

Approved: 2/2/93
Date

MINUTES OF THE HOUSE COMMITTEE ON TAXATION.

The meeting was called to order by Chairperson Keith Roe at 9:00 a.m. on January 28, 1993 in Room 519-S of the Capitol.

All members were present except:

Committee staff present:

Chris Courtwright, Legislative Research Department
Don Hayward, Revisor of Statutes
Bill Edds, Revisor of Statutes
Lenore Olson, Committee Secretary

Conferees appearing before the committee:

Mark Burghart, General Counsel, Kansas Department of Revenue
Alan Alderson, Home Builders Association of Greater Kansas City
Janet Stubbs, Home Builders Association of Kansas

Others attending: See attached list

Chairperson Roe opened the hearing on HB 2114.

HB 2114 An act relating to sales taxation; concerning the treatment of contractors, subcontractors and repairmen for retailer's retail sales tax purposes.

Mark Burghart, Kansas Department of Revenue, testified in support of HB 2114 and said that this bill amends several definitions in the retailers' sales tax act. Mr. Burghart also said that this bill is intended to address a number of concerns which have surfaced with regard to the treatment of contractors and the computation of gross receipts for sales tax purposes as shown on (Attachment 1). Mr. Burghart responded to questions and said that this is one of the most difficult tax issues faced by the Department of Revenue.

Alan Alderson, Home Builders Association of Greater Kansas City, testified in opposition to HB 2114. He stated that one portion of the bill is clearly intended to overrule a Kansas Court of Appeals case known as Bernie's Excavating and the Home Builders Association is opposed to this particular provision. Mr. Alderson asked to be allowed to submit an additional written response to the Committee after he has discussed the bill with his clients (Attachment 2).

Janet Stubbs, Home Builders Association of Kansas, testified in opposition to HB 2114 based upon the Association's understanding that the intent of this legislation is to enable the collection of sales tax on the service of excavation. Ms. Stubbs asked how a contractor is to tax when he takes material out of his inventory located at his business site and he does a job at a site where there is a lesser local option tax or no local option tax. Ms. Stubbs asked to be allowed to submit an additional written response after she reviews this bill with the members of the Home Builders Association of Kansas (Attachment 3).

Chairperson Roe closed the public hearing on HB 2114 and added that before any action on this bill would be taken the public hearing would probably be reopened.

Chairperson Roe requested the Committee to turn their attention to HB 2090, HB 2091, HB 2092 and HB 2093.

A motion was made by Representative Empson, seconded by Representative Brown, to report HB 2091 favorable for passage. The motion carried.

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON TAXATION, Room 519-S Statehouse, at 9:00 a.m. on January 28, 1993.

A motion was made by Representative Larkin, seconded by Representative Empson, to pass HB 2092 favorably. The motion carried.

A motion was made by Representative Empson, seconded by Representative Grotewiel, to pass HB 2090 favorably. The motion carried.

A motion was made by Representative Larkin, seconded by Representative Wagnon, to pass favorably HB 2093.

A substitute motion was made by Representative McKinney, seconded by Representative Lahti, to amend HB 2093 by removing Section 1. The motion to amend carried with 13 affirmative votes.

A motion was made by Representative Crowell, seconded by Representative Mollenkamp, to report HB 2093 adversely. The motion failed.

A motion was made by Representative Wagnon, seconded by Representative Adkins, to pass HB 2093 favorably as amended. The motion carried.

After Committee review, the minutes of January 27, 1993, were approved as printed.

The meeting adjourned at 10:10 a.m.

The next meeting is scheduled for February 1, 1993.

Date: 1/28/15

GUEST REGISTER

HOUSE COMMITTEE ON
ASSESSMENT AND TAXATION

[illegible]

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Department of Revenue
Legal Services Bureau

MEMORANDUM

To: The Honorable Keith Roe, Chairman
House Committee on Taxation

From: Mark A. Burghart, General Counsel
Kansas Department of Revenue

Date: January 28, 1993

RE: 1993 H.B. 2114

Thank you for the opportunity to appear on H.B. 2114. The bill amends several definitions in the retailers' sales tax act. It is intended to address a number of concerns which have surfaced with regard to the treatment of contractors and the computation of gross receipts for sales tax purposes. The bill is designed to accomplish the following:

1. Correct the problems caused by the Court of Appeals decision in *In re the Matter of the Appeal of Bernie's Excavating Company, Inc.*, 13 Kan. App. 2d 476 (1989).
2. Codify the Department of Revenue's policy regarding the computation of the gross receipts on construction contracts that was first published by the Department in 1972 and which has been utilized since that time.
3. Amend K.S.A. 79-3602(r) which cannot be reconciled with either K.S.A. 79-3603(l) or the voluminous case law that recognizes that contractors consume the materials they use in their construction contracts. The definition in its current form is nonsensical and cannot be reconciled with many other sales or use tax statutes.
4. Clarify the statutory basis for imposing sales tax on withdrawal from inventory for a business's own use and consumption.
5. Clarify that sales tax is accrued on withdrawals from a resale inventory.

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6. Provide a specific imposition on charges for excavation services under certain types of contracts.
7. Clarify existing law for cartage operations

GROSS RECEIPTS CONCEPT

The Kansas sales tax is a gross receipts tax. Stevens Enterprises, Inc. v. State Commission of Revenue and Taxation, 179 Kan. 696, 705-706, 298 P.2d 526 (1956). The term gross receipts, as used in most states, means the total of all sales made during a given period. It includes the amount received in money, credits, property or other money's worth in consideration of sales at retail within the state without deduction for the cost of the property sold, materials used, labor or service cost, or any other expense. In construing tax schemes which impose a "gross receipts" tax, courts have repeatedly refused to sever taxable from non-taxable portions of a billing. Courts have held that "gross receipts" taxes permit sales tax to be levied on receipts that include: (1) federal excise taxes, Gurley v. Rhoden, 421 U.S. 200 (1975), Martin Oil Service, Inc. v. Department of Revenue, 49 Ill. 2d 260, 273 N.E. 2d 823 (1971); Undercofler v. Capital Auto Co., 111 Ga. App. 703, 143 S.E. 2d 206 (1965), (2) labor and installation costs, Ferguson v. Cook, 215 Ark. 373, 220 S.W. 2d 808 (1949), (3) transportation costs, Belverdere Sand & Gravel Co. v. Heath, 259 Ark. 767, 536 S.W. 2d 312 (1976); Greenman's Trucking, Inc. v. Department of Revenue Services, 6 Conn. App. 261, 504 A. 2d 568 (1986); (4) the cost of "professional" services, Larey, Comm'r of Rev. v. Dungan-Allen, Inc., 244 Ark. 908, 428 S.W. 2d 71 (1968); Bigsby v. Johnson, __ Cal. __, 99 P.2d 268, 271-72 (1940); (5) interest charges, Rudolph Wurlitzer Co. v. State Board of Tax Administration, 281 Mich. 558, 275 N.W. 248 (1937); Olympic Motors, Inc. v. McCrosey, 15 Wash. 2d 665, 132 P.2d 355 (1942); and (6) mandatory gratuities, Anders v. State Board of Equalization, 82 Cal. App. 2d 88, 185 P.2 88 J (1947); see also Cohen v. Playboy Clubs International, Inc., 19 Ill. App. 3rd 215, 311 N.E. 2d 366 (1974). It would be difficult to conceive of any principle more essential to the effective administration of a sales tax measured by gross receipts than one that absolutely precludes breaking down the selling price into taxable and non-taxable components so that sales tax might be avoided on charges for the labor services alleged to be non-taxable.

PROPOSED CHANGES TO K.S.A. 79-3602(h)

The amendatory language proposes a definition for "gross receipts" for purposes of services made taxable under K.S.A. 79-3602(p) and K.S.A. 79-3602(q). These particular provisions impose a tax upon the services of installing or applying tangible personal property and for the services of repairing, servicing, altering or maintaining tangible personal property. The new language reflects the policy that has been in place since 1970 when the Kansas Legislature first imposed sales tax on labor services. The proposal

defines service provider because the imposition on installation services involves services performed on real property such as homes and buildings and services performed on tangible personal property, such as automobiles and television sets.

The last sentence defines gross receipts to include items removed from inventory for a business's own use.

PROPOSED CHANGES TO K.S.A. 79-3602(r)

This provision redefines contractor, subcontractor and repairmen so that the law is conceptually consistent. As it stands now, K.S.A. 79-3602(r) "deems" contractors to be retailers while K.S.A. 79-3603(l) provides that they are consumers. The two provisions are irreconcilable.

The proposal also allows contractors who maintain an inventory to purchase the items tax exempt as long as the items will be subject to tax when withdrawn from inventory or when sold at retail. This section should overcome many of the concerns that prompted passage of K.S.A. 79-3602(r) in the first place.

PROPOSED CHANGES TO K.S.A. 79-3602(s)

New subsection (s) provides a definition for "service of installing." It specifies that the taxable base for charges by a contractor or subcontractor for installation services shall be the difference between the total amount charged by the contractor or subcontractor and the tax paid materials and the tax paid charges of their subcontractors. Finally, subsection (s) would make excavation services taxable if performed for the purpose of installing, applying, repairing, servicing, altering or maintaining tangible personal property. This provision would effectively overturn the result in *Bernie's Excavating*.

The Department urges the Committee's consideration of these clarifying amendments. I would be happy to respond to any questions you might have.

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DANIEL B. BAILEY

MEMORANDUM

TO: Members of the House Taxation Committee

FROM: Alan F. Alderson, Attorney,
Home Builders Association of Greater Kansas City

RE: 1993 House Bill No. 2114

DATE: January 28, 1993

I am appearing today on behalf of the Home Builders Association of Greater Kansas City in opposition to certain of the provisions of House Bill No. 2114. Since the bill was only made available two days ago, it is unclear to me what some portions of the bill are intended to do and, therefore, we would like to reserve the right to prepare an additional response after we have heard the Department of Revenue's testimony today.

I have been working with the Home Builders Association of Greater Kansas City since last May or June in order to try to assist in providing clarification and direction after the enactment of the bill which imposed a 2.5% tax on original construction labor services. My involvement with that subsection of the law and other sections pertaining to contractors, dates back to 1978, when I worked for the Department of Revenue as a sales tax attorney and as General Counsel. For the last five or six years, I have also discussed contractor topics in seminars I have presented two or three times a year for the National Business Institute. I understand the complexity of the problems and I am sympathetic with any attempt the Department of Revenue is making to clarify their situation.

However, one portion of the bill is clearly intended to overrule a Kansas Court of Appeals case known as Bernie's Excavating and the Home Builders Association is opposed to this particular provision. The Kansas Court of Appeals held that services that could be clearly segregated and billed separately could include some taxable components and some non-taxable components. I think the Bernie's case can extend to additional services other than excavating, although the Department of Revenue's proposal as codified in new subsection (s) of K.S.A. 1992 Supp. 79-3602, as amended in this bill, would only apply to excavation services. In this regard, the Department of Revenue is asking you to overrule the Court of Appeals' determination of what is permissible under Kansas law.

I would ask to be allowed to submit an additional written response to the members of this Committee after I have heard the presentation made by the Department of Revenue and have been able to discuss these matters with my clients.

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HOUSE
TAXATION COMMITTEE

January 28, 1993

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

My name is Janet Stubbs and I am appearing today in opposition to HB 2114 on behalf of the Home Builders Association of Kansas and the Mechanical Contractors Association of Kansas.

Our opposition is based upon the understanding that the intent of this legislation is to enable the collection of sales tax on the service of excavation. We oppose any increase in the cost of production of residential or commercial structures.

The added cost of sales tax on residential excavation services would be small. However, each time we are faced with government seeking additional revenue, whether it is to increase the cost of building permits, hook up charges, etc., we are told the cost is so insignificant that the contractor will be able to absorb the cost or, if it is added to the consumer's bottom line, it will not be noticeable. After numerous "small increases", you arrive at a figure which affects the ability of the potential purchaser to qualify for the home they are hoping to purchase and the ripple effect begins.

Material prices are escalating rapidly. A Topeka lumber dealer sent notice to all of their contractor customers on the last day of 1992 which alerted them to this fact. It read in part, "Please take a close look at the enclosed Lumber & Plywood Market chart. What you see will amaze you. Lumber and plywood at the mill, in the last several weeks, moved higher at a more rapid pace than we have ever seen this time of year. It is anybody's guess, but our prediction for the winter and spring is that the market will continue to rise at the same rate of increase or greater than we experienced last year. Already, dimension lumber and plywood market prices exceed last year at this same time by over 30%." This memo went on to warn contractors to exercise caution on making bids for late winter.

Earlier this week I received a call from the accountant for a Wichita builder who was attempting to assist the contractor on pricing for bids for the next few months and was questioning me about the workers compensation projected rate increases.

Some of you will remember my Fact Sheet of the 1992 Session which advised that each time you increase the cost of a residential structure by \$1,000, 1% of the public is priced out of the market. Our economist went further to advise that for each \$1,000 increase there would be 200 fewer homes built in Kansas which equates to the loss of 335 Kansas jobs. Based upon these statistics, approximately \$7,370,000 in wages will be lost, equating to a loss of \$270,000 in personal income tax. Corporate income tax was not taken into consideration. However, I recently received a letter from the

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accountant of a Wichita builder who advises that \$4900 will be lost to the State of Kansas for each \$100,000 house which is not built.

We urge the 1993 Kansas Legislature to assist us in our effort to make housing affordable for all Kansas citizens by removing the sales tax imposed on original construction. This would certainly include the excavation portion which has been ruled to be exempt currently.

Thank you for the opportunity to appear and I would attempt to answer any questions.