Kansas taxable income) in the sample during tax years 2000 through 2002, the tax year 2003 data shows that retail trade represents the largest portion of Kansas taxable income, Kansas income tax liability generated before credits are taken, and net taxes paid after credits are taken.

Within the sample of 244 corporations, the group of top 20 corporations that claimed the most B&J credits during tax year 2003 were identified. Corporations in this group were divided into 2 broad categories by NAICS code: manufacturing/transportation/warehousing and retail/wholesale/other. The effective tax rate for each corporation was computed, as well as the average effective tax rate for each of the two categories. The results are shown below.

Top 20 B & J Credit Claimants

Tax Year 2003

6 in Manufacturing/Transportation/Warehousing	14 in Retail/Wholesale/Other
Total Taxable Income: $40.96 million	Total Taxable Income: $247.77 million
Total Net Tax: $1.742 million	Total Net Tax: $15.69 million
Ave. Effective Tax Rate: 4.2%	Ave. Effective Tax Rate: 6.3%
Range: -.58% to 7.78%	Range: 3.51% to 6.59%

The results continue to show a significant disparity between the average effective tax rate paid by the manufacturing/transportation/warehousing category vs. the retail/wholesale/other category. There is also wide disparity in effective tax rates paid by individual corporations within the manufacturing/transportation/warehousing category. For example, in tax year 2003, the 6 corporations in the manufacturing/transportation/warehousing category had an average effective tax rate of 4.2% (compared to a lower effective tax rate of 2.1% for tax years 2000 through 2002), although within that category, the effective tax rate ranged from –.58% to 7.78%. Of the corporations in the retail/wholesale/other category in tax year 2003, the average effective tax rate was 6.3%, although within that category, the effective tax rate ranged from 3.51% to 6.59%, a much smaller variance.

The Update to Table 3 (attached) compares the manufacturing firms and retail firms within the group of corporations included in the "top 20" in B & J credit claimants during tax years 2000 through 2003 (a sample size of 78 corporations). The amount of tax liability (measured before credits are taken), credits and net receipts (tax paid after credits were taken) for all four tax years for manufacturing and retail firms in the group are listed. Of the 78 corporations in the group, 17 were manufacturing corporations and 18 were retail trade corporations. The "total" row at the bottom sums the information not only for these 17 manufacturers and 18 retailers, but also the rest of the 78 corporations in the group.

The Update toTable 3 shows that manufacturing firms continue to succeed in offsetting much of their tax liability with credits, owing only 24% of the amount of their tax liability measured before credits were applied, while retailers offset a much smaller portion of their tax liability, still owing about 81% of the amount their tax liability measured before credits. The average payment percentage for all 78 corporations in this group of largest B&J credit claimants is about 57%.

Updated Conclusions

Many of the conclusions in the Analysis dated October 14, 2004 remain valid for the tax year 2003 corporate income tax data sample: manufacturers continue to utilize the business tax credit incentive programs heavily and have claimed the largest amounts of the credits. Because tax credits are used to lower tax burden, the effective tax rates continue to vary greatly within industry groups of all types. Generally, the manufacturing sector bears a smaller share of the corporate income tax burden than other sectors of the economy, compared to the taxable income generated by those sectors.

The tax year 2003 data sample reveals one important change: the retail sector has now become the most dominant portion of the corporate income tax base, generating the largest amount of Kansas taxable income and contributing the largest portion of the corporate income tax receipts. In tax years 2000, 2001 and 2002, the manufacturing sector generated the largest amount of Kansas taxable income (but not corporate income tax receipts). The retail sector has benefited less than the manufacturing sector from the tax credit programs. The retail sector typically bears a higher share of the corporate income tax burden, and pays higher effective tax rates.

Update to Table 2: Tax and Credits Statistics by Industry from a sample of 244 Corporations for Tax year 2003.

Industry (# of corporations)	Total Tax Liability	Total NR Credits	B&J	R&D	HPIP	CIME Credit	Total Ref. Credits	Net Receipts	Payment %
Agriculture, Mining and Utilities (10)	$12,487,012	$544,410	$0	$0	$544,410	$219,237	$0	$11,723,364	93.88%
Construction (6)	$666,750	$0	$0	$0	$0	$15,329	$16,256	$635,165	95.26%
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Total All Industries (244)	$115,948,066	$12,998,621	$3,905,719	$335,348	$8,296,431	$4,135,211	$82,308	$98,731,927	85.15%

Other services includes: Administrative and Waste Service, Educational Services, Arts, Entertainment and Recreation, Transportation and Warehousing, and other service sectors not specified by the current codes

Update to Table 3. Summary information for the corporations that claimed most B&J Credits from TY 2000 to 2003

Sector (# of sample)	Total Tax Liability	Total NR Credits	B&J	R&D	HPIP	BM&E	Total Ref. Credits	Net Receipts	Payment %
Manufacturing (17)	$45,169,004	$30,137,026	$15,507,797	$6,140,317	$8,400,818	$3,830,802	$298,675	$10,902,501	24.14%
retail Trade (18)	$41,517,023	$7,125,540	$7,125,540	$0	$0	$605,059	$0	$33,786,424	81.38%
Total (78)	$125,095,156	$46,969,073	$30,689,223	$6,694,224	$9,387,536	$5,917,080	$359,019	$71,242,175	56.95%