Legal Services
109 SW 9th Street
PO Box 3506
Topeka KS 66601-3506

Kansas
Department of Revenue

Phone: 785-296-2381
Fax: 785-296-5213
www.ksrevenue.org

Mark Burghart, Secretary

Laura Kelly, Governor

February 26, 2024

House Committee on Taxation

Testimony of The Kansas Department of Revenue in Support of House Bill 2796

by Michael Hale and Jordan Heller

The Honorable Adam Smith, Chairman House Committee on Taxation, and Members of the Committee:

The Department of Revenue respectfully submits the following testimony to the Committee in support of House Bill 2796.

Under Kansas law, a corporation is responsible for paying corporate income tax on its business income. Apportionment is the process of dividing the corporation's business income among the states in which the corporation conducts business by using a formula. The purpose of using an apportionment formula is to attribute to each state its fair share of the total business income of the corporation. Every state has adopted an apportionment formula by statute.

<u>Single Sales Factor</u>

The traditional apportionment formula takes the average of three percentages or "factors" and multiplies that average by a corporation's business income. The three factors included are commonly referred to as the "property factor," the "payroll factor," and the "sales factor."

Many states have moved away from the three-factor formula and have adopted formulas that use a single sales factor. As of now, Kansas is one of only five states that continue to use the three-factor formula for apportionment. Idaho is the most recent state (2021) to move away from the three-factor formula and toward the single sales factor formula. States have changed to a single sales factor formula in their statutes to accomplish three primary goals: 1) to reflect the changing business models of the 21st century – which is trending more towards service industries; 2) to increase employment and investment in their state; and 3) to become uniform with other states, making filing more efficient and less burdensome for corporate income taxpayers.

<u>Market Based Sourcing</u>

Currently, in Kansas, calculating the allocable sales of intangible personal property or services, within the sales factor, requires determining the location of the transaction's income producing activity. If the income producing activity is performed inside and outside Kansas, then sales are attributed to the state which has the greatest proportion of the income producing activity, based on a cost-of-performance measurement. The cost-of-performance measurement was adopted in 1967 when most sales – even intangible sales – were done in state. Since that time the US and Kansas economy have dramatically shifted toward a service-based economy. This, coupled with the advent of the internet in the 1990s and the explosion of e-commerce and digitizing of commodities, allows for most corporations to do business nationally and internationally. The current cost-of-performance measurement requires a corporate income taxpayer with activities both inside and outside of Kansas to go into a lengthy, time consuming and costly analysis to determine its sales in Kansas. Kansas is one of the last few states to retain the cost-of-performance measurement.

Many states that have adopted a single sales factor formula have also adjusted their method for sourcing sales of non-tangible personal property or services within the state to a market-based measurement. This market-based measurement assigns sales of intangible personal property or services to where the service or property is received, rather than performed. The same goals and reasons for adopting a single sales factor formula also apply to why Kansas should adopt a market-based sourcing measurement.

The Multistate Tax Compact

The original Multistate Tax Compact was adopted and put into Kansas statute by the legislature in 1967. Comparable statutes were also adopted within the Kansas Income Tax Act, so that ultimately, the two acts would mirror each other. Over time, the Kansas Income Tax Act has been amended, but not all similar sections of the Multistate Tax Compact, adopted into Kansas statutes, were amended. These differences have created conflict between the acts. The proposed legislation makes it clear that the Kansas statute controls over the Multistate Tax Compact and removes the concern that Article III of the Multistate Tax Compact enables taxpayers to make an election, whether for apportionment purposes or for classifying income, which would be in contradiction to what is required by the Kansas Income Tax Act. All the other states have adopted a similar statutory clarification.

Administrative and Policy Implications

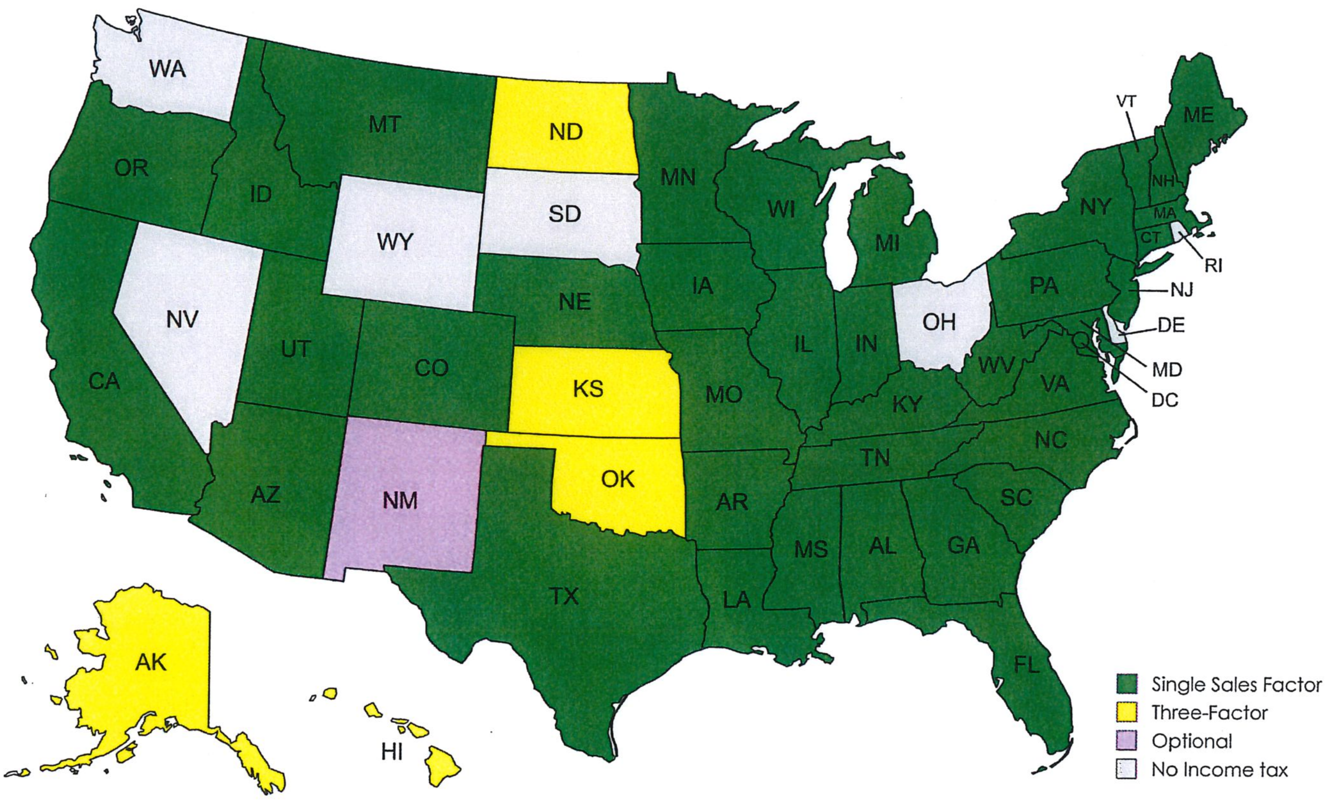
This legislation would align Kansas with most states in how it apportions and sources sales for purposes of calculating corporate income tax. Using uniformed methods for apportionment formulas and sourcing measurements creates savings in compliance costs for businesses. Kansas would treat their factor and sourcing the same as nearly every other state – which avoids having to identify specific data and generate unique returns for filings in Kansas. The Department too, will be able administer and enforce the Kansas tax laws more efficiently.

Additionally, in-state businesses may experience a reduction in corporate income tax liabilities as they no longer will be including the value of their property or payroll as measurement of their activity in Kansas. This, in turn, may spur additional investment in infrastructure in Kansas and result in the creation of new jobs within the state. In-state businesses will also benefit by being on a level playing field with out of state companies doing business in Kansas. Out-of-state business may benefit from a more streamlined measurement of sales and sourcing, which will be much easier for them to administer, and will reduce their costs of compliance.

Fiscal Impact

In general, the revenue effect of this proposed legislation would likely trend toward being nearly neutral.

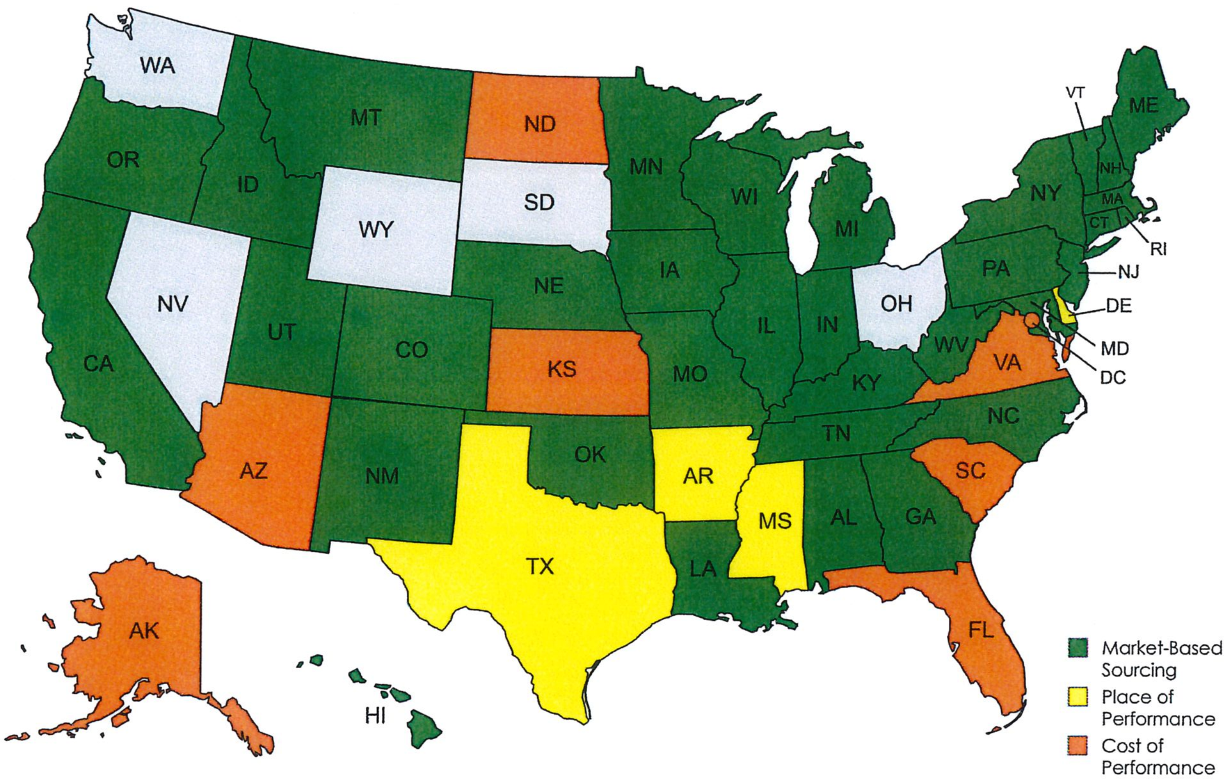
Sales/Receipts Factor Weighting



Sales factor States	3 Factor States	Optional States	No Income Tax States
Alabama	Alaska	New Mexico	Nevada
Arizona	Hawaii		Ohio*
Arkansas	Kansas		South Dakota
California	North Dakota		Washington
Colorado	Oklahoma		Wyoming
Connecticut			
Delaware			
Florida			
Georgia			
Idaho			
Illinois			
Indiana			
Iowa			
Kentucky			
Louisiana			
Maine			
Maryland			
Massachusetts			
Michigan			
Minnesota			
Mississippi			
Missouri			
Montana			
Nebraska			
New Hampshire			
New Jersy			
New York			
North Carolina			
Oregon			
Pennsylvania			
Rhode Island			
South Carolina			
Tennessee			
Texas			
Utah			
Vermont			
Virginia			
West Virginia			
Wisconsin			
Dist. of Columbia			

* Ohio has a Commercial Activity Tax

Sales/Receipts Factor Sourcing



Market Based Sourcing States	Cost of Performance States	No Income Tax States
Alabama	Alaska	Nevada
Arizona	Arkansas	Ohio *
California	Delaware	South Dakota
Colorado	Florida	Washington
Connecticut	Kansas	Wyoming
Georgia	Mississippi	
Hawaii	North Dakota	
Idaho	Texas	
Illinois	Virginia	
Indiana		
Iowa		
Kentucky		
Louisiana		
Maine		
Maryland		
Massachusetts		
Michigan		
Minnesota		
Missouri		
Montana		
Nebraska		
New Hampshire		
New Jersey		
New Mexico		
New York		
North Carolina		
Oklahoma		
Oregon		
Pennsylvania		
Rhode Island		
South Carolina		
Tennessee		
Utah		
Vermont		
West Virginia		
Wisconsin		
Dist. Of Columbia		

* Ohio has a Commercial Activity Tax