Approved: 3/19/93
Date

MINUTES OF THE HOUSE COMMITTEE ON TAXATION.

The meeting was called to order by Chairperson Keith Roe at 9:00 a.m. on March 17, 1993 in Room 519-S of the Capitol.

All members were present except:

Committee staff present: Tom Severn, Legislative Research Department
Chris Courtwright, Legislative Research Department
Don Hayward, Revisor of Statutes
Bill Edds, Revisor of Statutes
Lenore Olson, Committee Secretary

Conferees appearing before the committee:
Secretary of Revenue Nancy Parrish
Don Schnacke, Kansas Independent Oil & Gas Association
Dan Morgan, Associated General Contractors, Kansas City Chapter
Gus Meyer, Rau Construction Company
Dave Keil, Frito Lay
Jack Glaves, OXY USA, KN Energy, Panhandle Eastern
Art Brown, Kansas Lumber Dealers Association
Don Lilya, plant manager, Goodyear Tire & Rubber, Topeka
Bob Corkins, Kansas Chamber of Commerce and Industry
Ted Dankert, Dustrol, Inc.
Karen France, Kansas Association of Realtors
Phil Scaglia, Labor-Management Council of Greater Kansas City
Janet Stubbs, Home Builders Association of Kansas, Mechanical Contractors Association of Kansas, & Kansas Land Improvement Contractors Assn.
Ron Hein, Mesa, Inc.
Bernie Koch, Wichita Area Chamber of Commerce
Gary Hanson, Kansas Rural Water Association
Gerry Ray, Johnson County Commission and City of Overland Park
Craig Grant, Kansas NEA

Others attending: See attached list

A motion was made by Representative Brown, seconded by Representative Adkins, to introduce a bill on public utilities, to change the property tax assessment rate for competitive non-franchise telecommunications operations. The motion carried.

Chairperson Roe opened the hearing on SB 203.

SB 203 Economic development promotion; various tax adjustments.

Don Schnacke, Kansas Independent Oil & Gas Association, testified in support of SB 203. He stated that even with a reduction of the severance tax on natural gas, the overall tax rate on natural gas in Kansas will remain approximately three times that of the taxes on the same gas produced from the same field in Oklahoma. Mr. Schnacke also said that both irrigation pumping and oil well pumping should be exempt from sales taxes on utilities used in production and manufacturing (Attachment 1).

Dan Morgan, Associated General Contractors, testified in support of SB 203, stating that the Contractors feel the 1992 Kansas Legislature made a basically misinformed decision when it included a construction labor services tax in the funding formula for school finance and property tax relief in the closing days of the 1992 legislative session. He also said that most legislators did not understand the problems that would result from taxing new construction. (Attachment 2).

Representative Wiard said, "Sometimes we do make decisions and we're not always misinformed and its not because we don't always understand; we sometimes just have basic disagreements." Representative Wiard requested that his statement be part of the record.

Gus Meyer, Rau Construction, testified in support of SB 203. He said that the tax on construction is hurting the people who do not have a choice as to where to build their business by significantly increasing their cost (Attachment 3).

Dave Keil, Frito Lay, testified in support of SB 203, stating that this bill will help with Frito Lay's further expansion and could save them $44,000 in state taxes (Attachment 4).

Jack Glaves, OXY USA, KN Energy, Panhandle Eastern, testified in support of SB 203. He said that the severance tax rate on natural gas and the sales tax on utilities provisions of this bill should be adopted in the interest of tax fairness and economic development (Attachment 5).

Art Brown, Kansas Lumber Dealers Association, testified in support of the provision in SB 203 to restore the exemption for labor on original construction projects. He said that the problem with the current tax is that there simply is not the funding that the repeal of this exemption was supposed to provide (Attachment 6).

Don Lilya, Goodyear, testified in support of SB 203, stating that the Topeka Goodyear plant is the highest taxed plant in the United States. Mr. Lilya requested that every effort be made to have Kansas show a favorable attitude, not a negative position (Attachment 7).

Bob Corkins, Kansas Chamber of Commerce and Industry, testified in support of SB 203. He said that KCCI agrees with the rationale and conclusions in the Kansas Inc. report as updated on March 16, 1993 by Dr. Charles Warren and he explained the dispute KCCI has with the Department of Revenue estimated revenue for original construction services, as shown on (Attachment 8).

Ted Dankert, Dustrol, Inc., testified in support of the provision in SB 203 on sales tax on original construction, stating that the current tax is unfair to highway subcontractors who are not exempt because they technically are working for the prime contractor, not the State. (Attachment 9).

Karen France, Kansas Association of Realtors, testified in support of the sales tax exemption on new construction in SB 203. She said that this tax pushes business and jobs across state lines and reduces business within the state (Attachment 10).

Phil Scaglia, Labor-Management Council of Greater Kansas City, testified in support of SB 203. He said that the tax on labor services has a disproportional impact on economic development and specific industries. If left unchecked, serious ramifications will occur in terms of lost economic development (Attachment 11).

Janet Stubbs, Home Builders Association of Kansas, Mechanical Contractors Association of Kansas, and the Kansas Land Improvement Contractors Association, testified in support of SB 203. She said that attempts to discredit the Daicoff study by opponents of this bill is unfounded (Attachment 12).

Ron Hein, Mesa, Inc., testified in support of SB 203 regarding the severance tax portion of this bill. He said that it is time for the Legislature to jump start the natural gas industry by reducing the severance tax to at least parity with oil, by increasing the property tax credit to 3.67% for natural gas (Attachment 13).

Bernie Koch, Wichita Area Chamber of Commerce, testified in support of SB 203, stating that even with the very real questions about how lost revenue will be replaced, with which they sympathize, the Chamber cannot help but endorse this bill (Attachment 14).

Gary Hanson, Kansas Rural Water Association, testified in support of SB 203, stating that the taxes on utilities and on construction create a financial burden on rural water districts, cities, and their customers (Attachment 15).

Jerry Ray, Johnson County Commissioners and City of Overland Park, testified in support of SB 203. She said that Johnson County believes the sales tax on original construction is detrimental to the economic health of their community. The City of Overland Park believes this bill contains inequities and is a tax policy that will result in the loss of local jobs (Attachment 16).

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON TAXATION, Room 519-S Statehouse, at 9:00 a.m. on March 17, 1993.

Secretary of Revenue Nancy Parrish testified in opposition to SB 203. She said that this bill would reduce revenue to the State of Kansas by an estimated total of $49.2 million for FY 1994, which would be as difficult to replace as would reducing budgets by the same amount (Attachment 17). Secretary Parrish responded to questions and said that she stands by the Department of Revenue's fiscal note on the sales tax exemption on construction. She also said that FY 1993 revenues from contractors are estimated at $3 million to date with four months left in the Fiscal Year.

Craig Grant, Kansas NEA, testified in opposition to SB 203, stating that they are concerned that a good chunk of revenue will be cut with no apparent replacement for the revenues being taken away. He said that another major concern is that a major portion of that revenue was dedicated to the school finance formula.

Written testimony in support of SB 203 was submitted by:

Bernard Nordling Southwest Kansas Royalty Owners Association (Attachment 18)

Karl Peterjohn, Kansas Taxpayers Network (Attachment 19)

Ken Peterson, Kansas Petroleum Council (Attachment 20)

Donald Seifert, City of Olathe (Attachment 21)

Marty Vanier, DVM, Committee of Kansas Farm Organizations (Attachment 22)

Chairperson Roe closed the hearing on SB 203.

The meeting adjourned at 10:50 a.m.
The next meeting is scheduled for March 18, 1993.

Date: 3/17/93

GUEST REGISTER

HOUSE COMMITTEE ON
ASSESSMENT AND TAXATION

NAME	ORGANIZATION	ADDRESS	PHONE
HAROLD Pitts	AARP CCTF	TOPEKA	
Jim McBride	observer	Topeka	
Art Brown	KS LBR Dealers	Topeka	
Tom Tunnell	KS GRAIN & FEED ASSN	TOPEKA	
Alan Steppat	PETE McGill & Assoc.	Topeka	
GERRY RAY	Johnson County & City of OVERland Park	Overland Park	
David Keil	Frito-Lay, Inc.	Topeka	267-2600
Jack Glaves	Panhandle Eastern	Wichita	
Russell Bishop	Panhandle Eastern Corp	Houston, Texas	
Nelsie Sweeney	Overland Park Chamber	Overland Park	
Bill Mason	STATE Rep.	El Dorado	
Barbara Dankert	DUSTROL, INC.	TOWANDA/ELDORADO	
TED DANKERT	DUSTROL INC	TOWANDA,	536-2262
BoB Totten	Ks Contractors Association	Topeka	266 4152
Bernie Koch	Wichita Chamber	Wichita	316-268-1155
Ron Hein	Mesa	Topeka	273-1441
KAREN FRANCE	KAR	TOPEKA	
DON LILYA	GoodYEAR	TOPEKA	
MERLE BLAIR	GREATER TOPEKA Chamber Commerce	TOPEKA	
Christy Young	Topeka Chamber of Commerce	Topeka	234-2644
Chuck Stones	KBA	"	
Chris Ginn	Observer	Caldwell	

Date: 3-17-93

GUEST REGISTER

HOUSE COMMITTEE ON
ASSESSMENT AND TAXATION

NAME	ORGANIZATION	ADDRESS	PHONE
Nick Brewster	Amoco Corp.	4545 N. Lincoln Blvd Ste 116 - Okla City 73105	405 557-7560
ED SCHAUB	WESTERN RESOURCES	Topeka	575-6422
Phillip P. Scaglia	Labor-Management Council	Kansas City	926-4565
Wil Leiker	Topeka Goodyear	Topeka	
DON A. DUNN	GOODYEAR LOCAL 307	Topeka	266-5208
Woody Moses	Ks. Aggregate Producers	Topeka	235-1188
Mike Reecht	AT&T	Topeka	2322128
Janet Stubbs	HBAK, MCAK, KLICA	Topeka	233-9853
George Barbee	Ks Consulting Engrs	Topeka	
Sara Corless	HBA Greater KC & Remodelor's Council	KC	942-8800
Gus Meyer	Rau Construction	Overland Park, Ks	642-6000
Carl Daugherty	EMPIRE DISTRICT ELEC.	Columbus Ks	316 429 2375
DAN STEVENS	TEXACO INC.	TULSA, OK	918 560-6035
[illegible]	Associated Ks. Inst.	[illegible]	913 266-40[illegible]
Chris Beal	Greater K.C. Chamber	K.C.	221-2424
Dennis Schwartz	Kansas Rural Water Assoc.	Tecumseh	379-[illegible]553
Gary Hanson	KRWA	2887 SW MacVicar Topeka 66611	267-3410
BOB CORKINS	KCCI	Topeka	357-6321
John Pinegar	SW Ks Royalty Owners Assn.	Topeka	235-6245
Bud Grant	KCCI	TOPEKA	357-6321
Roger Franzke	Ks Gov Consulting		

KIOGA
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TESTIMONY OF DONALD P. SCHNACKE BEFORE THE HOUSE COMMITTEE ON TAXATION RE: SB 203

March 17, 1993

On behalf of KIOGA and its 1,000 member firms and individuals located throughout the State of Kansas, we appear in support of SB 203.

SB 203 contains three subjects relating to taxation:

1) Reduction of the severance tax on natural gas from 7% to 4.33%;
2) Repeal of the 2.5% sales tax on gas, electricity and water used in the production and manufacturing; and
3) Repeal of the 2.5% sales tax on services related to original construction.

The first two subjects arose from last summer's interim committee study and were contained in SB 3 (relating to the severance tax) and SB 4 (relating to taxing energy used in production). I'd like to address all three of these subjects briefly.

Reduction of the Severance Tax on Natural Gas

In 1974, KIOGA spearheaded an effort by then Governor Robert Docking and KCC Chairman Dale Saffels to recognize the Kansas county ad valorem tax as "*similar to and the same as*" a severance tax and subject to pass through the rate base and not be borne by producers. The Federal Power Commission and its successor the Federal Energy Regulatory Commission still recognize the county tax as the same as a severance tax, but, unfortunately today, most, if not all, contracts no longer provide for the pass through concept. The producers and the royalty owners now bear *all* production taxes--both severance and ad valorem taxes.

KIOGA was a party to conceiving the 7% severance tax rate in 1983. This rate took advantage of the pass-through concept and allowed the legislature and the Governor to reach their budgetary goals. Now that this pass-through is not used, in the name of equity and fairness, it is only right to reduce the severance tax rate to that applied to oil--4.33%.

In 1990 Kansas, Inc. authorized a study of taxes relating to Kansas oil and gas production. It calls attention to the change in Kansas taxing strategy which no longer allows Kansas producers to export the tax on natural gas.

3/17/93
House Taxation Cmte
Attachment 1

TESTIMONY OF DONALD P. SCHNACKE
BEFORE THE HOUSE COMMITTEE ON TAXATION
RE: SB 203
March 17, 1993

Even with a reduction of the severance tax on natural gas, the overall tax rate on natural gas in Kansas will remain approximately three times that of the taxes on the same gas produced from the same field in Oklahoma. This is because of the ad valorem tax imposed by the counties. In the Hugoton, the percentage equivalent continues to run from 10% to 17%. Add to this a reduced severance tax rate of 4.33% and the overall tax rate runs from 14% to 21% as compared to a 7% severance tax in Oklahoma. What is being suggested in SB 203 is no panacea for the industry. It doesn't even approach equity with other states.

The 1991 legislature authorized the Kansas Natural Gas Policy Commission (SCR 1626). Its goal was to provide the legislature and the Governor with a strategy to develop the full economic potential of the substantial natural gas reserves found in Kansas. The study was extended by the 1992 legislature (SCR 1633). The study is now complete. It emphasizes that the State of Kansas must assist the development of the natural gas industry. It states, "*Clearly, taxes are too high and are being borne solely by the producer.*"

Its first recommendation includes the concept of SB 203, the reduction of the state severance tax to an equivalent rate applicable to crude oil--4.33%.

Two other reports recently released, one by Kansas, Inc. entitled ***A Kansas Vision***, and one released by Governor Finney entitled ***Fossil/Non-Fossil Energy Report***, strongly recommend the reduction of the severance tax on natural gas as is proposed in SB 203.

In the 1992 session, HB 3181 passed the House 96-27. HB 3181 contained the same concept now included in SB 203--reduction of the severance tax on natural gas. It got entangled in the intrigue of the closing days of the session and although it passed out of the Senate Assessment and Taxation Committee, it was not considered on the floor of the Senate before adjournment.

Governor Finney called for an interim study on taxes relating to oil and gas production. After in-depth hearings, the Interim Committee this past fall recommended the introduction of the same bill passed last session by the House, identified in the 1993 session as SB 3 and now contained in SB 203.

Repeal of the Sales Tax on Electricity, Gas and Water Used in Production and Manufacturing

School finance was a difficult issue for us to work during the 1992 legislative session. We tiptoed around throughout the session trying to avoid the land mines that lay in wait for our industry. SB 4, arising from the Special Interim Study Committee this last summer, addresses one of the inequities contained in the school finance legislation. SB 4 is now contained in SB 203.

The 1992 legislative session was one that addressed excessive taxation of oil and gas producers. Legislation was passed in an attempt to prevent the premature abandonment of marginal oil wells.

In our analysis of the school finance legislation (HB 2892 - 1992), the positive effects on our industry of a uniform school levy of 32 mills was negated by the offsetting increases in state sales and income tax. The result was a wash.

TESTIMONY OF DONALD P. SCHNACKE
BEFORE THE HOUSE COMMITTEE ON TAXATION
RE: SB 203
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Last year the House voted to remove the sales tax exemption on electricity, gas and water used in manufacturing and production processes, defined under KSA 79-3602(m)(b). It was not mentioned during the floor debate that removing this exemption directly impacts Kansas oil and gas producers $5.7 million, adding yet one more level to the cost of operations of lifting crude oil and brine, at a time when lifting costs often exceed the price received for the crude oil produced. This is a cost that cannot be passed along to consumers. It is a new tax borne by producers.

For you who are not familiar with pumping oil wells, a pumping unit is often driven by an electric motor or an engine using gas. These power sources often run around the clock, 24 hours a day, 7 days a week. The cost for energy is a large percentage of the total lifting cost to oil producers.

The net effect of the 1992 legislation attempting to protect marginal oil wells is that they granted a modest exemption for marginal oil wells (SB 8 - 1992) from ad valorem taxes, but added a new sales tax on the same wells. Instead of paying the counties, now the producer pays the State. The predicament is that marginal oil wells and their associated jobs within the industry in Kansas are still in jeopardy. Marginal oil properties are the ones least able to pay the new tax.

All three recent reports I cited a minute ago recommend the repeal of the 2.5% sales tax on utilities consumed in production. Again, as a result of the Special Interim Committee study last summer, initiated at the request of Governor Finney, SB 4 was authorized for introduction and is now included in SB 203 with one exception--a funding proposal of a 0.1% sales tax to offset the tax being repealed.

In the section of the ***Report on Legislative Interim Studies to the 1993 Kansas Legislature*** which I have just handed out, please note on page 54 in the second paragraph under "Committee Activities" where it states, "*Conferees from the oil and gas industry said that the new 2.5 percent sales tax on utilities consumed in the production process was being unfairly levied on the oil and gas industry while irrigators remained exempt.*"

Oil pumping and irrigation pumping are the only industries that cannot pass the tax along in the price of their product. HB 2892 - 1992 contained language indicating irrigation would be taxed, but due to conflicting language, the Department of Revenue ruled irrigation as exempt. We maintain irrigation pumping and oil well pumping are the same and both should be exempt. SB 4, which the interim committee authorized and is now contained in SB 203, would accomplish this goal.

Repeal of the Sales Tax on Services Related to Original Construction

There were several days of testimony set aside for conferees to tell their story and voice their opposition to taxing services related to original construction. We hope those affected will have the opportunity to appear. We support the repeal as proposed in SB 203. It was interesting to us throughout the Senate hearings on SB 3 and SB 4 and the hearings to repeal of the sales tax on services related to original contruction, that not one conferee appeared to voice opposition to these three proposals. Objections raised in discussing this bill on the Senate floor were not supported by testimony from conferees before the Committee.

TESTIMONY OF DONALD P. SCHNACKE
BEFORE THE HOUSE COMMITTEE ON TAXATION
RE: SB 203
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The Fiscal Notes and Fiscal Impact

None of the reports cited by me make any recommendations regarding offsetting funds thought to be lost by lowering the severance tax or repealing the sales tax on energy or services. The argument on the Senate floor was that passage of SB 203 would stimulate jobs and business in Kansas and would be beneficial to the industries affected and the economy of the state resulting in increased tax revenues to the State. *New Section One* states this purpose clearly.

The Special Interim Committee felt that when recommending SB 4 (the utility tax bill) they included offsetting the anticipated loss with an 0.1% increase in sales tax. The staff fiscal note was a loss of $17 million and 0.1% sales tax would gain $24 million the first year. Kansas, Inc. estimates the impact at $13 million when repealing the tax.

The staff indicated there was a loss of $25 million on services. Kansas, Inc. says $9 million. The testimony indicates only $1.4 million came in during the first six months of the tax. This was not disputed on the Senate floor. No one apparently knows.

As to the severance tax on natural gas, all indications from information furnished recently by the KCC, are that due to increased production and increased prices for natural gas, the fiscal impact for the first year is still a gain of $770,000--better than a wash. The staff says there is a $7 million first year loss, but we do not believe they took into consideration current increased production trends, or increased prices adjusted upward for BTU content.

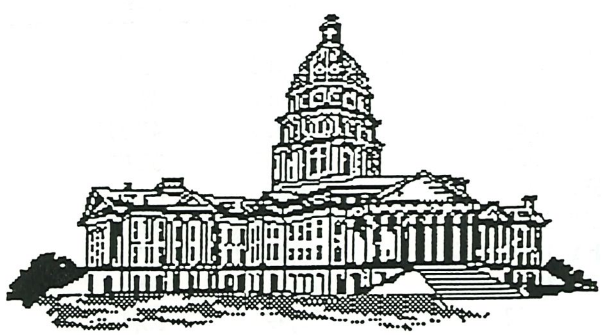
We think the Kansas, Inc. study which suggests losses of $13 million and $9 million may be realistic. If you feel it is important, this could be offset with the 0.1% sales tax as proposed in SB 4. The fiscal impact would be a first year net gain of $2 million.

In conclusion, we recommend passage of SB 203.

Donald P. Schnacke

SPECIAL COMMITTEES

Report on Legislative Interim Studies to the 1993 Kansas Legislature



Filed With the Legislative Coordinating Council
December, 1992

1-5

Proposal No. 7 -- Oil and Gas Taxation

Proposal No. 7 directed the Special Committee on Assessment and Taxation to study the taxation of oil and gas production in Kansas.

BACKGROUND

Although a severance tax in Kansas originally was enacted in 1957, the Kansas Supreme Court in January, 1958, held that tax invalid on the grounds that the title of the enacted bill was defective. (182 Kan. 437) The 1957 law imposed the tax on oil and gas production at the rate of 1 percent with no exemptions, and slightly over $2 million was collected during the six-month period in FY 1958 when the tax was operative.

The 1983 Legislature enacted a severance tax on oil, gas, coal, and salt. The current rate for oil and gas is 8 percent, but property tax "credits" of 3.67 percent for oil and 1 percent for gas reduce the effective rates for oil and gas to 4.33 percent and 7 percent, respectively. The current rate on coal is $1 per ton. The tax on salt, which was repealed in 1987, was 4 cents per ton.

Oil exemptions under the current law include low-production exemptions, new-pool exemptions, and tertiary-recovery exemptions. Gas exemptions include low-production, new-pool, and exemptions for gas used for domestic or agricultural purposes on the production unit from which it is severed. The first 350,000 tons of coal from each mine are exempt.

The 1987 Legislature enacted S.B. 1, which expanded the low-production exemption for oil; expanded the exemption for coal; and repealed the tax on salt.

A history of severance tax collections since FY 1984 is presented in the table below:

	Dollars in Thousands				
	Oil	Gas	Coal	Salt	Total
FY 1984	$ 70,768	$ 42,925	$ 306	$ 99	$ 114,099
FY 1985	66,490	41,912	427	86	108,914
FY 1986	56,457	41,713	680	87	98,936
FY 1987	28,273	32,018	1,044	81	61,376
FY 1988	34,336	43,319	1,025 *	10 *	78,690 *
FY 1989	24,031 *	51,971	0 *	-- *	76,002 *
FY 1990	25,454 *	57,737	0 *	-- *	83,190 *
FY 1991	36,819 *	59,242 (a	29 *	-- *	96,090 *
FY 1992	29,491 *	55,477 (b	0 *	-- *	84,969 *

* Legislation enacted in 1987 repealed the tax on salt and changed the exemptions for oil and coal.

a) Includes $2.3 million in receipts attributable to previous years' liability.

b) Includes $1.4 million in receipts attributable to previous years' liability.

Kansas, Inc. in 1990 commissioned a study of the overall tax burden on the oil and gas industry. The 1990 Special Committee on Assessment and Taxation was charged with reviewing the study and determining whether tax relief was warranted. The Kansas, Inc study concluded that the overall tax burden on the oil and gas industry was higher in Kansas than it was in surrounding states. The 1990 Special Committee reviewed a bill draft

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which would have exempted certain low-production oil properties from the property tax, but the Committee did not recommend that legislation to the 1991 Legislature or make any conclusions or recommendations.

The 1992 Legislature exempted from the property tax (retroactive to tax year 1992) the working interests from those oil leases with average daily production of 2 barrels or less, or 3 barrels or less when the completion depth is greater than 2,000 feet.

The 1992 Legislature also placed on the November 3 ballot a new classification resolution which will (among other changes) reduce the assessment level for low-production oil and gas from 30 percent to 25 percent. Oil leaseholds with average daily production of 5 barrels or less and natural gas leaseholds with average daily production of 100 mcf or less will qualify for the 25 percent assessment level starting in 1993. The voters adopted the resolution by a statewide vote of 472,300 to 420,808 (53 percent in favor to 47 percent opposed).

Another measure considered by the 1992 Legislature affecting the taxation of the oil and gas industry was H.B. 3181, which would have reduced, over a period of years, the severance tax rate on gas to the same effective rate as that imposed on oil (4.33 percent). Based on estimates made in April, the fully phased-in fiscal impact of that legislation would have been a reduction in receipts of approximately $20.1 million.

COMMITTEE ACTIVITIES

At the July meeting, staff briefed the Committee on the 1990 Kansas, Inc. study, presented a memorandum on the history of the severance tax, reviewed the fiscal note on H.B. 3181, distributed data on 1990 and 1991 mineral leasehold valuations by county, and discussed a data request which had been sent to county appraisers regarding the impact of the property tax exemption for low-production oil leases in House Sub. S.B. 8 and the potential impact of the oil and gas changes proposed in H.C.R. 5007.

In September, staff distributed a chart showing statewide property tax data by class for tax year 1992 and discussed the potential impact of the exemption in House Sub. S.B. 8. Conferees from the oil and gas industry said that the new 2.5 percent sales tax on utilities consumed in the production process was being unfairly levied on the oil and gas industry while irrigation remained exempt.

At the October meeting, staff estimated that the amount of appraised valuation removed from the tax base as a result of the low-production oil exemption in House Sub. S.B. 8 was about $74 million, and the amount of assessed valuation was about $22 million. Staff also said that the data received from the counties indicated that about 25 percent of the remaining oil and gas valuation statewide would qualify for the 25 percent assessment level under H.C.R. 5007, while 75 percent of the valuation would remain at the 30 percent level. This one feature alone of H.C.R. 5007 will reduce tax year 1993 assessed valuation by about $52.1 million, according to the data. Based on a statewide classification model developed by the Research Department using 1992 property tax data by class and the oil and gas data submitted by the counties, it was estimated that tax year 1993 total assessed valuation will be reduced by approximately $335 million to $357 million statewide under the new classification schedule.

Also in October, Dr. David Collins from the Kansas Geological Survey updated the Committee on changes in the oil and gas industry since the Kansas, Inc. study was released two years earlier. He said that one specific trend which deserved attention was the extremely low level of drilling activity which meant that additional crude oil capacity could not be developed fast enough to offset the natural decline in productivity. He also mentioned that the rapid increase in prices over the summer and fall for natural gas appeared to most dealers in the market to be more than just a temporary phenomenon. Conferees representing the industry then encouraged the Committee to recommend a severance tax reduction for natural gas.

CONCLUSIONS AND RECOMMENDATIONS

The Committee finds that a number of changes in recent years in the marketplace for natural gas have made it no longer possible to justify a higher severance tax rate on gas than the rate which is imposed on oil. The Committee also notes that school finance legislation enacted in 1992 has increased the property tax burden on many oil and gas properties. The Committee therefore recommends that the severance tax on natural gas be reduced (by increasing the property tax credit) to the same rate imposed on oil. Because of the fiscal considerations of such a policy decision, the Committee recommends that the severance tax reduction for gas be phased in over a period of years similar to the House Committee of the Whole version of 1992 H.B. 3181. Enactment of S.B. 3 would accomplish this recommendation.

The property tax credit for gas would be increased to 2 percent on July 1, 1993 (and the effective tax rate reduced to 6 percent); the credit increased to 3 percent on July 1, 1994 (and the effective tax rate reduced to 5 percent); and the credit increased to 3.67 percent on July 1, 1995 (and the effective rate reduced to 4.33 percent).

Based on the November estimates and assuming a two-month lag in receipts, the fiscal note to the State General Fund and the County Mineral Production Tax Fund is as follows:

	Dollars in Thousands			
	FY 1994	FY 1995	FY 1996	FY 1997 and Thereafter
State General Fund	$ (7,000)	$ (15,401)	$ (21,491)	$ (22,429)
County Mineral Production Tax Fund	(527)	(1,159)	(1,618)	(1,688)
TOTAL	$ (7,527)	$ (16,560)	$ (23,109)	$ (24,117)

The Committee also finds that the new 2.5 percent sales tax on utilities consumed in the production or manufacture of tangible personal property is a particularly onerous burden for the oil and gas industry. The Committee therefore recommends the restoration of that exemption and an increase in the sales and use tax rate from 4.9 percent to 5.0 percent to help finance the restoration. Enactment of S.B. 4 would accomplish these recommendations. FY 1994 receipts would increase by a net total of approximately $6.5 million due to the enactment of this bill.

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TESTIMONY BEFORE THE
HOUSE TAXATION COMMITTEE
Regarding Senate Bill 203
by

Dan Morgan, Director of Governmental Affairs
Kansas City Chapter, Associated General Contractors
and Builders' Association

March 17, 1993

Thank you, Mr. Chairman and members of the Committee. My name is Dan Morgan and I appear before you today in support of Senate Bill 203 on behalf of the Kansas City Chapter, Associated General Contractors and the Builders' Association. Together these organizations represent nearly 750 general contractors, subcontractors and material or service suppliers engaged in commercial and industrial building construction in northeastern Kansas and western Missouri. The majority of our members are located in and around Kansas City. Approximately 150 of our members are domiciled in Kansas. Another 200 or so Missouri-based members perform work in Kansas.

I appreciate the opportunity to speak to you this morning in strong support of SB 203 which we view as a much needed economic development and jobs bill. I want to take just a few minutes to address that portion of the bill which would repeal the state and local taxes on "labor services" used in new construction in Kansas. You may recall that many of us here today testified a few weeks ago in support of House Bill 2148 which also would repeal the tax on new construction labor services. Our arguments in support of SB 203 are very much the same as those for HB 2148 and, in the interest of time, I will just outline our basic arguments in support of both these proposals.

- As you know, the tax on new construction labor services was made a part of the school finance/property tax relief plan toward the end of the 1992 legislative session. We are convinced that most legislators simply did not understand the problems that would result from taxing a core industry like construction when they included a tax on new construction "labor services" in the school finance plan which was passed last session.

- While placing a tax on new construction may have been an expedient way to help fund school finance and provide property tax relief to many parts of the state, we submit that doing so without study and a realistic assessment of how much such a tax would actually raise and how damaging it would actually be was both unfair to our industry and counterproductive to the economic development interests of the state.

- There is no question that this tax on new construction labor services has placed the State of Kansas at a serious competitive disadvantage when competing against neighboring states for new business,

business expansion and economic development. And nowhere in the state are the consequences being felt more keenly than in Johnson and Wyandotte Counties which must compete with Kansas City metro area counties in Missouri where corporate income taxes, individual income taxes, sales taxes and commercial, industrial and residential taxes are lower and where labor services are not taxed on either new or remodel construction.[1]

- We are convinced that most legislators believed that only the actual labor performed on a job would be taxed when they voted to include a 2.5% tax on new construction in the school finance plan last session. Neither did they understand that local city and county tax would also be assessed as a result. The truth is that the term "labor services" includes much more than the actual labor performed on the job. Simply put, "labor services include the cost of virtually everything in the total construction contract price, except for materials. Labor services on a commercial building project would typically amount to 60 percent of the total contract price and materials would be 40 percent.

- This new "labor services" tax increases the total cost of a commercial building project in Johnson County, for example, by just under 2.5 percent. This new tax will now cost an owner or developer nearly $50,000 more to build a $2,000,000 building in Johnson County, Kansas, for example, rather than just across the state line in Missouri. That is a very serious economic disadvantage for Kansas. To figure the increase for other communities just add 2.5 percent to the local city and county rates and multiply that figure by 60 percent.

- Construction is an engine of economic growth. Construction activity has a direct economic impact on over forty related industries and an indirect impact on many more. When construction is down, jobs are down in all those industries. This tax is a strong deterrent to new construction in Kansas. Left in place, the new construction labor services tax will cost the state and its political subdivisions far more in lost revenues from lost economic development and associated sales, income and property taxes than the $8 to $10 million it will likely produce each year for school finance and property tax relief.

- We believe very strongly that it would be wrong to continue to impose a tax on labor services on new construction in Kansas rather than to use a more broad-based tax to help fund school finance. We feel the 1992 Kansas Legislature made a basically misinformed decision when it included a construction labor services tax in the funding formula for school finance and property tax relief in the closing days of the 1992 legislative session. Passage of this legislation will right that wrong and spur economic development and new job creation in Kansas. We urge your support for Senate Bill 203.

[1] Based on the 1992 Study of Business Taxes in Kansas and Nearby States by Institute for Public Policy and Business Research, Anthony L. Redwood, Executive Director.

TESTIMONY BEFORE THE HOUSE TAXATION COMMITTEE CONCERNING SENATE BILL SB 203

ARGUMENTS FOR THE REPEAL OF THE SALES TAX ON CONSTRUCTION SERVICES

BY GUS RAU MEYER
RAU CONSTRUCTION COMPANY
MARCH 17, 1993

My name is Gus Rau Meyer and I am President of Rau Construction Company. Rau Construction Company is a middle to large size construction company, founded in 1870, and doing business in the Kansas City Metropolitan area since the early 1900's. Our headquarters for over 35 years has been in Overland Park, being a pioneer during the growth in this area. Our main focus is in the construction of new commercial and industrial projects on a negotiated or design/build bases. This work is done almost without exception in the private sector.

Over the past 5 years, our annual billings have averaged approximately $18,500,000. During that period of time, our work volume was historically 1/3 in Kansas and 2/3 in Missouri. The majority of this work was new construction. Since the implementation of the Sales Tax On Construction Services last May, we have not contracted for any new construction in Kansas, but have been awarded or have contracted for over $10,000,000 in new construction in Missouri. The projects which we are negotiating and anticipate Contracting for in the first half of 1993 total an additional $15,000,000 in Missouri and only $750,000 in Kansas. These actual and anticipated awards mentioned above amount to over $25,000,000 worth of new construction in Missouri and only one project worth $750,000 of new construction in Kansas. This projects our Kansas contracts for the 12 month period after the implementation of the Tax on Construction Services to be less than 4% of our total Contracts, verses our historical average for Kansas of 32% over the last 5 years. The Sales Tax on Construction Services has not necessarily effected our total volume of work, but I feel that it has had an effect on what State our work is located in. Kansas has been the loser.

In previous testimony, I have submitted analysis of a theoretical project. This analysis showed that this sales tax on construction services would generate new tax revenues of approximately 2.46% of the cost of constructions. On the $750,000 project we just received a Contract for, this would amount to only $18,450 in new sales tax revenue. If the questions and feedback I received in my previous appearance before this Committee is true that the majority of the State is not experiencing any new construction, then I would tend to agree with many projections which have recently been done that show the total new sales tax generated by the tax on construction services will be very minimal.

This Tax effects both developers, which have to contend with the costs of this Tax on rental rates; and owner/users which have to access the cost of building a project in Kansas versus the numerous other states that are available. As I testified before, based on my "typical" small office building or retail store, this tax equates to an additional $1.64 per

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square foot of construction cost. Using a factor of; 90% rentable square footage, 10% financing and 20 year amortization, this would cause a $0.21 per square foot per year increase in rents to cover this cost. A cost per year for an Owner/User for the increase in his mortgage due to this tax would be very similar to this increase in rental rates, about $0.21 per square foot per year. A real example of the impact of this sales tax on new construction is with a repeat client we have been working with for over 2 years on a 300,000 square foot office structure for his own use in Overland Park. The client has spent considerable monies to bring his construction plans to a 98% complete condition. The project was put on hold about 1 year ago. Although the client continues to expand his workforce in the Kansas City Metropolitan area, this project appears to be canceled with one of the stated reasons being this Sales Tax on Construction Services.

Although I am not an economist or an actuary, my own analysis of the shift we have seen in the location of where the projects we are constructing (from historically 32% in Kansas to now only 4% in Kansas), combined with the analysis of the impact of this Tax on a hypothetical project, makes me believe that the Taxes (Sales Tax on Materials, Property, Income, etc) and other revenues being lost by the shifting of projects to outside of Kansas far outweigh the gains realized by the Sales Tax on Construction Services.

This does not even take into account the enforcement costs of this tax. It effects many small construction projects, built by hundreds and thousands of contractors, and generates little revenue. These enforcement cost may consume a major portion of, if not exceed, the tax generated. This waste of a developers or owners capital in itself would be a most compelling reason to repeal this Tax.

In conclusion, from a strictly "volume of work" and profit standpoint, the Sales Tax on Construction Services has not effected my company. The volume of work we have lost in Kansas, we have made up in Missouri. As a life long resident of Kansas, and a backer of it's high quality of life and standard of living, I feel this Tax is a disaster to the economic development in the State. It is hurting the people who do not have a choice as to where to build their business by significantly increasing their cost. It is also, and more importantly, driving the people who do have a choice away from Kansas. This is a near sighted Tax that demands a dollar up front today in lieu of many dollars in Sales Tax, Property Tax, Income Tax, and other revenues in the future. The repeal of this Tax may not bring back the businesses that have left Kansas, but will help retain the ones we have and attract more to come.

I thank you Mister Chairman and members of this committee for allowing me to appear before you today. I appreciate your consideration and ask for your support of SB 203 in repealing this Tax.

Frito Lay

BUSINESS IN KANSAS

- 900 EMPLOYEES STATE-WIDE
- $40,000,000 PAYROLL
- 7 STATE DISTRIBUTION (19% OF USA)
- TOPEKA EMPLOYER SINCE 1950'S
- PLANT EXPANSIONS : 1981, 1983, 1990, 1992
- PRODUCT RECOGNITION:
  - LAYS POTATO CHIPS®
  - RUFFLES POTATO CHIPS®
  - DORITOS®
  - CHEETOS®
  - TOSTITOS®
  - FUNYUNS®

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Frito Lay

BUSINESS COMPETITION

EXTERNAL COMPETITION = **VALUE**

- **ANHEISER -BUSCH : EAGLE**
- **GUYS**
- **KITTY CLOVER**

INTERNAL COMPETITION = **EXPANSION / GROWTH**

- **FREE ENTERPRISE SYSTEM**
- **VOLUME ALLOCATION**
- **LOW COST PRODUCER**

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Frito Lay

STATE TAXES

FRITO-LAY PLANT	1992 ACTUAL $	COST PER MLB	1993 ACTUAL $	COST PER MLB
TOPEKA	$521,200	$6.35	$906,000	$9.89
FRANKFORT, IN	$377,000	$3.44	$430,000	$3.92
BELOIT, WI	$181,700	$2.97	$188,000	$2.72
DALLAS, TX	$794,000	$8.81	$800,000	$8.14

- SB 203 VALUE $44,000
- BELOIT, WI AWARDED NEW POTATO CHIP FRYER – 1993
- ALL FIXED COST INCREASES MUST BE OFFSET WITH PRODUCTIVITY OR EXPENSE ELIMINATION

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REMARKS OF JACK GLAVES
BEFORE HOUSE TAXATION COMMITTEE
IN BEHALF OF
K. N. ENERGY, OXY USA, AND PANHANDLE EASTERN CORPORATION
IN SUPPORT OF SENATE BILL 203

The interest of my clients relates to the provision which reduces the effective severance tax rate on natural gas to the same rate imposed on oil, and to the restoration of the exemption on the sales tax as applied to utilities used in production, manufacturing, and refining.

OXY USA is adversely affected by both provisions in its extensive oil and gas operations in Kansas. OXY is an old line Kansas company, which started as Empire Fuel and Gas Company, later Cities Service, with its roots pre-dating the discovery of the El Dorado field in 1915, where it is still operating. It is, in fact, the largest oil producer in the state, and is a very active operator in the Southwest Kansas gas area, with over 1300 wells in the Hugoton Field area. It is an enduring corporate citizen which paid $16.4 million in 1992 in ad valorem ($9 million) and severance ($7.4 million) taxes.

Oxy's electric bill at El Dorado in 1992 was over $1 million, even though it owns its own distribution system and takes power off the grid. Its fuel and electricity expenses equated to about 22 percent (22%) of operating costs. This is marginal production, and every expense item is important in the abandonment versus continued production decision. In the Plainville District, its electric bill was over $2.5 million, which is about 40 percent (40%) of all operating expenses. The sales tax, as applied to its utility bills

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is onerous and one more impediment to successful oil operations in Kansas.

Panhandle Eastern's subsidiary, National Helium Corporation, operates a large helium and natural gas liquids extraction plant in the Liberal area. The plant was recently expanded and modernized involving an expenditure of some $25 million because of the revival of the helium market. Additionally, Air Products and Chemicals, Inc., constructed an adjacent facility for refining of the helium into a marketable product, also involving a multi-million dollar investment. These facilities, of course, added to employment and constitute ideals economic development for the Southwest Kansas area. Construction was completed on this plant, and operations began for extraction of helium in 1991. Economics of the operation were, of course, predicated on existing and projected tax burdens. No one anticipated recision of the exemption on sales taxes on utilities used in the manufacturing process. This is not an insignificant burden on this type operation, which is an extremely heavy utility user. The 1992 utility bills for National Helium alone totaled $8.3 million, which constitutes about 45 percent (45%) of the total operational expenses of the plant. Additionally, ad valorem taxes were paid in 1992 of over $1.5 million, with combined utilities and taxes of some $9.8 million, which was over 50 percent (50%) of operating expenses. The 2 1/2% sales tax resulted in an unanticipated financial burden exceeding $200,000 annually in addition to the local sales tax, which has now been applied, which adds another one percent (1%). Likewise, K. N. Energy operates an extraction facility at Scott City, which is similarly impacted by the sales tax on utilities.

These plants can be located wherever a natural gas transmission system exists, which is to say they can easily be located in Texas, Oklahoma, or Kansas. The Governor's Natural Gas Policy Committee has urged development of additional extraction facilities in Kansas and, in fact, more facilities are scheduled and contemplated. We believe that this onerous tax burden can be a significant factor in decisions for future investment in natural gas extraction facilities. This tax is not a "loop hole". It is a novel burden that is added to the cost of doing business in Kansas, and one more disincentive to locating a facility in Kansas and doing business here.

Another affect of this tax is to cause manufacturing and refining industries, such as those operated by my clients, to look seriously at cogeneration of electricity. National Helium, for example, is a high-load factor customer of West Plains Energy, which means it takes power around the clock, which is beneficial to the electric company and its other rate payers. The affect of losing this type of load is detrimental to the residential and commercial rate payers who would experience increased rates to cover the utilities' fixed costs. We note that the Kansas Inc. report of February 9, 1993, concludes that this particular tax has an estimated fiscal impact of $13 million annually. Senate Bill 4 originally proposed increasing the general sales tax rate from

$4.9% to 5%, with an estimated annual yield of $24 million. My clients believe that this is preferable to the negative affect on the economy of the taxes that are addressed by Senate Bill 203.

As to the severance tax issue, I believe your committee is well aware of the justification and need for reducing the severance tax rate on natural gas to the level of tax imposed on oil. I will thus concentrate my remarks on the fiscal impact resulting from the proposed phased-in reduction from the current 7% rate to 4.33%, which is the oil rate.

Revenues from the severance tax on natural gas, depend upon the volume of production and the price received. This issue was studied by the interim committee, and I have attached a portion of the Proposal #7 report which reflects the increase in revenue from the severance tax on gas from $32 million FY87 to over $55 million in FY92. I have also attached the January 6, 1993 Research Department memorandum to the Budget Committee, which indicates that for July-December of this fiscal year, the severance tax on gas produced $27.8 million or about 2.8 million (11%) above the consensus estimate of November 16, 1992, and about $6 million above the actual tax revenue for the like period in FY92 for a 27.3% increase. This unanticipated increase results from both production and price increases. We believe the trend will continue.

Oxy is the applicant in the pending proceedings before the KCC that is seeking revisions in the proration rules that it believes will result in stimulating additional investment of $60 million by it alone in the drilling of infill wells and facilities, which would result in increased production from the Hugoton Field, to the benefit of the Southwest Kansas economy and the state and local tax revenues.

Also attached hereto is a breakdown Kansas yearly gas production which indicates that even though only 36% of the infill wells have been drilled to date, the production from those wells equated to 13.6% of the total Kansas gas production in 1991. Unquestionably, the pending proceedings before the KCC can have a great affect on the pace of further development in Hugoton. It is apparent that regulation, economic, or political decisions will eventually result in a great number of these wells being drilled. Only about 1,400 out of a potential 4,000 have, in fact, been drilled. If 85% of the potential locations are, in fact, drilled, the additional 2,600 wells would involve an investment in Southwest Kansas between $400 and $500 million. We don't contend that the reduction in severance tax alone is going to cause this investment, but the tax burden is certainly a large impediment to exploration in Kansas visa vis other states. The current tax burden is counterproductive and short-sighted. The Hugoton Field extends over three states. Oklahoma has a 7% severance tax and no ad valorem tax on producing properties, this contrasts to Oxy's effective tax burden (severance and ad valorem) in Kansas in 1992, which equated of about 16% of gross revenue on the average in the big gas producing area. Obviously, when there is a choice to be made as to where exploration dollars are spent, the more than doubled Kansas tax burden is a compelling factor for exploration elsewhere. The reduction in the tax rate, we believe, will help accelerate further development in the Kansas gas producing areas, resulting in increased production and increased severance tax revenue.

The demand for gas is increasing. The National Energy Policy Act requires increased use of alternative fuels by private companies and government entities that own 50 or more vehicles. The goal is to reduce pollution as well as the country's dependance on imported oil. The United States has conservatively a 50 year supply of gas at today's consumption rates. We believe that it is evident that this Government policy, as well as the Clean Air Act, will create a large market for alternative fuels by the conversion of motor vehicles to run on CNG, and the greatly expanded use of natural gas in generation of electricity.

The price outlook is also encouraging the revived economy and return to more normal weather patterns have and will result in an increase. Natural gas for April delivery is now over $1.90 per Mcf on the future's market. This contrasts to the $1.60 per Mcf that was utilized in the Governor's Budget Report (Volume 1, Page 12) that was utilized for FY93 revenue projections, which compared to an average price of $1.33 that was utilized for FY92. The budget report assumes a FY94 average price of $1.55.

The projected revenue estimates assumed a constant production level for FY94 - FY97 of 630 Bcf. These production and price levels would yield annual revenues of $63 million at a 7% rate, and a $57 million at a 6% rate in FY94, thus the $7 million fiscal note that has been assumed to result from reducing the rate from 7% to 6% in FY94. A March 12, 1993 study by Dr. David R. Collins of the Kansas Geological Survey, Petroleum Research Section, concludes that nominations for Kansas natural gas during the next two winters are 30 - 40 billion cubic feet higher than current levels, which he believes reflects improved market access and increased production capacity resulting from infill development. His revised estimates for FY94 production is 660 Bcf. He believes that a price of $1.70 per Mcf is realistic with the result that total revenue at the proposed 6% rate (10 months) for FY94 of $64 million would be realized. This is $772,000 <u>above</u> the Legislative Research Consensus Estimate made in January 1993 at the current 7% rate. His FY95 projection under the Senate Bill 203 rates (2 months at 6%, 10 months at 5%) is for total gas severance tax revenue of $58.5 million, which is $4.7 million below the consensus estimate ($53.2 million) in the Governor's budget at the 7% rate. Dr. Collins assumed FY95 production of 680 Bcf and an average price of $1.80 per Mcf versus the consensus estimate that assumes 630 Bcf at $1.55 per Mcf.

Nominations in the Hugoton Field are up significantly, reflecting increased demand. Increased production is responding to increased pricing. All of this bodes well for greater production of Kansas gas which can enhance, rather than diminish, revenue to the state from the severance tax at the proposed reduced rate. Thus enabling the legislature to accommodate the needs of this vital industry while maintaining the budgetary requirements of the state at above the historic level of revenues realized from the natural gas tax. The added economic activity spurred by making our tax rate more competitive with the other exploration areas will more than offset any loss of revenue in the out years that might result from reducing the rate.

The current tax burden is counterproductive and short-sighted. We urge adoption of this portion of Senate Bill 203 in the interest of tax fairness, economic development, and encouragement of a vital Kansas industry.

Respectfully submitted,

Jack Glaves

PROPOSAL NO. 7 -- OIL AND GAS TAXATION

Proposal No. 7 directed the Special Committee on Assessment and Taxation to study the taxation of oil and gas production in Kansas.

BACKGROUND

Although a severance tax in Kansas originally was enacted in 1957, the Kansas Supreme Court in January, 1958, held that tax invalid on the grounds that the title of the enacted bill was defective. (182 Kan. 437) The 1957 law imposed the tax on oil and gas production at the rate of 1 percent with no exemptions, and slightly over $2 million was collected during the six-month period in FY 1958 when the tax was operative.

The 1983 Legislature enacted a severance tax on oil, gas, coal, and salt. The current rate for oil and gas is 8 percent, but property tax "credits" of 3.67 percent for oil and 1 percent for gas reduce the effective rates for oil and gas to 4.33 percent and 7 percent, respectively. The current rate on coal is $1 per ton. The tax on salt, which was repealed in 1987, was 4 cents per ton.

Oil exemptions under the current law include low-production exemptions, new-pool exemptions, and tertiary-recovery exemptions. Gas exemptions include low-production, new-pool, and exemptions for gas used for domestic or agricultural purposes on the production unit from which it is severed. The first 350,000 tons of coal from each mine are exempt.

The 1987 Legislature enacted S.B. 1, which expanded the low-production exemption for oil; expanded the exemption for coal; and repealed the tax on salt.

A history of severance tax collections since FY 1984 is presented in the table below:

	Dollars in Thousands				
	Oil	Gas	Coal	Salt	Total
FY 1984	$ 70,768	$ 42,926	$ 306	$ 99	$ 114,099
FY 1985	66,490	41,912	427	86	108,914
FY 1986	56,457	41,713	680	87	98,936
FY 1987	28,273	32,018	1,044	81	61,376
FY 1988	34,336	43,319	1,025 *	10 *	78,690 *
FY 1989	24,031 *	51,971	0 *	-- *	76,002 *
FY 1990	25,454 *	57,737	0 *	-- *	83,190 *
FY 1991	36,819 *	59,242 (a	29 *	-- *	96,090 *
FY 1992	29,491 *	55,477 (b	0 *	-- *	84,969 *

* Legislation enacted in 1987 repealed the tax on salt and changed the exemptions for oil and coal.

a) Includes $2.3 million in receipts attributable to previous years' liability.

b) Includes $1.4 million in receipts attributable to previous years' liability.

Kansas, Inc. in 1990 commissioned a study of the overall tax burden on the oil and gas industry. The 1990 Special Committee on Assessment and Taxation was charged with reviewing the study and determining whether tax relief was warranted. The Kansas, Inc study concluded that the overall tax burden on the oil and gas industry was higher in Kansas than it was in surrounding states. The 1990 Special Committee reviewed a bill draft

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STATE GENERAL FUND RECEIPTS
July – December, FY19[illegible]
(dollar amounts in thousands)

	Actual FY1992	FY 1993 Estimate*	FY 1993 Actual	FY 1993 Difference	Percent Increase -- FY 1993 Over FY 1992	Percent Increase -- FY 1993 Over Estimate
Property Tax:						
Motor Carriers	$5,794	$5,270	$5,682	$412	(1.9)%	7.8 %
Income Taxes:						
Individual	$412,005	$469,000	$469,342	$342	13.9 %	0.1 %
Corporation	76,452	86,000	84,203	(1,797)	10.1	(2.1)
Financial Inst.	934	1,700	2,508	808	168.5	47.5
Domestic Ins. Co.	(38)	(4)	(6)	(2)	---	---
Total	$489,353	$556,696	$556,047	($649)	13.6 %	(0.1)%
Inheritance Tax	$24,478	$27,500	$30,061	$2,561	22.8 %	9.3 %
Excise Taxes:						
Retail Sales	$403,714	$512,000	$510,996	($1,004)	26.6 %	(0.2)%
Comp. Use	49,947	60,000	58,879	(1,121)	17.9	(1.9)
Cigarette	28,268	26,100	26,660	560	(5.7)	2.1
Tobacco Prod.	1,028	1,115	1,104	(11)	7.4	(1.0)
Cereal Malt Bev.	1,618	1,550	1,492	(58)	(7.8)	(3.7)
Liquor Gallonage	6,603	6,700	6,556	(144)	(0.7)	(2.1)
Liquor Enforce.	11,454	12,100	12,844	744	12.1	6.1
Liquor Dr. Places	1,954	2,080	2,230	150	14.1	7.2
Corp. Franchise	3,758	3,835	3,943	108	4.9	2.8
Severance	36,812	38,420	40,943	2,523	11.2	6.6
Gas	21,891	25,100	27,860	2,760	27.3	11.0
Oil	14,921	13,320	13,084	(236)	(12.3)	(1.8)
Total	$545,157	$663,900	$665,648	$1,748	22.1 %	0.3 %
Other Taxes:						
Insurance Prem.	$32,371	$33,080	$33,103	$23	2.3 %	0.1 %
Miscellaneous	330	425	461	36	39.7	8.5
Total	$32,700	$33,505	33,564	$59	2.6 %	0.2 %
Total Taxes	$1,097,482	$1,286,871	$1,291,002	$4,131	17.6 %	0.3 %
Other Revenue:						
Interest	$23,833	$15,146	$15,922	$776	(33.2)%	5.1 %
Transfers(net)	7,850	1,190	1,421	231	(81.9)	19.4
Agency Earnings and Misc.	21,781	18,400	18,549	149	(14.8)	0.8
Total	$53,465	$34,736	$35,891	$1,155	(32.9)%	3.3 %
TOTAL RECEIPTS	$1,150,946	$1,321,606	$1,326,893	$5,287	15.3 %	0.4 %

* Consensus estimate as of November 16, 1992.

NOTE: Details may not add to totals due to rounding.

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Kansas Legislative Research Department

06-Jan-93

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KANSAS YEARLY GAS PRODUCTION
(Volumes in BCF @ 14.65 psia)

YEAR	STATE TOTAL		HUGOTON						PANOMA COUNCIL GROVE			HUGOTON-COUNCIL GROVE		ALL OTHER FIELDS		
	WITH HUGOTON INFILL	WITHOUT HUGOTON INFILL	WITH INFILL	WITHOUT INFILL	% OF STATE WITH INFILL	% OF STATE WITHOUT INFILL	INFILL ONLY	% OF STATE	(BCF)	% OF STATE WITH INFILL	% OF STATE WITHOUT INFILL	% OF STATE WITH INFILL	% OF STATE WITHOUT INFILL	(BCF)	% OF STATE WITH INFILL	% OF STATE WITHOUT INFILL
1987	459	458	265	265	57.78%	57.70%	0.7	0.1%	67	14.60%	14.63%	72.33%	72.49%	127	27.67%	27.73%
1988	581	570	338	328	58.23%	57.40%	10.7	1.8%	82	14.11%	14.39%	72.29%	71.93%	161	27.71%	28.25%
1989	530	504	354	327	66.74%	64.98%	26.5	5.0%	84	15.85%	16.67%	82.64%	81.55%	93	17.55%	18.45%
1990	528	473	333	278	63.07%	58.80%	54.6	10.3%	88	16.67%	18.60%	79.73%	77.38%	107	20.27%	22.62%
1991	568	491	384	307	67.56%	62.46%	77.3	13.6%	104	18.31%	21.18%	85.92%	83.71%	80	14.08%	16.29%

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MID-AMERICA LUMBERMENS ASSOCIATION

MLA
ARKANSAS KANSAS
MISSOURI NEBRASKA
OKLAHOMA

TESTIMONY BEFORE THE HOUSE TAXATION COMMITTEE

Senate Bill 203 Rm. 519-S March 17, 1993

Mister Chairman, members of the House Taxation Committee, my name is Art Brown, and it is my pleasure to visit with you today about Senate Bill 203. I represent the retail lumber and building material dealers in the state, and we support the re-instatement of the exemption for labor services on original construction projects.

I will be brief. As we see, one of the major problems with this new tax is that there simply is not the funding that the repeal of this exemption was supposed to provide.

1992 was a good year for construction in Kansas, mainly because of favorable mortgage rates. The same should hold true for 1993. As mortgage rates start to rachet upwards, and eventually this will happen, this will slow down construction activity on new projects.

If only $9 million can be generated in a year that is active in construction projects, based on the Kansas, Inc. estimate, how can the shortfall from this be made up when there is a significant decline in activity? With some of the latest economic news coming out of some of the bigger population centers in the state, there has to be concern as to just how much money this tax will generate.

In our view, the fiscal note used last year for revenue from this tax is unattainable in Kansas. There simply cannot be that much construction in the state to generate that much funding.

After passage of this exemption repeal, supply prices, as many of you may know from the media, have had a very severe price spike. There certainly does not appear to be any mandate in the near future that we can see as an industry to increase the supply of timber to the country. Yes, this is a problem that every one in the country faces who is trying to buy a home, but as cost is added to a product, no matter how insignificant it may be, at some point there is a "straw that breaks the camel's back." If interest rates start to escalate, and high demand could bring this process into play, this 2½% tax on original construction services is just the type of little straw that puts a tighter strain on the camel's face.

It is totally regressive in bringing any type of new business to Kansas in the form of general contractors. Why go through the hassle of the paperwork, when no other surrounding state has such a provision for their construction industry? Contractors are able to come in from out-of-state and build here in Kansas and get out of the state without having to pay the 2½% tax, and oh, yes, we all know they are supposed to, but do you honestly and truly believe there is enough manpower to catch every construction site in the state and who is doing the work? The bottom line is the locals lose the work and the border areas just lick their chops and smile all the way to the bank.

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LUMBER GROWS ON TREES

As stated in page 10 of the Governor's Economic and Demographic Report, new housing starts in Kansas are one of the seven components used to gauge economic forecasting in the state. We have to ask, why take a chance on possibly damaging an area that by almost any criteria, by any economist, is a major component of a state's—or for that matter a nation's—economy?

As long as we have this tax, it is going to be like having a ½" hole in the bottom of a bucket of water. The leakage out of the bucket, however, will not be water, it will be jobs. Let's keep the jobs and business here in Kansas. Re-instate the exemption on construction services, which is one of the provisions of this bill. It will be in all of our best interests to do so.

I will be glad to visit with any of you about my testimony or answer any questions you may have. I thank you for the opportunity to visit with you today.

GTK-

The Goodyear Tire & Rubber Company

P. O. BOX 1069
TOPEKA, KS 66601
PHONE (913) 295-7111

March 17, 1993

Dear Rep. Keith Roe:

My name is Don Lilya and I am the plant manager of the Goodyear Tire & Rubber Company tire manufacturing facility in Topeka. Goodyear's impact in the community and in Kansas is as follows:

•Employment	2,150 associates
•Annual payroll	$91.0 million
•Purchases of services	$15.0 million
•Utilities	$7.7 million
•Personal and Real Estate taxes	$2.2 million
•Sales tax	$320,000

In 1983, the Topeka plant had a tax liability of $1.6 million. The taxes increased every year until they peaked at $3.8 million in 1988, for a 138 percent increase in five years.

In 1989, re-classification and the inventory tax exemption reduced Goodyear's tax liability to $2.4 million. I was able to emphasize that as a favorable trend and Goodyear invested $32.0 million in the Topeka plant to expand production of radial truck tires.

The favorable trend continued with the passing of the school finance bill and our current tax liability is $2.2 million.

We are currently working with Akron to once again invest in Topeka with a $21.5 million expansion, and I know for a fact that long range plans dictate further investment in 1994-1995.

If we are to look to the future, we must make every effort to have Kansas show a favorable business attitude, not a negative position. Industries like Goodyear will provide the higher skilled, better paying jobs which will keep Kansas viable in the years ahead.

The Topeka plant is the highest taxed plant in the U.S. for Goodyear. My appeal to you is to consider removing the 2.5 percent tax on utilities used in manufacturing. This is a negative cost of $192,000 to our location and puts the Topeka, Kansas plant at a disadvantage when capital investment is being considered.

Donald E. Lilya

D.E. Lilya
Plant Manager

attachment

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TAXES - 1992

REAL ESTATE AND PERSONAL PROPERTY

PLANT	REAL ESTATE	PERSONAL PROPERTY	TOTAL
TOPEKA, KS	$691,156	$1,475,981	$2,167,137
LAWTON, OK	$513,382	$ 716,532	$1,229,914
FAYETTEVILLE, NC	$255,308	$ 507,357	$ 762,665
DANVILLE, VA	$225,824	$ 374,900	$ 600,724
GADSDEN, AL	$181,807	$ 294,492	$ 476,299
FREEPORT, IL	$417,303	- 0 -	$ 417,303
UNION CITY, TN	$ 12,300	$ 126,000	$ 138,300

LEGISLATIVE TESTIMONY

Kansas Chamber of Commerce and Industry

500 Bank IV Tower One Townsite Plaza Topeka, KS 66603-3460 (913) 357-6321

A consolidation of the Kansas State Chamber of Commerce, Associated Industries of Kansas, Kansas Retail Council

SB 203

March 17, 1993

KANSAS CHAMBER OF COMMERCE AND INDUSTRY

Testimony Before the

House Taxation Committee

by

Bob Corkins
Director of Taxation

Mr. Chairman and members of the Committee:

My name is Bob Corkins, director of taxation for the Kansas Chamber of Commerce and Industry, and I appreciate the chance to express our strong support for SB 203 and its proposal to create jobs by scaling back Kansas' onerous business tax burden.

> The Kansas Chamber of Commerce and Industry (KCCI) is a statewide organization dedicated to the promotion of economic growth and job creation within Kansas, and to the protection and support of the private competitive enterprise system.
>
> KCCI is comprised of more than 3,000 businesses which includes 200 local and regional chambers of commerce and trade organizations which represent over 161,000 business men and women. The organization represents both large and small employers in Kansas, with 55% of KCCI's members having less than 25 employees, and 86% having less than 100 employees. KCCI receives no government funding.
>
> The KCCI Board of Directors establishes policies through the work of hundreds of the organization's members who make up its various committees. These policies are the guiding principles of the organization and translate into views such as those expressed here.

Rather than repeat the points made by other conferees, or repeat relevant arguments I have already presented to this committee, I'll just touch on some highlights. The taxes serve to cut jobs, to drive employers out of Kansas, and have raised only a small fraction of the tax revenue anticipated.

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Furthermore, small businesses are experiencing an oppressive amount of paperwork in complying with these new taxes; out-of-state contractors have gained an advantage over resident businesses; manufacturers must pay more for utilities while pressure for layoffs is mounting; Kansas' natural gas producers got a huge property tax increase when they are already shouldering the largest tax burden in the nation for their industry; and, schools are suffering from a very unstable source of tax revenue.

My thrust today, however, is to address the state revenue estimates associated with SB 203. KCCI agrees with the rationale and conclusions contained in the Kansas Inc. report of February 9, 1993, as updated and explained to you yesterday by Dr. Charles Warren. I will elaborate on the dispute we have with KDOR's revenue estimate for original construction services.

KDOR estimates $12.6 million will be collected from the original construction tax in FY 93. This means actual receipts would be only 32% of the tax's original (May, 1992) annualized estimate. KDOR argues that $12.1 million, or 30% of the annualized estimate, is uncollectible due to the "grandfather clause" exemption for existing contracts. That leaves 38% of the annualized amount unexplained.

Consequently, the Department revised its estimate for FY 94 last January. They have conceded the total unexplained shortfall. Their figure for FY 94 now projects tax revenue of $24.7 million (plus a 4% inflationary growth factor). ***All*** of the 96% increase in projection over FY 93 is being attributed to the sunsetting of the grandfather exemption. KCCI finds this explanation to be totally unrealistic and implausible.

As Dr. Warren pointed out yesterday, KDOR's total FY 94 estimate assumes taxable new construction services will be about $1 billion. Specifically, $25.7 million in tax receipts would require a taxable base of $1.028 billion. As reported by the U.S. Department of Commerce, all 1992 construction projects in Kansas were valued at $1.3 billion in the aggregate. That figure includes all construction materials as well as the total value of projects exempted under our enterprise zone law.

Ignoring the enterprise zone factor for a moment, let's examine our tax base. Assuming taxable services account for 50% of project costs -- a very generous assumption

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employed by KDOR -- then half of $1.3 billion ($650 million) should be a more accurate estimate of the tax base for original construction. Instead, the Department contends that $2.056 billion worth of new projects will be let in FY 94 ($1.028 billion taxable services, plus $1.028 billion in materials).

Consequently, KDOR assumes a Kansas construction bonanza next year to the extent of $756 million over FY 93 ($2.056 billion, minus $1.3 billion). This 58% jump in construction activity would equate to 16,800 additional construction workers, $378 million in additional construction payroll, and almost $15 million in additional state income tax collections.

The more realistic estimate of $1.3 billion in construction activity highlights the reasonableness of Kansas Inc.'s fiscal note. $1.3 billion X 50% taxable service X .025 tax rate = $16.25 million in tax collections...as the ***maximum*** estimate. That total is quickly lowered by subtracting for projects exempt under the enterprise zone law and by applying a more conservative estimate which assumes only 40% of project costs are attributable to services. Hence, KCCI believes the $9 million fiscal note to be the best available.

The legislature's financial challenge represented by SB 203 is much simpler with the more accurate fiscal notes in focus. If passed, the bill would result in state FY 94 severance tax receipts *exceeding* those anticipated by the Governor's proposed budget. Sales tax receipts from new construction and from manufacturers' utilities would be curtailed by a total of $22 million. This amount could be compensated for with adjustments to overall state appropriations, which would be our preference, or it could be offset by an increase in the state sales tax rate to five percent, which KCCI would also support.

Most importantly, however, you should consider the implications of ***not*** passing SB 203. Kansas jobs are being lost. State sales tax collections and income tax collections will be lost due to those jobs...while also being lost due to imposition of the very taxes in question. Kansas should take corrective action now rather than do nothing and hope to weather the storm.

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TESTIMONY

BY TED DANKERT, PRESIDENT OF DUSTROL, INC.

BEFORE THE HOUSE ASSESSMENT AND TAXATION COMMITTEE

REGARDING

SALES TAX ON ORIGINAL CONSTRUCTION

SENATE BILL 203

Mr. Chairman and members of the House Assessment and Taxation Committee, I want to thank you for allowing me the opportunity to appear before you this morning to discuss the sales tax on original construction.

My name is Ted Dankert. I am President of Dustrol, Inc. of Towanda. We are a recycling contractor in south central Kansas specializing in cold milling, cold recycling, surface recycling and other pavement maintenance activities. We also have offices in four other states doing the same type of work as I just mentioned. I would estimate that 95% of our revenue is earned as a subcontractor.

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I am here this morning to support Senate Bill 203. I support this measure since it removes the 2 1/2 percent sales tax on the labor involved in the construction of roads and highways around the state. This tax was imposed last year as part of the School Finance Bill and raises an amount which varies somewhat depending on who computes the tax but probably is between 2 and 3 million dollars. As I stated, this tax was imposed as part of the School Finance measure, however, it is my understanding that it was not the intent of the Legislature to have it affect highway sub-contractors, such as mine, with the financial impact and administrative burden that it is having and will continue to have in the future.

There are several areas of concern in the regulation which I would like to emphasize.

- Highway Construction of all types is very competitive. On a national scale construction companies only average profits of approximately 2 1/2 to 5 percent. My company also makes, during normal years, profits of 2 1/2 to 5 percent. This tax on new construction of 2 1/2 percent dilutes our profit considerably in an industry already extremely competitive.

- It is difficult or unlikely that sub-contractors will be able to pass this tax on to prime contractors through the bidding process and consequently to the state because of two major factors:

  One, since the prime does not have to pay the tax, he will consider doing the work himself and save 2 1/2 percent. The other reason is that out-of-state contractors may try to avoid paying the tax and under-bid local companies and hope that are not audited.

- It is also my feeling that this tax will cause hardships to some of the very contractors, like minorities or women owned, that we have tried so hard to help over the years. Not only are they <u>not</u> administratively equipped to deal with this burden, they may be replaced by a prime doing their work because a prime contractor does not have to pay a tax on the same work on the same job.

- As I understand the theory of the tax, it exempts prime contractors because they work directly for the State. Sub-contractors are not exempt because they technically are working for the prime contractor, not the State. In my opinion this is an unfair interpretation of how contractors work together with the State in contractual relationships. Sub-contractors are bound by the same or similar contracts, insurance requirements, state inspector

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demands and personal contacts with state officials at all levels, the same as the prime contractor. This regulation seems to serve as a device to remove highway funds from the stated purpose and use them in other programs.

- Although the Department of Revenue problems are not my problems, I help support its activities through tax dollars. After having been recently audited, I know how difficult and expensive it can be to identify, audit and continuously enforce these very complex rules of sales tax. For example, tax on materials is 4.9 percent; this tax is 2.5 percent; dirt contractors pay no tax; no one pays tax if projects are exempt. I would suggest that this regulation added to our already difficult sales tax rules and interpretations will not result in the net increase of

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revenue dollars anticipated due in part to the cost of enforcement by the Department of Revenue.

- I might add at this point that contractors that move dirt on a project and incorporate this material back into the project are exempt from the tax. If I, for example, remove asphalt from the roadway and it is incorporated into the project, I <u>will</u> pay tax on our part. This illustrates another inequality in this regulation.

For those reasons, I ask that you remove the sales tax on labor regarding the construction of roads and highways.

I appreciate your time today and I will be glad to try and answer any of your questions.

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KANSAS ASSOCIATION OF REALTORS

REALTOR®

Executive Offices:
3644 S. W. Burlingame Road
Topeka, Kansas 66611
Telephone 913/267-3610

TO: THE HOUSE TAXATION COMMITTEE

FROM: KAREN FRANCE, DIRECTOR, GOVERNMENTAL AFFAIRS

DATE: MARCH 17, 1993

SUBJECT: SB 203

Thank you for the opportunity to testify. On the behalf of the Kansas Association of REALTORS, I appear today to support SB 203.

As we testified before this committee last year and again this year, we believe that placing a sales tax on new construction is a self-defeating effort on the part of the state of Kansas.

During the past recessionary cycle which the country has been experiencing, one of the "signs of recovery" which the economists were all looking for was whether the number of new building permits was increasing. New home construction is considered to be one of the leading economic indicators which economists use to predict upturns and downturns in our economy.

If new home construction is an industry which historically leads the economy out of a recession, why would the state of Kansas want to do anything which will hamper that industry? How can it be justified that increasing up-front costs of a new home will somehow be good for our economy? How can the state justify running jobs out of the state at a time when we are losing a critical number of jobs in other industries?

The annual revenue projection for this exemption last year was approximately $43 million. Yet, the state has been able to collect only a small portion of the projected "gold mine" and has greatly reduced the revenue estimate. We predicted last year that such a tax would not collect those projected amounts, only to be proven correct. We have serious concerns whether the $25 million revenue projection will add up.

To put the problem in perspective, the 2.5% sales tax on a $100,000 home would raise $1,000, based on the presumption that 40% of the cost of a home is labor. This would mean that we would have to build 25,000 $100,000 homes in order to raise $25 million. Even if we beat all housing records in the state, we will not see this kind of activity.

We have recently seen how cyclical our economy can be, thus demonstrating the need for diversity in order to ride the cyclical storms. Government should not be in the business of creating or exacerbating the tough economic cycles. The sales tax on new construction does just that by pushing business an jobs across state lines and by the outright reduction of business within the state.

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We know the prospect of raising $60 million by the removal of this exemption, along with the exemption for utilities used in production looked appealing because it was so large, at a time when the Legislature was looking for money. However, we are asking you to re-examine the decision made last year, along with re-examining the severance tax in light of the actual dollar amounts collected over the past six months, in light of the actual dollar amounts collected, in light of the dramatically reduced revenue projections and, most important in light of the pressing need for job creation in the state. We ask you to support this economic development package as a whole and recommend SB 203 favorable for passage.

Thank you again for the opportunity to testify.

<u>LABOR-MANAGEMENT COUNCIL OF GREATER KANSAS CITY</u>

TESTIMONY BEFORE THE HOUSE TAXATION COMMITTEE

PHILLIP P. SCAGLIA, EXECUTIVE DIRECTOR

<u>FOSTER ECONOMIC DEVELOPMENT FOR KANSAS -- PASS SB 203</u>

Good morning Mister Chairman, distinguished members of the Committee and honored guests. Thank you for the opportunity to appear before your Committee to discuss this most important and timely issue. My name is Phil Scaglia, and I represent the Labor-Management Council of Greater Kansas City (LMC).

The Labor-Management Council of Greater Kansas (LMC) is a civic organization comprised of Business leaders, Labor leaders and Community leaders interested in fostering cooperation on areas of mutual concern, such as economic development. The Council covers six (6) counties in Kansas and six (6) counties in Missouri with organizational membership of over 125 different organizations representing over 350,000 employees and union members.

The Council urges your consideration and support for SB 203. Specifically, the LMC Board of Directors has unanimously endorsed the repeal of the sales tax on labor services and the sales tax on utilities used in production and manufacturing. Business leaders and Labor leaders both recognize that taxing "labor services" and taxing utilities used in production and manufacturing adversely impacts the economic development potential of the State. The Council understands the dilemma which you as rational policy makers face in balancing the priorities of the State. LMC would submit that the desired outcomes of having these taxes are not being met, and that indeed these taxes put the State of Kansas at a disadvantage when compared to neighboring states.

An example is the sales tax on labor services. By design, it has a disproportional impact on economic development and specific industries. Unfortunately, if left unchecked serious ramifications will occur, not only in terms of lost economic development, but also upon the end source for these "phantom" tax revenues, the school finance formula.

The Labor-Management Council (LMC) urges your action in supporting and passing SB 203. Your leadership on this issue will prevent the State from loosing its comparative advantage in economic development.

The Labor-Management Council and I thank you for your time in discussing this critical issue. We encourage your support on this issue, and offer our assistance to you.

I would be happy to answer your questions.

Thank you.

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HOUSE TAXATION COMMITTEE

March 17, 1993
SB 203

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

My name is Janet Stubbs appearing today for the Home Builders Association of Kansas, Mechanical Contractors Association of Kansas and the Kansas Land Improvement Contractors Association in support of SB 203.

You have heard the basis for support we give to legislation which would remove the sales tax on new construction gross receipts, the Daicoff study, during testimony on HB 2148. Dr. Daicoff was hired by the Home Builders Association of Kansas to do a study to determine the effect of the passage of the school finance bill of 1992. The leadership of the HBAK weighed the value and ramifications of such a study due to the unknown result and the expense. However, the decision was made to proceed and Dr. Daicoff was instructed to ascertain an accurate, reliable picture of the effect of this legislation. He was not asked to slant the results nor would he have done so. The result was presented to you during the hearing on HB 2148.

Some of you have questioned the accuracy of the study stating that consideration of the effect factors other than the sales tax on the construction industry was not given. I ask that you reread the study and believe you will find that the comparison of Kansas with the surrounding states would, in fact, take into consideration the increased lumber prices, etc. Lumber prices, the economy and a presidential election year would have played a role in surrounding states as well. It could be said that the volatility of the tax structure in Kansas as a whole could also be a factor.

Attempting to discredit the Daicoff study is the logical strategy for opponents of this legislation. However, we believe their criticism is unfounded. We believe the Kansas Inc. study and the testimony from the Wichita accountant gives an accurate picture of the revenue which can be anticipated if this tax is left in place. It is our position that the amount of revenue realized, the difficulty of the collection, and the effect on the economy does not make it a worthwhile endeavor.

We urge your support of SB 203.

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HEIN, EBERT AND ROSEN, CHTD
ATTORNEYS AT LAW
5845 SW 29th Street, Topeka, Kansas 66614
Telefax: (913) 273-9243
(913) 273-1441

Ronald R. Hein
William F. Ebert
Eric S. Rosen

HOUSE TAXATION COMMITTEE
HEARING RE: SB 203
Presented by Ronald R. Hein,
on behalf of MESA, Inc.
March 17, 1993

Mr. Chairman, Members of the Committee:

My name is Ron Hein, and I am legislative counsel for Mesa. Mesa is one of the nation's five largest independent gas producers and currently has approximately 60% of its natural gas reserves in the state of Kansas.

To many, the "oil and gas" industry is viewed as being one industry. But, the Kansas tax burdens of oil producers and gas producers are significantly different.

Although both oil and natural gas are currently assessed at the highest classification rate, 50% above many other Kansas businesses, there is considerable disparity between the severance tax rate applied on gas versus oil.

Gas producers are levied at a rate of 7% of gross revenues; oil is taxed at a statutory rate of 4.33%, or about 40% less.

Furthermore, 1990 statistics reflect that due to certain existing exemptions in the severance tax law, the actual effective rate of tax collected on <u>oil</u> production was <u>2.41%</u>, which more closely approximates other Kansas gross receipt burdens. In contrast, the effective rate on <u>gas</u> production was <u>6.87%</u>. When viewed in relation to the value of production, <u>natural gas producers bore a 285% greater severance tax burden than oil producers</u>.

As you know, Kansas gas producers pay this disproportionately large gross receipts tax <u>in addition</u> to property taxes. Mesa currently bears an additional property tax burden of approximately 10% of gross natural gas income, as significantly increased by the school finance legislation passed last year.

For Mesa, this results in a combined gross receipts tax in excess of 17% since both severance and ad valorem taxes are levied and determined in part by the amount of gas a business produces. For comparative purposes, the combined gross receipts taxes is approximately 35% greater than what gas producers pay to the typical landowner for mineral rights.

The idea of a gross receipts tax in Kansas is not unique, but other industries pay rates of approximately 1%-2%, and more significantly, their taxes are <u>in lieu of other property taxes.</u> No other Kansas industry comes close to bearing the gross

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receipts tax burden levied on natural gas producers, which is levied irrespective of whether they are profitable or unprofitable.

Based upon 1990 statistics, the total wellhead value of crude oil produced in Kansas was 50% greater than the total wellhead value of gas produced. However, it had been estimated that the ad valorem burden was about equal before the statewide mill levy. This disparity of the tax burden as compared to gross revenues has increased under a statewide mill levy as a result of the following:

> Oil is spread throughout the state, and for the most part, oil producers in the state have benefited by a uniform mill levy. But, natural gas is heavily concentrated in the Hugoton Field where levies were increased by the uniform mill by as much as 100%.

When the discrepancy on ad valorem taxes between oil and gas is combined with the disparity in the severance tax rates between oil and gas, the unfairness of the current tax structure on the natural gas industry becomes painfully obvious.

The original rationale in 1983 for the severance tax being imposed on natural gas at 7%, versus 4.33% on oil, was two-fold:

> 1) The severance tax on natural gas could be passed to out of state consumers pursuant to then existing federal regulation:

Subsequent deregulation at the national level makes it no longer possible for natural gas producers to pass on the cost of a severance tax. Today, the tax is directly on Kansas producers.

> 2) The credit for ad valorem tax (3.67% for oil, and only 1% for gas) recognized the low ad valorem taxes in the Hugoton area and was an attempt to keep the combined ad valorem and severance tax burdens on oil producers and gas producers equal.
>
> This rationale was eliminated with the passage of a uniform mill levy.

Most industries, when facing excessive taxation, have the ability to increase the price of their product, reduce costs, or increase production in order to help mitigate the tax burden. None of these are true for the natural gas industry or for Mesa.

The price of natural gas is determined to a large extent by the "spot market", which is influenced by national and international market forces. Kansas, by itself, cannot change this.

Natural gas producers have already faced the difficult task of cost reductions. Mesa, for example, is operating with 35% fewer personnel than it had two years ago.

Lastly, gas producers in Kansas cannot apportion increased taxes over a greater amount of product, because producers are regulated by law as to how much gas can be produce.

Part one of the solution is to increase the severance tax credit for property tax on natural gas to 3.67%, thus reducing the severance tax rate to 4.33% on gas, the same rate now imposed on oil.

Part two involves removing regulatory dis-incentives for growth in the natural gas industry. The KCC is currently reviewing revision to its production allowable procedures which potentially could lead to increased production from both new and existing wells. Such increased economic activity will potentially regenerate some, if not all, of the dollars lost to the SGF by the decreased severance tax rate. The KCC and the Executive Branch are to be commended for their foresightedness in recognizing that Kansas has been losing production revenues to other states. Now, the Legislature must assist by insuring that the combined severance tax and property tax rates do not discourage production here.

Reduction of the Severance tax would help stimulate production, thereby increasing the assessed valuation of the Hugoton field (resulting in increased property tax receipts) and providing incentives to complete the infill drilling already approved by the KCC which alone would generate $400 million in capital investment in Southwest Kansas. The result would be more jobs, more taxes of all types, and more assessed valuation to benefit the region and the State.

Kansas, while being a major gas producing state, is a relatively small slice of a very big pie. Estimated 1991 overseas oil and gas exploration expenditures totalled $31.4 billion, while domestic exploration was $17.7 billion. Five years ago, domestic and foreign exploration and development were about equal. Kansas currently produces a smaller portion of its available resource than the other major energy producing states of Oklahoma, Texas, and Louisiana.

Kansas needs to "jump start" the industry. The KCC has stepped up to this problem for the industry and for Kansas. Now, it is time for the Legislature to assist by reducing the severance tax. Mesa strongly urges the legislature to reduce the severance tax on natural gas to at least parity with oil, by increasing the property tax credit to 3.67% for natural gas.

Thank you very much for permitting me to testify, and I will be happy to yield to questions.

TESTIMONY ON S.B. 203
HOUSE TAXATION COMMITTEE
MARCH 17, 1993

BERNIE KOCH
WICHITA AREA CHAMBER OF COMMERCE

Mr. Chairman, members of the Committee, thank you for your consideration and the opportunity to appear today. I'm Bernie Koch with the Wichita Area Chamber of Commerce, which supports Senate Bill 203.

Even with the very real questions about how lost revenue will be replaced, with which we sympathize, we cannot help but endorse this bill.

Historically, our business community has supported tax relief for the Kansas oil and gas industry. We've also opposed removal of sales tax exemptions, which happened last year with original construction services and utilities used in production. All three of these issues are important to our area.

I've been thinking about the arguments for and against this bill as it went through the Senate. Many of those who voted "no" did not disagree with the positions presented by proponents. They admitted there were problems with these taxes and that S.B. 203 was desirable. They acknowledged it would enhance job creation and economic development. They acknowledged the turmoil created especially by the sales tax on original construction services. The major argument against this bill was, "how do we replace the revenue?"

To me, the question here is an old one: Do the ends justify the means? Is it right to prolong bad public policy because it brings in money to fund admittedly important programs?

If you were suddenly to discover some ridiculous quirk in the law, some loophole, which allowed the State Revenue Department to send armed state employees out on the street to legally rob pedestrians to raise money for state programs, you would act very quickly to correct that situation. You would not be able to argue very effectively that, "we know it's not good public policy, but how are we going to replace the money?" Clearly, the end would not justify the means.

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So, I guess the question becomes a matter of degree. How bad does the public policy have to be before you move to change it?

The proponents of Senate Bill 203 have clearly articulated that the present situation is bad enough on the three matters addressed in the bill.

Clearly, the oil and gas industry is overtaxed in this state and is operating at a disadvantage. The sales tax on original construction services has not only resulted in tremendous turmoil, but the Revenue Department acknowledges it's very confusing. The Interim Tax Committee recommended removing the sales tax on utilities used in production because it flies in the face of good economic development policy.

I urge you to base your decision on Senate Bill 203 on the public policy questions of the taxes involved, not solely on revenue considerations.

Thank you for the opportunity to appear today.

KANSAS
RURAL
WATER
association
Quality water, quality life

P.O. Box 226 • Seneca, KS 66538 • 913/336-3760 • FAX 913/336-2751

March 17, 1993

Rep. Keith Roe, Chairman
House Committee on Taxation

Dear Chairman Roe and Members of the Committee:

Thank you for the opportunity afforded to the Kansas Rural Water Association to present testimony on SB 203. My name is Gary Hanson. I am an attorney in private practice in Topeka with the firm of Stumbo, Hanson & Hendricks. We are members of KRWA and we represent several KRWA member rural water districts and cities. KRWA provides training and on-site technical assistance to cities and rural water districts, mobile home parks and other community water systems.

The Kansas Rural Water Association supports SB 203. The bill contains provisions that eliminate the tax on utilities consumed in the production of tangible personal property and the tax on services performed in installing tangible personal property during new construction. Both of these taxes create a financial burden on rural water districts, cities and their customers.

Perhaps the most important difficulty created by each of these taxes is the difficulty of their administration. The best example of this concerns the application of the 2-1/2% sales tax on services performed in the installation of tangible personal property used in original construction. This is complicated by having to determine what is and what is not original construction (tax at the rate of 4.9% is to be paid if it is not original construction). Further, it is extremely difficult to distinguish between those services that are installation of tangible property and those that are merely preparatory. In the business of constructing a water line, those services performed in the digging of a trench are preparatory, and therefore not taxable, but the physical connection of the water line is taxable. In this business, there are many such situations where this distinction is all but impossible to make.

Because of the difficulty in applying the tax, KRWA finds that many of its members, and the engineers and contractors that perform services on their behalf, cannot understand how to comply with the law. As a result, we believe that that miscompliance and noncompliance are more common than not.

For all of these reasons, we urge favorable action by the Committee on SB 203.

Very truly yours,

Gary H Hanson

GARY H. HANSON

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GHH:de

Johnson County
Kansas

March 17, 1993

HOUSE TAXATION COMMITTEE

HEARING ON SENATE BILL 203

TESTIMONY OF GERRY RAY, INTERGOVERNMENTAL COORDINATOR
JOHNSON COUNTY BOARD OF COMMISSIONERS

Mr. Chairman, members of the Committee, my name is Gerry Ray representing the Johnson County Board of Commissioners. I am appearing today in favor of the repeal of the sales tax on original construction included in Senate Bill 203.

The Johnson County Commission is convinced that this tax is detrimental to the economic health of our community. Due to the national economy the construction activity has been off somewhat in the past two years, however it remains one the leading industries in our area. There is significant concern that the imposition of this latest tax will have an negative effect on the continued growth of the County. Being located on a state line we must always be conscience of the competitiveness of the tax structure. We believe we are falling behind in that competitiveness due to actions of the Legislature in the past several years.

The Committee is urged to seriously consider all of the ramifications of the sales tax and weigh them against the return being received from the tax that is insufficient for the purpose intended.

The Johnson County Commission requests that the Committee recommend SB 203 favorably for passage.

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Board of County Commissioners 111 South Cherry Street, Suite 3300 Olathe, Kansas 66061-3441 (913)764-8484 (5500)

The City of
Overland
Park
KANSAS

City Hall • 8500 Santa Fe Drive
Overland Park, Kansas 66212
913/381-5252 • FAX 913/381-9387

March 17, 1993

TO: House Taxation Committee

FROM: Gerry Ray, Legislative Liaison
The City of Overland Park

SUBJ: Testimony on Senate Bill 203

Mr. Chairman, members of the Committee, my name is Gerry Ray, speaking on behalf of the City of Overland Park in support of Senate Bill 203. My comments are directed at the section of the bill that repeals the sales tax on original construction.

When the City analyzed this tax that was imposed last year, it was apparent that there were many ways to avoid paying the sales tax. The potential for avoidance favored the larger contractors over smaller ones, because manufacturing firms or non-retail firms may qualify for exemption on construction materials and services. In other words, larger commercial operations are likely to be exempted from the tax whereas homeowners and the "Mom and Pop" businesses must bear the additional burden. The imposition of the sales tax on construction, places an additional burden on smaller contractors, because the costs of compliance associated with this new legislation are disproportionately greater for smaller firms making up a greater percentage of their total sales.

Kansas subcontractors are openly considering relocating billable offices in Missouri and avoid paying the tax. In addition general contractors have threatened to hire only Missouri subcontractors. Although we cannot put hard numbers on any of this movement, we believe it will happen in the long term.

The City reiterate support of SB 203 to repeal the sales tax on construction because we believe it contains inequities. In addition we believe it is a tax policy that will result in the loss of local jobs and increase economic development for other states.

It is the our opinion that if a cost/benefit analysis were conducted on this tax, the cost of loopholes, inequities, confusion and loss of jobs would certainly outweigh the benefits. Reports show that on $1.5 million in revenue was collected the first six months. That is not even close to the estimates provided the Legislature when the bill was being considered in 1992.

We urge the committee to carefully consider this matter and ask that you recommend the bill for passage.

STATE OF KANSAS

Nancy Parrish, Secretary of Revenue
Robert B. Docking State Office Building
915 S.W. Harrison St.
Topeka, Kansas 66612-1588

(913) 296-3041
FAX (913) 296-7928
Information (913) 296-3909

Department of Revenue
Office of the Secretary

TO: Keith Roe, Chairman and
Members of the House Taxation Committee

FROM: Nancy Parrish NEP
Secretary of Revenue

DATE: March 17, 1993

RE: Senate Bill 203

State expenditures occur in two major ways -- through the appropriations process where agency budgets and programs are funded, and through tax exemptions where revenue is lost due to exemptions for various groups or purposes.

S. B. 203 reduces revenue to the State of Kansas by an estimated total of $49.2 million for FY '94. For the next three fiscal years, the loss of revenue from each of the components of S. B. 203 is included below:

	LOSS IN GENERAL FUND REVENUES - IN MILLIONS		
SOURCE	FY 1994	FY 1995	FY 1996
UTILITIES EXEMPTION	$16.5	$17.2	$17.8
CONTRACTOR'S EXEMPTION	25.7	26.7	27.8
NATURAL GAS CREDIT	7.0	16.0	22.4
TOTAL LOSS	$49.2	$59.9	$68.0

Of the lost revenue $42.2 million is earmarked for the School Finance Fund and would reduce that fund by that amount.

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If revenues to the state are going to be reduced by nearly $50 million, then either the legislature needs to find a replacement revenue source, ie new taxes or reduce spending by $50 million.

As a former member of the legislature who served on the Conference Committee on School Finance, I don't envy the legislature's dilemma if S. B. 203 is passed. The School Finance Tax package was not perfect but instead was a product of compromise, a very long, arduous process of compromise.

Two of the components of S. B. 203 were major components of that final School Finance tax package, and they represent a favorable shift in tax policy by broadening the tax base. One method of making tax revenue more responsive to economic growth is through broadening the tax base.

The sales tax is generally considered to be a regressive form of taxation. Low income citizens pay a larger proportion of their income in sales taxes than upper income citizens. Many of the exemptions to the sales tax base make the sales tax system more regressive. On the other hand the repeal of certain exemptions makes the sales tax system more progressive. Last session's elimination of the exemption of labor on original construction and the exemption on utilities consumed in production increased the progressivity of the sales tax.

One example which illustrates that point is taxing labor services for remodeling and repairs at the full sales tax rate. Our old law which exempted labor services on new construction from the sales tax while applying sales tax to remodeling and repairs increased the regressivity of the sales tax. Applying sales tax to labor on original construction improves the progressivity of our sales tax as well as the fairness to all taxpayers.

Some of the opposition to the sales tax on labor for original construction has been due to the complexity of calculating the tax and the difficulty in collecting the tax. The complexity is primarily due to the half-rate (2.5%) on labor on original construction. Many of the problems in this area would disappear if all construction labor services were taxed at 4.9%.

Others who oppose this tax cite the problems in collecting the tax from all who should be paying the tax. As with other new taxes, there is a time lag while taxpayers are becoming educated about the tax and how to fill out the forms. In addition, when there is resistance to a new tax, some taxpayers are less likely to comply. The Department is tackling both of those problems without any additional resources, I might add.

Since the passage of the School Finance Tax package, the Representatives of the Department have made numerous presentations to Contractors' groups and to general audiences about the changes in the law. Department representatives met with the industry to get input about designing the new forms and writing the regulations. The Department will continue in our efforts to educate contractors about this new provision in law.

In addition, the Department has implemented a Discovery Unit to identify Contractors that are not complying with the new law. Those Contractors, once identified, will be referred to our Audit Bureau for a sales tax audit.

The Department of Revenue believes that the sales tax on labor on original construction is both enforceable and collectible; and to date, there have been no enforcement problems with the sales tax on utilities consumed in production.

To summarize, the Department of Revenue opposes S. B. 203. Replacing the nearly $50 million in lost revenue would be a difficult task for the legislature as would reducing budgets by that same amount. The benefits gained last session of broadening the sales tax base would be lost if S. B. 203 was enacted.

The Department respectfully requests the House Committee on Taxation to report S. B. 203 adversely.

STATEMENT OF
BERNARD E. NORDLING, EXECUTIVE SECRETARY
SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION
HUGOTON, KANSAS 67951

March 17, 1993

To the Honorable Members of the House Taxation Committee.

INTRODUCTION

Mr. Chairman and Members of the Committee:

My name is Bernard E. Nordling of Hugoton. I am Executive Secretary of the Southwest Kansas Royalty Owners Association. I am appearing on behalf of members of our Association and on behalf of Kansas royalty owners in support of Senate Bill 203. One of the purposes of the bill is to phase in the tax credit on natural gas over a three year period to equalize the tax credit of 3.67% granted to oil. The net result is to reduce the severance tax on gas from 7% to 4.33%, the same as the severance tax imposed on oil.

BACKGROUND INFORMATION

Our Association is a non-profit Kansas corporation, organized in 1948, for the primary purpose of protecting the rights of landowners in the Hugoton Gas Field. We have a membership of over 2,400 members. Our membership is limited to landowners owning mineral interests in the Kansas portion of the Hugoton Field - lessors under oil and gas leases as distinguished from oil and gas

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lessees, producers, operators, or working interest owners.

For those of you who are not familiar with the Hugoton Gas Field, it covers parts of 11 southwest Kansas counties, including Seward, Stevens, Morton, Stanton, Grant, Haskell, Finney, Kearny, Hamilton, Wichita and Gray. It extends through the Oklahoma Panhandle into Texas. The Hugoton Field runs 150 miles north and south and 50 miles east and west and is one common source of supply.

According to information furnished by the Conservation Division of the Kansas Corporation Commission, as of November 30, 1992, the Kansas portion of the Hugoton Field has 5,768 producing gas wells encompassing producing 2,650,315 acres. Production is from a depth of between 2,500 and 2,800 feet. Of the 5,768 wells in the Hugoton Field, 4,236 are the original Hugoton pay wells, and the remaining 1,532 are infill wells, or second wells producing from the shallow Hugoton pay.

Interestingly enough, the November 1992 KCC report on the Hugoton Field shows 1,119 wells with cancelled underages, or gas the companies have failed to produce over a six months period. There is considerable underproduction existing in the Field.

Lying within the confines of the Kansas portion of the Hugoton Field is another large gas field - the Panoma Council Grove Gas Field. It has defined limits of approximately two million acres, producing gas from a formation lying immediately below the Hugoton pay at a depth of between 2,800 and 3,100 feet. The latest

Kansas Corporation Commission figures show 2,345 Panoma Council Grove wells encompassing 1,480,534 producing acres.

PRESENT TAX BURDEN ON KANSAS ROYALTY OWNERS

In understanding our support to Senate Bill 203, it might be helpful for members of your honorable committee to understand the present taxing structure on minerals and oil and gas production in Kansas. Mineral and royalty owners in Kansas are paying four types of taxes on minerals and oil and gas production:

(a) Oil and gas personal property (ad valorem) taxes;

(b) Taxes on minerals in place;

(c) State severance tax of 7 per cent net of the gross value on gas and 4.33 per cent net of the gross value on oil; and

(d) Conservation levy of 4.3 mills on gas and 13.5 mills on oil assessed on production (helps pay administrative costs of the Kansas Corporation Commission).

Both taxes listed under (a) and (b) are paid through the local county treasurer's office. Taxes listed under (c) and (d) are paid on the state level and are listed on monthly royalty statements and deducted from monthly oil and gas royalties. The gas companies operating in the Hugoton Field pay these same taxes with the exception of Item (b), taxes on minerals in place.

STATE SEVERANCE TAX BURDEN

The state severance tax is already taking a heavy toll this area of the state as shown by the following mineral tax revenue raised by the state severance tax from the following southwestern Kansas counties for the period from 1983 through 1990:

*MINERAL TAX REVENUE

County	1990 Calendar Year	Cumulative 1983-1990
Finney	$ 4,214,303.00	$ 24,403,171.00
Ford	226,457.00	2,073,008.00
Grant	11,035,195.00	47,373,012.00
Gray	112,000.00	1,024,246.00
Greeley	516,527.00	5,333,410.00
Hamilton	758,542.00	4,551.962.00
Haskell	4,325.498.00	22,888,788.00
Kearny	6,050,146.00	40,972,348.00
Lane	601,441.00	6,445,505.00
Meade	1,536,830.00	11,232,489.00
Morton	5,526,925.00	34,521,635.00
Scott	116,843.00	904,431.00
Seward	4,223,840.00	27,356,217.00
Stanton	1,452,618.00	12,122,157.00
Stevens	17,286,624.00	73,575,446.00
Wichita	44,318.00	276,656.00
Southwest Kansas Total	$58,028,107.00	$315,054,380.00
State Total	$87,460,587.00	$659,734,635.00

These 16 Southwest Kansas counties, out of a total of 105 counties in the state, bore 2/3rds of the state severance tax burden for 1990. Another way to explain this heavy tax load is to convert it into a mill levy. For Stevens County, for example, the state severance taxes of $17,286,624.00 taken from the county for state use in 1990 is the equivalent of a 57 mill levy.

*The above mineral tax revenue information was obtained from the Kansas Department of Revenue. Figures for 1991 have not been made available to date.

SURVEY CONDUCTED TO DETERMINE TOTAL TAX BURDEN ON SOUTHWEST KANSAS ROYALTY OWNERS

A survey of its members was conducted last year by the Southwest Kansas Royalty Owners Association to determine the 1991 total tax burden placed on royalty owners in southwest Kansas. The survey was conducted to show the percentage of gross royalty income being paid in ad valorem and state severance taxes. Over 500 SWKROA members responded to the survey. The results of the study reveal the 1991 tax burden on our members, county by county:

Percentage of Gross Income Paid in Taxes In Hugoton Field Area

	RANGE		
COUNTY	Low	High	Average
Finney	12.6%	39.1%	21.83%
Grant	9.0%	26.4%	14.20%
Hamilton	12.6%	32.9%	21.00%
Haskell	9.2%	35.1%	13.66%
Kearny	9.1%	19.5%	12.03%
Morton	9.1%	33.8%	13.64%
Seward	12.1%	29.4%	19.85%
Stanton	9.0%	25.9%	13.74%
Stevens	9.1%	30.9%	11.44%

The additional tax burden of the statewide school tax levy of 32 mills imposed by the 1992 Kansas Legislature on school districts within the southwest Kansas area has increased this tax burden tremendously.

The reaction to these additional taxes has been dramatic as evidenced by the filing of 890 individual tax protests in Stevens County, involving 5,989 tax statements, 1,300 tax protests in Grant County, and 830 tax protests in Morton County.

An example of the substantial increase in taxes brought about by the new school tax levy was furnished by one of our SWKROA members who owns land in Stevens County. His ad valorem taxes paid to the Stevens County Treasurer for 1991 was $2,837.47. Taxes for 1992 on the same property, including local ad valorem taxes on farm land and gas royalties, totalled $4,944.16, an increase of almost 75%!

We do not have tax figures available for the producers operating in the Hugoton Field but feel certain they have experienced sharply increased ad valorem taxes in those counties where school districts were so adversely affected by the 32 mill statewide school tax levy.

MISCONCEPTION AS TO THE PERSONAL WEALTH OF ROYALTY OWNERS

There is a misconception that the average royalty owner is rolling in wealth. The Hugoton Gas Field has been in existence since the 1920's and all the original royalty interests have gone through several estates. The royalty interests in each estate are usually divided among several heirs. Consequently, by now, there are thousands of Hugoton Field royalty owners, most of them owning only small fractional royalty interests. In other words, there are many royalty owners throughout the state who have been adversely affected by the statewide school levy.

Many of our members are also elderly persons receiving social security benefits and depending on gas royalty income to supplement their social security benefits. Increased taxes are of deep concern to them, as evidenced by their response to our survey conducted to determine their 1991 tax burden, referred to above. Senate Bill 3 will grant some relief from this heavy tax burden.

IMPACT OF TAXES ON NATURAL GAS INDUSTRY IN HUGOTON AREA

In 1989, a study of the oil and gas industry in Kansas was conducted by Arthur D. Little, Inc., for Kansas, Inc. The study revealed there are significant regional variations in the tax burden within the state on the oil and gas industry. The study acknowledged the importance of the Hugoton Field area in Kansas and made comparisons of the tax burden on the Hugoton area with the rest of the state.

According to the study, in 1988, the Hugoton area accounted for 11% of Kansas oil production and 83% of its gas production. Relatively little of this production was exempt from severance taxes. As a result, the total severance tax burden on the value of production was considerably higher in the Hugoton Field - 6.8% versus 3.0% for the rest of the state. Similarly, Hugoton area ad valorem taxes as a percentage of gross production revenues were higher than the rest of the state - 6.9% versus 4.2%.

The Arthur Little study also revealed that the combined tax burden (severance and ad valorem) for the Hugoton area totalled 13.7% of revenue versus 7.2% for the rest of the state. Obviously, the Hugoton Field area is already paying more than its fair share of the tax burden on oil and gas production.

IMPORTANCE OF NATURAL GAS INDUSTRY TO KANSAS ECONOMY

Kansas is ranked sixth among the natural gas producing states, and the importance of encouraging natural gas production in the state should be obvious. In fact, the 1991 Kansas Legislature, through Senate Concurrent Resolution No. 1626 (extended by Concurrent Resolution 1633 of the 1992 Kansas Legislature), mandated the appointment of a Commission on Natural Gas Policy to, among other things, encourage natural gas production in the state.

The resolution begins with the following statements:

> "WHEREAS, natural gas is one of the major resources of the state of Kansas, the waste of which seriously impairs the economic condition of present and future generations of Kansas; and
>
> WHEREAS, Kansas natural gas reserves are presently being produced and sold in the interstate market at a discount to alternate fuels and at prices which may be below the cost to find and develop new natural gas reserves in the state; and
>
> WHEREAS, many of the natural gas producing states of the United States are taking action to design and establish state energy policies and are actively participating in the formulation of a natural energy policy which will have a critical impact on the natural gas industry of the state of Kansas; and
>
> WHEREAS, it is necessary and desirable for the State of Kansas to work with other natural gas producing states to establish effective state and national energy strategies which promote the production and use of natural gas in an orderly manner and at a price that reflects the fair value of this resource......"

I am a member of that Commission. We met for several months to develop recommendations to the Governor and the Legislature on the steps needed to be taken to encourage natural gas production and use within the state. It is my understanding the report is at the printers and will be made available to Governor Finney and all members of the Legislature within the next two weeks.

One of the top priorities of the Kansas Commission on Natural Gas Policy was to seek a workable solution to the already heavy tax burden on the natural gas industry. <u>Its very first recommendation is to reduce the severance tax on gas to 4.33% as proposed by Senate Bill 203</u>.

<u>FEAR OF LOSING PRESENT GAS MARKET TO OTHER STATES</u>

The natural gas industry throughout the United States has been a depressed industry for several years, with mild winters and the "gas bubble."

For years, the major gas companies operating in the Hugoton Gas Field have used the Field as a storage reservoir and historically have not taken their monthly allowables, resulting in a tremendous amount of underproduction over the years. Instead, the companies have gone to other areas of the country for their gas supplies where the tax burden is not so great. The statewide school tax levy passed by the 1992 Kansas Legislature and approved by Governor Finney added substantially to the already heavy tax burden and gave further reason for the gas companies operating in the Hugoton Field to seek more favorable markets elsewhere.

If the Kansas Legislature fails to help reduce this already heavy tax load on the natural gas industry, there is nothing to keep the gas companies from moving to other parts of the country or world for their gas markets where prices and taxing structures are more attractive, resulting in the continued use of the Hugoton Field for storage.

REDUCED TAX BURDEN COULD BENEFIT INFILL DRILLING

Infill drilling (the drilling of a second Hugoton pay gas well on each 640 acre unit), inaugurated by the Kansas Corporation Commission after extensive hearings in 1987, has given a shot in the arm to the Kansas economy with increased drilling activity and increased natural gas reserves.

Slightly more than one-third of the infill wells have been drilled to date on approximately 4,200 Hugoton gas units. For various reasons, some of the producers have been slow in drilling their infill wells. Obviously, the drilling of the remaining infill wells would add greatly to the economy of Southwest Kansas and the State of Kansas in general through increased investments and production. Passage of Senate Bill 203 could be the key to open the door for speeding up the infill drilling program. Potentially, there are approximately 2,700 infill wells remaining to be drilled if the producers exercise their right to do so. The drilling of even 2,000 more infill wells at a cost of $150,000 each would generate revenues of Three Hundred Million Dollars.

NATURAL GAS PROCLAIMED AS FUEL OF THE FUTURE

For the past several months, a great deal of publicity has been given to natural gas as being the fuel of the future. In fact, the attached article appeared in the Sunday (January 31, 1993) issue of the Wichita Eagle and shows the potential of natural gas as the fuel of the 90s.

Kansas is fortunate to have the largest gas field in the free world within its boundaries. We should do everything possible to encourage gas production within the state. Passage of Senate Bill 203 is a step in the right direction. We respectfully encourage this committee to favorably recommend Senate Bill 203 for passage.

Thank you for this opportunity to present my statement to your honorable committee.

Respectfully submitted,

B E Nordling

B.E. Nordling
Executive Secretary
SOUTHWEST KANSAS ROYALTY
OWNERS ASSOCIATION

BEN/emp

If the ship of the '90s comes in, it may be burning natural gas

By Dan Blake
Associated Press

NEW YORK — After more than a century of being viewed as a stepchild to crude oil, natural gas soon could become the fuel of the '90s.

Touted as clean, cheap and abundant, natural gas has captured the attention of the Clinton administration, which plans to encourage its use over imported oil. The new president's chief of staff is a former natural gas company chief and the new Department of Energy secretary drives a natural gas-powered car.

"Expectations have always been great, and those expectations have never been realized," said T. Boone Pickens, a Texas oilman and natural gas supplier. "I have seen us at this point for 30 years."

But concerns about future supplies lead some energy experts to describe natural gas as more of a "transition fuel" to tide the country over until renewable sources like solar or wind power are further developed.

Then there's the question of cost. As more gas is produced, drillers are likely to require higher prices to go after a product expected to become increasingly less accessible over the next few decades.

And although natural gas burns cleaner than oil or coal, environmental preservation could become an issue as drillers seek access to vast amounts of gas in the outer continental shelf, wildlife areas and marine sanctuaries, areas currently off-limits to drilling.

For now, though, natural gas proponents frequently point to its comparatively lower price.

e 2C

GAS

Prospects improve for gas industry

From Page 1C

For example, it costs about $580 a year to heat a mid-size house in a temperate climate, based on government figures and current market prices. It would cost more than $800 to heat that same house with oil, by far the most common method for home heating in the United States, according to Fueloil & Oil Heat, a trade publication.

"There aren't many people who will pay to change the situation for environmental concerns. ... Natural gas is cheaper," Pickens said in a recent interview. "There's so much room between today's natural gas price and gasoline."

A recent Department of Energy report, though, indicated natural gas prices would certainly rise in the future.

The study, compiled over two years by the department's advisory National Petroleum Council, estimated, for example, wholesale prices would have to double to $3.50 per 1,000 cubic feet before it would be worth producers' time and money to retrieve 64 percent of the country's gas.

Some of the gas would have to be recovered from between coal seams through horizontal drilling and other unconventional methods that are time-consuming and more expensive.

The wholesale price of natural gas averaged $1.75 per 1,000 cubic feet last year. Retail prices averaged around $5.80 per 1,000 cubic feet.

Wholesale oil prices now average about $18 a barrel, or the energy equivalent of $3 per 1,000 cubic feet of wholesale natural gas.

The Energy Department study estimates there are 1.3 quadrillion cubic feet of natural gas in the continental United States. The broad estimate assumes drilling technology continues advancing through 2010.

But even if Americans don't increase their consumption of gas, the domestic supply would run out in 65 years, analysts say.

Importing gas from anywhere other than Canada would mean huge transportation costs. To be shipped by tanker, gas has to be cooled to 256 degrees below zero until it turns to liquid.

Japan, which imports nearly all its natural gas as liquid, pays about $4 per 1,000 cubic feet to buy liquefied natural gas from Indonesia. U.S. prices likely wouldn't rise high enough to justify transporting gas from Alaska's oil fields, which are also rich in natural gas, the National Petroleum Council said.

About a third of the world's reserves of natural gas is in the Middle East; about 4 percent is in the United States.

U.S. suppliers have been anxiously awaiting an increase in natural gas usage for some time now.

Years of low prices, slack demand and plentiful supply have meant bad times for many natural gas companies, some of which have gone bankrupt over the years.

Since the late 1970s, the government had discouraged the use of natural gas, which it considered to be in short supply. Instead, it gave incentives for drillers to look for unconventional energy sources. The result was natural gas demand dropped off sharply, but supplies rose as more gas was found.

Clinton has been thin on specifics on how to emphasize natural gas use, and any new proposals would have to clear Congress. But with Thomas McLarty, former chief of natural gas producer and distributor Arkla Inc., and Hazel O'Leary, a former executive at Northern States Power Company in Minnesota, chosen for White House chief of staff and energy secretary, respectively, the industry hopes to be heard in Washington.

New markets give the industry its best prospects in years.

Pickens, with more than a trillion cubic feet of natural gas to sell, has been driving around the country in his natural-gas powered Cadillac recruiting customers. He's offering to convert commercial and government auto fleets to natural gas and install the refueling facilities if they promise to buy his gas at gasoline prices for three years.

Pickens predicts 10 percent of the nation's automobiles will run on natural gas by the end of the decade.

Amoco Corp., which hold's the largest reserves of natural gas in the country, more than 11 trillion cubic feet, has installed compressed natural gas pumps at some service stations.

Natural gas utilities also have set up refueling pumps to get gas to motorists. And the auto companies have natural gas test vehicles, but haven't begun marketing the autos because of the lack of refueling stations.

Electric utilities also are building new generators that run on natural gas and natural gas air conditioners are available for industrial and commercial users.

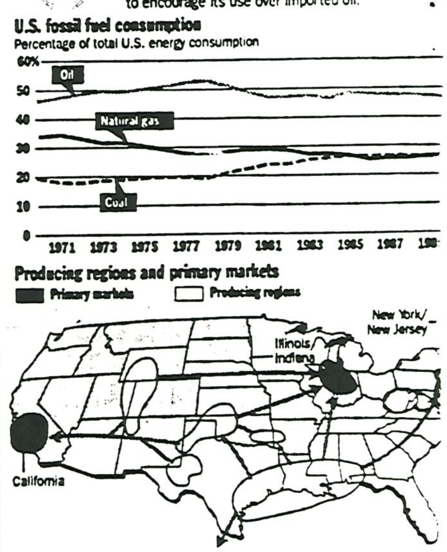
Delivering all that gas will require large networks of pipeline, something analysts say is already in place from the '70s when natural gas use was much higher.

The National Petroleum Council says pipeline capacity was enough to carry 120 billion cubic feet per day in 1991, well above the peak demand in 1991 of 102 billion cubic feet. But as demand moves to less conventional locations and uses, new lines will be needed.

Ronald Barone, natural gas analyst at Kidder, Peabody & Co., estimates that gas consumption by 1995 will have risen 15 percent from 1991 to 22 trillion cubic feet per year.

Natural gas trends

After years of lagging demand, natural gas may beco[me] the fuel of the '90s. The new Clinton administration [plans] to encourage its use over imported oil.



Source: Arthur Andersen, Cambridge Energy Research Associates

THE WICHITA EAGLE
Sunday, Jan. 31, 1993

1812

KANSAS TAXPAYERS NETWORK
P.O. Box 20050
Wichita, KS 67208
316-684-0082

Statement on S.B. 203
House Taxation Committee
17 March 1993

By Karl Peterjohn

Kansas' business climate is not competitive. The tax climate is particularly hostile to business. Let me cite Kansas Inc.'s recent study, "Cost & Taxes in Selected Kansas Industries, 1992 update," described the additional cost government imposes on business as between 7 and 17 percent more than neighboring states (P 99).

The same study indicates that taxes on business income in Kansas provide a much larger portion of state revenue than in surrounding states. The chart on page P. 108 of this study graphically shows how much more Kansas business pays. S.B. 203 would eliminate a portion of the hostile business climate which exists in Kansas today. This hostility is having a negative impact on energy production, new construction, and manufacturing. These new taxes are not generating the revenue which was expected when school finance reform added these taxes last year.

Creating a positive climate for business in Kansas is important. With the massive layoffs in south central Kansas it is imperative to try and provide a more favorable climate for conducting business in this state. It is the private sector which provides long term job growth in the states economy. Therefore, I urge you to pass S.B. 203 in its current form.

I regret that a number of previous engagements prevents me from appearing personally in front of your committee. I look forward to providing this committee with the Kansas Taxpayers Network material which documents the extent of the hostile tax climate which exists in Kansas.

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Attachment 19

Kansas
Petroleum
Council

STATEMENT TO THE HOUSE TAXATION COMMITTEE
IN SUPPORT OF SENATE BILL 203
Submitted by Ken Peterson, executive director
MARCH 17, 1993

The Kansas Petroleum Council appreciates the opportunity to submit a statement in support of Senate Bill 203, which includes a phased increase in the property tax credit against the severance tax on natural gas.

The Kansas Petroleum Council is a trade association that represents some of the companies with production interests in the Hugoton natural gas field of Southwest Kansas.

We support Senate Bill 203. A number of conferees will address various parts of this legislation, so we will concentrate our comments on the severance tax portion.

Senate Bill 203's proposed change in the way Kansas taxes natural gas is a matter of fairness and equity. It represents a major step toward putting Kansas natural gas on a more favorable competitive edge with other production states.

A lot has happened to the energy market since the Kansas Legislature enacted the severance tax in 1983. The statutory severance tax was 8 percent of gross production, but lawmakers granted property tax credits that resulted in an effective tax rate of 4.33 percent for oil and 7 percent for natural gas.

The Legislature justified the tax differential because oil producers could not pass along the tax. Most natural gas, on the other hand, was sold under long-term contracts. The Federal Energy Commission said these contracts allowed the pass-through of production taxes.

However, in the decade since the severance tax was enacted, natural gas deregulation and subsequent FERC rulings have basically disallowed the pass-through of the severance tax on natural gas. Gas producers today are in the same situation as oil producers. They can no longer pass along the tax.

The Arthur D. Little Report commissioned by Kansas Inc. pointed out that the effective tax rate on Kansas oil and gas is 9.7 percent compared to 3.3 percent on commercial and industrial property. The tax burden is even more distorted for gas properties in the Hugoton field. Depending upon location in the Hugoton field, the effective tax rate on natural gas - property and severance tax - ranges from 13 to 20 percent. In some cases, the tax rate has increased 50 percent in the past two years. I doubt if you will find any other industry in Kansas that has such a burdensome tax rate, especially one that comes right off the top.

3/17/93
House Taxation Cmte
Attachment 20

(913) 234-0589 • FAX (913) 235-6179 • SUITE 1005, MERCHANTS TOWER • 800 SW JACKSON ST. • TOPEKA, KANSAS 66612-1216

STATEMENT TO THE HOUSE TAXATION COMMITTEE
IN SUPPORT OF SENATE BILL 203
MARCH 17, 1993

Senate Bill 203 is a step toward bringing some equity and fairness into the severance tax rate. Obviously, it is not a cure-all and we are not here today promising that enactment of this measure will create immediate increases in the production and sale of Kansas natural gas.

However, what we can say is that this legislation will allow Kansas natural gas to compete and provide long-term benefits to gas producers, royalty owners and the state.

I would like to stress two final points:

First, we all know that natural gas is becoming increasingly popular as an energy source. It is clean, relatively abundant and has great promise as a so-called "bridge fuel." The Hugoton natural gas field is a tremendous natural resource for Kansas if the state nurtures it. A key ingredient of proper management is a fair tax policy, not one that imposes a 7 percent severance tax rate and adds at least that much again in property taxes.

Second, as many of you know, the energy industry continues to suffer from a tremendous downturn. More than 400,000 jobs have been lost since the early 1980s, a staggering figure that should be a national scandal but instead appears to be a national secret. Oil and gas companies continue to reduce their work force, tighten their budgets and look hard at new expenditures, particularly in the depressed domestic exploration and production area. Competition is keen for every dollar, and a highly taxed project becomes less attractive and less profitable.

The changes in Senate Bill 203 would send a signal to gas producers that Kansas wants to develop its resources. It would allow Kansas natural gas to compete in an increasingly open market with gas produced by other states.

We urge this committee to favorably recommend Senate Bill 203 for passage.

Thank you.

City of Olathe

MEMORANDUM

TO: Members of the House Taxation Committee

FROM: Donald R. Seifert, Assistant Director, Administrative Services DRS

SUBJECT: SB 203 - Various Tax Adjustments

DATE: March 17, 1993

On behalf of the city of Olathe, thank you for the opportunity to comment in support of SB 203. This bill would restore sales tax exemptions for utilities consumed in the manufacturing process and labor services in new construction. These exemptions were repealed last year as part of the 1992 school finance legislation. Restoration of these exemptions is one of the priorities of our governing body's 1993 legislative program.

The Olathe economy has a significant base of manufacturing. A number of our manufacturers, such as Bendix-King, Delco Battery, and Southwest Petro-Chem are quite energy intensive. The city believes the 2.5% sales tax imposed last year on utilities consumed in manufacturing was ill advised, adding an additional burden making our Kansas manufacturers less competitive in national and world markets. We believe this tax is contrary to the economic development efforts of the state to create and retain basic jobs.

The city also supports repeal of the sales tax on labor services in new construction. We believe this tax places an onerous burden on a vital industry in our area, creates disincentives to using Kansas labor, and has proven to be an administrative nightmare. In addition, it appears the tax is falling far short of revenue projections, further emphasizing the difficulties with compliance and collection.

As the Committee knows, with addition of local sales taxes, the 2.5% rate imposed last year by these new taxes is actually 4.1% in our community. The total rate is even higher in some places in Kansas. Since the Department of Revenue will not honor charter ordinances on this issue, we strongly support SB 203 to send a positive message to two of our most important Kansas industries.

Thank you again for the opportunity to comment.

3/17/93
House Taxation Cmte
Attachment 21

Committee of Kansas Farm Organizations

Marty Vanier, DVM
Legislative Agent
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Manhattan, Ks 66502
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Committee of Kansas Farm Organization Members

- Associated Milk Producers, Inc.
- Kansas Agri-Women Association
- Kansas Association of Nurserymen
- Kansas Association of Soil Conservation Districts
- Kansas Association of Wheat Growers
- Kansas Cooperative Council
- Kansas Corn Growers Association
- Kansas Electric Cooperative
- Kansas Ethanol Association
- Kansas Farm Bureau
- Kansas Fertilizer and Chemical Association
- Kansas Grain and Feed Dealers Association
- Kansas Grain Sorghum Producers
- Kansas Livestock Association
- Kansas Meat Processors Association
- Kansas Pork Producers Council
- Kansas Rural Water Districts Association
- Kansas Seed Industry Association
- Kansas Soybean Association
- Kansas State Grange
- Kansas Veterinary Medical Association
- Kansas Water Resources Association
- Kansas Water Well Association
- Mid America Dairymen, Inc.
- Western Retail Implement & Hardware Association

STATEMENT OF THE

COMMITTEE OF KANSAS FARM ORGANIZATIONS

BEFORE THE

HOUSE TAXATION COMMITTEE

KEITH ROE, CHAIRMAN

REGARDING SB 203

MARCH 17, 1993

The Committee of Kansas Farm Organizations (CKFO) is a coalition of 26 agribusiness organizations that spans the entire spectrum of Kansas agriculture, including crop, livestock and horticultural production, input suppliers, allied industries and professions.

CKFO supports the interim committee proposal to restore the exemption of the 2.5% sales tax on utilities consumed in the production of value added products. Simply stated, we believe it sets a bad precedent to require a sales tax on inputs. We believe this is double taxation as the end products are taxed again at sale. This is a hidden tax which is passed on to Kansas consumers and reduces competitiveness of Kansas companies that engage in interstate commerce.

While I represent a wide range of groups involved in agriculture, specifically this tax has affected our members who are involved in flour and feed processing, fertilizer blending, production greenhouses and farmer-owned cooperatives. Your committee will receive testimony from others that provide specific and detailed examples of the effects of the 2.5% sales tax on utilities consumed in production.

I appreciate the opportunity to provide testimony to the committee today.

3/17/93
House Taxation Cmte
Attachment 22