

MINUTES OF THE HOUSE TAXATION COMMITTEE

The meeting was called to order by Chairman Kenny Wilk at 9:00 A.M. on February 12, 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
Rose Marie Glatt, Committee Secretary

Conferees appearing before the committee:

Secretary Wagon, Kansas Department of Revenue
Jim Bartle, General Counsel, Kansas Department of Revenue
Mike Boekhaus, Director of Audit Bureau
Shirley Sicillan, General Counsel, Multistate Tax Commission
Marlee Carpenter, Kansas Chamber of Commerce

Others attending:

See attached list.

Representative Owens requested a bill introduction on behalf of Representatives Hill and Mast which would allow an income tax credit from adoption expenses. Representative Owens made the motion to move the request and Representative Carlson seconded. The motion carried.

Representative Metsker requested the introduction of two sales tax exemptions relating to the GM Fairfax Retirees Club and the Veterans Voices Writing Project. Representative Carlson moved the request, and Representative Owens seconded. The motion carried.

Chairman Wilk advised the committee that President Bush plans to announce the federal stimulus package later this week, which in turn may effect the state since Kansas is coupled to the Federal guidelines. They are currently preparing data on the effects of the new stimulus package for review. The Chairman also announced the Committee will hear Sub-committee's reports and recommendations on BOTA and Disaster relief next week.

HB 2762 - Corporate income taxation changes relating to apportionment of net income, business income and surtax on corporations.

Chris Courtwright said the bill would allow full apportionment of business income for all tax years commencing after December 31, 2008. In addition, it would allow a taxpayer to include only the net gain from sales of business assets when calculating the sales factor. Finally, **HB 2762** would reduce the surtax rate for corporations with Kansas taxable income in excess of \$50,000 from 3.35 percent to 2.85 percent. This rate reduction would go into effect starting in tax year 2009.

The Chairman opened the public hearing on **HB 2762** and invited Secretary Wagon to explain the details of the bill.

Secretary Wagon said that during the 2007 legislative session, the House Tax Committee considered a proposal to broaden the definition of "business income" contained in statute. This proposal was subsequently referred for interim study to the Special Committee on Assessment and Taxation, which studied the issues and made recommendations. She introduced staff members that followed her to the podium to provide more details.

Jim Bartle, General Counsel, KDOR, spoke to the Committee about a proposed balloon amendment on **HB 2762** (Attachment1). He reviewed the recommendations made by the Special Committee on Assessment and Taxation:

CONTINUATION SHEET

MINUTES OF THE House Taxation Committee at 9:00 A.M. on February 12, 2008 in Room 519-S of the Capitol.

1. The Committee finds that changing the definition of business income to include both the functional and transactional tests would encourage additional corporations to locate in Kansas.
2. The Committee notes that the Secretary of Revenue appears to have reached an agreement with various interested parties on specific language regarding this provision.
3. The Committee, therefore, amends the introduction of legislation that would clarify the definition of business income to add the functional test.

Mr. Bartle explained three reasons for amending the definition of "business income" which follow:

1. Broadening the tax base will make it possible to reduce the corporate income tax rate or provide some other form of tax relief.
2. Codification of the functional test will bring Kansas into conformity with other states that impose a corporate income tax, the vast majority of which utilize both the functional and transactional tests.
3. Multi-state uniformity, with respect to the definition of "business income," will prevent the under-inclusion and over-inclusion of income in determining the tax liabilities of corporations with operations in several states.

He said the proposed balloon, attached to his testimony, is consistent with the recommendation of the Interim Committee and asked for the Committee's support. In response to a question from the Chairman, he said that the language in the balloon has been agreed upon with members of the business community. Members of the working group that drafted the language were: James Bartle, Mark Burghart, Mark Beshears, Lucky DeFries, attorneys that represent the Kansas Chamber of Commerce.

Gordon raised an issue on which part of the amendment language would be struck and agreed to get back to the Committee with details.

Mike Boekhaus, Director of Audit Bureau, reviewed slides from a power point presentation on Business and Nonbusiness Income (Attachment 2). He gave an example of what happens when a business sells a plant for \$100 million gain and what happens in Kansas verses other states. He also described "churning" and gave an example of non-churning and churning tax calculation.

Shirley Sicillian, General Counsel, Multi-state Tax Commission, provided national context for two of the proposed amendments being considered:

- 1) an expansion of the definition of "business income"
- 2) a clarification that the sales factor does not include returns of principal from short-term investments

Both proposed amendments address issues that have been, or are being, faced in many states as well as Kansas. Both would address tax issues that are consistent with other states (Attachment 3).

Marlee Carpenter, Kansas Chamber of Commerce, rose in support of corporate income tax reduction to foster economic growth and job creation in the state. As Kansas competes with other states, the Kansas corporate income tax stands out as a disincentive for investment (Attachment 4). Her testimony included a 2007 Corporate survey series, which ranks the factors used when considering new business ventures. Also included was a "background paper," which is an executive summary on the 2008 State Business Tax Climate Index.

The Chairman closed the hearing on HB 2762.

The meeting was adjourned at 10:55 A.M. The next meeting is February 13, 2008.

HOUSE TAXATION COMMITTEE

DATE: Feb 12

NAME	REPRESENTING
<i>Jim Mays</i>	<i>Spirit AeroSystems</i>
<i>Bernie Koch</i>	<i>Wichita Chamber</i>
<i>Jacquelyn Koehler</i>	<i>Kansas, Inc.</i>
KEVIN GREGG	KMCA
<i>Christy Caldwell</i>	<i>Topeka Chamber</i>
<i>Shahira Safford</i>	<i>KS Grain & Feed Assn.</i>
<i>Maxee Carpenter</i>	<i>KS Chamber</i>
RONALD RICHY	NARFE
<i>Ron Secher</i>	<i>Hein Law Firm</i>
<i>Kent Eckles</i>	<i>O. P. Chamber of Commerce</i>
DINA FISK	VERIZON
<i>Jamie Slack</i>	<i>federico Consulting</i>
<i>Mark Desetti</i>	KNEA
<i>Mike Bookhaus</i>	KDOR
<i>Richard Crum</i>	KDOR
<i>Ben Cleever</i>	D&B
<i>Mike Murray</i>	<i>Embany</i>
<i>Spry Jesch</i>	<i>PMCH of KS</i>
<i>John Frederick</i>	<i>The Boeing Company</i>

Testimony to the House Taxation Committee
James Bartle, General Counsel, Kansas Department of Revenue
February 12, 2008

Department of Revenue's Testimony in Support of House Bill 2762
And Proposed Balloon Amendment

Chairman Wilk and Members of the Committee:

During the 2007 legislative session, this Committee considered a proposal to broaden the definition of "business income" contained in K.S.A. 79-3271(a). This proposal was subsequently referred for interim study to the Special Committee on Assessment and Taxation, which issued the following recommendation:

The Committee finds that changing the definition of business income to include both the functional and transactional tests would encourage additional corporations to locate in Kansas.

The Committee notes that the Secretary of Revenue appears to have reached an agreement with various interested parties on specific language regarding this provision.

* * *

The Committee therefore recommends the introduction of legislation that would clarify the definition of business income to add the functional test;

The reasons for amending the definition of "business income" have been addressed in prior testimony and may be summarized as follows:

- Broadening the tax base will make it possible to reduce the corporate income tax rate or provide some other form of tax relief
- Codification of the functional test will bring Kansas into conformity with other states that impose a corporate income tax, the vast majority of which utilize both the functional and transactional tests
- Multistate uniformity with respect to the definition of "business income" will prevent the underinclusion and overinclusion of income in determining the tax liabilities of corporations with operations in several states

As indicated above, the Department of Revenue has worked with representatives of the business community to draft language required to make the necessary amendments to K.S.A. 79-3271(a). The agreed-upon language is attached hereto, and we offer it as a balloon amendment to Section 1 of House Bill 2762, lines 15-34. This amendment incorporates the functional test, makes income apportionable to the full extent permitted under the Constitution of the United States, and will be effective for tax years beginning on and after January 1, 2009. The election to treat all income as business income will remain in effect in the same manner as under current law.

We believe our proposed balloon is consistent with the recommendation of the Interim Committee and appreciate your support for this amendment.

79-3271. Apportionment of net income; definitions. As used in this act, unless the context otherwise requires: (a) For tax years commencing prior to January 1, 2009, “business income” means income arising from transactions and activity in the regular course of the taxpayer’s trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer’s regular trade or business operations, except that a taxpayer may elect that all income constitutes business income. For tax years commencing after December 31, 2008, “business income” means: (1) income arising from transactions and activity in the regular course of the taxpayer’s trade or business; (2) income arising from transactions and activity involving tangible and intangible property or assets used in the operation of the taxpayer’s trade or business; or (3) income of the taxpayer that may be apportioned to this state under the provisions of the Constitution of the United States and laws thereof, except that a taxpayer may elect that all income constitutes business income. Any election made under this subsection shall be effective and irrevocable for the tax year in which the election is made and the following nine tax years and shall be binding on all members of a unitary group of corporations.

Mike Bookhaus
Director of Audit &
Bureau

Business/Nonbusiness Income

- KS uses the transactional test to determine if business income is subject to apportionment.
- The transactional test excludes extraordinary transactions not occurring in the regular course of the taxpayer's business.
- The transactional test excludes large non-Kansas transactions, such as the sale of business plant and equipment or subsidiary stock, from the Kansas tax base.
- All other states imposing an income tax have broader definitions of business income that would include those transactions in their income tax bases.

Business vs. Nonbusiness Income

Business Income

- Business income is subject to apportionment.
- The income is taxed based on the percentage of the taxpayer's business within the state divided by its business activity everywhere.

Tax Calculation:

$$\begin{aligned} & \text{Gain from transaction} \\ & \times \text{ apportionment percentage} \\ & \quad \underline{\times \text{ tax rate}} \\ & \quad \text{State tax} \end{aligned}$$

Nonbusiness Income

- Nonbusiness income is subject to allocation.
- The income is allocated to the location of the property if it is real or personal tangible property.
- The income is allocated to the taxpayer's domicile if it is from intangible property.

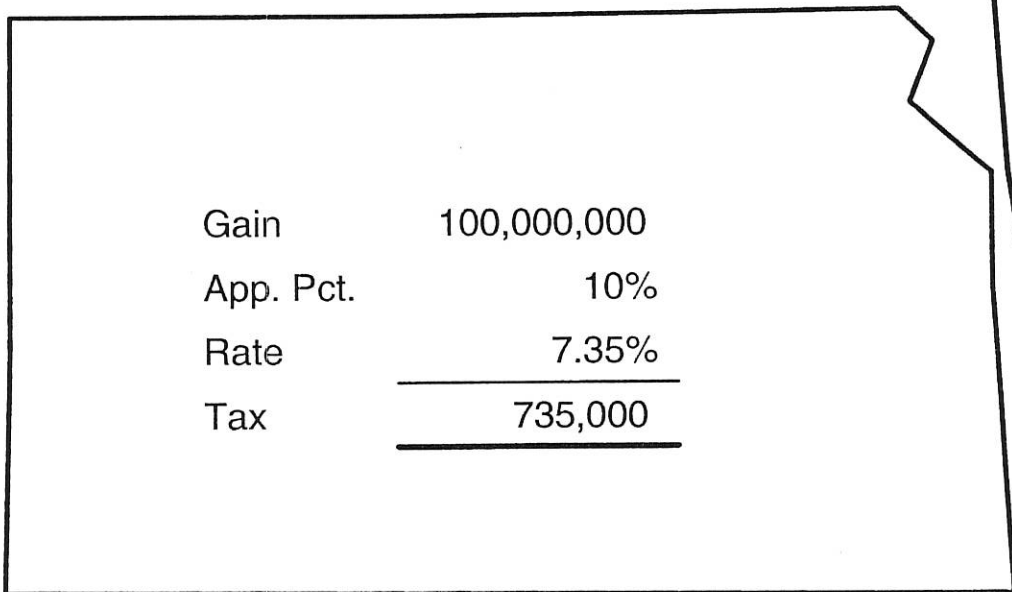
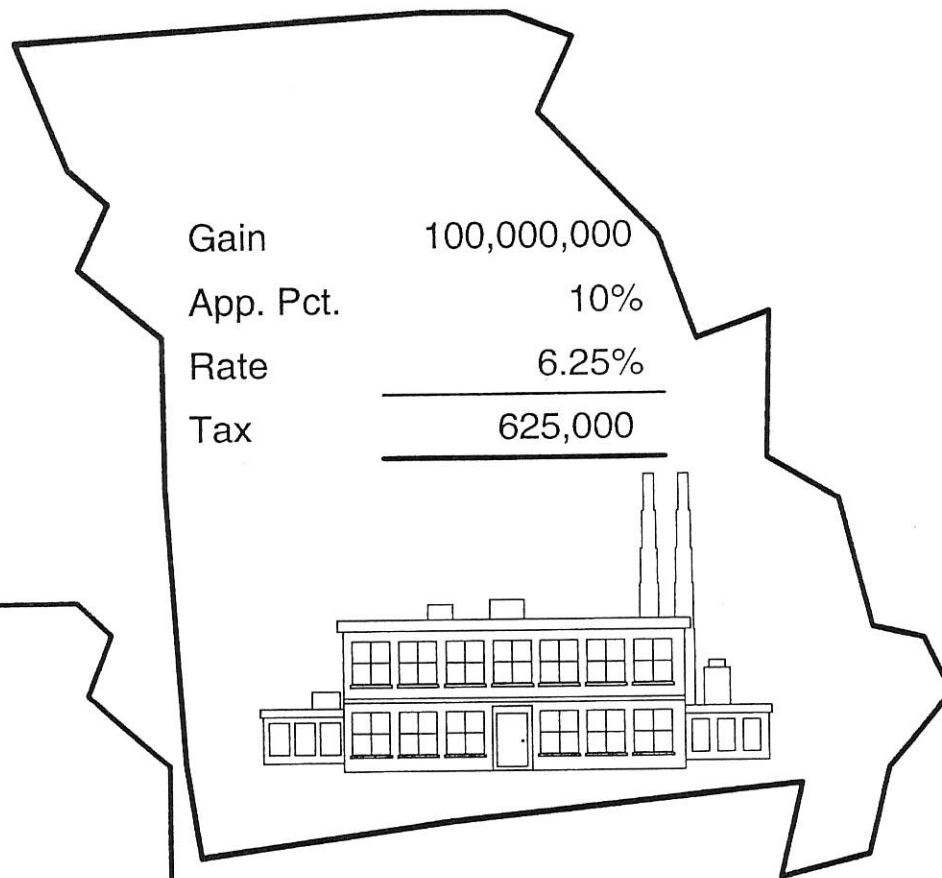
Tax Calculation:

$$\begin{aligned} & \text{Gain from transaction} \\ & \quad \underline{\times \text{ tax rate}} \\ & \quad \text{State tax} \end{aligned}$$

Sale of Business Assets

Business Income Gain Same Definitions

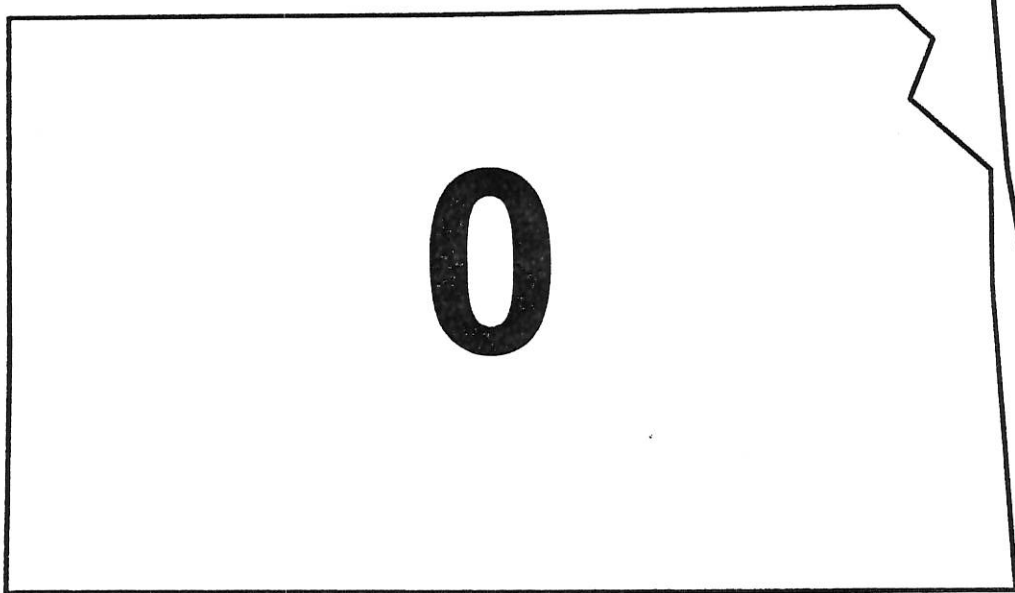
Missouri-based company sells plant for \$100 million gain. The Company conducts 10% of its business in both MO and KS.



Sale of Business Assets

Nonbusiness Income Gain Same definitions

Missouri-based company sells plant for \$100 million gain. The company conducts 10% of its business in both MO and KS.



Gain	100,000,000
Rate	6.25%
Tax	<u>6,250,000</u>

A simple line drawing of a factory building with two tall smokestacks on the right side.

Sale of Business Assets

Business Income Gain Different Definitions

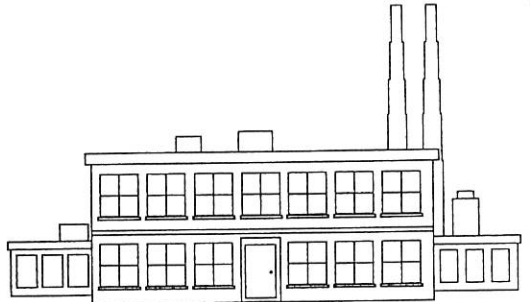
Missouri-based company sells plant for \$100 million gain. The Company conducts 10% of its business in both MO and KS.

Nonbusiness Income

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Business Income

Gain	100,000,000
App. Pct.	10%
Rate	6.25%
Tax	<u>625,000</u>

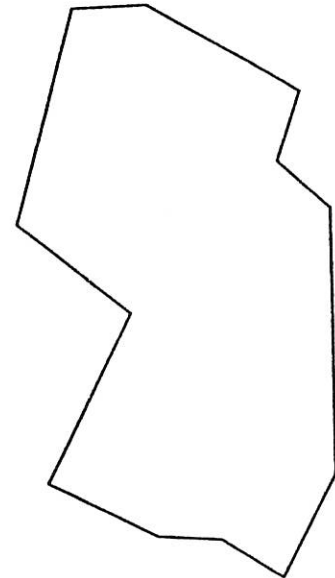


**State tax savings:
\$735,000**

Sale of Subsidiary Stock

Business Income Gain Same Definitions

New Jersey-based company sells subsidiary stock for a \$5 billion gain. The company conducts 1% of its business in KS and 5% in NJ.



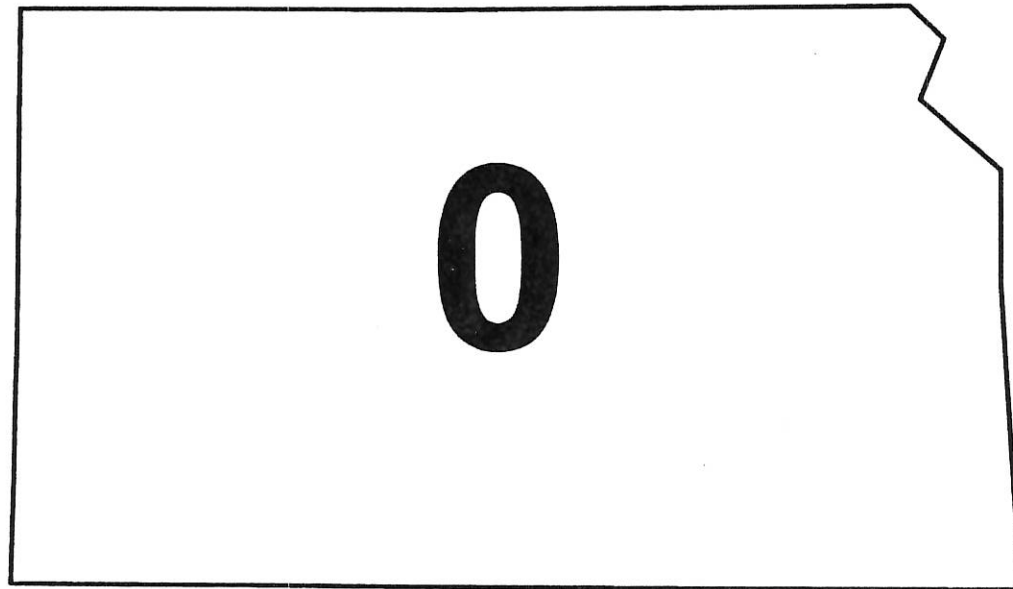
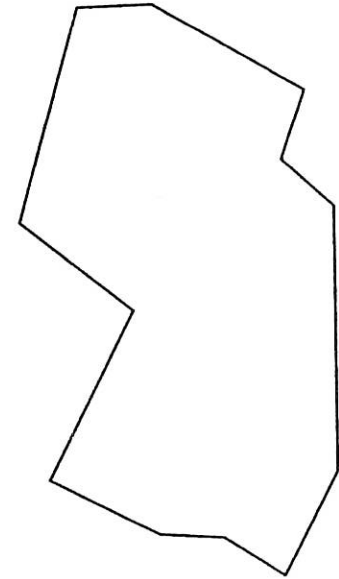
Gain	5,000,000,000
App. Pct.	1%
Rate	7.35%
KS Tax	<u>3,675,000</u>

Gain	5,000,000,000
App. Pct.	5%
Rate	9.00%
NJ Tax	<u>22,500,000</u>

Sale of Subsidiary Stock

Nonbusiness Income Gain Same Definitions

New Jersey-based company sells subsidiary stock for a \$5 billion gain. The company conducts 1% of its business in KS and 5% in NJ.

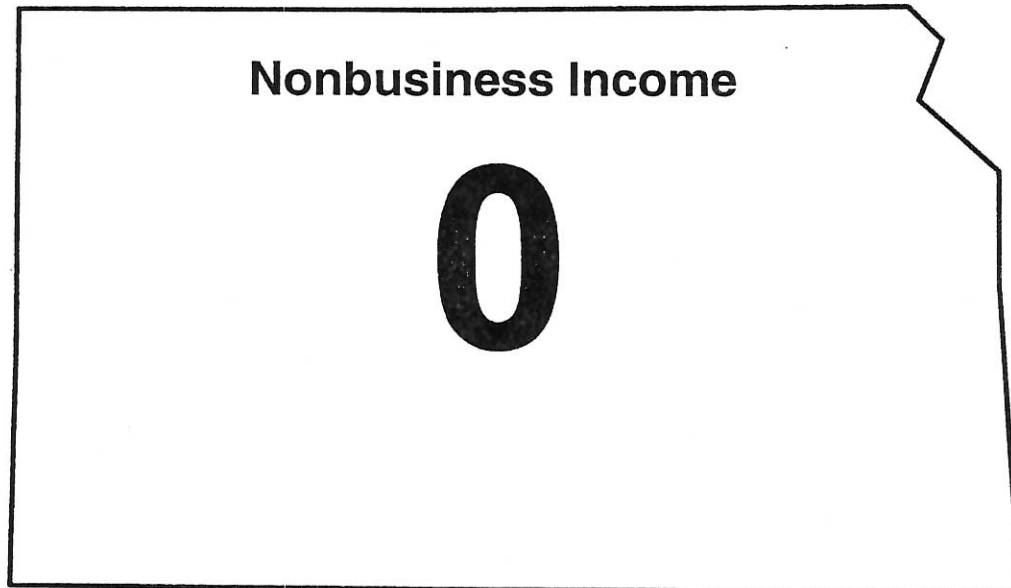
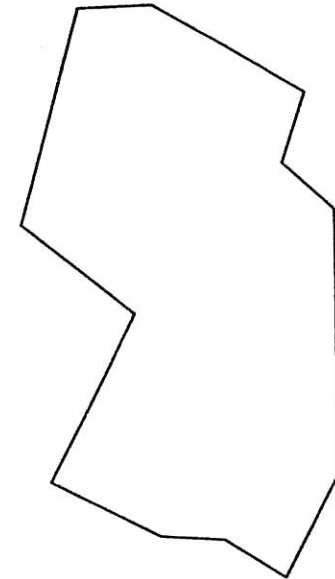


Gain	5,000,000,000
Rate	9.00%
Tax	<u>450,000,000</u>

Sale of Subsidiary Stock

Business Income Gain Different Definitions

New Jersey-based company sells subsidiary stock for a \$5 billion gain. The company conducts 1% of its business in KS and 5% in NJ.



Business Income

Gain	5,000,000,000
App. Pct.	5%
Rate	9.00%
NJ Tax	<u>22,500,000</u>

**State tax savings:
\$3,675,000**

Churning occurs when a taxpayer attempts to inflate the denominator of the sales factor by including large volume repetitive transactions such as overnight investments.

EXAMPLE

A California-based company with \$500 million in federal taxable income has annual Kansas sales of \$50 million and sales everywhere of \$5 billion. The company invests its cash reserves in overnight investments. Its cash reserves at the end of each day are \$5 million. The company takes the position that these overnight investment should be included in gross receipts, adding over \$1.8 billion of additional sales (365 * \$5 million) for a total of \$6.8 billion in everywhere sales.

Non-churning tax calculation

Kansas Sales	50,000,000
Sales Everywhere	5,000,000,000
Percentage	1.0000%
Income	500,000,000
Tax Rate	7.35%
Kansas Tax	367,500

Churning tax calculation

Kansas Sales	50,000,000
Sales Everywhere	6,825,000,000
Percentage	0.7326%
Income	500,000,000
Tax Rate	7.35%
Kansas Tax	269,231

Kansas state tax savings: \$98,269



MULTISTATE TAX COMMISSION

Working Together Since 1967 to Preserve Federalism and Tax Fairness

**To: Representative Kenny Wilk, Chair
Members of the House Tax Committee**

From: Shirley Sicilian, General Counsel, Multistate Tax Commission

Date: February 12, 2008

Subject: House Bill 2762

Chairman Wilk and members of the House Tax Committee, thank you very much for the opportunity to testify today on House Bill 2762. My name is Shirley Sicilian. From 1996 to 2003 I was policy director and then general counsel at the Kansas Department of Revenue. I'm now general counsel for the Multistate Tax Commission. The Commission is a government instrumentality, created under the Multistate Tax Compact. Kansas was the first state to adopt the Compact, back in 1967. (See K.S.A. 79-4301) Today, forty-seven states and the District of Columbia are members of the Commission in various capacities. Secretary of Revenue Wagon chaired our organization for a year until last July.

The Department asked if I would testify today and provide some national context for two of the proposed amendments you are considering in HB 2762: (1) an expansion of the definition of "business income," and (2) a clarification that the sales factor does not include returns of principal from short-term investments. Both proposed amendments address issues that have been, or are being, faced in many states in addition to Kansas; and both would address these issues consistently with other states.

1. Expansion of the Definition of "Business Income"

A taxpayer doing business in several states must determine how much of its total income is taxable in each of those states. Kansas and approximately 38 other states have adopted the Uniform Division of Income for Tax Purposes Act (UDITPA), in whole or in significant part, for making that determination. Approximately 25 of these states follow the UDITPA rule that characterizes income as either business income or non-business income. Business income is apportioned among the several states in which the taxpayer does business. For these states, non-business income is allocated to a single state, usually the taxpayer's commercial domicile. UDITPA defines Non-business income simply as all income other than business income. While business income is defined as:

- (1) Income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes
- (2) income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

(numbers added)

Kansas courts have interpreted this UDITPA definition as providing a single “transactional” test for business income.¹ But today the clear majority view is that an item of income will be considered business income if either of two tests is met: a transactional test, (1), and a functional test,(2).² In those states where the court found only a transactional test, the legislature often followed up with a statutory amendment to add a functional test.³

Inconsistent definitions of “business income” among the states create a potential for over or under taxation. For example, consider a multistate business that is subject to tax in two states, where State A uses only the transactional test and State B uses both the transactional and functional test. Assume a particular item of taxpayer’s income does not meet the transactional test, but it meets the functional test in State B. If the taxpayer’s commercial domicile is in State A, with the transactional test only, it will pay tax on the income in both states. If the taxpayer’s commercial domicile is in State B, with both tests, it will pay tax on only a portion of its income, the portion attributed to State B.⁴

The proposed amendment would bring Kansas back into uniformity with the other UDITPA states by adding the functional test as a second method for identifying business income. A number of other states that had not incorporated the functional test have also added it recently. These include Mississippi (2001), Oregon (2004), and Kentucky (2006).⁵

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 noted that “the principle that a State may not tax value earned outside its borders rests on the fundamental requirement of both the Due Process and Commerce Clauses that there be ‘some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.’”⁶ The *Allied Signal* Court recognized the UDITPA definition of business income is “compatible” with these constitutional principles.⁷ There has been a definite trend over the last few years for states to move in the direction of broadening the definition of business income “to the extent permitted by the U.S. Constitution: Minnesota

¹ *In re Tax Appeal of Chief Industries, Inc.*, 255 Kan. 640 (1994).

² CCH Commentary, Multi-Corp-Income, *Distinction Between Business and Non-Business Income* (2007). See also, e.g., *Hoechst Celanese Corp. v. Franchise Tax Board*, 25 Cal.4th 508 (2001); *Laurel Pipeline Co. v. Commonwealth*, 615 A.2d 841 (Pa. 1994); *Texaco-Cities Service Pipeline Co. v. McGaw*, 182 Ill. 2d 269 (1998); *Polaroid Corp. v. Offerman*, 349 NC 290 (1998); *Willamette Industries, Inc. v. Oregon Department of Revenue*, 331 Or 311 (2000); *Kemppel v. Zaino*, 91 Oh St.3rd 420 (2001).

³ See, e.g., Tenn. Code Ann. §67-4-2004, Ala. H.B. 7 (Dec. 28, 2001).

⁴ Kansas allows taxpayers to elect to characterize ALL income as business income, which should help taxpayers domiciled in the state to avoid over taxation, but which would not address under taxation of entities domiciled outside the state. K.S.A. 79-3271(a).

⁵ Mississippi, A.B. 1695, 2001; Oregon, OAR 150-314.610(1)-(A)(2); Kentucky, 103 KAR 16:060E.

⁶ Quoting from, *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-345 (1954)

⁷ *Allied Signal v. Dir. Div. of Taxation*, 504 U.S. 765 (1992).

(1999), Alabama, Pennsylvania (2001); New Jersey, North Carolina (2002); Illinois (2004); and Georgia (2005)⁸.

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

Once the amount of business income subject to apportionment is determined, the next step is to determine the share of that income that is attributable to a particular state. As you know, Kansas uses the UDITPA formula, which 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. The proposed amendment would clarify an issue that has come up in many states with respect to the sales factor: specifically, whether repeated returns of principal from short term investments should be included in the sales factor as “gross receipts.”

This issue arises when a taxpayer is engaged in selling goods or services that generate large sums of excess cash on a short-term basis. Rather than let these sums lay idle, even for a brief period, taxpayers often form a treasury division to efficiently employ the cash in various types of short-term, often over-night, investments. Some taxpayers have argued that the UDITPA sales factor should include, in addition to the income generated from these short-term investments, the repeated returns of the re-invested principal.

The problem with a rule that includes the return of principal in the sales factor is that it distorts the apportionment of a taxpayer’s income. Gross receipts from the taxpayer’s sales of tangible property would become increasingly overwhelmed in the sales factor as the average maturity period taxpayer chooses for its treasury function investments shortens. As the length of the taxpayer’s average maturity period drops, the more the principal is “turned over,” and the more gross receipts attributable to the location of the treasury function would climb. As gross receipts attributable to the treasury function climb, unvarying receipts attributable to the states from sales of taxpayers primary product would become increasingly underrepresented in the sales factor ratio and the percentage of total business income apportioned to those states would shrink.

Noted tax authority, Professor Hellerstein, explains that this result causes a distortion because there is no correlation between the amount of receipts and the corresponding amount of income from the investments:

For example, the purchase at a discount of a thirty-day \$1 million certificate of deposit at the beginning of each month and its sale or redemption at the end of the month would yield \$12 million of receipts during the course of a year, whereas the purchase at a discount and subsequent sale or redemption of a one-year \$1 million certificate of deposit would yield only \$1 million of receipts. Yet the intangible interest income earned from these investments is likely to be quite similar and clearly will not vary by a factor of twelve.

(Hellerstein & Hellerstein, *State Taxation* (3d ed. 2001) Part IV ¶9.18[4][c].)

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

⁸ 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.

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 possible incentive it creates for further distortion through further shortening the term of investment, has prompted jurisdiction after jurisdiction to exclude the return of principal from the sales factor by court decision⁹ or legislation. Today, 39 jurisdictions exclude returns of principal from the sales factor.

Given this high level of uniformity, 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 apportionment 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. 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. By the same token, 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.

⁹ 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);

Legislative Testimony

achieve
more

HB 2762

February 12, 2008

**Testimony before the Kansas House Taxation Committee
By Marlee Carpenter, Vice President of Government Affairs**

Chairman Wilk and members of the committee;

The Kansas Chamber of Commerce supports the reduction of the corporate income tax to foster economic growth and job creation in the state. As Kansas competes with other states, the Kansas corporate income tax stands out as a disincentive for investment.

The corporate income tax continues to be an important factor for job location and investment. The most recent site selectors study has ranked Corporate Tax Rate third only behind Highway Accessibility and Labor Costs. Kansas' labor costs are relatively low when compared with other states and Kansas roads compare very favorably to other states. The Kansas corporate income tax does not compare favorably with other states we compete with for job, investment and economic growth. I have attached this study to my testimony.

The Kansas Chamber's 2007 CEO and Business Owners Poll is a scientific survey of 300 businesses from all parts of the state. The Chamber annually conducts this survey to gauge the mood of Kansas businesses. This year's poll ranks lower business taxes as the most important issue to the profitability of a business. This is significant because for the first time in four years lower taxes has eclipsed health care costs. In addition, sixty-seven percent of business owners believe that they pay too much in taxes. These two indicators are significant because despite the progress we have made in the last couple of years in the area of business taxes, more needs to be done to improve the business climate in the state. I have attached this polling information to my testimony.

In addition, as you compare the corporate income tax to other states, Kansas does not fare well. The Tax Foundation's 2008 State Business Tax Climate Index ranks the Kansas business climate 33rd. Looking at our neighbors and how they compare in overall business climate, all but one is higher than Kansas. CO – 13th, MO -15th, OK – 19th. Only NE is lower at 43rd. When comparing our corporate income tax rate, Kansas ranks 38th in the Tax Foundation Index. Missouri's top corporate income tax rate is significantly lower than Kansas' at 6.25%.



As other states make improvements to their tax climates, Kansas need to continue to make progress and improvements as well as we compete for jobs and investments on a daily basis. Corporate income tax rate reduction is important. Kansas companies will have more money to make capital investments and create jobs. Business growth, job creation and investment helps drive the economy. With a more competitive tax climate, the tax base will be broadened and there will be more money for other state priorities.

The Kansas Chamber supports corporate income tax reductions, but we continue to have concerns with the redefinition of non-business income. This definitional change being considered in HB 2762 means a \$20 million tax increase on companies doing business, making investments and creating jobs in the state. The business community also recognizes that Kansas is alone in its definition of business income however there is much case law and legal precedent to back up our treatment of non-business income. That being said, we are willing to work with the House and the Senate to enact a comprehensive, pro-business tax package that will better position Kansas in the fight for jobs and investment.

The second part of HB 2762 deals with the sales factor when figuring corporate income taxes and apportioning income to the state. The business community contends that this statutory change is unnecessary and that the Secretary of Revenue already has discretion to do this under her current authority.

As Kansas corporate income tax receipts continue to come in above estimate, the business community is encouraged that a pro-growth tax package can be passed that includes corporate income tax reductions as well as specific changes in the treatment of corporate income tax credits. We are committed to working together to make Kansas a more competitive place to do business so that more companies view Kansas as a great place to make investments and create jobs.

Thank you for your time and I will be happy to answer any questions.

Kansas Chamber, with headquarters in Topeka, is the leading statewide pro-business advocacy group moving Kansas towards becoming the best state in America to live and work. The Chamber represents small, medium and large employers all across Kansas.



Ranked #10: Availability of High-Speed Internet Access

By Michelle Comerford, Senior Location Consultant, Austin Consulting (Oct/Nov 07)

As more and more companies adopt Internet-based enterprise systems, AVAILABILITY OF High-speed Internet ACCESS will remain among the top-10 factors in Area Development's Corporate Survey. **More**



Ranked #9: Energy Availability & Costs

By Eric Stavriotis, Jones Lang LaSalle (Oct/Nov 07)

While ENERGY AVAILABILITY AND COSTS is not a critical site selection factor for some, it does have a significant impact on data center decisions. **More**



Ranked #8: Availability of Skilled Labor

By Richard L. Ferguson, CEO and Chairman of the Board, ACT, Inc. (Aug/Sep 07)

The high ranking of the availability of skilled labor factor is confirmed by those firms taking advantage of programs pre-certifying workers' skills. **More**



Ranked #7: Occupancy or Construction Costs

By Les J. Cranmer, Senior Managing Director, and Art M. Wegfahrt, Corporate Managing Director, Studley, Inc. (Aug/Sep 07)

A closer look at the Corporate Survey reveals that the occupancy or construction costs factor is not as critical to the location decision as it first appears. **More**



Ranked #6: Tax Exemptions

By Michael Press, Managing Director, Business Incentives Advisory, Duff & Phelps LLC, New York (Jun/Jul 07)

Area Development's 2006 Corporate Survey respondents are so familiar with the benefits of TAX EXEMPTIONS for both economic development and other purposes that they have ranked this factor high in importance. **More**



Ranked #5: Availability of Telecommunications Services

By Dan Gatti, Innovative Capital Ventures, Inc. (Jun/Jul 07)

The companies that rated AVAILABILITY OF TELECOMMUNICATIONS as very important in Area Development's 2006 Corporate Survey realize that those communities setting ICT trends are more attractive locations than those just reacting to these trends. **More**



Ranked #4: State and Local Incentives

By Michael Huber, Cushman & Wakefield - Location Incentives Group (Apr/May 07)

As in 2005, the results of Area Development's 2006 Corporate Survey demonstrate that state and local incentives are given increasing consideration in the facilities planning process. **More**



Ranked #3: Corporate Tax Rate

By Tom Bertino, Strategic Relocation & Expansion Services Practice, KPMG LLP (Apr/May 07)

Respondents to Area Development's 21st Annual Corporate Survey have named Corporate Tax Rate as the third most important factor in the site selection process behind only labor costs and highway accessibility

More



Ranked #2: Highway Accessibility

By Rick Thomas, Director Managed Transportation, CEVA Logistics (Feb/Mar 07)

Highway accessibility was ranked as the #2 factor by the respondents to Area Development's 2006 Annual Corporate Survey for a myriad of reasons. **More**



Ranked #1: Labor Costs

By John M. Rhodes, Senior Principal, Moran, Stahl & Boyer, LLC (Feb/Mar 07)

The respondents to the 2006 Corporate Survey conducted by Area Development identified the cost of labor as the number-one factor for making site selection decisions. Here is some insight into the importance of labor costs. **More**

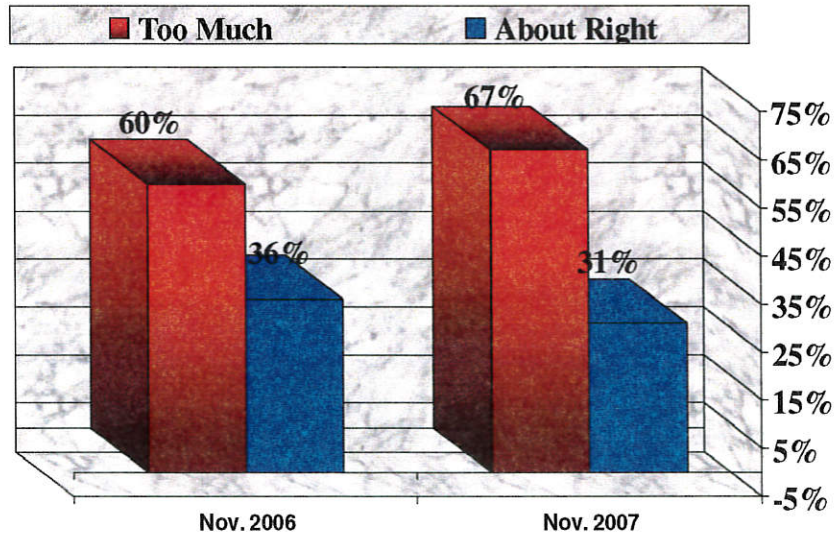
Most Important to Profitability

MENTIONED:	Nov. 07	Nov.06	Nov.05	Nov. 04
Lower taxes on business	46%	46%	39%	38%
Managing health care costs	41%	47%	46%	42%
Economic incentives for business	21%	20%	20%	15%
Stop friv. lawsuits/Tort reform	18%	22%	21%	21%
Decrease regulation/mandates	18%	18%	14%	13%
Workers' Compensation	14%	13%	14%	11%
Limit growth of state gov.	12%	7%	10%	8%
Unemployment Compensation	4%	4%	9%	5%

(2 responses accepted)

Amount of Taxes Paid

67% Too much vs. 0% Not enough vs. 31% About right amount vs. 1% Undecided



BACKGROUND PAPER

October 2007, Number 57

2008 State Business Tax Climate Index An Executive Summary

By

Curtis S. Dubay and Chris Atkins

Introduction

The Tax Foundation presents the 2008 version of the State Business Tax Climate Index (SBTCI) as a tool for lawmakers, the media, and individuals alike to gauge how their states tax systems compare. Policymakers can then use the SBTCI to pinpoint changes to their tax systems that will explicitly improve their states' standing in relation to competing states.

How much states collect in taxes is critical, but how they take it is also important. In other words, quite apart from whether a state's total tax burden is higher than in other states, it can enact (and many states do) a set of tax laws that cause great damage to the economy.

The modern market is characterized by mobile capital and labor. Therefore, companies will locate where they have the greatest competitive advantage. States with the best tax systems will be most competitive in attracting new businesses and be the most effective at generating economic and employment growth.

Although the market is now global, the Department of Labor reports that most mass job relocations are from one U.S. state to another rather than to an overseas location.¹ This means that state lawmakers must be aware of how their states' business climates stack up to others in their region and nationwide.

State lawmakers are always tempted to lure business with lucrative tax incentives and sub-

sidies. This can be a dangerous proposition, as a case in Florida illustrates. In July of 2004 Florida lawmakers cried foul because a major credit card company announced it would close its Tampa call center, lay off 1,110 workers, and outsource those jobs to another company. The reason for the lawmakers' ire was that the company had been lured to Florida with a generous tax incentive package and had enjoyed nearly \$3 million worth of tax breaks during the previous nine years.²

Lawmakers create these deals under the banner of job creation and economic development, but the truth is that if a state needs to offer such packages, it is most likely covering for a woeful business climate plagued by bad tax policy. A far more effective approach is to systematically improve the business tax climate for the long term. When assessing which changes to make, lawmakers need to remember these two rules:

1. Taxes matter to business. Taxes affect business decisions, job creation and retention, plant location, competitiveness, and the long-term health of a state's economy. Most importantly, taxes diminish profits. If taxes take a larger portion of profits, that cost is passed along to either consumers (through higher prices), workers (through lower wages or fewer jobs), or shareholders (through lower dividends or share value).

¹ U.S. Department of Labor, "Extended Mass Layoffs in the First Quarter of 2007," August 9, 2007, located at <http://www.bls.gov/news.release/mslo.nr0.htm>.

² Dave Wasson, "Florida Lawmakers Slam Capital One's Layoff After Years of Tax Breaks," *Tax Analysts*, July 27, 2004.

Curtis Dubay is an economist at the Tax Foundation, and Chris Atkins is the foundation's senior tax counsel. They would like to thank the co-authors of previous editions, J. Scott Moody, Wendy P. Warcholik and Scott A. Hodge.

Thus a state with lower tax costs will be more attractive to business investment, and more likely to experience economic growth.

- States do not enact tax changes (increases or cuts) in a vacuum. Every tax law will in some way change a state's competitive position relative to its immediate neighbors, its geographic region, and even globally. Ultimately it will affect the state's national standing as a place to live and to do business. Entrepreneurial states can take advantage of the tax increases of their neighbors to lure businesses out of high-tax states.

Clearly, there are many non-tax factors that affect a state's business climate: its proximity to raw materials or transportation centers, its regulatory or legal structures, the quality of its education system and the skill of its workforce, not to mention the intangible perception of a state's "quality of life."³ Some of these factors are, of course, outside of the control

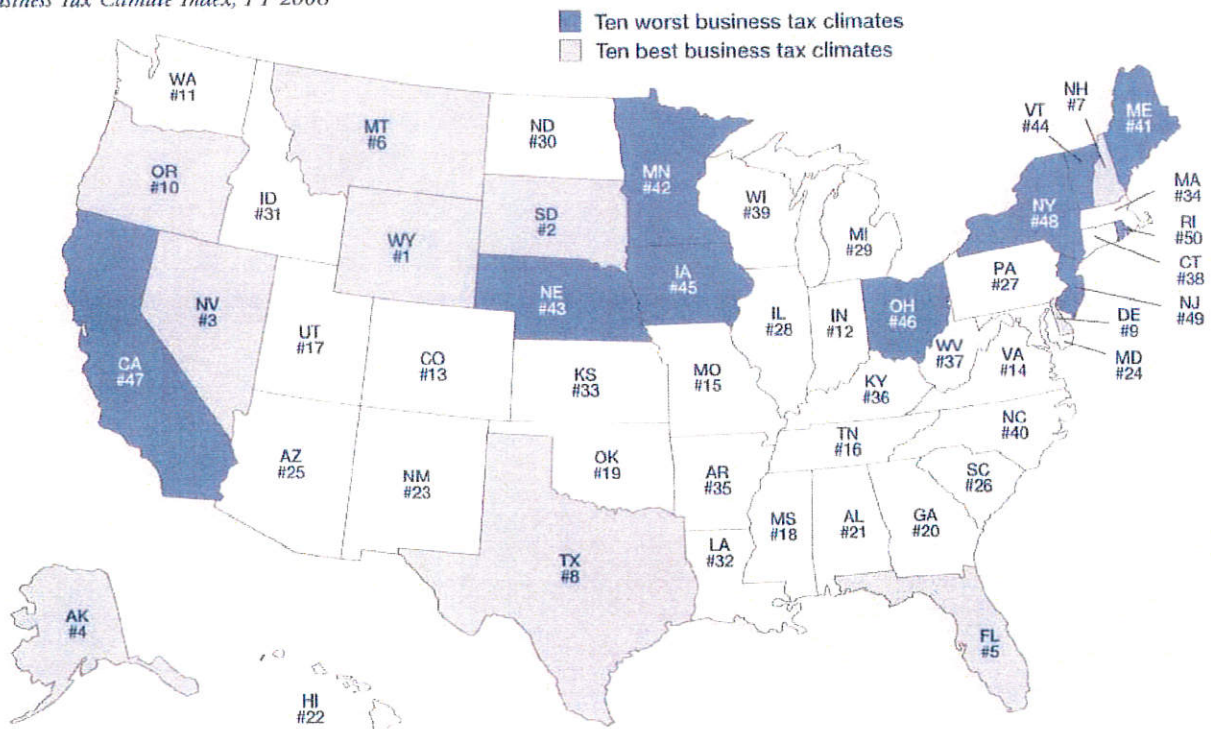
of elected officials. Montana lawmakers cannot change the fact that Montana's businesses have no immediate access to deepwater ports. Lawmakers do, however, have direct control over how friendly their tax systems are to business.

Purpose

The SBTICI is designed to measure the competitiveness of each state's tax system so lawmakers, the media and the public alike can gauge how their state compares to other states. They can also use the SBTICI to pinpoint specific changes that will increase the competitive standing of their state.

Good state tax systems levy low, flat rates on the broadest bases possible, and they treat all taxpayers the same. Variation in the tax treatment of different industries favors one economic activity or decision over another. The more riddled a tax system is with these politically motivated preferences the less likely

Figure 1
State Business Tax Climate Index, FY 2008



Source: Tax Foundation

³ A trend in tax literature throughout the 1990s has been the increasing use of indexes to measure a state's general business climate. These include the Center for Policy and Legal Studies' "Economic Freedom in America's 50 States: A 1999 Analysis" and the Beacon Hill Institute's "State Competitiveness Report 2001." Such indexes even exist on the international level, including the Heritage Foundation and *Wall Street Journal's* "2004 Index of Economic Freedom." Plaut and Pluta (1983) examined the use of business climate indexes as explanatory variables for business location movements. They found that such general indexes do have a significant explanatory power helping to explain, for example, why businesses have moved from the Northeast and Midwest towards the South and Southwest. In turn, they also found that high taxes have a negative effect on employment growth.

it is that business decisions will be made in response to market forces. The SBTCI rewards those states that apply these principles in five important areas of taxation: individual income taxes, major business taxes, sales taxes, unemployment insurance taxes, and taxes on wealth or assets such as property.

How the State Business Tax Climate Index is Calculated

The SBTCI places 113 variables into five component indexes that each measure a different sector of a state's business tax climate. The five component indexes are the Corporate Tax Index, Individual Income Tax Index, Sales Tax Index, Unemployment Tax Index and Property Tax Index. The total score for each state is calculated based on the scores on each of the five component indexes.

Using the economic literature as our guide, we designed these five component indexes to score each state's business tax climate on a scale of zero (worst) to 10 (best). Each component index is devoted to a major area of state taxation and each has two equally weighted sub-indexes, some of which include several categories and variables under them. Overall, there are 10 sub-indexes and 113 variables. The ranking of the states on each of the five major component indexes is presented in Table 2 on page 4.

Results of the 2008 State Business Tax Climate Index

The ten best states in the Tax Foundation's 2008 State Business Tax Climate Index are as follows:

- | | |
|-----------------|------------------|
| 1. Wyoming | 6. Montana |
| 2. South Dakota | 7. New Hampshire |
| 3. Nevada | 8. Texas |
| 4. Alaska | 9. Delaware |
| 5. Florida | 10. Oregon |

The ten worst states are:

- | | |
|---------------|------------------|
| 41. Maine | 46. Ohio |
| 42. Minnesota | 47. California |
| 43. Nebraska | 48. New York |
| 44. Vermont | 49. New Jersey |
| 45. Iowa | 50. Rhode Island |

Table 1
State Business Tax Climate Index, 2007 and 2008

State	FY 2008 State Business Tax Climate Index		FY 2007 State Business Tax Climate Index		Change from 2007 to 2008	
	Score	Rank	Score	Rank	Score	Rank
Alabama	5.37	21	5.37	21	0.00	0
Alaska	7.19	4	7.21	4	-0.02	0
Arizona	5.19	25	5.11	30	0.07	5
Arkansas	4.94	35	4.90	35	0.04	0
California	4.12	47	4.14	46	-0.03	-1
Colorado	5.89	13	5.82	13	0.07	0
Connecticut	4.89	38	4.77	39	0.13	1
Delaware	6.03	9	6.09	9	-0.06	0
Florida	7.03	5	6.83	5	0.20	0
Georgia	5.38	20	5.35	22	0.03	2
Hawaii	5.33	22	5.33	23	0.00	1
Idaho	5.06	31	5.21	26	-0.16	-5
Illinois	5.14	28	5.14	27	0.00	-1
Indiana	5.93	12	5.88	11	0.05	-1
Iowa	4.54	45	4.53	44	0.01	-1
Kansas	4.97	33	5.01	32	-0.04	-1
Kentucky	4.94	36	4.81	38	0.13	2
Louisiana	5.02	32	5.00	33	0.02	1
Maine	4.69	41	4.70	40	-0.02	-1
Maryland	5.25	24	5.12	28	0.13	4
Massachusetts	4.96	34	4.84	37	0.13	3
Michigan	5.13	29	5.12	29	0.00	0
Minnesota	4.60	42	4.63	42	-0.03	0
Mississippi	5.44	18	5.48	18	-0.04	0
Missouri	5.58	15	5.54	16	0.04	1
Montana	6.34	6	6.32	7	0.03	1
Nebraska	4.56	43	4.45	45	0.11	2
Nevada	7.35	3	7.31	3	0.04	0
New Hampshire	6.24	7	6.19	8	0.06	1
New Jersey	3.88	49	4.10	47	-0.23	-2
New Mexico	5.28	23	5.38	20	-0.10	-3
New York	4.11	48	4.08	48	0.03	0
North Carolina	4.73	40	4.70	41	0.04	1
North Dakota	5.08	30	5.11	31	-0.03	1
Ohio	4.14	46	3.93	49	0.21	3
Oklahoma	5.42	19	5.42	19	0.00	0
Oregon	5.98	10	6.01	10	-0.03	0
Pennsylvania	5.15	27	5.22	25	-0.06	-2
Rhode Island	3.78	50	3.67	50	0.11	0
South Carolina	5.18	26	5.26	24	-0.09	-2
South Dakota	7.46	2	7.51	2	-0.05	0
Tennessee	5.53	16	5.51	17	0.02	1
Texas	6.23	8	6.42	6	-0.19	-2
Utah	5.44	17	5.54	15	-0.10	-2
Vermont	4.54	44	4.54	43	0.00	-1
Virginia	5.69	14	5.59	14	0.10	0
Washington	5.95	11	5.83	12	0.12	1
West Virginia	4.90	37	4.98	34	-0.08	-3
Wisconsin	4.77	39	4.85	36	-0.08	-3
Wyoming	7.71	1	7.77	1	-0.06	0
District of Columbia	4.49	-	4.47	-	0.02	-

Note: The higher the score, the more favorable a state's tax system is for business. Scores from 2003 and 2004 are calendar year; from 2006 through 2008 they are fiscal year (July 1-June 30).
Source: Tax Foundation

Tax competition is an unpleasant reality for state revenue and budget officials, but it is probably the most effective restraint on state and local taxes. When a state imposes higher taxes than a neighboring state, business will cross the border to some extent. Therefore states with more competitive tax systems score well in the SBTCI because they are best suited to generate economic growth.

The first two editions of the SBTCl covered each state's tax climate as it existed in the calendar year starting January 1. For example, the 2004 SBTCl ranked each state as it entered calendar year 2004. Starting with the 2006 edition, the SBTCl has measured each state's business tax climate as it stands at the beginning of

the standard state fiscal year, July 1. Therefore, this edition is the 2008 SBTCl and represents the tax climate of each state as of July 1, 2007, the first day of fiscal year 2008 for most states. Please view the full study on our website at www.taxfoundation.org/files/bp57.pdf, or, alternatively, call or write us for a free copy.

Table 2
Major Components of the State Business Tax Climate Index, FY 2008

State	Overall Rank	Corporate Tax Index Rank	Individual Income Tax Index Rank	Sales Tax Index Rank	Unemployment Insurance Tax Index Rank	Property Tax Index Rank
Alabama	21	21	19	25	12	12
Alaska	4	26	1	5	47	22
Arizona	25	24	26	45	3	10
Arkansas	35	35	29	37	18	16
California	47	40	50	42	15	5
Colorado	13	15	13	11	20	15
Connecticut	38	17	18	30	19	50
Delaware	9	48	32	2	7	7
Florida	5	14	1	19	2	18
Georgia	20	6	24	16	22	33
Hawaii	22	9	43	17	23	4
Idaho	31	19	34	34	44	2
Illinois	28	29	12	32	42	40
Indiana	12	22	10	12	10	17
Iowa	45	45	45	20	37	31
Kansas	33	38	25	24	9	38
Kentucky	36	39	31	10	48	20
Louisiana	32	18	28	47	8	21
Maine	41	43	38	13	40	41
Maryland	24	7	37	7	30	39
Massachusetts	34	46	15	8	49	45
Michigan	29	49	14	14	45	25
Minnesota	42	44	39	40	39	19
Mississippi	18	8	16	35	5	32
Missouri	15	10	23	22	4	9
Montana	6	16	20	3	21	8
Nebraska	43	33	33	46	17	42
Nevada	3	1	1	43	41	13
New Hampshire	7	50	9	1	38	36
New Jersey	49	41	49	44	24	49
New Mexico	23	36	17	41	13	1
New York	48	23	41	49	46	43
North Carolina	40	25	44	39	6	34
North Dakota	30	27	36	29	26	6
Ohio	46	37	48	36	11	44
Oklahoma	19	13	22	31	1	24
Oregon	10	20	35	4	32	14
Pennsylvania	27	42	11	26	25	47
Rhode Island	50	34	47	33	50	48
South Carolina	26	11	27	18	43	29
South Dakota	2	1	1	38	33	11
Tennessee	16	12	8	48	31	35
Texas	8	47	7	28	14	27
Utah	17	5	30	27	28	3
Vermont	44	32	46	15	16	46
Virginia	14	4	21	6	29	23
Washington	11	31	1	50	36	28
West Virginia	37	28	40	21	35	26
Wisconsin	39	30	42	23	27	37
Wyoming	1	1	1	9	34	30

Note: States without a particular tax rank equally as number 1.
Source: Tax Foundation



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