

Approved: Feb 4, 1993
Date

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION.

The meeting was called to order by Chairperson Audrey Langworthy at 11:05 a.m. on January 27, 1993 in Room 519-S of the Capitol.

Members present: Senator Langworthy, Senator Tiahrt, Senator Martin, Senator Bond, Senator Corbin, Senator Feleciano Jr., Senator Lee, Senator Reynolds, Senator Sallee,

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

Conferees appearing before the committee: Mayor Ed Eilert, Overland Park
Gus Meyer, Rau Construction, Greater KC metropolitan area
Dan Morgan, KC Chapter, Assoc. General Contractors
Jeff Jones, Wardcraft Homes, Clay Center
Mary Birch, Overland Park Chamber
Larry Gordon, Gordon Energy, Olathe
Harold Teague, Teague Electric, Lenexa
Ed DeSoignie, Heavy Constructors Ass'n, greater KC area
Phillip P. Scaglia, Labor-Management Council of greater KC
Bates Dyer, Thorne Larkin Real Estate, Leavenworth
Chris Beal, Greater Kansas City Chamber

Others attending: See attached list

Labor Services - Original construction

Mayor Ed Eilert, Overland Park, was the first conferee. He spoke in favor of repealing the sales on original construction labor services. (Attachment 1) He said tax receipts are going to be much less than the estimate, and the tax favors the larger contractors and discriminates against the smaller builder. When questioned what should be the alternative for revenue, he said spending should be reduced.

Gus Meyer, Rau Construction, greater KC metropolitan area, stated the volume of their business in Kansas has gone down from 32 percent in Kansas to 4 percent in Kansas since the implementation of this tax. He thinks the tax is not gaining revenue for Kansas, but is costing revenue. He said this tax is a disaster to the economic development in our state and is hurting everyone. (Attachment 2)

Dan Morgan, Kansas City chapter, Associated General Contractors and the Builder's Association, read from a prepared statement. (Attachment 3) He stated there is no question but this tax has placed Kansas at a great disadvantage when competing against neighboring states. Commercial building construction in the Kansas City area has declined by 45-50 per cent over the past three or four years. "Labor services" includes the cost of virtually everything in the total construction contract price, except for materials. This is about 60 percent of the total contract price.

Jeff Jones, Wardcraft Homes, Clay Center, spoke about his business of custom built homes which are delivered in a single unit to customers in Kansas, Nebraska and Colorado. (Attachment 4) He hopes the 1993 legislature will repeal this tax on labor for new construction. He also stated when the new law went into effect, no one in government could explain how it would affect Wardcraft. He spent about \$5,000 trying to get the answer. When the city of Clay Center granted relief from the 1 per cent city tax, the Kansas Department of Revenue said the tax would have to be reinstated because their computer software could not handle this exception.

Mary Birch, Overland Park Chamber of Commerce, spoke concerning economic development and the instability of the tax rate in Kansas. (Attachment 5) She said only 12 other states have this tax and they do not border on Kansas. She also stated the tax on construction services creates an incentive for general contractors

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION, Room 519-S
Statehouse, at 11:05 a.m. on January 27, 1993.

working in Kansas to subcontract in Missouri.

Larry Gordon, Gordon Energy and Drainage Co., Olathe, said he has a problem which was created by the Kansas legislature and he hoped they will solve it this session. He listed what this legislation has done to his company. (Attachment 6) He listed the numbers of hours and how they were spent in trying to comply with this legislation and he asked how small companies could survive with this tax on construction services.

Harold Teague, Teague Electric Construction, Inc., Lenexa, stated he is losing work to out-of-state contractors because of this tax. (Attachment 7) He also said he is looking at relocating his business to Missouri because of this. He said if the legislature does remove this tax, it may be too late to change his plans. He also stated he paid \$5 million in taxes in 1992.

Ed DeSoignie, Heavy Constructors Association of the greater Kansas City area, read from a prepared statement. (Attachment 8) He requested the elimination of this 2.5 per cent sales tax on construction labor services. He said this tax has added costs to the public, created concern for future economic development and had been a problem administratively for construction firms.

Phillip P. Scaglia, Labor-Management Council of greater Kansas City, urged action on removing the sales tax on labor services. (Attachment 9) The repeal of this tax will keep the state of Kansas from losing its comparative advantage in economic development.

Bates Dyer, Thorne Larkin Real Estate, Leavenworth, requested the reinstatement of the original construction sales tax exemption. (Attachment 10)

Chris Beal, Greater Kansas City Chamber of Commerce, stated the Chamber represents over 3,000 businesses. The Chamber joins in the support of the repeal of the sales tax on original construction. (Attachment 11) He said there is general concern in the Kansas City area about this tax. Some businesses may seek to avoid the Kansas City area entirely.

Senator Feleciano requested Charles Warren, President, Kansas, Inc., appear again before the committee in regard to his remarks concerning the loss of jobs in Wichita at Boeing and Sears. He stated this had nothing to do with the tax structure in Kansas. Senator Langworthy said he would be invited to come back.

The meeting adjourned at 12:05 p.m.

The next meeting is scheduled for January 28, 1993.

GUEST LIST

COMMITTEE: Senate
ASSESSMENT & TAXATION

DATE: Jan 27

NAME (PLEASE PRINT) ADDRESS COMPANY/ORGANIZATION

Gus Meyer	9650 Wall Overland Park	Rau Construction Co
DAN MORGAN	Kansas City	:AGC/Builders'
TOM SATTERY	Topeka	AGC of KS
JERRY WITMAN	TOPEKA	THBA -
Bob Corkins	Topeka	KCCI
Bernie Koch	Wichita	Wichita Chamber
JERRY LINDBERG	LIBERAL	
KAREN FRANCE	TOPEKA	KAR
Debbie Beam	Topeka	Topeka Bd of Realtors
Mark McCrory	Topeka	Topeka Home Bids.
Phil Scaglia	Kansas City	Labor-Management Council
Christy Young	Topeka	Topeka Chamber of Com
Judy Brown	"	An Institute of Architects
Donald P. Shunk	"	ICIDGK
Leo Brown	Topeka	18 CB Adm & Bldg
Bates Rye	Leavenworth	Thos. Lark Realty
Harold C. League	Overland Park	League Elec
Larry Gordon	Olathe	Gordon Energy & Drains
Julie Sutter	Kansas City	Home Builders Assn.
Frances Kastner	TOPEKA	KS Food Packers Assn
John Clark	the	Hallmark
Mary Birch	O.P. Chambers	
Nelle Sweeney	O.P. Chambers	
Larry Ray	O.P. & O.P.	
Bob Totten	Topeka	KS Contractors Assoc.

Don Sefer - City of Olathe - Olathe, KS

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Testimony before the Senate Assessment and Taxation Committee

Audrey Langworthy, Chairman

Good morning, Chairman Langworthy, Vice-Chairman Tiahrt, and members of Senate Assessment and Taxation Committee. My name is Ed Eilert, Mayor of the city of Overland Park. I am here today to speak in favor of the repeal of the Sales Tax on Original Construction Labor Services.

In our initial analysis of this tax, it became very evident that numerous loopholes, inequities, and opportunities for "creative tax avoidance" existed. A majority of these loopholes favored the larger contractors over smaller ones. Some examples include:

- The Department of Revenue, Division of Taxation, advises that original construction labor services performed by a general contractor prior to entering a written binding contract with the purchaser of the home are exempt from the sales tax. The larger contractors who can afford to finance and build a home in advance of having a contract for sale are not impacted by this tax.

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- A general contractor may accept in good faith an invoice or bid from a subcontractor that states "all applicable sales tax is included." The general contractor will be absolved from any further liability for the sales tax by accepting in good faith the subcontractor's invoice or bid. The burden and liability for collecting this tax rests with the subcontractor.
- The 1992 Legislature passed legislation that revised the Kansas Enterprise Zone Act to extend development incentives to businesses through the entire State of Kansas. No longer do businesses have to locate or expand in a predesignated "zone" to be eligible for benefits.

Manufacturing firms creating 2 or more jobs or non-retail firms that create 5 or more jobs may qualify for a sales tax exemption on construction materials and services. The bottom line is that large commercial operations are exempted from paying the tax, but the homeowner who has no means of avoiding the tax is left to bear the additional burden.

The issue of whether or not to expand the base and impose a sales tax on professional services was considered by the Legislature. Proponents of this legislation were not successful. However, recent administrative rulings by the Department of Revenue now conclude that professional services, such as architecture, engineering, or surveying, performed by a contractor, in addition to the taxable

services performed by the same contractor, are not excludable from the taxable base. It appears someone has cleverly found a way to back-door a tax on professional services.

- Pursuant to KSA 12-191, the labor, profit and overhead portion of a total contract under \$10,000 is subject to the contractor's business site sales tax rate in addition to the state sales tax. If a business location does not exist in Kansas and the total contract is under \$10,000, the labor, profit, and overhead is subject to the state sales tax rate only. In essence, no city sales tax will be collected unless the business is domiciled in Overland Park.

The above-mentioned provision is cause for great concern, because of the potential loss of local jobs that may occur. It has not been a full year since the implementation of this tax, but three things are already occurring that will eventually result in the loss of local jobs.

- (1) Kansas subcontractors are considering relocating their billable offices to Missouri to take advantage of this loophole and to avoid paying this tax.
- (2) In an attempt to keep the cost down on a new home, general contractors have threatened to hire only Missouri subcontractors.

- (3) Other local subcontractors are planning to move outside the corporate limits of any city into unincorporated areas just to avoid the 1% local tax.

The continued 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 proportionately greater for smaller firms and make up a greater percentage of their total sales.

Placing the burden on smaller contractors is not economically rational, because it is the smaller contractors who are largely responsible for the growth in construction employment. According to Dun and Bradstreet, 46% of the residential construction firms in Johnson County employ 2 or fewer employees; 59% have 3 or fewer employees. These entrepreneurs are not only the backbone of the construction industry in Johnson County, but also of the State of Kansas. The continued imposition of this tax places an undue burden and will have a disparate impact on the firms that are contributing heavily to our economy.

I reiterate my support for the repeal of this tax because of its inherent inequities. I am not convinced that it was the intent of this Legislature to create a tax policy that will result in the loss of local jobs and increased economic development for the State of Missouri.

I am also not convinced that the slight increase in sales tax revenue is enough to compensate for the lack of fairness in how this tax is applied. I sincerely believe that if a cost/benefit analysis were conducted on this tax, the cost of loopholes, inequities, confusion and loss of jobs would certainly far outweigh the benefits (\$1.5 million in revenue for the first six months). We urge your careful reconsideration of this matter and trust that you will conclude that a complete repeal is the best solution toward correcting a system so inundated with flaws.

Thank you for this opportunity. I would be happy to respond to questions.

**TESTIMONY BEFORE THE SENATE
ASSESSMENT AND TAXATION COMMITTEE**

**ARGUMENTS FOR THE REPEAL OF THE
SALES TAX ON CONSTRUCTION SERVICES**

**BY GUS RAU MEYER
RAU CONSTRUCTION COMPANY
JANUARY 27, 1993**

My name is Gus Rau Meyer and I am Vice President of Rau Construction Company. Rau Construction Company is a middle to large volume 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 average annual billings have been 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.

I am submitting with this testimony a projection of what the effect of the Sales Tax on Construction Services has on a hypothetical \$2,000,000, 30,000 square foot, new construction project. Examples of a project of this size would be a medium size "strip" shopping center or a small to average size 2 story office building. This project would be about 1/2 the size of the typical area grocery store of 1/6 the size of the latest K-Mart or Walmart Super Stores. This "hypothetical" project could be found in any area of the State. The labor provided by all Contractors on this job amounts to 39.31% of the "hard" construction cost or \$786,227. The Subcontractor and General Contractor Overhead and Profit amount to \$414,918 of the hypothetical project. The additional amount of costs (costs in addition to those previously under the Tax on Materials) subject to the new Sales Tax on Construction Services is \$1,201,145, or over 60% of this \$2,000,000 project. The 4.1% Tax generates additional tax receipts of \$49,247 or

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Attach. 2-1*

TESTIMONY BEFORE THE SENATE ASSESSMENT AND TAXATION COMMITTEE
ARGUMENTS FOR THE REPEAL OF THE SALES TAX ON CONSTRUCTION SERVICES
BY GUS RAU MEYER
JANUARY 27, 1993
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2.46% of the cost of the project over the previously enacted Sales Tax. Based on 30,000 gross square feet, this equates to an additional \$1.64 per 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. This is a tremendous burden in any real estate market, let alone a depressed real estate market, be it a commercial, retail, or industrial application.

This Tax not only effects developers which have to contend with the costs of this Tax on rental rates, but it also effects the decisions of owner/users. We have been working with a repeat client 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 \$2,000,000 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.

In conclusion, from a strictly "volume of work" and profit standpoint, the Sales Tax on Construction Services does not effect 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 its high quality of life and standard of living I feel this Tax is a disaster to 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 Madam Chairman and members of this committee for allowing me to appear before you today. I appreciate your consideration and ask for your support in repealing this Tax. If you have any questions, I would be glad to address them.

JANUARY 27, 1993
 TESTIMONY BEFORE THE SENATE ASSESSMENT AND TAXATION COMMITTEE
 BY GUS RAU MEYER

TYPICAL CONSTRUCTION COST
 \$2,000,000.00 BUILDING

	ESTIMATED SHELL CONST.	ESTIMATED INTERIOR CONST.	TOTAL COST	% LABOR	ESTIMATED LABOR PORTION
GENERAL CONDITIONS	23,952	15,000	38,952	85.00%	33,109
EXCAVATION	15,216		15,216	30.00%	4,565
ASPHALT	181,100		181,100	25.00%	45,275
REINFORCING STEEL	25,177		25,177	42.00%	10,574
FOUNDATIONS	44,585		44,585	65.00%	28,980
FLAT CONCRETE	158,740		158,740	42.00%	66,671
MASONRY	176,447		176,447	55.00%	97,046
STRUCTURAL STEEL	155,267		155,267	44.00%	68,317
CARPENTRY	25,845	65,212	91,057	50.00%	45,529
MILLWORK	4,406	15,915	20,321	7.00%	1,422
FLAT ROOFING	78,690		78,690	27.00%	21,246
SHEETMETAL	33,509		33,509	30.00%	10,053
CAULKING	3,420		3,420	60.00%	2,052
HOLLOWMETAL	7,010	11,645	18,655	50.00%	9,328
GLASS & GLAZEING	32,981		32,981	33.33%	10,993
HARDWARE	4,418	7,763	12,181	10.00%	1,218
DRYWALL	128,588	85,397	213,985	35.00%	74,895
ACOUSTICAL CEILING	18,173	17,856	36,029	50.00%	18,015
FLOORING	2,397	58,226	60,623	25.00%	15,156
CERAMIC TILE	2,532		2,532	33.00%	836
PAINT & WALL COVERINGS	4,874	59,747	64,621	75.00%	48,466
TOILET ROOM ACC.	4,389		4,389	20.00%	878
PLUMBING	45,548	7,763	53,311	45.00%	23,990
FIRE SPRINKLERS	17,188	6,599	23,787	62.50%	14,867
H.V.A.C.	85,627	15,527	101,154	45.00%	45,519
ELECTRICAL	167,611	50,462	218,073	40.00%	87,229
Sub Total	1,447,690	417,112	1,864,802	39.31%	\$786,227
G/C OH&P (7.25%)	104,958	30,241	135,198		=====
BUILDING TOTAL	\$1,552,648	\$447,353	\$2,000,000		=====

NEWLY TAXABLE AMOUNTS

LABOR	\$786,227	
SUB OH&P	\$279,720	15% X \$1,864,802
G/C OH&P	\$135,198	

TOTAL \$1,201,145
 =====

LBR SRVCS TAX (4.1%) \$49,247
 % OF PROJECT 2.46%
 COST/SF (30,000 SF) \$1.45
 AMORTIZED COST/SF/YR \$0.19 90% RENTABLE, 10% INTEREST
 20 YEAR AMORTIZATION

**TESTIMONY BEFORE THE SENATE
ASSESSMENT & TAXATION COMMITTEE**
regarding
SALES TAX ON NEW CONSTRUCTION LABOR SERVICES
by Dan Morgan
Kansas City Chapter,
Associated General Contractors
and
The Builders' Association
January 27, 1993

Thank you Madam Chairman and members of the committee. My name is Dan Morgan and I appear today on behalf of the Kansas City Chapter, Associated General Contractors and the Builders' Association. Together, these associations represent almost 750 general contractors, subcontractors and material or service suppliers engaged in commercial and industrial building construction throughout western Missouri and northeastern Kansas. Approximately 150 of our members are domiciled in Kansas and another 200 or so Missouri-based members perform work in Kansas in the metropolitan Kansas City area.

We certainly welcome the opportunity to finally have an open discussion on the issue of sales tax on "labor services" in new construction which we are very much opposed to. Unfortunately this new tax on construction was made a part of the school finance/property tax relief plan at the "eleventh hour" in last year's 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 approved the substitute for House Bill 2892 last session. While placing a tax on new construction may have seemed an expedient way to help fund school finance and provide property tax relief to many parts of the state, we submit that it was both unfair and counterproductive to do so.

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 will the consequences be 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 These are very important considerations to owners or developers who are deciding whether to build an office building on College Boulevard in Kansas or on Ward Parkway in Missouri.

*Sen. Asses + Taxation
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¹Based 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.

Fueled by the Fed's monetary policy to lower interest rates, the single-family residential construction market did experience a boom in Johnson County and the metropolitan Kansas City area counties in Missouri in 1992. However, 1992 multi-family building starts were anemic in Johnson County and commercial building construction remained in the tank. Overall the value of combined commercial/residential construction contracts recorded in the county was nearly 20% below the ten-year, inflation-adjusted average for the period.

Commercial building construction in the Kansas City area has declined by 45-50% from three or four years ago due to changes in federal tax laws, tight lending practices and a sluggish economy. The new construction labor services tax is now an added deterrent to growth on the Kansas side of the metropolitan Kansas City area and to the state generally.

An example will demonstrate the impact of the new labor services tax on a new \$10,000,000 commercial project in Johnson County. First of all, please recognize 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 the 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. Under previous law, the sales tax on a \$10,000,000 project would have been \$260,000 (i.e. \$4,000,000 x 6.5%, i.e. combined 4.9% state and 1.6% local tax). With the new labor services tax there will now be an additional \$246,000 tax burden on the same structure (i.e. \$6,000,000 x 4.1%, i.e. combined 2.5% state and 1.6% local tax) built in Kansas. It will now cost an owner or developer almost a quarter of a million dollars more to build that building in Kansas rather than just across the state line in Missouri. That is a very serious disadvantage for Kansas.

In closing, let me remind you that 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. With new buildings come new or expanded businesses, new employees and residents to the state and new homes in our communities. These business and payroll dollars flow down through every sector of the economy. This generates economic growth and that growth generates additional tax income for state and local government. Much of this is lost when business and industry are forced to locate elsewhere because of prohibitively high tax levels at home.

We believe very strongly that it would be shortsighted and 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 hasty and basically uninformed 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.

Left in place, this new 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 it produces for school finance. Common sense dictates that it must be repealed and another source of funding, if necessary, should be found. We ask for your support and thank you for this opportunity to be heard.

With that, I would be glad to try to answer any of your questions.



Wardcraft Homes

P.O. Box 55
Clay Center, Ks. 67432

913-632-5664
South Highway 15

January 27, 1993

TO WHOM IT MAY CONCERN:

Wardcraft Homes, Inc. was founded in 1971 in Clay Center, Kansas. A Kansas corporation employing about eighty (80) people which generates about \$5,000,000 in gross revenue annually, Wardcraft constructs custom built homes and delivers them as a single unit to customers throughout Kansas, Nebraska, and Colorado. A Wardcraft home differs from a mobile home in three major ways: 1) Wardcraft builds to the Uniform Building Code (U.B.C.); mobile homes are built to the H.U.D. code. 2) Wardcraft Homes are delivered as a single unit, up to 28 feet wide by 60 feet long; mobile homes are delivered in sections up to 16 feet wide and put together at the site. 3) Wardcraft Homes are financed and taxed as real estate; mobile homes are financed and taxed as personal property.

Wardcraft hopes that the 1993 legislature will repeal the 2.5% sales tax on labor for new construction. We do not think the tax is in the best interest of our industry or the public home building industry or people wanting a new home. To further complicate the effect of this tax, because what we build in Kansas is exported, this tax adds about \$1,200.00 to our average home and thus gives our competition in Nebraska and Colorado a \$1,200.00 advantage over us. Please help keep our exported products competitive! Help keep jobs in Kansas!

When the new tax law went into effect, no one in government was able to explain how it affected Wardcraft Homes, Inc. We spent about \$5,000.00 with lawyers and accountants, trying to get an explanation from the state.

After months of research and hundreds of telephone calls, we began to see some light at the end of the tunnel. We requested, and received, from the City of Clay Center, relief from the 1% city tax over which they had control. Then, after having been granted this request, to our utter amazement we received from the State of Kansas, Department of Revenue, a letter indicating that this 1% tax would have to be reinstated, because the computer software was unable to handle this exception! Dumbfounded by this attitude, we are here today to plead for tax exemption for our exported products. Help keep the jobs in Kansas.

Sen Arnes & Taxation
Jan 27, 1993
attach 4-1

**BACKGROUND PAPER
ARGUMENTS SUPPORTING THE REPEAL
OF THE SALES TAX ON CONSTRUCTION SERVICES**

The Overland Park Chamber of Commerce has requested that CERI develop arguments supporting the repeal of the sales tax on construction services for presentation to the Johnson County Legislative delegation. The sales tax on original construction services, which took effect on July 1, 1992, was one of the revenue enhancement provisions of the School District Finance and Quality Performance Act (H.B. 2892).

There are at least four considerations that should temper the evaluation of any of the arguments presented in this paper - and those during the upcoming legislative session - by members of the Johnson County legislative delegation. They are:

1. The tax hasn't been in effect for a sufficient length of time to accurately measure its full impact. At the time of this writing, the sales tax on construction services has been in place for only slightly more than seven months. This is simply not enough time for there to have been any readily measurable data generated with which to accurately judge impact. This analytical problem is compounded first by the residential building boom that has taken place during 1992, as a result of the monetary policies of the Federal Reserve; and secondly, by the commercial real estate slump the economy has experienced over the past few years. It could be several years before any totally defensible data on either side of the argument can be assembled. (We do, however, present below the results of a CERI study comparing Johnson County's vs. suburban Missouri's single family residential market share in the first five months after enactment of the tax, during this year's building boom vs. the same period during the boom of 1987).

2. The construction sector makes up a significant portion of the Johnson County economy. The latest available data from the U.S. Dept. of Commerce (1990) shows that there were 1,072 construction firms in Johnson County which provided 11,670 jobs and an annual payroll (in 1990 dollars) of \$282,537,000.

3. Construction is basic within the Johnson County economy. In CERI's latest economic base analysis, eight industry groups in the construction sector of Johnson County's economy were identified as net exporters of services (and therefore, importers of money) into the county's economy.

4. Johnson County's construction industry makes up a substantial portion of the construction sector in the state's economy. In 1990, Johnson County's construction companies provided 25.6% of the construction industry's jobs in the entire state. Moreover, the Johnson County economy accounted for nearly one-half (42.7%) of the net increase in construction jobs in the state between 1989 and 1990.

The balance of this paper presents a number of factors that we feel argue for repeal of the sales tax on original construction services and concludes with statements extracted from CERI's clipping file expressing the opinions of others opposed to the tax.

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*** The sales tax on original construction services has a negative impact on the state's competitive climate.**

All other things being equal, a sales tax on original construction services will add to the cost of relocating or starting a business in Kansas when compared with the majority of our competitors nationwide. Only twelve other states impose a sales tax on labor for original construction: Arizona, Connecticut, Delaware, Hawaii, Iowa, Mississippi, New Mexico, South Dakota, Tennessee, Texas, Washington and West Virginia - and significantly, none of the states surrounding Kansas impose the tax.

Also, it can be argued that the imposition of a tax on construction services can be seen as a threat - providing an indication to site selectors across the nation that the Kansas Legislature may be willing to tax other services in the future.

*** The sales tax on original construction services has a negative impact on Johnson County's competitive climate in similar markets within the metropolitan area.**

The imposition of the sales tax on original construction services increases the cost of comparable buildings in Johnson County over similar structures in Missouri. For instance, the sales tax collected for construction of a \$200,000 home in Johnson County is presently \$3,712 greater than for the same structure in Lees Summit. Moreover, the sales tax on construction of a \$10,000,000 office building in Johnson County would be \$181,625 greater than for construction of the same building on Ward Parkway.

While it is still too early to completely isolate and measure the negative impact of the sales tax on construction services, we have attempted to draw some conclusions from data that are presently available. CERI staff collected and analyzed building permit data from June (when the tax went into effect) until November (the latest month available) in comparable suburban markets in Kansas and Missouri during the five months of the 1992 building boom, with the same period during the comparable residential boom of 1987.

The markets we compared include unincorporated Johnson County, Leawood, Lenexa, Olathe, Overland Park and Shawnee on the Kansas side. The Missouri markets includes Lees Summit, Blue Springs, Independence, unincorporated Cass County, unincorporated Platte County and Belton.

We found that in 1987, Johnson County captured 60% of a total market of 2,405 homes built in these areas. In 1992, however, Johnson County's market share dropped to 54% of a total of 2,282 single-family homes. Therefore, if Johnson County had maintained the same market share during the 1992 building boom as it captured in 1987, there would have been approximately 27.4 more homes per month, or 329 homes per year, constructed in Kansas. Assuming an average sales price of \$161,450 per home, this translates into an

annual loss of \$53,117,050 in construction activity in this market alone. Admittedly, the Kansas sales tax on construction services may not be the only reason for this difference in market share - but it most assuredly is one of the reasons.

*** The tax on construction services creates an incentive for general contractors working in Johnson County to subcontract for special trades with Missouri firms.**

The regulations governing the collection of the sales tax on original construction services specify that, if a contractor's place of business is outside the state of Kansas, no city or county local tax applies if the total contract amount is \$10,000 or less. Additionally, the Department of Revenue has ruled that Kansas cities and counties cannot exempt construction services from local sales taxes. These two considerations provide an incentive for general contractors in Kansas to subcontract with Missouri firms in order to hold down construction costs.

*** The sales tax on construction creates a competitive advantage for Missouri construction firms bidding on work in Kansas.**

According to a report prepared by the American Institute of Certified Public Accountants, the states that have enacted sales taxes on services have experienced difficulty collecting sales taxes from out-of-state vendors for services performed in-state. This increases the probability that Missouri subcontractors can avoid the tax and thus underbid their Kansas competitors.

*** The sales tax on original construction services complicates the efforts of community-based economic development organizations.**

The fact that the tax erodes the state's competitive position places local economic development officials in Kansas in the position of having to promote "creative tax avoidance" just to remain on a level playing field. The Kansas Enterprise Zone Act provides a way to offer an incentive through abatement of the tax, but it is inflexible and discriminates against non-manufacturing businesses and small start-up firms - the kind of establishments that have provided the majority of the job growth in Johnson County in the past two decades.

It is not inconceivable that economic development officials in Johnson County could find themselves in the position of having to recommend the use of Missouri-based construction companies in order to land a business prospect.

*** The sales tax on construction services creates an incentive for small special trade subcontractors to relocate to Missouri.**

The regulations stated above provide an incentive for start-up and small special trade contractors to move their firms across the state line. If this migration does indeed occur, it could have a considerable impact on the Johnson County economy. According to the 1990 Kansas County Business Patterns, the latest available, the Johnson County economy contained 655 Special Trade Contractors (SIC 17). These firms provided 6,698 jobs and an annual payroll of \$162,457,000. Significantly, these firms are predominately small businesses - 55% employ fewer than five workers and 76% employ less than ten - only 3% employ more than fifty persons.

*** Small and emerging construction firms are especially disadvantaged by the tax on construction services.**

Small firms must bear a greater burden from imposition of the construction service tax because the additional compliance costs associated with such a tax are proportionately greater for small firms and make up a greater percentage of their total sales - an additional reason for the small Johnson County firm to relocate to Missouri. These higher relative costs erode the ability of small businesses to effectively compete against large firms and negatively impact their growth and expansion.

Since it is the small and emerging businesses which are producing most of today's job growth, the enactment of the sales tax on construction services was contrary to the stated goals and objectives of many of the State of Kansas' economic development programs. By continuing to impose the tax, the state risks stunting the growth of those firms that would create the most employment in the struggling construction sector of the Kansas economy.

*** The cost to governments for administering and enforcing the tax on construction services is more expensive than for normal retail "point of sale" collection.**

The administration and enforcement of a tax on any service is bound to be more difficult and costly than for normal retail "point-of-sale" collection procedures. This will no doubt, translate into a need for additional state personnel, resulting in larger government and reducing net tax revenues.

GORDON ENERGY & DRAINAGE CO.
15570 S. KEELER
OLATHE, KANSAS 66062
(913 764 6229)

DRAIN TILE - WATERPROOFING - SUMP PUMPS - BASEMENT CRACK REPAIR - ATTIC FANS

January 27, 1993

To: Kansas State Legislators

From: Larry Gordon
Home Address 1441 Sleepyhollow
Olathe, Kansas 66062

Re: Sales Tax on Construction

I currently employ 15 people. We work in the residential construction industry throughout Johnson County and the surrounding areas. I have a problem that was created by the Kansas Legislature. I would very much appreciate you making it a high priority to solve this session.

Problem #1

You passed a law that required my company to collect sales tax on labor for the state of Kansas. It was passed in such a way to:

- 1) Give very little notice before it became law.
- 2) It was unclear who would get tax exempt certificates.
- 3) The decision of what jobs would be tax exempt would not be decided until after the job was done in some cases.
- 4) **No** canned computer programs will allow one sales tax rate for labor and another for material.
- 5) I am the lucky one, there are only a few companies that are computerized. If you are not computerized, and a small company with no office staff you probably make that very hard decision -

Do I stay in business or do I comply.

- Note: A) Each home that is build uses between 60 & 100 companies to build the home.
- B) According to Dun and Bradstreet
- 1) 46% of these companies have 1 or 2 employees
 - 2) 88% of these companies have less than 10 employees

What did it cost me? (See Detail on attachment A)

- 1) 312 hours of mine and my staff's time (approximately the same as one person for 2 months).
- 2) It's not over with yet.
- 3) Do you really believe that those companies with 1 or 2 employees
 - A) Have the expertize to comply ?
 - B) Can spend that kind of time to comply?

What can you do about it?

- 1) Never ever pass laws without considering what the cost (including paperwork) is to small business.
- 2) Repeal the current law concerning sales tax on residential construction. Please don't send those families considering buying homes in Johnson county over to Missouri.

Problem #2

The State of Kansas says I still have to collect the city's part of the construction sales tax. The city of Olathe says I don't have to collect the tax.

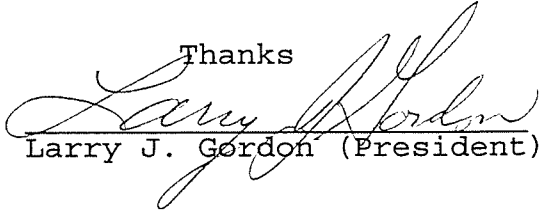
What can you do about it?

- 1) Repeal the current law concerning sales tax on residential construction for the state of Kansas.
- 2) If you don't repeal the law, at least clarify it so the city can make the decision not to collect the sales tax.

*Sen. Assess & Taxation
Jan. 27, 1993 - Attach. 6-1*

If you have any questions on the above or attached, please call or write. I am planning to hear from you soon on what you can do for me on the above.

Thanks


Larry J. Gordon (President)

Attachment A:

GORDON ENERGY & DRAINAGE CO.

Time spent on New Sales Tax (effective 6/01/92)

January 20, 1993

Larry

5	Meetings to find out what to do about sales tax	5 @ 3 hrs	= 15 hrs
	Edit invoicing computer programs to take different sales tax for labor and material. (Note: I could find no "off-the-shelf" computer program that would deal with labor tax at one rate and material tax at a different rate.)		
			= 30 hrs
	Write a database computer program to keep track of what jobs had tax exempt certificates.		
			= 25 hrs
	Myself and my sales staff trying to communicate the new sales tax code to our customers.		
			= 40 hrs
	My office staff spent approximate 20 minutes for each tax exempt certificate they received.		
	(See below for details.)	607 certificates @ 20 minutes	=202 hrs
	Total hours spent --->		=312 hrs

Office Staff - Why so much time?

- 1) Phone calls:
 - A) From customers to explain difference between old and new tax, to explain where tax is broken out on our invoices.
 - B) To customers to request certificates of exemption and collect difference between what they did pay and what they should have paid.
- 2) Data Base:
 - A) Entry of all addresses of jobs sent to us by builders indicating that they had applied for exempt status.
 - B) Entry of all certificate numbers when received.
 - C) Before mailing any invoice for a Kansas job, it was checked against the data base for an indication that an exemption certificate had been supplied to us or the builder had applied for one. All information for that particular invoice was entered on that record. A printout was run and attached to each invoice, showing the customer exactly how much tax had been due under the old system and how much was owed under the new system if we had a certificate of exemption in our possession.

- D) When payment was received, all checks were checked against the data base to determine if they were paying for a tax exempt job. The following information was entered in the data base: a) invoice paid in full except for the exempt amount, b) amount of tax on the invoice paid was more or less than the exempt amount (if the builder had not indicated to us from the outset that this job was to be exempt, we would not have sent a notation with the invoice showing how much of the tax they actually owed). Any tax exempt certificates that arrived with checks were entered into the data base along with all information pertaining to that invoice. If amount of tax paid was more than necessary (ie: they paid tax on a tax exempt job) a refund check will be written.
- E) Run report from data base and compare to what was outstanding on Accounts Receivable Statements for each builder that had paid short.
- F) Any invoice that was paid short of the amount billed, then required a negating invoice to clear it off our books (enter invoice in computer, approve, print, make 0 deposit to clear.
- G) Update data base showing this invoice was cleared from builder's records and ready to be accounted for to the state.

3) Letters:

Written to customers showing in detail where they underpaid and how much was still owing.

These steps were taken for a period of 6 months, June through December 1992.

TEAGUE

Electric Construction, Inc.

TESTIMONY PROVIDED TO THE SENATE ASSESSMENT
AND TAXATION COMMITTEE

REGARDING THE CONSTRUCTION SALES TAX

January 27, 1993

Chairman Langworthy and Members of the Committee:

My name is Harold Teague. I am the owner of Teague Electric Construction, Inc. of Lenexa, Kansas. My business has been in operation in Kansas for approximately 15 years and in Lenexa for the last 13 years. I have 68 employees on my payroll and am a resident of Overland Park, Kansas. In 1992, my business paid state, federal and local taxes on the more than \$ 5 million in business we did.

As a result of the actions of the 1992 Kansas Legislature, my business was forced to quickly respond to the new law requiring the collection of sales tax on "labor services" in new construction implemented in June. About that same time, I had an opportunity to bid on a job in Overland Park. My bid was \$ 41,698.37 of which included \$ 2,544.97 in sales tax to cover tax on the materials, labor, profit and overhead as required by the printed guidelines of the Kansas Department of Revenue. Unfortunately, I lost the bid to a Texas contractor. After some checking, I was later told that the additional sales tax made the difference between getting the job and losing it. The Texas contractor made it clear to the company offering the job that they would not have to pay the tax.

For this reason and the ensuing administrative nightmare that was created by the Kansas Department of Revenue, I was forced to look at alternatives to restructure and relocate my business. I am negotiating for a building in Grandview, Missouri. I will meet again on Friday with the building owners to firm up my plans. I am in the process of obtaining the appraisal and finalizing my decision.

Sen. Assess. & Taxation
Jan. 27, 1993
Attach. 7-1

cont. page 2

Your decision today or sometime in the next few months may come too late to change my plans, but I would urge you to take a common sense solution to your need for revenue. Kansas needs the kind of jobs my employees have. Good jobs are hard to find as many discovered in the last two to three years. I hope you will do your best to repeal this tax that has put Kansas construction at a distinct disadvantage.

Thank you for your interest. I would be happy to answer any of your questions.

Sincerely,

TEAGUE ELECTRIC CONSTRUCTION, INC.

A handwritten signature in cursive script, reading "Harold A. Teague". The signature is written in dark ink and is positioned above the printed name and title.

Harold A. Teague
President

Heavy Constructors



...making it better

The Heavy Constructors Association of The Greater Kansas City Area



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Excavation Division

WILLIAM D. LAMM
LARRY HUDGENS
Utility Division

TESTIMONY

BY THE

HEAVY CONSTRUCTORS ASSOCIATION OF GREATER KANSAS CITY Before The Senate Committee on Assessment and Taxation Regarding 1993 Senate Bill No. 4 January 27, 1993

Madam Chairman, members of the Senate Assessment and Taxation Committee, thank you for the opportunity to submit some brief comments regarding Senate Bill No. 4 and the taxation of construction services.

My name is Ed DeSoignie. I am the Assistant Executive Director of the Heavy Constructors Association of the Greater Kansas City Area. The Association is a chapter of the Associated General Contractors of America and represents over 150 heavy, highway, and municipal-utilities construction companies and affiliated member firms in the Kansas City construction industry.

I am appearing before you this morning on behalf of the association members to respectfully request elimination of the 2.5 percent sales tax on construction labor services. The present tax has resulted in added costs to the public, created concern with future development in communities, and been an administrative problem for construction firms.

Construction costs are ultimately borne by the end consumer of the product. While in the case of a home it is the homeowner, in other instances it may be each of us, the products or services we purchase reflect those higher costs. Public policy exempting construction labor services has been based on this knowledge, and sought to encourage development through the exemption as a benefit to the public. We believe the desirability of such a policy remains unchanged.

We ask that in your deliberations on Senate Bill No. 4 that K.S.A. 1992 Supp. 79-3603 (p) be amended to exempt construction labor services on the original construction of a building or facility or the construction, reconstruction, restoration, replacement or repair of a bridge or highway (please see attached).

Thank you for the opportunity to appear before you this morning. This concludes my prepared remarks.

Sen. Assess & Taxation
Jan. 27, 1993
Attach. 8-1

The gross receipts received for the service of installing or applying tangible personal property which when installed or applied is not being held for sale in the regular course of business, and whether or not such tangible personal property when installed or applied remains tangible personal property or becomes a part of real estate, except that no tax shall be imposed upon the service of installing or applying tangible personal property in connection with the original construction of: (1) (A) an oil or gas well; and (B) a community housing development project sponsored by a nonprofit community housing development organization; and (2) ~~a tax at the rate of 2.5% shall be imposed upon the gross receipts received from the service of installing or applying tangible personal property in connection with the original construction of~~ a A building or facility or the construction, reconstruction, restoration, replacement or repair of a bridge or highway.

LABOR-MANAGEMENT COUNCIL OF GREATER KANSAS CITY

TESTIMONY PRESENTED BY

PHILLIP P. SCAGLIA, EXECUTIVE DIRECTOR - (816) 926-4565

REPEAL THE SALES TAX ON LABOR SERVICES

Good morning Madam 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 action on repealing the sales tax on labor services. The LMC Board of Directors has unanimously endorsed the repeal of this tax. Business leaders and Labor leaders both recognize that taxing "labor services" adversely impacts the economic development potential of the State. The Council understands the dilemma which you as a rational policy maker faces in balancing the priorities of the State. LMC would submit that the desired outcomes of having this tax are not being met, and that indeed this tax puts the State of Kansas at a disadvantage when compared to neighboring states.

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

The Labor-Management Council (LMC) urges your action in repealing the sales tax on labor services. Your leadership on this issue will prevent the State from losing its comparative advantage in economic development.

The 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.

Sen. Assess. & Taxation
Jan. 27, 1993
Attach. 9-1

1-27-93

TESTIMONY
BY
BATES DYER, LEAVENWORTH KS
THORNE LARKIN REAL ESTATE
FOR
THE SENATE TAXATION COMMITTEE

JANUARY 27, 1993

DISADVANTAGES OF THE SALES TAX ON NEW CONSTRUCTION

Sen. Assess + Taxation
Jan. 27, 1993
Attach. 10-1

1. REAL ESTATE/CONSTRUCTION/DEVELOPMENT IN KANSAS CITIES BORDERING OTHER STATES UNFAIRLY IMPACTED. i.e. Exact same home in Missouri costs less by the sales tax amount (\$1,200-\$1,500 on a \$100,000 home.) All other Kansas taxes also higher, so no offsetting advantage.
2. MUNICIPALITIES WITH LOCAL SALES TAXES UNFAIRLY IMPACTED. e.g. Leavenworth City/Lansing City adds 1%--Leavenworth County 0% so cheaper to build new home in county vs. within the city limits. Most cities would opt out of local tax portion if allowed and understood.
3. NEW HOMES BECOMING NON-COMPETITIVE VS. EXISTING HOMES. Costs of new home sale already escalating due to increases in building permit fees, development costs, financing requirements/costs and materials costs. Now the new sales tax is an added burden with no value to the buyer.
4. BUILDERS, DEVELOPERS SUBCONTRACTORS WITH A CHOICE ARE CHOOSING TO DO BUSINESS IN MISSOURI (OR ELSEWHERE) VS. KANSAS AND /OR TO CURTAIL OR DISCONTINUE SPECULATIVE BUILDING. Many Missouri based subcontractors prefer not to work for Kansas builders due to the administrative hassle.
5. BILLINGS, RECORD KEEPING, PAYMENT TO STATE IS AN ADMINISTRATIVE NIGHTMARE. Most subs/small builders not staffed to handle this. More administrative expense required which no one can afford. Many errors being made.
6. ALL OF THE ABOVE ADVERSELY IMPACTS WORKING PEOPLE IN KANSAS WHO NEED THE HELP MOST. Small builders, subcontractors, real estate agents (many of whom are single parents/working mothers) and related industry employees. This is happening when interest rates are uncommonly low. The problem just gets worse as rates rise.

PRE-EMPT A CATASTROPHE! REINSTATE THE NEW CONSTRUCTION SALES TAX EXEMPTION!!



GREATER KANSAS CITY ♥
CHAMBER OF COMMERCE

TESTIMONY OF CHRISTOPHER E. BEAL

GREATER KANSAS CITY CHAMBER OF COMMERCE

SENATE ASSESSMENT AND TAXATION COMMITTEE

JANUARY 27, 1993

Senator Langworthy:

My name is Chris Beal and I am a registered lobbyist for the Greater Kansas City Chamber of Commerce and I am appearing before your committee today to express the Chamber's opposition to the sales tax on original construction and the Chamber's support of its repeal. In the interest of time, I will keep my remarks brief.

The Chamber represents over 3,000 businesses in the Greater Kansas City metropolitan area. Our membership is made up of businesses on both sides of the state line including many contractors and home builders. The Chamber joins other organizations in support of the repeal of the sales tax on original construction.

In considering its position on tax policy in Kansas, the Chamber has serious concerns about the making of tax policy in Kansas. It appears that tax policy is often made without regard to its economic impact on jobs and job creation and without any long-term strategic financial plan.

The Chamber recognizes that federal mandates and court orders make it necessary to seek additional revenues. However, more attention needs to be given to the actual cost of the tax increases in terms of the administrative costs, and its impact on jobs rather than solely on the estimated revenues it may bring to the state's treasury.

Sen. Assess & Taxation

Jan. 27, 1993

Attach. 11-1

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911 MAIN STREET
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816/221-2424 FAX 816/221-7424