

MINUTES OF THE HOUSE TAXATION COMMITTEE

The meeting was called to order by Chairman Kenny Wilk at 9:00 A.M. on February 1, 2008 in Room 519-S of the Capitol.

All members were present.

Committee staff present:

Chris Courtwright, Legislative Research Department
Gordon Self, Office of Revisor of Statutes
Ryan Hoffman, Legislative Research Department
Scott Wells, Office of Revisor of Statutes
Richard Cram, Department of Revenue
Rose Marie Glatt, Committee Secretary

Conferees appearing before the committee:

Secretary Joan Wagon, Kansas Department of Revenue (KDOR)
Jeffrey D. Morris, Coffeyville City Manager
Representative Stan Frownfelter

Others attending:

See attached list.

The Chairman said they would address the sales tax issue first, and reminded the Committee during their hearing yesterday they discussed extending the policy that was granted to the Greensburg area retroactively to southeast Kansas. They will gut **HB 2336**, which is a sales tax exemption dealing with currency, and use that as the vehicle.

Representative King reviewed the new bill that contained draft language. It is identical to the bill that was passed in the 2007 session during Seine Die for Greensburg (Attachment 1). Discussion followed regarding the refund ability process. Representative King commended Representative Palmer and Williams for their work on the bill. Gordon Self requested authority to make minor changes to the bill, based on review by KDOR and the Adjutant General's office. There was no opposition to that request. The fiscal note is approximately \$3 to \$5 million.

Representative King made a motion to strip language from **HB 2336**, and insert language from the Greensburg bill and make it a substitute bill. It was seconded by Representative Owens. The motion carried.

Representative Peck made a motion the Taxation Committee move out **Substitute for HB 2336** favorably for passage. Representative Menghini seconded. The motion carried.

HB 2640 - Income tax credit for capital investments in businesses located in a city substantially damaged by disaster.

The Chairman invited Richard Cram to the podium to explain the term "Capital Investment." A memorandum on "Capital Expenditures" was distributed (Attachment 2). He said terms within Kansas Income Tax code, will have the same meaning in comparable text from the Internal Revenue Code, so people would look to the term Capital Expenditure for definitions. In general, federal regulations consider "capital expenditures" to include amounts paid to add to the value, or substantially prolong the useful life, of property owned by the taxpayer, such as plant or equipment, or to adapt property to a new or different use. He reviewed examples of capital expenditures. He recommended that the Committee determine what to include in "capital investment" based on the intent of the bill.

The Department staff suggested, as a starting point, they consider the current language used for the Business and Job Development and HPIP tax credit programs (Attachment 3). Those are the same terms used in the new **SB 497**, which limits the investment, for tax credit purposes, to investments in real property improvement and businesses machinery and equipment that stays at the facility. At this time, it does not cover inventory. The Chairman suggested that they use language in the state statute.

Discussion followed regarding interpretation of definitions.

CONTINUATION SHEET

MINUTES OF THE House Taxation Committee at 9:00 A.M. on February 1, 2008 in Room 519-S of the Capitol.

Secretary Wagon said that the Committee has to answer the question of whether they want to do more for people in disaster areas, than what is currently covered under various programs?

Representative King explained differences between **HB 2640** and **SB 497**. He suggested language for the bill should include: repairs, building new structures, which are used in a revenue producing enterprise, and inventory. Secretary Wagnon said the Department would work with the Revisor's office to draft language to amend **HB 2640**, however there are differences between the approaches in the two bills, especially pertaining to the prospective piece.

Stan Frownfelter spoke to the Committee regarding disaster insurance commonly carried by businesses.

In response to a question, Jeffrey D. Morris, Coffeyville City Manager, came to the podium to explain the difficulties he and his staff in Coffeyville, would have in handling distribution of incentive funds, given the scenario that the city received those dollars instead of the individual businesses.

The following memorandums were distributed: 1) Definition of "City Substantially Damaged by Disaster"; 2) Chart on nine counties with the number of structures severely damaged in 2007; and, 3) Kiowa County Business Restoration Assistance Program(Attachment 4).

After lengthy discussion, the Chairman said that due to the complexity of the subject, he would consider the creation of a sub-committee to study the topic in-depth and return with their recommendations. Anyone interested to serving on said committee, should speak to someone on leadership.

The meeting adjourned at 10:55 a.m. The next meeting is February 5, 2008.

By Committee on Agriculture and Natural Resources

AN ACT concerning sales taxation; relating to exemptions; flood disaster emergencies; certain construction materials and services.

Be it enacted by the Legislature of the State of Kansas:

Section 1. The following shall be exempt from the tax imposed under the Kansas retailers' sales tax act: All sales of tangible personal property or services purchased for the purpose of and in conjunction with constructing, reconstructing, enlarging or remodeling a business facility that was previously located in any county declared to be in a state of disaster emergency pursuant to presidential disaster declaration DR 1711, and that has been damaged or destroyed by flooding and other severe weather as a result of such disaster, and the sale and installation of machinery and equipment purchased for installation at any such business facility, including any fence, the purpose for which is to enclose land devoted to agricultural use. Any person constructing, reconstructing, remodeling or enlarging a business facility in any such county, who had leased such a facility to a business in any such county prior to the occurrence of such disaster, and that such business has been damaged or destroyed by flooding and other severe weather as a result of such disaster, and which such facility shall be leased in whole or in part, to a business that was previously located in any such county, prior to the occurrence of such disaster and that such business has been damaged by flooding and other severe weather as a result of such disaster, that would be eligible for a sales tax exemption hereunder if such business had constructed, reconstructed, enlarged or remodeled such facility or portion thereof itself shall be entitled to the sales tax exemption under the provisions of this section. When a person shall contract for the construction, reconstruction, enlargement or remodeling of any such business facility, such person shall obtain from the state within 60 days of the effective date of this act, an exemption certificate for the project involved. The certificate shall be furnished to the contractor to purchase materials,

machinery and equipment for incorporation in such project. The contractor shall furnish the number of such certificates to all suppliers from whom such purchases are made, and such suppliers shall execute invoices covering the same bearing the number of such certificate. Upon completion of the project the contractor shall furnish to the person that obtained the exemption certificate, a sworn statement, on a form to be provided by the director of taxation, that all purchases so made were entitled to exemption under this subsection. All invoices shall be held by the contractor for a period of five years and shall be subject to audit by the director of taxation. Any contractor or any agent, employee or subcontractor thereof, who shall use or otherwise dispose of any materials, machinery or equipment purchased under such a certificate for any purpose other than that for which such a certificate is issued without the payment of the sales or compensating tax otherwise imposed thereon, shall be guilty of a misdemeanor and, upon conviction therefor, shall be subject to the penalties provided for in subsection (g) of K.S.A. 79-3615, and amendments thereto. Sales tax paid on and after the occurrence of the disaster provided for in this section, but prior to the effective date of this act upon the gross receipts received from any sale which would have been exempted by the provisions of this subsection had such sale occurred after the effective date of this act shall be refunded. Each claim for a sales tax refund shall be verified and submitted to the director of taxation upon forms furnished by the director and shall be accompanied by any additional documentation required by the director. The director shall review each claim and shall refund that amount of sales tax paid as determined under the provisions of this subsection. All refunds shall be paid from the sales tax refund fund upon warrants of the director of accounts and reports pursuant to vouchers approved by the director or the director's designee. The provisions of this section shall be part of and supplemental to the Kansas retailers' sales tax act.

Sec. 2. This act shall take effect and be in force from and after its publication in the Kansas register.

Testimony to the House Taxation Committee

Richard Cram

February 1, 2008

Information on Capital Expenditures

Representative Wilk, Chair, and Members of the Committee:

K.S.A. 79-32,109(a) provides that any term used in the income tax act “shall have the same meaning as when used in a comparable context in the federal internal revenue code.” The term “capital expenditures,” as used in the federal internal revenue code, is very broad. Since the term “capital investment” is not defined in House Bill 2640, the federal term “capital expenditures” might be relied upon for guidance. **In general, federal regulations consider “capital expenditures” to include amounts paid to add to the value, or substantially prolong the useful life, of property owned by the taxpayer, such as plant or equipment, or to adapt property to a new or different use.** Incidental repairs or maintenance are not considered to be capital expenditures. Income Tax Regulation Section 1.263(a)-1. Under I.R.C. Section 263, capital expenditures generally cannot be deducted from income but must instead be charged to a capital account and depreciated or amortized over the useful life of the asset. Ordinary and necessary business expenses, on the other hand, are deductible from income in the year incurred. I.R.C. Section 162.

Regulation Section 1.263(a)-2 provides some examples of capital expenditures, including:

- (a) cost of acquisition, construction, or erection of buildings, machinery and equipment, furniture and fixtures, and similar property having a useful life substantially beyond the taxable year;
- (b) amounts expended for securing a copyright;
- (c) cost of defending or perfecting title to property;
- (d) amounts expended for architect’s services;
- (e) commissions paid in purchasing securities;
- (f) certain amounts assessed and paid under bondholder or shareholder agreements;
- (g) certain holding company guarantees of dividends; or
- (h) cost of good will.

Capital expenditures under the I.R.C. also can include amounts paid to acquire or produce real or personal property (Regulation Section 1.263(a)-3), amounts paid to acquire or create intangibles (stocks, bonds, debt instruments, patents, trademarks, insurance contracts, software, etc.) (Regulation Section 1.263(a)-4), amounts paid to

facilitate an acquisition of a trade or business, a change in capital structure of a business entity (such as mergers and acquisitions, recapitalizations, etc.), and certain other transactional costs (Regulation Section 1.263(a)-5). Inventory costs can be considered capital expenditures. Regulation Section 1.263(a)-1. Intangible drilling costs for oil and gas are also considered capital expenditures (although the taxpayer can in some cases elect to deduct these rather than capitalize). Regulation Section 1.612-4.

The current Business & Job Development (B&J) and High Performance Incentive Program (HPIP) tax credit programs use a much narrower definition of investment for purposes of the investment tax credits earned than the term "capital investment" or "capital expenditures." See K.S.A. 2007 Supp. 79-32,154 (attached). The investment is the value of real and tangible personal property, excluding inventory, constituting the qualified business facility or used in the operation of such facility for which the credit is claimed. K.S.A. 2007 Supp. 79-32,154(e). Intangible assets are not included. "Facility" is defined at K.S.A. 2007 Supp. 79-32,154(a) as the factory, mill, plant, refinery, warehouse, feedlot, building or complex of buildings, land on which the facility is located, and all machinery and equipment located at or in the facility and used in its operations. Mobile equipment, such as motor vehicles that leave the facility, are excluded. Wells and agricultural land (except feedlots) are excluded. "Qualified business facility" is defined at (b) as employed by the taxpayer in a "revenue producing enterprise," as defined in (c). Similar definitions are used in Section 2 of Senate Bill 497.

Kansas Statutes Annotated
Updated Through the 2006 Legislative Session

Statute Number: 79-32,154
Chapter Title: TAXATION
Article Title: INCOME TAX
Tax Type: Individual Income Tax; Corporate Income Tax; Privilege
Brief Description: Same; definitions.
Keywords:

Body:

79-32,154

Chapter 79.--TAXATION

Article 32.--INCOME TAX

79-32,154. Same; definitions. As used in this act, the following words and phrases shall have the meanings respectively ascribed to them herein:

(a) "Facility" shall mean any factory, mill, plant, refinery, warehouse, feedlot, building or complex of buildings located within the state, including the land on which such facility is located and all machinery, equipment and other real and tangible personal property located at or within such facility used in connection with the operation of such facility. The word "building" shall include only structures within which individuals are customarily employed or which are customarily used to house machinery, equipment or other property.

(b) "Qualified business facility" shall mean a facility which satisfies the requirements of paragraphs (1) and (2) of this subsection.

(1) Such facility is employed by the taxpayer in the operation of a revenue producing enterprise, as defined in subsection (c). Such facility shall not be considered a qualified business facility in the hands of the taxpayer if the taxpayer's only activity with respect to such facility is to lease it to another person or persons. If the taxpayer employs only a portion of such facility in the operation of a revenue producing enterprise, and leases another portion of such facility to another person or persons or does not otherwise use such other portions in the operation of a revenue producing enterprise, the portion employed by the taxpayer in the operation of a revenue producing enterprise shall be considered a qualified business facility, if the requirements of paragraph (2) of this subsection are satisfied.

(2) If such facility was acquired by the taxpayer from another person or persons, such facility was not employed, immediately prior to the transfer of title to such facility to the taxpayer, or to the commencement of the term of the lease of such facility to the taxpayer, by any other person or persons in the operation of a revenue producing enterprise and the taxpayer continues the operation of the same or substantially identical revenue producing enterprise, as defined in subsection (i), at such facility.

(c) "Revenue producing enterprise" shall mean:

(1) The assembly, fabrication, manufacture or processing of any agricultural, mineral or manufactured product;

(2) the storage, warehousing, distribution or sale of any products of agriculture, aquaculture, mining or manufacturing;

(3) the feeding of livestock at a feedlot;

(4) the operation of laboratories or other facilities for scientific, agricultural, aquacultural, animal husbandry or industrial research, development or testing;

(5) the performance of services of any type;

(6) the feeding of aquatic plants and animals at an aquaculture operation;

(7) the administrative management of any of the foregoing activities; or

(8) any combination of any of the foregoing activities.

"Revenue producing enterprise" shall not mean a swine production facility as defined in K.S.A. 17-5903, and amendments thereto.

(d) "Qualified business facility employee" shall mean a person employed by the taxpayer in the

operation of a qualified business facility during the taxable year for which the credit allowed by K.S.A. 79-32,153, and amendments thereto, is claimed:

(1) A person shall be deemed to be so engaged if such person performs duties in connection with the operation of the qualified business facility on: (A) A regular, full-time basis; (B) a part-time basis, provided such person is customarily performing such duties at least 20 hours per week throughout the taxable year; or (C) a seasonal basis, provided such person performs such duties for substantially all of the season customary for the position in which such person is employed. The number of qualified business facility employees during any taxable year shall be determined by dividing by 12 the sum of the number of qualified business facility employees on the last business day of each month of such taxable year. If the qualified business facility is in operation for less than the entire taxable year, the number of qualified business facility employees shall be determined by dividing the sum of the number of qualified business facility employees on the last business day of each full calendar month during the portion of such taxable year during which the qualified business facility was in operation by the number of full calendar months during such period. Notwithstanding the provisions of this subsection, for the purpose of computing the credit allowed by K.S.A. 79-32,153, and amendments thereto, in the case of an investment in a qualified business facility, which facility existed and was operated by the taxpayer or related taxpayer prior to such investment, the number of qualified business facility employees employed in the operation of such facility shall be reduced by the average number, computed as provided in this subsection, of individuals employed in the operation of the facility during the taxable year preceding the taxable year in which the qualified business facility investment was made at the facility.

(2) For taxable years commencing after December 31, 1997, in the case of a taxpayer claiming a credit against the premium tax and privilege fees imposed pursuant to K.S.A. 40-252, and amendments thereto or the privilege tax as measured by net income of financial institutions imposed pursuant to chapter 79 article 11 of the Kansas Statutes Annotated, "qualified business employee" shall not mean any person who is employed in the operation of a qualified business facility in the state due to the merger, acquisition or other reconfiguration of the taxpayer unless such employee's position represents a net gain of total positions created by the taxpayer and the employee's position was not in existence at the time of the merger acquisition or other reconfiguration of the taxpayer.

(e) "Qualified business facility investment" shall mean the value of the real and tangible personal property, except inventory or property held for sale to customers in the ordinary course of the taxpayer's business, which constitutes the qualified business facility, or which is used by the taxpayer in the operation of the qualified business facility, during the taxable year for which the credit allowed by K.S.A. 79-32,153, and amendments thereto, is claimed. The value of such property during such taxable year shall be: (1) Its original cost if owned by the taxpayer; or (2) eight times the net annual rental rate, if leased by the taxpayer. The net annual rental rate shall be the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals. The qualified business facility investment shall be determined by dividing by 12 the sum of the total value of such property on the last business day of each calendar month of the taxable year. If the qualified business facility is in operation for less than an entire taxable year, the qualified business facility investment shall be determined by dividing the sum of the total value of such property on the last business day of each full calendar month during the portion of such taxable year during which the qualified business facility was in operation by the number of full calendar months during such period. Notwithstanding the provisions of this subsection, for the purpose of computing the credit allowed by K.S.A. 79-32,153, and amendments thereto, in the case of an investment in a qualified business facility, which facility existed and was operated by the taxpayer or related taxpayer prior to such investment the amount of the taxpayer's qualified business facility investment in such facility shall be reduced by the average amount, computed as provided in this subsection, of the investment of the taxpayer or a related taxpayer in the facility for the taxable year preceding the taxable year in which the qualified business facility investment was made at the facility.

(f) "Commencement of commercial operations" shall be deemed to occur during the first taxable year for which the qualified business facility is first available for use by the taxpayer, or first capable of being used by the taxpayer, in the revenue producing enterprise in which the taxpayer intends to use the qualified business facility.

(g) "Qualified business facility income" shall mean the Kansas taxable income derived by the taxpayer from the operation of the qualified business facility. If a taxpayer has income derived from the operation of a qualified business facility as well as from other activities conducted within this state, the Kansas taxable income derived by the taxpayer from the operation of the qualified business facility shall

DEFINITION OF "CITY SUBSTANTIALLY DAMAGED BY DISASTER"

As used in this section, a "city substantially damaged by disaster" means a city: (a) located in a county in which a disaster emergency has been declared by the president under the provisions of the Robert T. Stafford disaster and emergency assistance act; (b) having 25 buildings with damage from that disaster of at least 50% of their appraised value (i.e. "severely damaged") or having at least one percent of the buildings in the city, whether public or private, severely damaged by the disaster, whichever number is greater; and (c) with damage to the city government caused by that disaster (including damage to city-owned property and infrastructure, municipal disaster relief costs, and the municipal cost of any disaster-related property buy-out) exceeding 15% of the city's prior year general budget.

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	Greensburg	Coffeyville	Neodesha	Independence	Fredonia	Iola	Osawatomie	Chanute	Erie
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Destroyed Building Test

Total Housing Structures	887	5550	1301	4730	1297	2885	1947	4262	545
Need to Qualify under HB 2640	25	56	25	48	25	29	25	43	25
Actual Severely Damaged Structures	887	est. 400	est. 150	160-170	est. 100	est. 100	est. 350-400	85-100	

City Taxpayer Burden Test

2007 General Budget	\$695,962	\$10,238,745	\$1,922,126	\$5,669,870	\$1,105,948	\$3,839,347	\$1,760,821	\$6,046,467	\$562,480
Need to Qualify under HB 2640	\$104,394	\$1,535,812	\$288,319	\$850,481	\$165,892	\$575,902	\$264,123	\$906,970	\$84,372
Municipal-Related Disaster Damage	Many Millions	Over \$4 million		Over \$6 million			est. \$500,000	\$1.25 million	

Kiowa County Business Restoration Assistance Program

House Bill 2540 was passed by the 2007 Kansas Legislature establishing the Kiowa County business restoration assistance program. The program was established for the purpose of assisting businesses that were in operation in Kiowa County and damaged by the tornado and other severe weather in Kansas on May 4, 2007.

The business restoration assistance program includes:

- **INVESTMENT ASSISTANCE**
A grant of up to 10% of qualifying investment made to rebuild or replace a business facility in Kiowa County and the business machinery and equipment of a business that has been damaged or destroyed by the tornado or other severe weather that occurred on May 4, 2007.
- **JOB RESTORATION ASSISTANCE**
A grant of up to \$3,500 per qualifying job to a business damaged by the tornado and severe weather on May 4, 2007 that fills an employment position in Kiowa County, Kansas.
- **SALES TAX EXEMPTION**
A sales tax exemption is available for those businesses in Kiowa County that were damaged as a result of the tornado and other severe weather on May 4, 2007. This sales tax exemption will exempt all construction, reconstruction, materials and machinery and equipment to be incorporated into the business facility. Replacement of tornado damaged or destroyed fencing, the purpose for which is to enclose land devoted to agricultural use shall also be exempt from sales tax.

To date the Kansas Department of Revenue has pre-approved assistance as follows for the Kiowa County Business Restoration Assistance Program:

70 applications have been pre-approved for assistance

Pre-approved assistance total-\$4,171,607

Investment assistance-\$2,691,107

Job restoration assistance-\$1,480,500 (423 jobs)

To date the Kansas Department of Revenue has processed the following requests for payment of the restoration assistance:

15 requests for payments have been received and processed

Total assistance given to businesses-\$635,088

Investment assistance-\$36,588

Job restoration assistance-\$598,500 (171 jobs)

To date the Kansas Department of Revenue has received the following requests for sales tax exemption:

65 requests for project exemption certificate have been received and approved

Total estimated project costs-\$19,056,412

Estimated state sales tax foregone-\$1,000,000

Southeast Kansas Business Restoration Assistance Program

A Southeast Kansas (SEK) business restoration assistance program was established by the State Finance Council for the purpose of assisting businesses with less than 50 employees that were in operation in one of the affected counties and damaged by the flooding and other severe weather in Kansas that began on June 26, 2007. The counties included in this SEK business restoration assistance program are: Allen, Anderson, Bourbon, Butler, Chautauqua, Cherokee, Coffey, Cowley, Crawford, Edwards, Elk, Franklin, Greenwood, Harper, Labette, Linn, Miami, Montgomery, Neosho, Osage, Pawnee, Wilson, and Woodson

The business restoration assistance program includes:

- **INVESTMENT ASSISTANCE**
A grant of up to 10% of qualifying investment made to rebuild or replace a business facility within the same community in one of the affected counties and the business machinery and equipment of a business that has been damaged or destroyed by the flood or other severe weather that began on June 26, 2007.
- **JOB RESTORATION ASSISTANCE**
A grant of up to \$3,500 per qualifying job to a business damaged by the flood and other severe weather that began on June 26, 2007 that restores an employment position within the same community in one of the affected counties.
- **RENTAL ASSISTANCE**
An assistance grant for the rent paid by a qualified business to lease a temporary business facility within the same community while the permanent facility is being rebuilt. Rental assistance will be granted for a period of up to six months and may not exceed a total of \$1,500.

To date the Kansas Department of Revenue has pre-approved assistance as follows for the Southeast Kansas Business Restoration Assistance Program:

69 applications have been pre-approved for assistance

Pre-approved assistance total-\$3,564,516

Investment assistance-\$1,647,516

Job restoration assistance-\$1,904,000 (544 jobs)

Rental assistance-\$13,000

To date the Kansas Department of Revenue has processed the following requests for payment of the restoration assistance:

21 requests for payments have been received and processed

Total assistance given to businesses-\$618,798

Investment assistance-\$48,028

Job restoration assistance-\$567,000 (162 jobs)

Rental assistance-\$3,770