MINUTES

SPECIAL COMMITTEE ON ASSESSMENT AND TAXATION

October 24-25, 2002
Room 519-S—Statehouse

Members Present

Representative John Edmonds, Chairman
Senator David Corbin, Vice Chairman
Senator Les Donovan
Senator Janis Lee
Senator Mark Taddikin
Representative Jerry Aday
Representative Deena Horst
Representative David Huff
Representative Nancy Kirk
Representative Bruce Larkin
Representative Bill Light
Representative Bonnie Sharp

Staff Present

Chris Courtwright, Kansas Legislative Research Department
April Holman, Kansas Legislative Research Department
Gordon Self, Revisor of Statutes Office
Gary Deeter, Committee Secretary

Conferees

Mark Beck, Director, Property Valuation Division, Kansas Department of Revenue
Bill Waters, Tax Attorney, Kansas Department of Revenue
Richard Cram, Director, Policy and Research, Kansas Department of Revenue
Patrick Hubbell, Kansas Railroads
Don Moler, Executive Director, League of Kansas Municipalities
Marlee Carpenter, Director of Taxation, Kansas Chamber of Commerce and Industry
Leslie Kaufman, State Director, Kansas Farm Bureau Public Policy Division
Martha Neu Smith, Executive Director, Kansas Manufactured Housing Association
Todd Johnson, Director, Stockgrowers Council and Membership, Kansas Livestock Association

Hal Hudson, State Director, National Federation of Independent Business
Joyce Bartel, Field Service Manager, Kansas Department of Revenue
Dedra Platt, Kansas Department of Revenue

Thursday, October 24
Morning Session

In the absence of the Chairman, the Vice Chairman called the meeting to order at 10:08 a.m. Mark Beck, Director, Property Valuation Division of the Kansas Department of Revenue (KDOR), introduced Topic 1, the legal issues related to granting income tax credits to railroads, saying that the income tax credit provided by KSA 2001 Supp. 79-32, 206 is presently being litigated between the State Board of Tax Appeals (SBOTA) and the Union Pacific Railroad. He noted that the wording used to extend the credit to railroads could be interpreted to extend the credit to all utilities. He then introduced Bill Waters, a tax attorney for KDOR, who provided (Attachment 1) addressing the issue. Mr. Waters said that the federal Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act) requires that railroad property be assessed for property tax purposes at the same rate as other commercial and industrial property. However, he said that federal courts have not ruled on whether the equity principle applies to taxes other than property taxes, an issue which should be resolved by the litigation between SBOTA and the Union Pacific.

Mr. Waters then turned to the second question at issue—whether the income tax credit provided by KSA 2001 Supp. 79-32,206 must be extended to public utilities, saying that utilities are classified differently from railroads and therefore do not fall under the statute, since uniformity is not required between classes under Kansas law; only sub-classes must be uniform and equal. He noted that the Kansas Supreme Court has not yet addressed the concept of parity across class lines, nor have they considered the tenuous principle that a tax credit for some taxpayers destroys tax uniformity and equality for all. In discussing the issue, members recalled that the intent of the tax credit was to apply only to railroads. Answering questions, Mr. Waters said the present draft proposal could be interpreted to apply to all utilities. Chris Courtwright noted that granting the tax credit to all utilities would cost the state $42 million.

Patrick Hubbell, representing Kansas Railroads, spoke in favor of granting a property tax credit to railroads for machinery and equipment expenditures (Attachments 2 and 3). He reviewed the 4-R Act and the special expenses applicable to railroads. He noted that the intent of the 2002 Legislature's SB 39 was to grant this credit only to railroads beginning in 2005, when the credit amount would be 20 percent. He promised that if the wording were acceptable, the railroads would not file for credits from previous years.

After further discussion among the members, *Senator Corbin made a motion, seconded by Senator Lee, to recommend that the Legislature clarify the intent of SB 39 to extend the tax credit only to railroads. The motion passed unanimously*.

Chris Courtwright reviewed the Family Development Account draft report and proposed legislation, the latter which was approved by the Senate during the 2001 and 2002 sessions (SB's 231 and 403), differing primarily in whether these accounts would reside with the Department of Commerce and Housing or the State Treasurer's office. The Legislative Coordinating Council approved a request to have the Special Committee further study the issue (Attachments 4 and 5). Gordon Self described the primary provisions of the bill: deposits not to exceed $2,000 per year, no account to exceed $50,000 total, the total of all accounts authorized per year not to exceed $ 0.5 million, and the accounts to be held by the State Treasurer.

After discussion among members, *a motion was made by Representative Light, seconded by Representative Aday, to endorse the concept of the Family Development Account Program, allowing interested parties to draft legislation during the next legislative session. The motion passed*.

Afternoon Session

Chris Courtwright briefed the Committee on the proposal to sunset sales tax exemptions (Attachment 6). The Chairman observed that the purpose of the discussion was to assess the concept of sunsetting the exemptions, not evaluate individual exemptions. Don Moler, Executive Director, League of Kansas Municipalities, spoke in favor of reducing sales tax exemptions, stating the negative impact that exemptions have on local government entities, whose funding base revolves around sales taxes and property taxes (Attachment 7). He recommended a hiatus on any subsequent sales tax exemptions and a comprehensive review of existing exemptions, deleting special interest exemptions, and retaining only those with merit. The Chairman noted that, because of the number of exemptions any review would require an incremental approach.

Marlee Carpenter, Director of Taxation, Kansas Chamber of Commerce and Industry (KCCI), opposed a sunset policy for tax exemptions, detailing the negative impact on businesses were such an approach to be implemented (Attachment 8). She said that rescinding sales tax exemptions would communicate instability to Kansas business owners and would make Kansas less attractive to prospective businesses. In response to a question, Ms. Carpenter said even if the overall sales tax rate were reduced by eliminating sales tax exemptions, the KCCI would still oppose such a move. However, she said the Chamber might agree to some selected removal of exemptions.

Leslie Kaufman, State Director for the Kansas Farm Bureau Public Policy Division, opposed any change in the status of sales tax exemptions (Attachment 9). She said sales tax exemptions were appropriate for agriculture, business, industry, and some not-for-profit groups. She noted that especially in agriculture, added expenses (such as eliminating a sales tax exemption) cannot be recouped by increasing the cost of items sold, since agriculture is at the mercy of market forces beyond its control in setting prices for products. Ms. Kaufman recommended considering exemptions on a case-by-case basis rather than by a general policy decision.

Martha Neu Smith, Executive Director, Kansas Manufactured Housing Association, spoke in opposition to any sunset provision for state sales tax (Attachment 10). She traced the history of exemptions applying to manufactured housing, saying that affordable housing is important for Kansas citizens and noting that rescinding exemptions for manufactured housing would add financial hardship to low-income families dreaming of owning their own home.

Todd Johnson, Director, Stockgrowers Council and Membership, Kansas Livestock Association (KLA), spoke against sunsetting sales tax exemptions affecting livestock and agriculture (Attachment 11). He stated that these exemptions were instituted to stimulate the agricultural economy; revoking such exemptions would further constrict a struggling industry. Answering questions, Mr. Johnson said he would oppose recision only on those exemptions applicable to the KLA.

Hal Hudson, State Director, National Federation of Independent Business, urged the Committee to delay any sunset of sales tax exemptions until the beginning of the fiscal year after enactment, *e.g.,* enacted in FY 2003, effective date FY 2005 (Attachment 12). He noted that late notification of changes creates needless problems for small business owners.

Members raised the question of sales and use tax collection on Internet sales with Richard Cram, Director, Policy and Research, Kansas Department of Revenue. He said if a company has a "nexus" in the state and acts as an agent for an Internet company, the .com clearly owes Kansas sales tax on sales to Kansas citizens. He said that if a company has no nexus in the state, the issue is less clear, but that presently KDOR is taking action to collect sales taxes from all Internet companies who make sales to Kansans.

Written testimony was submitted as follows:

- the Kansas Association of Counties (Attachment 13) supporting a sunset of sales tax exemptions;

- Alan Alderson, Legislative Counsel for Southwestern Association, opposing the elimination of sales tax exemption for farm machinery and equipment; (Attachment 14); and

- Kathy Damron, legislative advocate for the YMCAs of Kansas, opposing any recision of sales tax exemptions for not-for-profit agencies in Kansas (Attachment 15).

After discussion, the Committee chose to take no action on the issue of sunsetting sales tax exemptions.

April Holman briefed the Committee on Topic 6 regarding collecting sales tax on firearms purchased from out-of-state and shipped to Kansas. She referred to Attachment 16, a letter from Pat Livingston, a pawnshop owner in Ogden, Kansas, who complained that some gun dealers are acting as receiving agents for out-of-state gun sales to individuals in Kansas without collecting sales tax. Ms. Holman noted that the issue is one of enforcement, not a proposed change in the law.

Richard Cram and Joyce Bartell, Field Service Managers, KDOR, explained the applicable law regarding "isolated and occasional" exemptions to sales tax law, however, vendors at gun shows, arts and craft shows, trade shows, etc., are retailers and subject to Kansas sales tax laws (Attachment 17). Mr. Cram said an item is exempt from sales tax if the person did not acquire the item with the purpose of reselling it and only makes one sale in a 12-month period, a policy which applies to farm sales, garage sales, and estate sales. He said since the 1998 federal Brady law permits firearms to be sold only by a federally-licensed dealer, who must conduct a background check on any purchaser and receive a photo identification of that purchaser, any dealer who acts as a shipping agent for an individual purchasing a firearm from out of state is in violation of both federal and state laws. Ms. Bartell outlined the procedure for collecting sales tax from the more than 200 trade shows that occur annually in Kansas, totaling some 5,000 vendors. She said the department has simplified the process (decreased paperwork, Internet registration) to encourage compliance from vendors.

The minutes for the September 19-20, 2002, meeting were approved. (Motion, Representative Horst, second, Representative Sharp.)

Friday, October 25
Morning Session

Chris Courtwright reviewed the draft Committee report on the Motor Fuels Tax, a report which proposes to move the point of taxation on motor fuel to the supplier level, otherwise known as "tax at the rack" (Attachment 18). The change was proposed during the 2002 Legislative Session by SB 537, which would allow out-of-state terminal suppliers to pre-collect and remit taxes on motor-vehicle fuels imported from another state into Kansas in the same manner as taxes paid if the fuels were in-state, except that the 2.5 percent shrinkage allowance would be amended (2.25 percent to the distributor, 0.25 percent to the supplier). KDOR estimates a $1.5 million increase in collections for FY 2003 and $3 million annually thereafter. Mr. Courtwright offered several options, which included reintroducing SB 537 to the 2003 Legislature, or modeling a proposal on legislation adopted by other states. Answering questions, Dedra Platt, KDOR, said the legislation stalled during the 2002 Session because KDOR and the petroleum industry could not agree on the language of the bill. The industry wanted to model the legislation using Missouri's statute.

A motion passed unanimously recommending KDOR continue to negotiate with the petroleum industry to work out differences with the expectation of passing legislation during the 2003 Session. (Motion, Senator Lee, second, Representative Larkin.) Senator Lee commented that her motion is neutral regarding the tax-at-the-rack concept.

Mr. Courtwright reviewed the State General Fund (SGF) receipts for July-September, the first three months of FY 2003, noting the continued downward cycle (down $59.6 million below estimates) (Attachment 19). Members discussed the implications of this trend. Mr. Courtwright extrapolated from data a possible shortfall of $455 million in FY 2003. He said the tax increase mandated by the 2002 Session was producing less revenue in sales and other taxes, but was producing slightly more from the cigarette tax. Senator Lee requested the actual receipts for the past four years (July-September) to view possible trends.

April Holman introduced a draft report re-evaluating KSA 79-1439A relating to the property tax treatment of independent living centers, a reassessment prompted by SB 479 during the 2002 Legislative Session, which would eliminate the property tax exemption (Attachment 20). Senator Emler testified that the proposed recision was prompted by abuse of the exemption by independent living centers. Testimony on the bill noted several inequities which deny counties revenue and unfairly discriminate against low-income citizens. Answering questions, Ms. Holman said eligibility for the exemption was expanded in 1999, when the Legislature amended KSA 79-201b, Fifth based on I.R.S. Revenue Ruling 72-124. After much discussion of options, *Senator Lee made a motion, seconded by Senator Corbin, to recommend formation of a working group early in the 2003 Legislative Session selected by the Senate Assessment and Taxation Committee Chairman and the House Taxation Committee Chairman, using SB 479 to develop appropriate legislation by February 1, 2003. The motion passed*.

Members discussed the agenda for the November meeting and adjourned at 11:39 a.m. The next meeting is scheduled for Thursday, November 14, 2002.

Prepared by Gary Deeter
Edited by April Holman and Chris Courtwright

Approved by Committee on:

November 14, 2002