

MINUTES OF THE HOUSE TAXATION COMMITTEE

The meeting was called to order by Vice Chair Richard Carlson at 9:00 A.M. on February 13, 2008 in Room 519-S of the Capitol.

All members were present except: Representatives King - Excused  
Representatives Holland- Excused

Committee staff present:

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

Conferees appearing before the committee:

Stan Ahlerich, President, Kansas Inc.  
Art Hall, Executive Director, Center for Applied Economics, KU School of Business  
Marlee Carpenter, Kansas Chamber of Commerce  
Tim Whitsman, Wichita Independent Business Association  
Ken Daniels, KS Small Biz. Com  
Derrick Sontag, National Federation Independent Bussinesses  
Alan Cobb, Americans For Prosperity  
Richard Cram, KDOR

Others attending:

See attached list

Representative Owens requested a bill introduction, on behalf of Representative Virgil Peck, that would allow cities to request assistance from KDOT or the National Guard to help with the demolition of flood damaged houses. Representative Carlson seconded. The motion carried.

Representative Crum requested a bill introduction that would allow Butler County to place a County wide sales tax on the ballot for revenue for public safety, capital projects and/or bridge or road construction. Representative Owens seconded. The motion carried.

**HB 2751 - Authorizing the option to expense investment expenditures as an alternative to depreciation in calculating income tax liability.**

Gordon Self stated the bill was worked in conjunction with the Revisor's staff and Professor Hall. Mr. Self provided a general overview of the bill and said Dr. Hall would provide details of the seventeen page bill. The taxpayer is allowed to take the full expenditure on the investment in the first year, rather than depreciate the expense over a period of years. He distributed a briefing statement on the Expensing Deduction (Attachment 1).

The Vice Chair opened the public hearing on **HB 2751**.

Stan Ahlerich, President, Kansas Inc. distributed written testimony that provided insight to the expensing proposal that is relative to many of the concepts that were brought forth during the 2007 statewide economic development strategic planning process. During that process, participants articulated six guiding principles, (listed in testimony) regarding economic development efforts. In their assessment, the expensing proposal meets each guiding principle and would provide an immediate income tax deduction for new capital investments for any business (Attachment 2).

Art Hall, Executive Director, Center for Applied Economics, Kansas University, said that they are trying to implement a tax policy that honors the notion that "every business matters" (Attachment 3). What they are doing, as a matter of tax and economic policy, is to establish a value for Kansas investments made in Kansas. Something the federal government does not do under normal rules. Part of the challenge was to create a procedure, that worked seamlessly with the way federal rules work and how the Kansas tax system

## CONTINUATION SHEET

MINUTES OF THE House Taxation Committee at 9:00 A.M. on February 13, 2008 in Room 519-S of the Capitol.

interacts with it. They believe that has been accomplished in **HB 2751**, with one small exception, which he explained.

He described how the Federal Stimulus package would affect the Kansas budget. He stressed two points: **HB 2751** is *not effective* until January 1, 2009 and everything from the federal level will happen in 2008.

He reviewed seven key points of the Federal Rules for Expensing (Section 179). He guided the Committee through the basic mechanics used by a small business, showing calculations from the Kansas Expensing under Adjustments for Federal Rules (Attachment 4). Discussion followed regarding the formula, its rationale and impact of the fiscal note.

Marlee Carpenter, Kansas Chamber of Commerce, said that the Chamber of Commerce is supportive of new and innovative ideas that will provide incentives for investment in the state (Attachment 5). Attached to her testimony was a copy of the Business Opportunity/Vitality-Score Performance, 2002-2006, which ranks Kansas 45, among the fifty states. This is indicative that businesses are not starting in Kansas as rapidly as they are in other states. Companies should be able to choose between the expensing option or continue their existing tax option.

Tim Whitsman, Wichita Independent Business Association, testified that they are supportive of efforts to increase business investment in Kansas. This legislation makes it less difficult for companies that lack the resources to devote entire departments to mastering the intricacies of an incentive to take advantage of the intent of the legislation (Attachment 6). Discussion followed regarding the multiplier used by businesses of varying size. He was asked and agreed to provide information regarding a general idea of what the average multiplier might be.

Ken Daniels, KansasSmallBiz.com answered a previous question on the percentage of Kansans that work for large and small businesses - 8 to 19 % of all Kansans work for the government; of the remaining Kansans, 54% work for small business and 46% work for large business. Any businesses in Kansas, whatever size, benefits the tax base of Kansas and is good for the economy! He said that "expensing" is just "sudden depreciation". It will reduce this year's income, but increases future income for all years when regular depreciation would have been taken (Attachment 7).

Derrick Sontag, National Federation testified that **HB 2751** would allow all taxpaying businesses the option of expensing or accessing applicable tax incentives when making qualified investments. In response to previous discussion he said that 94% of business in Kansas have less than 100 people. NFIB polling has found that one in five small businesses encounter "consistent" cash flow problems. The passage of this bill will have a direct impact on the more than 300,000 small businesses in Kansas (Attachment 8).

Alan Cobb, Americans For Prosperity, appeared in support of the bill, as a way to increase the competitiveness of Kansas businesses. This bill would take another positive step away from picking winners and losers and giving each Kansas business an equal opportunity to expand his or her business (Attachment 9).

It was noted that written testimony from Duane Simpson, was distributed from Kansas Grain & Feed Association, in support on **HB 2751** (Attachment 10).

Richard Cram testified from a neutral position, but expressed concerns regarding **HB 2751**. He said the Department's first and foremost concern is the proposal's staggering initial negative fiscal impact. The estimated fiscal impact in the first year of implementation would be negative \$68 million. The bill would also add significant complexity to the tax laws by creating another set of depreciation rules different from federal law. He said that there are numerous expensing programs at the federal level and questioned the need for more at the state level (Attachment 11).

The meeting was adjourned at 10:25 A.M. The next meeting is February 14, 2008.



MARY ANN TORRENCE, ATTORNEY  
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OFFICE OF REVISOR OF STATUTES  
KANSAS LEGISLATURE

Legal Consultation—  
Legislative Committees and Legislators  
Legislative Bill Drafting  
Legislative Committee Staff  
Secretary—  
Legislative Coordinating Council  
Kansas Commission on  
Interstate Cooperation  
Kansas Statutes Annotated  
Editing and Publication  
Legislative Information System

**Briefing on House Bill 2751 -  
Expensing Deduction**

Office of Revisor of Statutes

February 13, 2008

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For tax years after December 31, 2008, HB 2751 allows individuals and businesses to elect to expense those expenditures on real and tangible personal property investments for which the taxpayer could otherwise take a depreciation deduction against such taxpayer's adjusted gross income or Kansas taxable income. An expensing deduction is in a sense a highly accelerated depreciation deduction. The taxpayer is allowed to deduct the full expenditure on the investment in the first year, rather than depreciate the expense over a period of years.

Under Kansas tax law an individual's adjusted gross income or a corporation's Kansas taxable income is the same as that reported for federal tax purposes. In calculating these amounts taxpayers are allowed depreciation deductions for expenditures on investment property in accordance with depreciation schedules. Thus, a federal depreciation deduction has already been accounted for in calculating adjusted gross income and Kansas taxable income. In order to work within this system HB 2751 uses the following formula to determine the amount an individual or corporation may expense for state tax purposes:

Aggregate Expenditure x Applicable Factor = Amount of Expense Deduction

The "aggregate expenditure" is the cost, including construction, fabrication and installation, for the acquisition of the investment property. The applicable factor is based on the

method of depreciation and the classification of the property that is reported on the taxpayer's federal income tax return. The applicable factor is found by referencing the appropriate table, which will be published in the statute. For tangible personal property the table is broken down by method of depreciation and classification of property. For example, a taxpayer using Method B (the 200% double declining balance method with half-year and quarter-year conventions) for property classified as 5-year property would use a factor of 0.201. That factor multiplied by the aggregate expenditure on the property would give the taxpayer the amount that may be deducted if the taxpayer elects to expense the investment expenditure. For real property the table is broken down by the type of property and the month such property is placed in service.

The election to expense may only be taken in the taxable year in which the investment expenditure is incurred by the taxpayer. It must also be taken in lieu of taking any other depreciation deduction the taxpayer may be entitled to take for that particular investment expenditure, including depreciation deductions the taxpayer may have been entitled to take in future tax years. If the election is made the taxpayer also becomes ineligible to apply for investment tax credits that would otherwise be available for the investment expenditure. If the expense deduction exceeds the taxpayer's liability, the expense deduction may be carried forward until it is fully used.

Any subsequent sales of the investment property to an unrelated third party shall be governed by the provisions of K.S.A. 79-3276 relating to capital gains and losses. If the situs of the property is relocated outside the state, then the expense deduction is subject to recapture. The recapture amount is the lesser of: (1) the federal adjusted tax basis for the investment property; or (2) the calculated expensed amount.

For corporate taxpayers there are two additional provisions regarding expensing. First, the expense deduction may only be taken against Kansas taxable income and may not be apportioned to taxable income apportioned to other states. Second, a member of a unitary group filing a combined report may take the expense deduction for an investment expenditure made by another member of the combined group, provided that the deduction is only taken against Kansas taxable income of the member making the election.

**Kansas, Inc. Testimony on House Bill 2751**  
**House Taxation Committee**  
**February 13, 2008**  
**Stan R. Ahlerich, President**

Chairman Wilk, members of the House Taxation Committee, Kansas, Inc. appreciates the opportunity to provide testimony on House Bill 2751 concerning income taxation, relating to deductions and expensing of investment expenditures.

Kansas, Inc. is an independent, objective, and non-partisan organization designed to conduct economic development research and analysis with the goal of crafting policies and recommendations to ensure the state's ongoing competitiveness for economic growth. Through analysis and open dialogue, Kansas, Inc. identifies policy options and builds consensus essential for concerted action on vital economic issues.

**Kansas, Inc. stands as a proponent of House Bill 2751.** Through our testimony, we hope to provide insight in regards to the expensing proposal relative to many of the concepts that were brought forth during the 2007 statewide economic development strategic planning process. Entitled *Leveraging our Foundations and Designing the Future: A Kansas Economic Renaissance*, the 2007 strategic plan was the result of a yearlong process, driven by sound, fundamental research and tested with business input throughout the state.

During the strategic planning process, participants articulated six guiding principles regarding economic development efforts.

- Pay attention to existing businesses, as they are already here and will continue to be an important part of the current and future Kansas economy.
- From a local perspective, hold the cities and counties harmless in regards to state economic development initiatives. State initiatives must not unwillingly shift the burden to local government, unless this shift has been requested.
- The state must be business and capital friendly to encourage growth and investment in Kansas.
- Every business matters in Kansas, whether small or large, the economic development strategy must recognize and assist all types of businesses.
- Limited economic development resources require focused efforts with measurable results.
- With limited resources, focus on the high-value targets through prioritization and addressing the most important issues first.

In our assessment, the expensing proposal set forth in House Bill 2751 meets each of these guiding principles. Expensing would provide an immediate income tax deduction for new capital investments for any business; it would be a pro-investment tax policy that would treat all businesses – small and large, equally. Expensing would also complement recent reforms to the machinery and equipment exemption and franchise tax, further distinguishing Kansas as a destination for capital investment. Expensing would essentially make the state an investment-driven partner for the economic benefit of all Kansans, with the only cost to the state being the time value of money when compared to depreciation. Expensing would be an option for businesses, and as an option it would remove tax bias and greatly simplify income tax administration for both the taxpayer and tax authorities. Strategy 24 within the Strategic Plan (attached to our testimony) specifically addresses the expensing concept from a business and tax climate perspective.

In conclusion, expensing provides an additional tool to that will better position our business tax climate for future economic growth. Again, thank you for the opportunity and we applaud the common sense approach of your Committee to build prudent policies for our future.

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## ***Business and Tax Climate***

***Mission – Create a tax and regulatory structure that is competitive and conducive for the growth of existing and new businesses of all sizes.***

### **Introduction**

*We have to recognize what we can and can't do, and focus on the areas where we can make an impact. Remember who and what got us here – every business matters.*

- Statewide Cell members, 2007 Strategic Planning process

From 1990 to 2004, only 3.2 percent of new jobs created in Kansas were created by companies moving into Kansas from outside the state. Expansions of existing Kansas businesses accounted for 39.8 percent of the new jobs, while new start-up businesses accounted for 57.0 percent.<sup>1</sup>

Kansas must have a competitive business and tax climate to nurture Kansas business of all sizes and in all stages. Throughout the state it was heard that every business matters, whether large or small, a start-up or multi-generational operation. Businesses must have a level playing field regarding state incentives. Kansas should not forget the businesses that grew our economy into what it is today. The focus should not be on just attracting companies to locate in Kansas as start-ups and expansions are important to the economy. Kansas must focus its efforts on a few specific issues instead of offering a vast array of complex incentives and other options. A focused business tax climate can provide the foundation for our future business. We need a capital friendly business climate that holds cities and counties harmless.

### **Strategy 24 – Remove barriers and be competitive for capital as it relates to business climate.**

#### **24-1 Consider implementing a form of universal expensing or 100 percent accelerated depreciation of all capital investment in Kansas, similar to the High Performance Incentive Program (HPIP), but applied to all businesses without regulatory barriers.**

Expensing would provide an immediate income tax deduction for new capital investments for any business. This would be a pro-investment tax policy with no subsidies, which treats all businesses – small and large, equally. Expensing would complement the recent competitive reforms related to property and franchise taxation and further distinguish Kansas as a destination for capital investment. Expensing would also make taxes more equitable, because it results in equal tax treatment among businesses of all types and sizes. The existence of an income tax makes the Kansas government a de facto silent partner in every Kansas business. Because it operates as an extension of U.S. income tax law, Kansas income tax law does not act as an investment-driven partner, and expensing would reverse the situation and turn the government into an investment-driven partner for the economic benefit of all Kansans. The state would become a true partner with businesses, with the only cost to the state being the time value of money when compared to depreciation. This recommendation would allow every business an election to expense capital investments and research and development investments in Kansas. It would allow unlimited carry-forward of unused expense, replace specific tax credits and allow businesses to keep tax credits already earned.<sup>2</sup>

Expensing is a little used depreciation procedure that removes tax bias and greatly simplifies income tax administration for both the taxpayer and tax authorities.

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<sup>1</sup> The Center for Applied Economics, School of Business, University of Kansas, 2006.

<sup>2</sup> Hall, Arthur. *Expensing: A Competitive Leap for Kansas Tax Policy*. The Center for Applied Economics, School of Business, University of Kansas, September 2007.

## **24-2 Study the effect of a reduction or elimination of the corporation income tax and the income taxation of capital gains.**

The information for this recommendation is primarily sourced from the Kansas Department of Revenue's *Analysis of Corporate Income Tax*<sup>3</sup> for the years 2000 – 2003 with historical information regarding the corporate income tax and the four 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 fell 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 updated conclusions for tax year 2003 remained similar to previous tax years: 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; and 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 revealed one important change – the retail sector, instead of the manufacturing 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.<sup>4</sup>

These and similar studies must continue to be part of the decision-making process regarding our business and tax climate.

## **24-3 Study the erosion of the property tax base and our property tax valuation methods.**

The information for this recommendation is primarily sourced from the Kansas Department of Revenue's *Erosion of our Property Tax Base*.<sup>5</sup> Threats to the financing of local governmental services are looming on the horizon throughout the nation. State and local policymakers in Kansas have largely avoided draconian measures concerning the property tax, but the property tax base in Kansas has steadily narrowed over the past century and been reduced substantially in the last twenty years. The property tax began as a simple tax on all wealth. Since it was adopted in Kansas in the mid-1800s, statutory and constitutional changes have transformed it into a tax that is largely a real estate tax supplemented by a tax on utility property and motor vehicles, both of which are declining in relative importance. In view of the importance of the property tax as a source of local government revenue, Kansas faces painful choices. Among the possible policies are the following:

- Continue on the current path. This choice will undoubtedly make financing local government more difficult and will raise the burden on residential property.
- Clean up the property tax laws and develop rational policy for exemptions and then examine all present and proposed exemptions in light of the policy.
- Return towards uniform and equal. Drafting and passing such an amendment would require the agreement of major interest groups and might require a commission or some kind of mini constitutional convention.
- Repeal all taxes on personal property and reconfigure local government and government functions so that local governments finance only property-related services from the property tax.
- Authorize local government broader access to sales and income taxes. This choice might be done by consolidating small governments or by creating more effective taxing districts.

These and similar studies must continue to be part of the decision-making process regarding our business and tax climate.

<sup>3</sup> *Analysis of Corporate Income Tax 2000-2002 Executive Summary October 15, 2004*, Kansas Department of Revenue, October 2004.

<sup>4</sup> Update to *Analysis of Kansas Corporate Income Tax To Reflect Tax Year 2003*, Kansas Department of Revenue, February 2006.

<sup>5</sup> Fisher, Glenn, and Crystal Gile. *Erosion of the Property Tax Base*, Hugo Wall School of Urban and Public Affairs, Wichita State University for the Kansas Department of Revenue, December 2006.



## **Strategy 25 – Create the opportunity for more efficient government.**

- 25-1 Provide incentives and remove barriers to allow for cooperation between local government, state government, and other entities. Examine and apply best practices when addressing the opportunity for more efficient government. Collaboration efforts must be initiated from the local level and not forced upon locals by the state. Hold cities and counties harmless.**

Technology presents several opportunities for local and state government, as well as businesses to increase their efficiency and expand their services. Whether state officials are improving government performance, recruiting businesses, examining the business climate or regulating industries, they must be aware of the latest technological trends to provide for the opportunity for efficient government interaction and collaboration. These efforts must be initiated from the local level and not forced from the state level.

Given common issues and opportunities that span beyond individual cities, counties, regions and even states, cooperation through formal agreements or informal collaborative mechanisms may provide the means to address economic development, homeland security, environmental protection, natural resources management, health care and other issues from a more regional scale.

Bringing opportunities to the local level on a statewide basis can be accomplished through these efforts, while holding the cities and counties harmless.

- 25-2 Encourage the increased participation with the Information Network of Kansas by all state and local government entities to improve government efficiency and provide access to government information and services at all levels.**

The Information Network of Kansas was created to provide Kansans equal electronic enterprise access to state, county, local, and other public information, as a government service administered for the good of the public, while benefiting from the entrepreneurial spirit and efficiencies found in private industry. Underpinning the overall strategy of INK is a unique partnership model that leverages the enormous wealth of knowledge and resources in all parts of the state sector. This model goes well beyond a simple aggregation approach to add significant value to the users through a rich offering of state and local government informational products and services and access to a committed and dedicated web development community.

The INK Strategic e-Government plan focuses on collaborating with state and local entities to create applications, which are enterprise in scope, highly integrated and transformational. The plan includes the following broad development themes organized around portal perspectives: Kansas Business Center, Legislative (e-Democracy), Transportation, Medical Services, Agriculture, Public Safety, and Education. The success of INK will ultimately depend on the added value that it can offer to its broad array of users. Using a variety of measurement tools, including surveys, customer service communication and feedback channels, site monitoring, focus groups and in-depth interviews involving both end users and partners, INK will generate detailed analysis to measure the value created by its offerings and how to better meet the needs of its users and partners.

## **Strategy 26 – Reduce state and local regulatory barriers to business.**

- 26-1 Develop and promote methods to reduce local and state barriers to a quality business atmosphere, such as reducing multiple licensing within and across communities, cities, counties, and the state. (addressed under 26-3)**
- 26-2 Develop a statewide network of task forces to improve the business and regulatory climate at the city, county and state levels. (addressed under 26-3)**
- 26-3 Move towards using technology from the state to provide electronic services to meet local government needs per their request.**

Many methods could be utilized on a routine basis by the state to access current information regarding state and local barriers to business. This information could be provided as it relates to industry clusters, sectors, regions, businesses and our core strengths.

Developing applications in partnership with INK could provide an online source of statewide information. Creating an ongoing statewide network of task forces, similar to the Kansas, Inc. Strategic Planning process, could provide the state with the necessary information to improve the business and regulatory climate at the city, county and state levels.

Recommending the Secretary of Commerce be appointed to the Information Network of Kansas Board could also provide continuity and insight regarding this strategy. As the State's lead economic agency, the Kansas Department of Commerce (Commerce) has a clear mission: to empower individuals, businesses, and communities to realize prosperity in Kansas. The inherent synergies between the mission of the Kansas Department of Commerce and INK suggest the head of the state's lead economic agency should be appointed by the Governor as one of the two Executive Branch chief executive officers as representatives to the INK Board, based on K.S.A. 74-9303. Currently the Secretary of Transportation and the Secretary of Revenue are on the Board as the Governor's appointments.

**Strategy 27 – Develop a tax structure, incentives, and regulations that are business-friendly and competitive on a local, state, national, and international level.**

**27-1 Create a contingency fund of \$40 million to be used at the discretion of the Department of Commerce to provide flexibility and funding above and beyond the current range of incentive programs to compete with other states and countries that provide large incentives for existing and new businesses and projects.**

Retaining existing businesses is important for the Kansas economy. Kansas needs an overall strategy to compete with other states and countries that offer large incentives to attract and retain businesses. This strategy should support the state's overall economic development strategy. While Kansas' current incentives are competitive, in many cases these may not be the most important factor when businesses decide to locate.

Every year states are confronted with hundreds if not thousands of offers and threats by businesses to move in or move out, taking or bringing with them tens of thousands of jobs. Businesses know all the information about the state, but the state doesn't now if the business is bluffing in its decision to move, or what the bottom line figure is that will influence its decision.<sup>6</sup>

We must maintain our current incentive package and look for additional ways to attract and retain businesses in Kansas. A contingency fund would assist the Department of Commerce in achieving its mission to empower individuals, businesses, and communities to realize prosperity in Kansas.

**27-2 Create a cross-agency team comprised of the Kansas Department of Commerce, Kansas Technology Enterprise Corporation, Kansas, Inc., Kansas Bioscience Authority, and Network Kansas to review existing and proposed regulations to ensure that they are not unnecessarily impeding economic development.**

The impact of state regulatory policies on economic development must be considered when agencies carry out their responsibilities. Individual policies designed to stimulate economic development sometimes work at cross-purposes, suggesting a need for greater coordination in development strategy

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<sup>6</sup> 2002 State New Economy Index, *Economic Development Strategies for the New Economy*, Progressive Policy Institute, 2002.

and tactics. Studies of the impact of state regulation on economic development are every bit as controversial and difficult to interpret as those evaluating the impact of tax and spending policies.<sup>7</sup>

The impact of regulatory policies on economic development should be explicitly weighed against other priorities by state agencies. Regulations that impose significant costs on business should not be enacted unless the expected benefits more than offset the costs and can be substantiated. Unnecessary regulations can discourage firms from locating or expanding in Kansas and should be eliminated to the extent possible.<sup>8</sup>

The cross-agency team should be given an opportunity to provide an evaluation or recommendation on proposed regulations that affect economic development.

### **27-3 Routinely study and benchmark parameters regarding our tax and regulatory structure and report recommendations to the Governor and Legislature.**

The Consensus Revenue Estimating Group is comprised of representatives from the Division of the Budget, Department of Revenue, Legislative Research Department and a consulting economist from the University of Kansas, Kansas State University, and Wichita State University. The group meets in the spring and fall of each year to make initial estimates for the budget year and revise estimates for the current year. The Group was organized to eliminate controversies between the Executive and Legislative branches over general fund revenue estimates and to establish a procedure whereby revised estimates for the current fiscal year would be made available to both the Governor and Legislature in December of each year so estimates could be used for planning purposes. The Executive and Legislative staffs also jointly review estimates periodically to determine whether more recent economic information or revenue trends warrant revisions of the estimates.

Due to the statutory strategic planning and benchmarking missions of Kansas, Inc., the agency should be involved at some capacity with this group. As an outgrowth of the 2007 Strategic Planning process, a group similar to the Academic and Policy Resource Team, consisting of individuals from several Regents institutions and state agencies should meet on a routine basis to discuss the overall economic landscape of Kansas beyond the scope of the Consensus Revenue Estimating Group.

### **Strategy 28 – Attract and retain national corporate headquarters in Kansas.**

Research has shown: national headquarters constitute only a small share of all business establishments; provide a small share of the economic base; are not very likely to move between regions; when they do move, the causes are typically outside the reach of state policy; and when they move for reasons that can be affected by state policy, the appropriate policies typically are ones that should not be targeted to headquarters as such. However, there are good reasons to develop a concrete strategy and policy on headquarters, as from time to time the legislature has considered or taken action to attract or retain establishments in Kansas.<sup>9</sup>

#### **28-1 Formalize what Kansas is doing right by targeting national headquarters and continuing to equalize state incentives.**

Kansas performs well at attracting and retaining national headquarters of medium-sized and multi-state corporations. We should build upon that success by recognizing headquarters as a desirable target in our economic development strategy. Recognizing that most headquarters in Kansas will collocate with operational units, attracting operational units is the key to attracting their attached headquarters. Of the remaining stand-alone headquarters, nearly all will locate in the largest metropolitan areas, and they

<sup>7</sup> Tannenwald, Robert. *State Regulatory Policy and Economic Development*, New England Economic Review, Federal Reserve Bank of Boston, March/April 1997.

<sup>8</sup> Redwood, Anthony, and Charles Krider. *Kansas Economic Development Study: Findings, Strategy, and Recommendations*, Institute for Public Policy and Business Research, University of Kansas, June 1986.

<sup>9</sup> Burrell, David. *Attracting and Retaining National Corporate Headquarters in Kansas*, Ad Astra Institute of Kansas for Kansas, Inc., November 2006.

require a concentration of professional business services, good airline connections, and a high quality of life. Headquarters will be contributing elements rather than major drivers of the Kansas economy. Particularly important in Kansas is the emphasis on startup support, K-12 education, quality of life, skilled workforce, technology development, and research universities. Kansas should endorse the existing practice of making national headquarters eligible for all relevant state-level incentives.

**28-2 Prioritize relevant elements of the existing strategic plan, including improving air travel connections, supporting local enterprise development, and assisting local firms in becoming multi-state firms.**

Limited air connections have posed an impediment to some headquarters' location in Wichita and to some extent in Greater Kansas City. Limited air connections affect many other establishments as well. Efforts to subsidize improved air travel have been expensive, but given their broad benefits they may be cost effective. Policymakers should monitor the impact of the 2006 Affordable Airfare Fund<sup>10</sup> on airline service in Wichita and consider cooperating with Missouri to secure an airline hub at Kansas City International Airport.

Homegrown startups, including low-tech, may have the potential to expand into national corporations. Enterprise development may be a tool that can assist startups, even though it is mainly targeted for different objectives. Also, some homegrown firms may start out as local to Kansas and expand into multi-state or international firms. Assistance from local and state government could help them with their expansion efforts.

**28-3 Consider new initiatives targeted to headquarters by preparing targeted place marketing materials and outreach campaigns.**

Many key factors affecting the location of existing corporate headquarters are either outside the control of state government, such as mergers, acquisitions, current location of owners; or else not easily targeted specifically to headquarters, such as airline service, quality of life, and startups. Incentives can be targeted to headquarters, but there is little data supporting narrowly targeted incentive programs. Based on this, we recommend only one fully targeted policy option – preparing targeted “place marketing” materials and outreach campaigns. Kansas must explain succinctly, with clear evidence, why Kansas is an attractive location for national corporate headquarters. It would be helpful if the campaign had a broader target, such as including branch headquarters and back offices as well. Working cooperatively with local governments would also be effective.

**28-4 Consider new initiatives of broader significance, including strengthening benefit recapture or claw back rules, efforts toward developing a cooperative policy on border competition, and providing for agency disclosure by site selection consultants operating in Kansas.**

Several policy options, while relevant to headquarters, would have much more general impacts. Existing recapture rules differ greatly between programs and in many cases are absent. Economic development contracts could provide for repayment of assistance in all instances where private profits materialize, and yet the intended public benefits to Kansas don't materialize due to relocation or other circumstances. Kansas should review the implications of border competition with Missouri and border cities. There could be real benefits from convening a body of interested governmental units to see if a basis of common interest could be established. Site selection consultants may lobby a city or landholder on behalf of a firm, or may try to sell a city location to a firm. In some cases, it is unclear whose interests the consultant is acting on, and incentives, outside interests, and other factors may send distorted signals likely to cause economically inefficient outcomes. Potential laws requiring full disclosure of agency agreements, similar to those covering real estate agents, could address this issue.

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<sup>10</sup> 2006 House sub. for Senate Bill 475 created the \$5 million Affordable Airfare Fund to be administered by the Department of Commerce and used to fund the program to provide more air flight options, more competition for air travel and affordable air fares for Kansas, including a regional airport in western Kansas.

## **A Permanent Economic Stimulus for Kansas**

By Arthur P. Hall

President Bush signed the Economic Stimulus Act of 2008 this week. Individuals and families will receive tax rebates. Businesses will receive greater tax deductions for capital investments made in 2008.

The business stimulus comes at an opportune time. The Kansas legislature is now debating a bill that will make the same type of tax deductions permanent for all Kansas businesses starting in 2009, a change that will leverage the federal stimulus and help make Kansas a permanently more desirable destination for capital investment, a key driver of high-wage jobs.

The Kansas legislation would allow all businesses an option to immediately deduct the full cost of an investment that federal rules disallow. It simulates at the state level a procedure that tax experts call "expensing," one of the key provisions in the federal stimulus package.

The Kansas expensing legislation emerged as a key feature of the state's strategic economic plan, as developed by Kansas, Inc., the agency statutorily responsible for crafting such plans. Community and business leaders from every part of the state helped craft the plan during dozens of meetings held last year.

An inspiring theme developed from the meetings: "Every business matters." Unwittingly or not, Kansas tax and economic development policies tend to play favorites. Yet, there is evidence that inclusive policies that create a level playing field for businesses of all types and sizes offer a superior long-term strategy.

Expensing is a tax policy that honors the level-playing-field strategy. Through a simple procedure, it allows businesses to perceive the same expected investment return that would exist if there were no income tax. This powerful outcome gives the same pro-investment benefit to each business, and will make Kansas more competitive, even against states without income taxes, like Nevada, South Dakota, and Texas.

Kansans would win a trifecta if the expensing legislation passed this year. In the past two legislative sessions, Kansas lawmakers have modernized the tax system in a pro-investment direction by eliminating the property tax on new machinery and equipment and phasing out the archaic business franchise tax. Both of these reforms apply automatically and equally to every business, honoring the sentiment that every business matters. Expensing offers the perfect next step in the modernization process.

A Washington, D.C. policy group has alarmed state budgeters with news that the business components of the federal stimulus package will flow through to states. The group's Kansas estimate is a reported \$87 million in lost revenue.

That number should be viewed with skepticism. It could be as low as \$37 million. And that does not count the potential for offsetting sales tax revenue from the household part of the

stimulus package: by mid-year, more than 1.2 million Kansas taxpayers will receive checks averaging about\$1,100.

Nevertheless, optimists can view the federal flow-through as an opportunity. Kansas budgeters can use 2008 to make budget adjustments that will accommodate the expensing provision in 2009 and beyond.

Economists can demonstrate that expensing gives the same investment return to the state as it does to each business—a genuine partnership. Investments require a short-term sacrifice to produce a long-term gain. Without a short-term budget impact there can be no long-term economic impact.

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Arthur P. Hall is executive director of the Center for Applied Economics at the University of Kansas School of Business.

###

**The Kansas, Inc. Expensing Proposal (HB 2751)**  
Implementation and Interaction with Federal Depreciation Rules

Prepared for Kansas, Inc. by  
Art Hall, Executive Director  
Center for Applied Economics, KU School of Business

Presented to the House Committee on Taxation  
February 13, 2008

**Overarching Goals:**

- Every business matters—strive for inclusive policies and a level playing field among businesses of all types and sizes.
- Build on the pro-investment initiatives passed in recent legislative sessions.
- Create a simple, low-cost procedure that allows business taxpayers to perceive the same expected investment return that would exist if there were no income tax.

**Federal Rules for Expensing (Section 179):**

- The “normal” expensing limit of \$25,000 will once again become law in 2011 if the increased limits in current law are not renewed.
- Before the Economic Stimulus Act of 2008, the expensing limits scheduled for 2008 were:
  - A maximum expensing amount of \$128,000 per taxpayer. (No real property.)
  - An investment limit of \$510,000. A taxpayer must reduce the \$128,000 amount dollar-for-dollar (but not below zero) for every dollar in which the cost of the eligible property exceeds \$510,000.
  - These amounts, indexed for inflation, will be the limits for 2009 and 2010.
- The Economic Stimulus Act of 2008 raised the 2008 expensing limits:
  - A maximum expensing amount of \$250,000 per taxpayer. (No real property.)
  - An investment limit of \$800,000.
- The Economic Stimulus Act of 2008 also implements “bonus depreciation” for 2008, which allows an additional depreciation amount equal to 25 percent of the cost of the property to be taken in years one and two. For example, a \$1,000 investment would get “bonus depreciation” of \$250 in year one and another \$250 in year two. The remaining \$500 would follow standard depreciation rules.

## Implementation: Understanding the Kansas Adjustment Factor

- The key—and novel—implementation feature of the Kansas, Inc. proposal relates to the “Kansas Adjustment Factor.” The list of adjustment factors can readily change to accommodate any new federal depreciation schedule. But unique items, like federal bonus depreciation and federal expensing, can be best handled by subtracting their dollar value from the Kansas investment amount before applying the Kansas adjustment factor.
- The set of adjustment factors currently listed in HB 2751 do not attempt to adjust for federal expensing (Section 179): Section 179 deductions get double counted, following the precedent of all current-law Kansas investment tax credits, which effectively double count federal depreciation.
- The set of adjustment factors currently listed in HB 2751, for simplicity, consolidate several federal depreciation schedules. For example, the adjustment factors for tangible personal property consolidate the “mid-quarter” conventions into the “half-year” convention. This consolidation promotes simplicity and has a minor impact on the value of expensing to the taxpayer.

### Calculating the Kansas Adjustment Factor: An Example

*Acme Call Centers has a state-of-the-art facility in Hays, Kansas. Acme purchases \$500,000 worth of new furniture to expand its call center. The CFO of Acme knows that furniture is classified as a 7-year form of property for federal depreciation purposes. She decides to use the 200% Declining Balance depreciation method (employing the half-year convention).*

Acme Call Centers' Federal Depreciation Deduction Schedule								
Year	1	2	3	4	5	6	7	8
Dollars	71,450	122,450	87,450	62,450	44,650	44,600	44,650	22,300

Present Value of Federal Depreciation Schedule (at 8% rate of interest, Year 1 not discounted):

$$388,500 = \frac{71,450}{(1.0)^1} + \frac{122,450}{(1.08)^2} + \frac{87,450}{(1.08)^3} + \frac{62,450}{(1.08)^4} + \frac{44,650}{(1.08)^5} + \frac{44,600}{(1.08)^6} + \frac{44,650}{(1.08)^7} + \frac{22,300}{(1.08)^8}$$

Difference between Full Investment Amount and Present Value of Depreciation:

$$\$500,000 - \$388,500 = \$111,500$$

Calculation of Kansas Adjustment Factor (Invariant to Investment Size)

$$\$111,500 \div \$500,000 = 0.223$$



Continuation of Example—Kansas Expensing under Adjustments for Federal Rules

Kansas Expensing Deduction with No Adjustment:

$$\$500,000 \times 0.223 = \$111,500$$

Kansas Expensing Deduction with Adjustment for Bonus Depreciation

*(Bonus Depreciation =  $\$500,000 \times 0.25 \times 2 = \$250,000$ )*

$$\$500,000 - \$250,000 = \$250,000 \times 0.223 = \$55,750$$

Kansas Expensing Deduction with Adjustment for Section 179

*(Federal Expensing Limit =  $\$128,000$ )*

$$\$500,000 - \$128,000 = \$372,000 \times 0.223 = \$82,956$$

## Legislative Testimony

**achieve**  
*more*

HB 2751

February 13, 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 supports tools and incentives that make Kansas more attractive as we compete for investment and jobs with other states. Expensing of capital investment is a new and innovative idea that will incent investment in the state and the Chamber is excited to exploring how it will make Kansas a better place for economic expansion and development.

The Kansas Chamber conducts an Annual Competitiveness Index that compares Kansas on over 80 indicators with other states. Kansas has lagged other states in Business Opportunity and Vitality. The Business Opportunity and Vitality measurement looks at start up companies and entrepreneurial activity in a state. Kansas ranks 45<sup>th</sup> among 50 states, indicating that businesses are not starting in Kansas as rapidly as they do in other states. Improvements need to be made so that atmosphere in Kansas can foster new companies and entrepreneurial activity in the state.

Expensing of investment is something that could help change the dynamics as businesses begin, grow, locate, expand, create jobs and invest in Kansas. Expensing is a tool that can be used to both foster new companies and attract companies to the state. Expensing can be a great incentive for businesses in Kansas.

Business incentives continue to be an important factor as businesses make decisions on where to locate, expand, invest and create jobs. Site selectors have ranked State and Local Tax Incentives fourth behind Corporate Tax Rate, Highway Accessibility and Labor Costs. In addition, the Kansas Chamber's 2007 CEO and Business Owners Poll ranks economic incentives for business as the third most important issue to their profitability, behind managing health care costs and lower taxes on business.

Because Kansas is lagging in Business Opportunity and Vitality and investment incentives are of critical importance to our members, the Kansas Chamber is committed to ensuring that the state's investment incentive programs are indeed an incentive for making investments in the State of Kansas.



The current investment incentive system has many problems, from the over \$300 million in outstanding, unused HPIP tax credits, to the very complicated, complex system we have put into place to apply and receive these credits. Only companies with sophisticated accounting departments and lawyers on staff can take advantage of these tax credits.

The business community is supportive an easier system that rewards all companies for capital investment in the state, regardless of size, sophistication and amount of investment. Economic growth and job creation is key as we work to make Kansas a more attractive place to locate, expand and crate jobs.

However, as we work towards a new system, we need to ensure that companies that take advantage of the current incentive system continue to be made whole. There needs to be a choice or election so that companies currently benefiting from the process can still benefit, but other companies, specifically small and medium sized businesses can have an incentive for investment as well.

At our December Board meeting, a policy was passed that instructed us to continue to work with partners on this issue. The policy states:

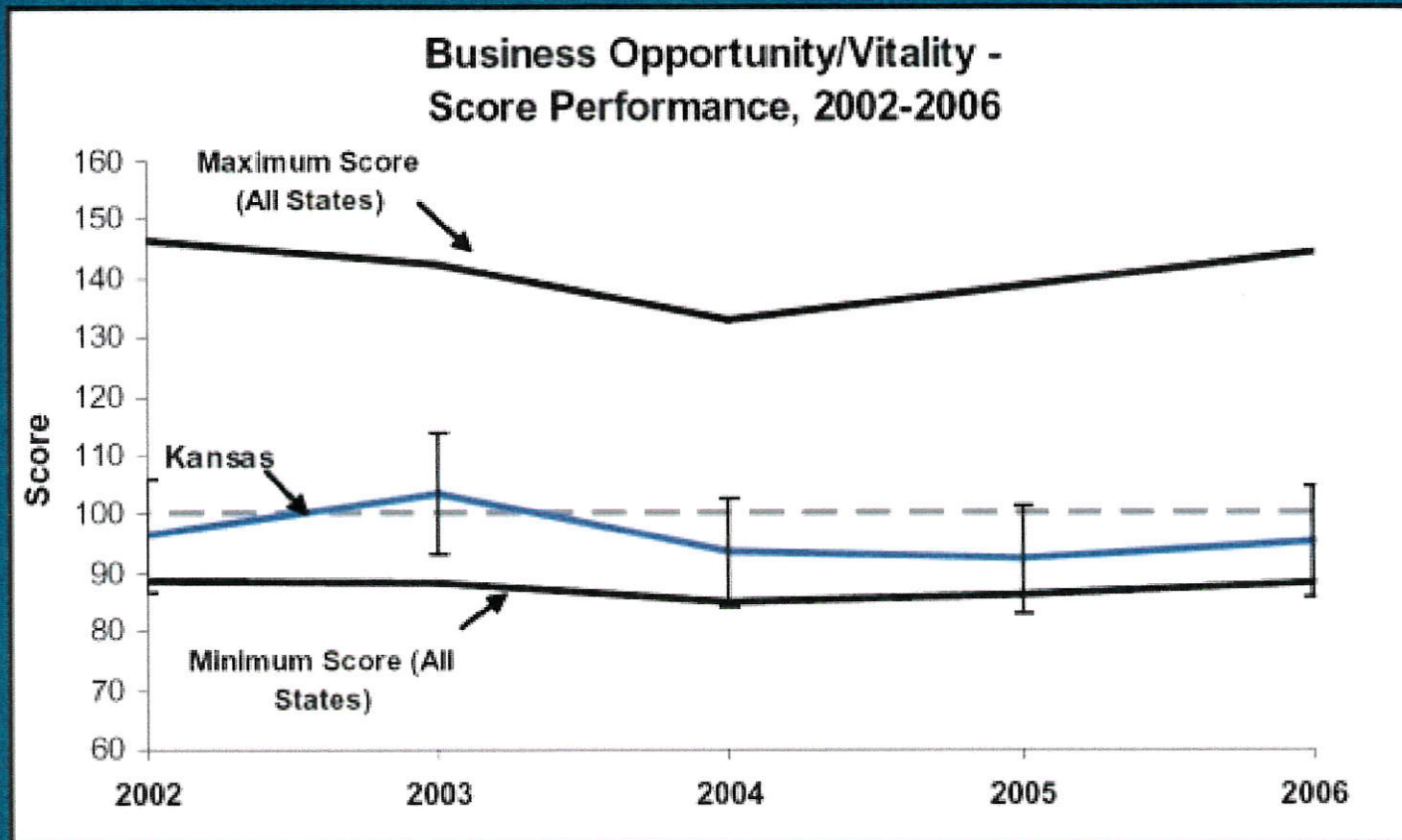
**Tax—Expensing of Investment**

The Kansas Chamber will work with partners to explore the pros and cons of direct expensing of capital investment. The Kansas Chamber will continue to be engaged in discussion of proposals that will allow all businesses an election to “expense” or immediately deduct the full cost of all capital investment and research and development investments made in the state of Kansas.

The Kansas Chamber is supportive of new and innovative ways to look at incentives for investment in the state and look forward to working with the Legislature as we continue the dialogue on expensing of investment for all Kansas companies.

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.*



Note: vertical bars show range of values within 10% of Kansas score.



**Wichita Independent Business Association**

*THE VOICE OF INDEPENDENT BUSINESS*

**Legislative Testimony**

**HB 2751**

**February 13, 2008**

**Testimony before the Kansas House Taxation Committee  
By F. Tim Witsman, President, WIBA**

Chairman Wilk and members of the committee:

The Wichita Independent Business Association supports efforts to increase business investment in Kansas. We are especially supportive when that legislation makes it less difficult for companies that lack the resources to devote entire departments to mastering the intricacies of an incentive to take advantage of the intent of the legislation.

The United States' economy measured by its gross domestic product consists of:

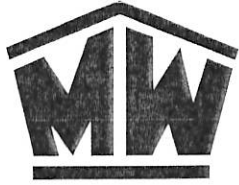
Consumption		70%
Government Spending	19%	
Business Investment		17%
Net Exports/Imports		-6%

Of these components only one has a positive multiplier, meaning that money spent in it creates multiples of that expenditure. That component is business investment. The amount of the multiplier varies by the type of investment and industry. If consumption is the charcoal of the economy, business investment is the lighter fluid. If it is government policy to increase income in a state or country, then tax policy should be geared to encourage investment because it can have the most positive impact on increasing income, expenditures, and tax receipts. That makes it good policy for the citizen and for the government that should take in more with a growing economy.

The Economic Recovery Act recently passed at the Federal level tries to increase both consumption and business investment. The Wichita region is unique in terms of how our gross domestic product works. Consumption has only a .48 correlation with our region's GNP. That is very different from the national correlation of .92. A correlation of 1.00 means a perfect correlation. In the Wichita region business investment has a .53 correlation with regional GDP. In essence, it has a stronger influence on our regional economy than consumption, making it the most important contributor to GDP growth in our region. Since our regional economy makes up roughly 22% of the state economy, that makes encouragement of investment by business a very wise decision for everyone in Kansas.

We concur with the Kansas Chamber's recommendation that we not take away the ability of some companies, usually larger ones, to utilize existing incentives through a choice or election.

HB 2751 provides the opportunity to do something that makes economic sense and improves the chances of medium and small business to grow the Kansas economy.



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Presentation to the House Taxation Committee  
February 13, 2008

By Kenneth L. Daniel  
C.E.O., Midway Wholesale, Topeka  
and  
Publisher, KsSmallBiz.com

Mr. Chairman and Members of the Committee:

My name is Kenneth Daniel. I am the C.E.O. of Midway Wholesale, a building materials distributor headquartered in Topeka with branches in six other Kansas Cities. I am also the publisher of KsSmall.Biz.com.

I strongly encourage you to support House Bill 2751.

The way I look at it, expensing is just "sudden depreciation". It will reduce this year's income, but it will increase future income for all years when regular depreciation would have been taken.

What I like is that I know how my company is doing this year, but I don't know how it will do in those future years. If I'm having a great year, I can go ahead and make that big investment, lowering this year's income. It also reduces my risk of losses in those future years, making it easier to stay profitable in those years.

If it is a good, profitable business move for me to buy an item, it will be a good, profitable move for the state, too.

The federal government already allows a certain amount of expensing for small businesses to reduce red tape and serve as an economic stimulus. Whatever the state can do to enhance it will benefit business in Kansas.

Large public corporations are unlikely to use expensing to any great extent.

Where it will really help is with the larger privately-owned businesses. The larger the privately-owned business, the more expensing will help them. My company will not be covered under the federal law for 2007 because we "invested too much".

Ironically, I think this will result in less income to the federal treasury from us over the next several years than if they had allowed us to expense.

I will be happy to answer any questions the committee might have.



The Voice of Small Business®

**Legislative Testimony  
Derrick Sontag, NFIB State Director  
House Bill 2751  
February 13, 2008**

Mr. Chairman and members of the committee:

Thank you for the opportunity to appear before you in support of House Bill 2751.

As many of you may know, NFIB/KS determines its' legislative agenda by balloting the more than 4,500 NFIB members in Kansas. A large majority of respondents must agree in order for the organization to advocate for the passage or defeat of the issue in question. This process allows the organization's legislative agenda to be determined by the thousands of Kansans who are operating small and independent businesses on a daily basis.

Specific to this issue, NFIB members have long supported the existence of expensing provisions on the federal level. The federal expensing mechanism has assisted small businesses with their efforts to expand or in some cases, start-up their businesses. With this in mind, NFIB/Kansas addressed the issue of small business expensing on the state level by crafting a question for the 2008 state ballot. **When asked if whether the state of Kansas should enact legislation that would allow all businesses an election to expense capital investments made in the state of Kansas, the results were as follows.**

*Yes: 81.5% No: 10.8% Undecided: 7.1% No Response: 0.6%*

House Bill 2751 would allow all taxpaying businesses the option of expensing or accessing applicable tax incentives when making qualified investments. The option of expensing is better suited for most small businesses as the current tax incentive structure has restrictions in place that make it difficult for small businesses to qualify or even apply for. HB 2751 would provide all Kansas small businesses an immediate deduction against their income taxes. Thus expensing recognizes the value of investments of all types and sizes.

On average, nearly 10,000 Kansas businesses are started in a given year and more than 5,000 expand. These businesses are small and typically encounter cash flow problems the first few years in existence and sometimes beyond. NFIB polling indicates that one in five small businesses encounter "consistent" cash flow problems, while one in two businesses encounter problems but not frequently enough to be considered consistent. **When determining how to address a cash flow problem, approximately 71% of small businesses will "adjust scheduled purchases/investments"**.

Implementation of a state expensing provision would help small businesses avoid making the decision to suspend investment decisions, due to cash flow concerns. Thus increasing the amount of capital investments made in Kansas, which would be of direct benefit to the Kansas economy. This tax structure would result in a win-win situation for those involved. Small businesses will be better prepared to carry out expansion projects

which often times results in an increase in jobs, while the state will benefit from the long-term realization of increased tax revenues due to the rise in the number of capital expenditures made in Kansas.

Enactment of this legislation would create an environment in which the state of Kansas encourages and recognizes the economic value of capital investments made by all businesses. This would build upon the work already done by this body in structuring a more business-friendly environment for businesses to own and operate a business in Kansas.

Policy determinations, such as those made in phasing out the franchise tax and removing property tax considerations from the purchase of machinery and equipment, have started Kansas down the road of establishing a simplified, uniform tax system that doesn't rely on government subsidies.

I would encourage the committee to carefully consider adoption of HB 2751. Passage of this bill will have a direct impact on the more than 300,000 small businesses in Kansas.

Thank you for your time and consideration on this important matter.

Derrick Sontag  
State Director  
National Federation of Independent Business/Kansas





# AMERICANS FOR PROSPERITY

K A N S A S

February 13, 2008

On behalf of the more than 13,000 Kansas members of Americans for Prosperity, we support HB 2751 as a way to increase the competitiveness of Kansas businesses.

The various current incentives programs seem to have limited success in Kansas.

The reasons for this are simple enough.

Wall Street is filled with firms and individuals who do nothing but try to pick winners and losers in the marketplace. These folks are paid a lot of money, yet still often fail on specific picks and they frequently miss new industries and trends. (Like the Internet!)

By passing HB 2751, the Legislature will take another positive step away from picking winners and losers and giving each Kansas business an equal opportunity to expand his or her business.

Investors purchase mutual funds because they lack the knowledge, or lack the time to acquire the knowledge, needed to become a market segment expert to give them the comfort needed to purchase stock in an individual company. By purchasing shares in a mutual fund, they are not picking a specific winner, but rather allowing the marketplace to diversify the investors' risk. Beyond this, only 20% of managed mutual funds beat the S&P 500. Even the experts within

The market beats managed mutual funds 80% of the time in a given year. This means that the generic marketplace outperforms even those fund experts with all of their knowledge.

HB 2751 would do much the same for you as Kansas policy makers.

Thank you for your time.

Alan Cobb  
AFP Kansas State Director

Duane Simpson

## Kansas Grain & Feed Association

# Kansas Agribusiness Retailers Association Association of Ethanol Processors



Ethanol - Made In Kansas

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Topeka, Kansas 66612

(785) 234-0461  
Fax (785) 234-2930  
www.KansasAg.org

### Written Statement in Support of Senate Bill 2751 House Taxation Committee Kenny Wilk, Chairman February 13, 2008

Thank you Mr. Chairman and members of the Committee; I am Duane Simpson, Chief Operating Officer and Vice President of the Kansas Grain and Feed Association (KGFA), Kansas Agribusiness Retailers Association (KARA) and Kansas Association of Ethanol Processors (KAEP). I am testifying on behalf of these organizations in support of Senate Bill 2751.

KGFA is a volunteer trade association that represents approximately 900 grain elevators, grain merchandisers, feed manufacturers and flour mills in the state. We represent over 98% of the commercially licensed grain storage in Kansas. KARA's 700 member firms are comprised primarily of 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. KAEP represents the ethanol manufacturing industry and its allied businesses in Kansas.

Under the current investment tax credit programs, many of our members either do not qualify for the tax credits or find it too difficult and time consuming to apply and receive them. We believe that this bill would make it more likely that our members would not only be eligible for the tax incentives, but they would actually receive them by being able to deduct full cost of their capital investment immediately.

Expensing removes the tax bias against small businesses that specialize in anything other than earning state tax credits. It levels the playing field and gives equal tax treatment to all businesses, making it a uniform and fair way of rewarding new capital investments in Kansas. We believe that all businesses should have the choice to expense their capital investments when they file their taxes rather than having to pre-qualify for tax credits through the Department of Commerce.

Each of our associations support an easier tax investment incentive system that ensures companies of all sizes are given an incentive to make investments in our state. Thank you for your consideration of this bill. On behalf of all of our members, I ask the committee to pass HB 2751.

HS Taxation  
2-13-08  
Attachment 10

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Testimony to the House Taxation Committee

Richard Cram

February 13, 2008

**Department Concerns with House Bill 2751**

Representative Wilk, Chair, and Members of the Committee:

House Bill 2751 would give all businesses the option of expensing depreciable property. This proposal would be unique among the states. The intent of the bill is to encourage business capital investment in Kansas.

The Department raises several concerns, first and foremost the proposal's staggering initial negative fiscal impact. The Department estimates that the fiscal impact in the first year of implementation would be negative \$68 million. The State of Kansas must by law balance its budget each year and maintain a specified ending balance. Unlike the federal government, the State cannot deficit-finance an incentive program of this magnitude. If revenues fall short of the budget, the budget must be cut. When the State each year must collect sufficient revenues to fund the programs and services that its citizens demand, allowing for full expensing of depreciable property against income makes little sense.

The textbook definition of depreciation is: "The allocation of the initial cost of an asset over its useful life. The annual expense of plant and equipment is matched against the revenues being produced." *Foundations of Financial Management*, Block and Hirt, McGraw-Hill 12<sup>th</sup> ed. (2008). When the business purchases an asset, that asset contributes to the production of income. A delivery business purchases a truck for making deliveries. If the truck were expected to be serviceable for 10 years, would it make sense to subtract the full cost of the truck from the business's income in the year of purchase when trying to accurately determine the profitability of the delivery business? As the *Accounting Workbook for Dummies* (Tracy, 2006, p. 78) aptly states: "Charging the entire cost of fixed assets to expense at the time they're bought or constructed wouldn't be very smart."

For federal income tax purposes, the taxable income for a business is determined after subtraction of applicable depreciation deductions. Following accounting concepts, the federal income tax code incorporates its own set of depreciation rules: the modified accelerated cost recovery system (MACRS), defining 9 classes of assets with useful lives ranging from 3 years (such as software) to 39 years (commercial real property). The useful lives for assets in the defined classes are quite generous. For example,

automobiles are classified as 5-year property, so are depreciated over 5 years. The actual useful life of an automobile typically far exceeds 5 years. In addition, the depreciation schedules set forth in the federal income tax code under MACRS are heavily front-loaded. For example, during the first 2 years of 5-year property, the MACRS permits depreciation deductions totaling of 52% of the asset cost.

Congress recently approved a stimulus package, H.R. 5140 (expected to be signed by the President today) that on top of MACRS, provides an addition one-time first-year depreciation deduction of 50% of the asset cost. For the remaining 50% of the asset cost, the business can take additional depreciation under the MACRS. The Joint Committee on Taxation explains this provision as follows:

Assume that in 2008, a taxpayer purchases new depreciable property and places it in service. The property's cost is \$1,000, and it is five-year property subject to the half-year convention. The amount of additional first-year depreciation allowed under the provision is \$500. The remaining \$500 of the cost of the property is deductible under the rules applicable to five-year property. Thus, 20 percent, or \$100, is also allowable as a depreciation deduction in 2008. The total depreciation deduction with respect to the property for 2008 is \$600. The remaining \$400 cost of the property is recovered under the otherwise applicable rules for computing depreciation.

This same stimulus package also increases the Section 179 expensing allowance to small businesses from \$128,000 to \$250,000.

Because the calculation of Kansas taxable income begins with federal adjusted gross income for individuals and federal taxable income for corporations, the depreciation deductions allowed under the federal income tax laws are already taken into account in determining the business's Kansas taxable income. The Joint Committee on Taxation estimates that these 2 provisions will negatively impact federal income tax revenues by \$44.8 billion in fiscal year 2008. The Center on Budget and Policy Priorities estimates this will translate to a \$2.9 billion revenue loss to the states, including a negative \$87 million impact on Kansas. The substantial federal tax relief granted to businesses in H.R. 5140 that will automatically reduce state revenues. Kansas can ill afford to dabble further in this area with House Bill 2751.

House Bill 2751 will add significant complexity to the tax laws by creating another set of depreciation rules different from federal law. In addition, if expensed assets are later sold, a new set of rules unique from federal law are also put in place for determining Kansas taxable gains or losses on the sale.

Section 2(e) allows a corporation to take the full expensing deduction against its Kansas taxable income, even though that same corporation may be doing business in several states and only a portion of its business income would be subject to Kansas tax. The State takes the full hit on the expensing, but can tax only part of the income.

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Revised January 30, 2008

## **BUSINESS TAX CUTS IN STIMULUS PACKAGE WOULD COST STATES BILLIONS OF DOLLARS**

By Nicholas Johnson and Iris J. Lav

States stand to lose billions of dollars in revenue under the business tax cuts in the stimulus package that the Bush Administration and House leaders announced January 25. Some 36 states would likely lose a total of about \$2.9 billion in revenue from the “bonus depreciation” and investment “expensing” provisions, due to the linkages between federal and state tax codes. (For state-by-state data, see below.) Under a slightly smaller stimulus package that has been proposed in the Senate, states would lose proportionately less (about \$2.2 billion). Some of the states that stand to lose revenue under the House or Senate packages, or both, already face significant fiscal problems from the weakening economy.

### **Revenue Loss Would Reduce Economic Benefits of Stimulus**

Such revenue losses would make any economic stimulus package less effective. That is, they would force states to cut services even more deeply and/or to raise taxes to an even greater degree than they would otherwise need to close their budget gaps. Unlike the federal government, states cannot run deficits; they must balance their budgets.

When states must cut programs to balance their budgets, they lay off workers, reduce payments to contractors, cut reimbursements to providers, or reduce benefit payments to individuals. This reduces the amount of money that people and firms have to spend and thereby reduces demand for private-sector goods and services. Tax increases have a similar effect. As a result, some of the added economic activity that arises from the business tax breaks in the stimulus package would be offset in part by states' actions to compensate for the revenue loss.

### **Most State Tax Codes Tied to Federal Code**

The revenue loss would occur for this reason: nearly all of the 47 states with corporate and/or personal income taxes (counting the District of Columbia as a state) base their taxes on the federal definition of income. When the federal government creates a new tax deduction or exemption or expands an existing one, this change typically flows through to the state tax calculation as well.

- Some 25 states are expected to lose revenue as a result of bonus depreciation, which allows corporations to claim a tax deduction for up to half of the cost of new investments in 2008 right away rather than spreading out the cost over several years. A preliminary estimate, based on a review of each state's tax code, suggests the bonus depreciation provision in the House package (apparently the product of negotiations among the Speaker, the Minority Leader and the President) could cost those 25 states \$2.9 billion. The bonus depreciation proposal in the Senate (which would spread the deduction over a longer period than the House proposal and hence cost the federal government \$36.6 billion in 2008 and 2009, compared to \$49.5 billion for the House proposal) would cost states proportionately less, \$2.2 billion. See the table below for state-by-state estimates of revenue losses.<sup>1</sup>
- At least 32 states would be expected to lose revenue due to the increase in Section 179 expensing included in both the House and Senate packages. (Section 179 expensing allows many smaller and mid-sized businesses to deduct all the costs of new investments right away, rather than spreading them out over several years.) The cost to those states would total about \$200 million. For the states that would be affected by this provision, see the table below.
- A few states also would lose revenue under the Senate's "net operating loss carryback" proposal, allowing businesses to claim refunds of taxes paid over the last five years if they experience losses this year. The states likely would include Alaska, Georgia, Missouri, and Oklahoma, and perhaps others.

### Many States Already Facing Budget Problems

These federal changes would not affect *every* state. A few states do not have income taxes; others have separated their tax codes from the federal code with regard to these types of provisions. A few states would be affected by one change but not the other.

Nonetheless, the breadth and high potential cost to affected states should give federal policymakers pause. So should the fact that many of these states already face substantial fiscal problems as a result of the economic downturn. **Already, 28 states are projecting budget deficits and, in the 19 states that have quantified their deficits for the upcoming fiscal year, they total at least \$32 billion.** That total will rise when additional states make estimates.

Because states have balanced budget requirements, they will be cutting spending and raising taxes to close these gaps — actions that can deepen the country's economic problems — *irrespective* of any business tax cuts Congress may enact as part of a stimulus package. But the business tax cuts now under discussion would increase the depth of the budget cuts or the amount of tax increases states would have to enact. **If these tax cuts become part of the enacted stimulus package, the provision of federal fiscal relief to the states will become even more urgent.**

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<sup>1</sup> A previous version of this analysis estimated that 30 states would lose revenue due to bonus depreciation, with total revenue loss of nearly \$4 billion. However, the House and Senate proposals are drafted in such a way that four states that originally appeared to be affected (Connecticut, Illinois, Massachusetts, and Pennsylvania) in fact will not be affected, and a fifth state (Vermont) will be affected to a smaller degree. (Specifically, the House proposal revises Section 168(k) of the Internal Revenue Code rather than creating a new section of code; this revision allows those five states to continue their current policy of rejecting Section 168(k) deductions — thereby avoiding revenue loss from bonus depreciation — without new state legislation.)

**STATES LIKELY TO LOSE REVENUE FROM HOUSE BONUS DEPRECIATION  
AND SECTION 179 EXPENSING PROPOSALS**  
All Figures in Millions of Dollars

State	Potential Revenue Loss from Bonus Depreciation	Potential Revenue Loss From Expensing	Total
<i>Alabama</i>	\$83	\$3	\$87
Alaska	15	1	16
<i>Arizona</i>	-	-	-
Arkansas	-	-	-
<i>California</i>	-	-	-
Colorado	104	5	109
<i>Connecticut</i>	-	7	7
Delaware	42	1	44
<i>Florida</i>	224	2	226
Georgia	-	10	10
Hawaii	-	-	-
Idaho	-	2	2
<i>Illinois</i>	-	12	12
Indiana	-	6	6
<i>Iowa</i>	-	-	-
Kansas	84	3	87
<i>Kentucky</i>	-	-	-
Louisiana	106	4	110
<i>Maine</i>	28	-	28
<i>Maryland</i>	-	-	-
<i>Massachusetts</i>	-	13	13
<i>Michigan</i>	162	8	170
<i>Minnesota</i>	-	-	-
<i>Mississippi</i>	-	2	2
<i>Missouri</i>	94	5	100
Montana	27	1	28
Nebraska	40	2	42
<i>Nevada</i>	-	-	-
<i>New Hampshire</i>	-	-	-
<i>New Jersey</i>	-	-	-
New Mexico	42	1	44
<i>New York</i>	795	40	835
North Carolina	275	12	287
North Dakota	16	0.4	17
<i>Ohio</i>	144	-	144
<i>Oklahoma</i>	85	3	89
Oregon	103	6	109
Pennsylvania	-	12	12
<i>Rhode Island</i>	28	-	28
<i>South Carolina</i>	-	4	4
South Dakota (bank tax only)	7	-	7
Tennessee	-	1	1
<i>Texas</i>	-	-	-
Utah	67	3	70
<i>Vermont</i>	7	1	8
<i>Virginia</i>	-	12	12
Washington	-	-	-
West Virginia	72	2	74
<i>Wisconsin</i>	-	-	-
Wyoming	-	-	-
D.C.	39	2	41
<b>Total</b>	<b>\$2,691</b>	<b>\$187</b>	<b>\$2,878</b>

States in italics are projecting deficits. See text for list of states affected by Senate "net operating loss" provision

Estimates assume a federal bonus depreciation plan that costs the federal government \$50 billion in fiscal years 2008 and 2009, as has been proposed in the House of Representatives. Estimates were derived by scaling the \$50 billion figure to the individual state level using state and federal corporate income tax collections data for FFY2007. States with revenue loss are those that under current state law would conform automatically to the revenue change, and/or that have conformed routinely to bonus depreciation changes in the past.

Sources: Commerce Clearing House State Tax Guide; state tax departments; CBPP review of state statutes.

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**DISTRIBUTIONAL EFFECTS BY FILING STATUS OF  
A PROVISION TO PROVIDE TAX CREDITS FOR INDIVIDUAL TAXPAYERS AS CONTAINED IN  
THE "ECONOMIC STIMULUS ACT OF 2008,"  
AS PASSED BY THE HOUSE OF REPRESENTATIVES AND THE SENATE ON FEBRUARY 7, 2008 (1)**

Calendar Year 2008

INCOME CATEGORY (2)	NUMBER OF RETURNS AFFECTED AND CHANGE IN FEDERAL TAXES (MILLIONS OF RETURNS AND DOLLARS)							
	Single Returns		Joint Returns		H of H Returns		Total Returns	
	Returns	Dollars	Returns	Dollars	Returns	Dollars	Returns	Dollars
Less than \$10,000.....	8.8	-\$2,845	1.1	-\$723	2.0	-\$1,288	11.8	-\$4,856
\$10,000 to \$20,000.....	16.2	-\$5,858	2.1	-\$1,782	3.6	-\$2,472	22.0	-\$10,112
\$20,000 to \$30,000.....	9.1	-\$4,554	2.5	-\$2,199	3.6	-\$2,864	15.2	-\$9,617
\$30,000 to \$40,000.....	7.7	-\$4,252	3.3	-\$3,311	3.2	-\$2,711	14.2	-\$10,274
\$40,000 to \$50,000.....	6.3	-\$3,701	3.8	-\$4,148	2.3	-\$2,072	12.4	-\$9,921
\$50,000 to \$75,000.....	8.7	-\$5,187	11.2	-\$13,824	3.1	-\$2,642	23.0	-\$21,652
\$75,000 to \$100,000.....	2.5	-\$1,096	10.4	-\$14,237	1.0	-\$681	14.0	-\$16,014
\$100,000 to \$200,000....	0.1	-\$32	15.2	-\$20,146	0.1	-\$22	15.4	-\$20,199
\$200,000 and over.....	(3)	-\$1	0.1	-\$49	(3)	(4)	0.1	-\$50
<b>Total, All Taxpayers....</b>	<b>59.4</b>	<b>-\$27,525</b>	<b>49.7</b>	<b>-\$60,419</b>	<b>19.0</b>	<b>-\$14,752</b>	<b>128.0</b>	<b>-\$102,696</b>

Source: Joint Committee on Taxation

Details may not add to total due to rounding.

(1) Distributes the effect of the tax credit for tax year 2008. Does not include amounts paid in rebates to individuals not eligible for the credit in tax year 2008. Taxpayers eligible for the credit because they receive VA disability income or VA DIC income are not included in the analysis. For this particular proposal, the distributional analysis does not include all behavioral effects.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 2006 levels. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.

(3) Less than 50,000.

(4) Decrease of less than \$500,000.



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**DISTRIBUTIONAL EFFECTS OF  
A PROVISION TO PROVIDE TAX CREDITS FOR INDIVIDUAL TAXPAYERS AS CONTAINED IN  
THE "ECONOMIC STIMULUS ACT OF 2008,"  
AS PASSED BY THE HOUSE OF REPRESENTATIVES AND THE SENATE ON FEBRUARY 7, 2008 (1)**

Calendar Year 2008

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Average Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$4,856	-117.5%	\$4	0.2%	-\$1	(5)	3.7%	-0.6%
\$10,000 to \$20,000.....	-\$10,112	-72.7%	\$14	0.7%	\$4	0.2%	3.7%	1.0%
\$20,000 to \$30,000.....	-\$9,617	-24.0%	\$40	1.9%	\$31	1.5%	9.2%	7.0%
\$30,000 to \$40,000.....	-\$10,274	-15.2%	\$67	3.2%	\$57	2.9%	12.1%	10.2%
\$40,000 to \$50,000.....	-\$9,921	-11.3%	\$88	4.2%	\$78	3.9%	14.3%	12.7%
\$50,000 to \$75,000.....	-\$21,652	-8.6%	\$252	12.0%	\$230	11.5%	16.3%	14.9%
\$75,000 to \$100,000.....	-\$16,014	-6.3%	\$254	12.1%	\$238	11.9%	18.4%	17.2%
\$100,000 to \$200,000....	-\$20,199	-3.3%	\$608	28.9%	\$588	29.4%	22.4%	21.7%
\$200,000 and over.....	-\$50	(5)	\$776	36.9%	\$776	38.8%	25.8%	25.8%
<b>Total, All Taxpayers.....</b>	<b>-\$102,696</b>	<b>-4.9%</b>	<b>\$2,103</b>	<b>100.0%</b>	<b>\$2,001</b>	<b>100.0%</b>	<b>19.6%</b>	<b>18.6%</b>

Source: Joint Committee on Taxation

Details may not add to total due to rounding.

- (1) Distributes the effect of the tax credit for tax year 2008. Does not include amounts paid in rebates to individuals not eligible for the credit in tax year 2008. Taxpayers eligible for the credit because they receive VA disability income or VA DIC income are not included in the analysis. For this particular proposal, the distributional analysis does not include all behavioral effects.
- (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 2006 levels.
- (3) Federal taxes are equal to individual income tax (including the outlay portion of the EIC), employment tax (attributed to employees), and excise taxes (attributed to consumers). Corporate income tax is not included due to uncertainty concerning the incidence of the tax. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis. Does not include indirect effects.
- (4) The average tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).
- (5) Less than 0.05%.

ESTIMATED BUDGET EFFECTS OF THE  
"ECONOMIC STIMULUS ACT OF 2008,"  
AS PASSED BY THE HOUSE OF REPRESENTATIVES AND THE SENATE ON FEBRUARY 7, 2008

Fiscal Years 2008 - 2018

[Billions of Dollars]

Provision	Effective	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2008-13	2008-18
<b>I. Recovery Rebates and Incentives for Business Investment</b>														
1. 2008 Recovery Rebate for Individuals - \$600 single filer (\$1,200 for joint filers); plus \$300 per qualifying child for the child tax credit; credit reduced by 5% of so much of the taxpayer's adjusted gross income as exceeds \$75,000 (\$150,000 for joint filers) [1]; and treatment of the U.S. Possessions [2].....	tyba 12/31/07	-106.7	-10.0	---	---	---	---	---	---	---	---	---	-116.7	-116.7
2. Disregard rebate income for purposes of means tested Federal programs [3].....	DOE	----- <i>No Budgetary Effect</i> -----												
3. Appropriations to carry out recovery rebates.....	DOE	-0.2	-0.1	---	---	---	---	---	---	---	---	---	-0.3	-0.3
4. Social Security Administration Funding [3].....	DOE	[4]	[4]	---	---	---	---	---	---	---	---	---	[4]	[4]
5. Increase Section 179 Expensing and Phaseout Amounts for 2008 (\$250,000 and \$800,000).....	tyba 12/31/07	-0.9	-0.6	0.5	0.3	0.2	0.2	0.1	0.1	---	---	---	-0.3	-0.1
6. 50% Bonus Depreciation for Property Placed in Service in 2008 [5].....	[6]	-43.9	-5.6	11.2	8.5	7.4	5.8	3.6	2.3	1.3	1.0	1.0	-16.7	-7.4
<b>Total of Recovery Rebates and Incentives for Business Investment .....</b>		<b>-151.7</b>	<b>-16.3</b>	<b>11.7</b>	<b>8.8</b>	<b>7.6</b>	<b>6.0</b>	<b>3.7</b>	<b>2.4</b>	<b>1.3</b>	<b>1.0</b>	<b>1.0</b>	<b>-134.0</b>	<b>-124.5</b>
<b>II. Housing GSE and FHA Loan Limits - Temporary Conforming Loan Limit Increase for Fannie Mae and Freddie Mac [3].....</b>														
	DOE	[4]	---	---	---	---	---	---	---	---	---	---	[4]	[4]
<b>NET TOTAL .....</b>		<b>-151.7</b>	<b>-16.3</b>	<b>11.7</b>	<b>8.8</b>	<b>7.6</b>	<b>6.0</b>	<b>3.7</b>	<b>2.4</b>	<b>1.3</b>	<b>1.0</b>	<b>1.0</b>	<b>-134.0</b>	<b>-124.5</b>

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. The date of enactment is assumed to be March 1, 2008.

Legend for "Effective" column: tyba = taxable years beginning after  
DOE = date of enactment

tyba = taxable years beginning after

\*Footnotes for JCX-17-08 appear on the following page]

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**Footnotes for JCX-17-08:**

[1] Some taxpayers will receive a refundable credit equal to \$300 (\$600 for joint filers) plus \$300 per qualifying child if the sum of the their earned income, Social Security income, VA disability income, and VA dependent indemnity compensation equals at least \$3,000. Only taxpayers with a valid Social Security number may receive the credit.

[2] Includes the following outlay effects:	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2008-13</u>	<u>2008-18</u>
a. Stimulus rebate for individuals.....	36.8	3.6	---	---	---	---	---	---	---	---	---	40.4	40.4
b. Treatment of the U.S. Possessions [7].....	1.0	0.3	---	---	---	---	---	---	---	---	---	1.3	1.3

[3] Estimate provided by Congressional Budget Office. Estimate is preliminary and subject to change.

[4] Increase in outlays of less than \$50 million.

[5] Estimate shown after interaction with section 179 provision.

[6] Effective for property placed in service after December 31, 2007, in taxable years ending after such date.

[7] Estimated outlay effects as a result of U.S. possessions provision provided by the Joint Committee on Taxation in consultation with the Congressional Budget Office.