

Chairman Caryn Tyson
Senate Committee on Assessment and Taxation
Kansas State Capitol
300 SW 10th Ave., Room 548-S
Topeka, KS 66612

RE: Testimony **OPPOSING** SB 306

Chairman Tyson and members of the Committee:

Thank you for allowing me the opportunity to present written testimony in opposition to SB 306. SB 306 is flawed, incapable of being effectively administered and poorly- reasoned tax policy. It would unfairly punish Kansas taxpayers without providing any state benefit. There is no compelling reason for its passage.

Principles of Good Tax Policy

As this committee is aware, the following are some of the fundamental principles of sound tax policy¹:

1. Equity and Fairness: Similarly situated taxpayers should be taxed similarly.
2. Neutrality: Taxes should neither encourage nor discourage personal or business decisions.
3. Simplicity: Tax codes should be easy for taxpayers to comply with.
4. Effective Tax Administration: Costs to administer and collect taxes should be kept to a minimum.

SB 306 violates each of these governing principles.

TEFFIs

TEFFIs are specialized trust companies subject to review and examination by the Office of the State Banking Commissioner. A TEFFI provides alternative asset investors with financing options, trust administration and custodial services, all delivered in a fiduciary capacity.

“Alternative assets” is a term referring to professionally managed investments which are not publicly traded. Examples include private equity, private real estate funds, venture capital funds, etc. - the same type of investments held by large institutional investors (such as KPERS).

These alternative assets are placed in Kansas trusts or Kansas custodial accounts which are administered by a TEFFI as trustee or custodian. As with any other investor, a TEFFI investor or customer recognizes gain or loss as prescribed by federal and state law. There are no special tax

¹ See: The Tax Foundation, *Principles of Sound Tax Policy*, www.taxfoundation.org and The Association of International Certified Professional Accountants, *Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals*, www.aicpa.org.

rules or loopholes applicable to the investment gain or loss of a TEFFI customer or a TEFFI investor.

Punitive to Kansans and Kansas Taxpayers

SB 306 would prohibit Kansas taxpayers from claiming losses on their Kansas income tax return arising from “any investment” in a TEFFI. Consider a simple example: Two taxpayers - one living in Kansas City, Kansas and the other in living Kansas City, Missouri. Both make an investment in a TEFFI (e.g., purchasing publicly traded stock of a TEFFI or its parent company). Both taxpayers sell their stock for a loss (i.e., the sales price is less than the original purchase price), meaning that they both have a **real** economic loss.

Both taxpayers would be entitled to recognize that loss on their respective federal income tax returns. In addition, the Missouri taxpayer would be entitled to recognize the investment loss on his/her Missouri income tax return (as would a taxpayer of any other state with a state income tax). However, SB 306 would prohibit the Kansas investor from recognizing the very same loss on his/her income tax return. Why? For no reason other than the taxpayer’s residency in Kansas and the industry he/she chose to invest in.

SB 306 would not only impact Kansas investors, but Kansas employees. The TEFFI Act requires a TEFFI to employ Kansans. A TEFFI may choose to issue stock to such employees as a part of an equity compensation plan. SB 306 would require the Kansas employee to recognize compensation income on the receipt of such stock but would then deny the Kansas employee from later claiming a loss if he/she sold the stock for an amount less than the compensation income previously recognized.

Stated differently, SB 306 would require Kansas taxpayers to pay Kansas income tax on any gain or compensation attributable to an investment in a TEFFI but would disallow any economic loss attributable to the very same investment.

SB 302 would further exacerbate the punishment of Kansas taxpayers by making the disallowance of losses **retroactive**. SB 306 provides that it is effective “For all taxable years beginning after December 31, 2021” meaning that the bill would apply to taxable year 2022 – a tax year which has closed and for which returns have already been filed. SB 306 would therefore require **every Kansas taxpayer** to review his/her 2022 tax filing and, if a loss in a TEFFI investment was recognized, file an amended income tax return and pay any associated tax, penalties and interest.

Well-reasoned tax policy should not impose such an inequitable treatment of the Kansas taxpayer/employee nor the draconian (and retroactive) tax result it produces.

Incapable of Efficient Administration and Enforcement

SB 306 is incapable of being effectively and efficiently enforced and would impose unnecessary burdens and costs on Kansas taxpayers and the Kansas Department of Revenue.

A TEFFI is likely to be a publicly traded company. If a Kansas investor were to make a direct investment in a TEFFI's publicly traded stock, the gain or loss associated with that investment might be easily ascertainable and enforcement of SB 306's disallowance of any loss relatively straightforward.

However, a Kansas investor could own (perhaps unknowingly) an investment in a TEFFI where the information is not easily, if at all, available. Assume that a Kansas resident invests in a mutual fund and the mutual fund invests in the publicly traded stock of a TEFFI. The mutual fund would issue a Form 1099 to the Kansas taxpayer listing the aggregate return the investor has achieved through his/her investment in the mutual fund. Will the Kansas taxpayer know if the mutual fund has invested in a TEFFI or that he/she has a loss from a TEFFI investment? Will the Kansas taxpayer or the Kansas Department of Revenue be able to ascertain the portion of that mutual fund investment attributable to a TEFFI?

Similarly, assume that a Kansas resident invests in a private equity fund and that private equity fund invests in a TEFFI or assume that the fund invests in a company that itself has made an investment in a TEFFI. Any attempt to determine the portion of the taxpayer's net return attributable to a TEFFI investment, if any, will be complex and complicated – if not impossible.

SB 306 would impose this complexity on **every Kansas taxpayer**, forcing them to perform an in-depth study of their investment portfolios and tax statements in a frustrating and perhaps costly effort to ascertain whether any portion of that portfolio includes an investment in a TEFFI. It is unclear whether many investment vehicles will even furnish the data necessary for the Kansas taxpayer to answer this question. Compliance with this bill will be costly and challenging, if not actually impossible.

Similar complexities and frustrations will arise for the Kansas Department of Revenue in attempting to administer and enforce this bill. There are no sound reasons or tax policy considerations that justify the creation of such enforcement complexity or the inequitable treatment of Kansas taxpayers.

Conclusion

SB306 violates fundamental principles of sound tax policy and unfairly targets Kansas taxpayers and employees. It creates inconsistencies by taxing income from a particular investment while denying the recognition of economic losses incurred from that very same investment. SB 306 hurts Kansans. It is incapable of being efficiently administered and would impose an undue burden on Kansas taxpayers and the Kansas Department of Revenue. I urge this committee to reject SB 306 and to vote against its passage.

Thank you again for allowing me to submit written testimony in opposition to this bill.



Sincerely,

A handwritten signature in blue ink that reads "Derek L. Fletcher". The signature is fluid and cursive, with a long horizontal stroke at the end.

Derek L. Fletcher
Trust Company President and Chief
Fiduciary Officer