

Approved: February 9, 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 February 2, 1993 in Room 519-S of the Capitol.

Members present: Senator Langworthy, Senator Tiahrt, Senator Martin, Senator Bond, Senator Corbin, Senator Feleciano Jr., Senator Hardenburger, 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: Bob Corkins, KCCI
Alan Alderson, Homebuilders Association of greater KC
Roger Schultz, Homebuilders Association of Kansas
Dr. Darwin Daicoff, University of Kansas
Dean Ferrell, Pres., Ferrell Construction
Art Brown, Mid-America Lumber Dealers Association

Others attending: See attached list

Request for Introduction of bills

Bud Grant, KCCI, requested the introduction of a bill to raise sales tax 1 tenth of one percent and grants retailers a discount of 3 percent of the collection reimbursing them for their administrative costs.

Senator Bond moved this bill be introduced. The motion was seconded by Senator Tiahrt. Motion carried.

Chris McKenzie, League of Kansas Municipalities, requested the introduction of several bills: (Attachment 1)

1. An increase in local option sales tax authority
2. Local option earnings tax
3. Local option excise tax on cereal malt beverages
4. Local option income tax surcharge

Senator Martin moved these bills be introduced. The motion was seconded by Senator Hardenburger. Motion carried.

Senator Feleciano moved the introduction of a bill to waive sales tax on entry fees for nationally sponsored sporting events. The motion was seconded by Senator Martin.

Senator Tiahrt said he had a bill drafted which would cover this area and asked Senator Feleciano to work together with him on it.

Senator Feleciano withdrew his motion and Senator Martin withdrew his second.

SB 4 - Sales tax exemption for utilities in production; rate increase Re Proposal No. 7

Bob Corkins, KCCI, said they support SB 4 with its move away from industry-penalizing "value added" tax. (Attachment 2) He said manufacturers are hit hard by the new sales tax on their energy. Passage of SB 4 would rectify the economic policy errors enacted in 1992.

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION, Room 519-S
Statehouse, at 11:05 a.m. on February 2, 1993.

Labor services - original construction

Bob Corkins, KCCI, said Kansas needs to achieve an overall Kansas tax structure which is competitive with neighboring states. He said KCCI advocates an increase in the state sales tax instead. This tax would more evenly be borne by all Kansas residents. (Attachment 3)

Alan Alderson, Homebuilders Association of greater Kansas City, urged the committee to restore the sales tax exemption of original labor services. (Attachment 4) He listed 6 areas of particular concern.

Roger Schultz, Homebuilders Association of Kansas, voiced strong opposition to the 2.5 percent tax placed on new construction. (Attachment 5) His association has contracted with Kansas University professor, Dr. Darwin Daicoff to provide statistics and effects this tax has had on the state of Kansas

Dr. Darwin Daicoff, Kansas University, spoke from a prepared statement. (Attachment 6) He told of the effect on Kansas construction during the first half of 1992 and then after the sales tax exemption was removed on labor services on new construction, during the second half of 1992. He also included charts of the surrounding states housing construction compared to Kansas.

Dean Ferrell, President, Ferrell Construction, expressed his concern about the affects of the 2.5 percent sales tax on labor services for original construction. (Attachment 7) He said it has placed a heavy burden on all contractors. It has become an accounting nightmare and he said there has to be a better solution than applying two separate taxes with different rates to the same job. He does not believe this was the intent of the legislature.

Mark Ciardullo of the Department of Revenue responded to questions by the committee. Representatives of the Department will appear before the committee on this topic next week.

Art Brown, Mid-America Lumbermens Association, said the prime reason for any improvement in new construction in the state of Kansas is because of the low interest rates. He said Johnson county would be impacted the greatest because of its closeness to the state line of Missouri where contractors could build there instead of Kansas. He strongly supported the reinstatement of this exemption. (Attachment 8)

The meeting adjourned at 12:00 noon.

The next meeting is scheduled for February 3, 1993.

GUEST LIST

COMMITTEE: Senate
ASSESSMENT & TAXATION

DATE: Feb 2, 1993

| NAME (PLEASE PRINT) | ADDRESS | COMPANY/ORGANIZATION |
|---------------------|--------------------------------------|--------------------------------------|
| ROGER SCHULTZ | 4741 TUTTLE CIRCLE MANHATTAN | SCHULTZ CONST KANSAS HOMEBUILDERS |
| GIL BRISTOW | 1916 Bluestem Trail MANHATTAN, KS | BRISTOW Const/HBA |
| BEV BRADLEY | TOPEKA, KS | KS Assoc of Opticians |
| MICHAEL REELINT | " | .AT&T |
| Mary Shivers | Topeka | KDOT |
| Gerry Ray | Overland PK | Johnson Co City of OP |
| Janet Stukka | Topeka | HBA of Ks. |
| ARK BROWITT | " | KS E&A Dealers |
| WILLIAM STEVENS | Tulsa, OK | Texaco Inc |
| ALAN ANDERSON | Topeka | HOMEBUILDERS OF K.C. |
| Jordan T. Horvath | Topeka | CPAK |
| Mark McCrory | Topeka | McCrory Const, Inc |
| Debbie Beam | Topeka | Topeka Bd of Realtors |
| Nelsie Sweeney | Overland Park | OP Chamber |
| Bernie Koch | Wichita | Wichita Chamber |
| Bill Janacek | Wichita | Boeing |
| Bob Corkins | Topeka | KCCI |
| PAUL GRANT | " | " |
| Tom Slattery | TOP | AGC of KS |
| DEAN F. PERRELL | TOPEKA | PERRELL CONSTRUCTION |
| T.C. Anderson | Topeka | KSCPA |
| MARK A. BURGHART | TOPEKA | REVENUE |
| NANCY PARRISIL | Topeka | REVENUE |
| Steve Stoltz | " | " |
| MARK CIARDULLO | " | " |

Ann Papay

Brad Welch

Carl Daugherty

Appraiser

Hearny/Greeley Co

Empire District Elec.

Ulysses, Ks

LaHar, KS

Columbus Ks



**THE LEAGUE
OF KANSAS
MUNICIPALITIES**

**Municipal
Legislative
Testimony**

AN INSTRUMENTALITY OF KANSAS CITIES 112 W. 7TH TOPEKA, KS 66603 (913) 354-9565 FAX (913) 354-4186

TO: Senate Committee on Assessment and Taxation

FROM: *CM* Chris McKenzie, Executive Director

DATE: February 2, 1993

RE: Request For Introduction of Bills Concerning Local
Option Taxing Authority of Cities and Counties

Approximately one week ago you heard testimony about the erosion in recent years of the financial capacity cities and counties and you are aware of public concern about city and county dependence on the property tax. On behalf of the League of Kansas Municipalities and the Kansas Association of Counties I respectfully request the introduction by the Committee of four bills which would grant cities and counties in Kansas additional local option tax authority in order to lessen our reliance on the property tax. The proposed measures are as follows:

(1) **Increase in Local Option Sales Tax Authority.** This bill would expand the local option sales tax authority of cities and counties in .25% increments up to a maximum of an additional 1% in authority in lieu of the additional 1% authority granted by the 1992 legislature for health care purposes.

(2) **Local Option Earnings Tax.** This bill would grant cities and counties the ability to levy up to a 2% tax (in .25% increments) on the earnings of individuals and corporations located within such city or county.

(3) **Local Option Excise Tax on Cereal Malt Beverages.** This bill would grant cities and counties the authority to levy up to a 10% excise tax on the sale of cereal malt beverage in the original, unopened container. At present cities and counties receive only a \$50 license fee from establishments selling such products.

(4) **Local Option Income Tax Surcharge.** This bill would grant cities and counties the authority to levy up to a 10% income tax surtax on the state income tax liability of individuals and corporations.

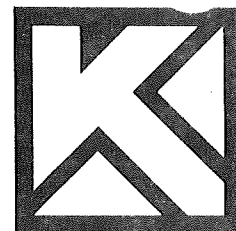
Copies of these proposed measures have been provided to the Chair of the Committee and staff. Please let me know if you would like to see copies of the proposals.

Thank you for your consideration.

cc. John Torbert, Executive Director, Kansas Association of Counties

Senate Assessment + Taxation
February 2, 1993
Attachment 1-1

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
January 28, 1993

SB 4

KANSAS CHAMBER OF COMMERCE AND INDUSTRY
Testimony Before the
Senate Committee on Assessment and Taxation
by
Bob Corkins
Director of Taxation

Madam Chair 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 opportunity to speak today. KCCI supports SB 4 with its move **away from** the industry-penalizing, "value added," inflationary tax policy created by imposing sales tax upon electricity, gas and water consumed in manufacturing processes.

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.

Many of the arguments you heard yesterday regarding the sales tax on original construction services are applicable in this context as well. In both cases, the bottom

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attachment 2-1*

line which should control your policy decision relates to jobs and the disposable income of average Kansas taxpayers. These two sales tax exemptions were created to foster job creation, to protect the competitive position of Kansas businesses, and to avoid the inflationary and inequitable practice of "tax pyramiding."

Also, in both cases, the taxes were imposed last year in the name of property tax relief. As I indicated in my earlier testimony regarding construction services, however, **property tax** relief (if in fact it was experienced at all by an individual taxpayer) does not necessarily equate to **tax** relief.

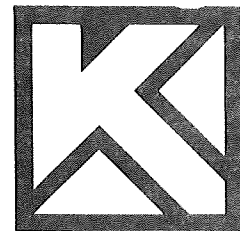
This is particularly true with respect to industry. Manufacturers are hit hard by the new sales tax on their energy. Manufacturers will be unfairly burdened by the higher property tax rate applied to public utilities. Manufacturers make large scale expansion plans which now entail the added cost of a sales tax on construction services. Many manufacturers will suffer an increase in their state corporate income taxes...up from an already extremely high burden for our region of the country. And manufacturers must also pay property taxes on their machinery (often of much greater value than their real estate) at a rate 25 percent higher than last year.

Any of these increases, taken in isolation, may have been reasonable or at least tolerable as part of the overall restructuring of Kansas taxes. Some, like the sales tax on consumed utilities, are more onerous than others.

Clearly, such tax burdens work in opposition to basic economic development. Manufacturers provide on average the state's highest wage jobs, with the greatest potential for spin-off employment in other businesses in their communities. They also offer the best source for generating Kansas wealth through the products which they export.

With all due respect, we believe that SB 4 is the minimum which this legislature should do to rectify the economic policy errors enacted in 1992. Again, I appreciate your consideration and stand ready to respond to any questions.

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

Sales Tax - New Construction

January 27, 1993

KANSAS CHAMBER OF COMMERCE AND INDUSTRY
Testimony Before the
Senate Committee on Assessment & Taxation
by

Bob Corkins
Director of Taxation

Madam Chair and members of the Committee:

My name is Bob Corkins, director of taxation for the Kansas Chamber of Commerce and Industry. Thank you for the opportunity to speak today. For years, I've been arguing the Chamber's position that we strongly oppose **any** expansion of Kansas' sales tax base. Now, our members are committed to removing that expansion which was suffered through passage of the 1992 school finance reforms...in particular, the tax upon original construction services.

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.

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attachment 3-1
Febr. 2, 1993*

KCCI's guiding tax objective is to achieve an overall Kansas tax structure which is competitive with neighboring states. We need not be the lowest tax state, but we cannot be the highest, and we cannot afford isolated taxes which stick out like sore thumbs in this part of the country.

If this assessment of tax policy sounds familiar to you, it's because Mr. Redwood and Ms. Oslund of Kansas University's IPPBR delivered the same analysis to you last week. My point to you today is that our sales tax on original construction services is a "sore thumb." None of our surrounding states imposes a similar burden on this industry which has historically led us out of regional and national economic recessions.

I cannot provide hard numbers which prove that the tax has resulted in a specific statistic of lost jobs, more business emigrations, fewer construction permits, delayed business expansions, and higher consumer prices. I can confidently say that these results are inevitable to varying degrees and that the tax has **unquestionably** fed the perception of Kansas as having an unstable tax climate for business -- another of the tax policy red flags forewarned by the university economists.

Some argue that businesses are responsive to their bottom lines and that property tax relief has counterbalanced the negative effects of the new sales taxes which fund it. This premise is true, but the actual result has not been evenly experienced. By repealing sales tax exemptions you target specific sectors of taxpayers for tax increases. Since property tax relief has not been uniformly enjoyed, specific businesses which did not receive a significant property tax cut, and which are particularly hurt by the repeal of the exemption for construction services, have been net losers.

That's why KCCI advocated, and now still advocates, an increase in the state sales tax **rate** to replace the recently broadened sales tax **base**. An increase in the rate would be more evenly borne by all Kansas residents instead of the isolated sector which was most directly burdened by the tax on original construction services.

We believe that state legislation implementing this change is warranted, necessary and justified. I thank you again for this forum and stand available for any questions you may have.

ALDERSON, ALDERSON, MONTGOMERY & NEWBERY

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MEMORANDUM

OF COUNSEL

TO: MEMBERS OF SENATE ASSESSMENT AND TAXATION COMMITTEE DANIEL B. BAILEY

FROM: ALAN F. ALDERSON, ATTORNEY, HOME BUILDERS ASSOCIATION OF
GREATER KANSAS CITY

RE: SALES TAX ON ORIGINAL CONSTRUCTION

DATE: JANUARY 27, 1993

I am appearing today on behalf of the Home Builders Association of Greater Kansas City to urge you to restore the sales tax exemption of original construction labor services that existed prior to the 1992 legislative session. I have been working with the Home Builders Association of Greater Kansas City since immediately after the passage of 1992 House Bill No. 2892 and have participated in a number of meetings in which contractors and representatives of the Kansas Department of Revenue have been present. My involvement with the original construction exemption, however, dates back to 1978 when I first went to work for the Kansas Department of Revenue as a sales tax attorney -- shortly after the legislature had restored the provisions of the labor services subsection of the Kansas sales tax law after it had been stricken down by the Supreme Court as unconstitutionally vague. In addition, I have discussed this topic in seminars I have presented two or three times a year for the last 5 or 6 years for the National Business Institute.

I am of the opinion that the imposition of sales tax on original construction labor services has created more difficulties for contractors than the amount of revenue being collected could ever possibly justify. I have been attempting to obtain a series of private letter rulings from the Director of Taxation which would clarify the Department of Revenue's position on a number of the troublesome issues and, while the Department's position has become clearer in a number of these areas, the interpretation of the newly-enacted subsection continues to create uncertainty and unequal treatment for Kansas contractors and subcontractors. A number of the difficulties created or exacerbated by the imposition of the 2 1/2% tax on original construction labor services are as follows:

1. By interpretation of the Department of Revenue, professional services, such as real estate commissions, so-called professional fees and land costs are not considered to be included within the taxable service base. However, upon inquiry, it has been determined that builder's fees are not considered to be within the ambit of "professional fees".

Neither profit nor overhead are excluded from the sales tax base and, while I do not quibble with this interpretation, the Director of Taxation has ruled that items such as building permits and sewer hook-up fees are includable in the sales tax base. I find it very hard to distinguish

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between other non-service items, such as real estate commissions and professional fees and those items that the Director of Taxation considers to be part of the base.

Also troubling is the attempted distinction between excludable and includable professional fees. The Director contends that architecture, engineering or surveying performed by a contractor who also performs taxable services are not excludable from the tax base. Would these services be excludable if performed through a separate corporation?

2. Although I would not argue with the Director's interpretation of the law in this regard, the contractor also must be aware that travel expenses, per diem expenses, the purchase, lease or rental of machinery and equipment, consumable supplies such as form lumber, sandpaper, tools and other equipment are considered to be a part of the tax base. All in all, trying to make sense out of the elements that are required by the Department of Revenue to be included in the base for sales tax purposes is unbelievably confusing for contractors.

3. To further compound the problem, there are certain of the elements of a sales tax base that can be excluded by contractor who segregates the payment of certain fees and expenses and makes those acquisitions or pays those expenses through a separate corporation in which there are no employees performing actual labor services. Obviously, only the larger construction companies can afford to create these separate corporations for the purpose of shielding non-labor items from the tax base. The savings that can be obtained through the creation and operation of these separate corporations makes it worthwhile for the larger contractors, however. This works a discrimination against the small contractors subcontractors who cannot afford to operate under multiple corporate shells. The Department of Revenue has ruled that sewer hook-up fees, building permits and the like can be acquired through these corporations without sales tax. Professional services, whatever those include, could also probably be dropped into a separate corporation for exclusion purposes.

4. The larger contractors are also in a position to build spec homes they own themselves to shield original construction from sales tax. Sales tax would only apply to services performed for sale at retail and, just as if you set out to build your own home, a contractor can do the same thing if he structures his financing properly. Obviously, not all contractors are in a position to take advantage of this type of arrangement.

5. The Department of Revenue has agreed that the Bernie's Excavation case applies to allow bifurcation of certain types of contracts. In Bernie's, the Kansas Court of Appeals upheld a Board of Tax Appeals decision in which an excavation was allowed to segregate his billings between taxable and non-taxable services. The Court -- correctly, I believe -- held that an excavation contractor is actually performing two services, under certain circumstances: (1) The non-taxable service of digging a ditch, for example, and (2) the taxable "installation" of pipe. The Court said that, as long as the Contractor properly segregates his billing for the two services, the performing of the non-taxable service does not have to be included in the taxable portion of the service base.

While the enactment of the tax on original construction labor services does not affect the Court's decision in Bernie's, the Department of Revenue is unwilling to extend the ruling in Bernie's beyond its' application to excavation contractors. There are other situations in which it is clear that a contractor may be performing services which could be segregated into taxable and non-taxable components. One example is the clean-up and detail work done at the completion of a construction project. A crew may be sent to the building to do clean-up, which would normally be considered to be a non-taxable service, but this crew may also be required to install switch plates, light fixtures, and other detailing items. The Department has ruled that the performance of any of these minor taxable installation services renders the entire clean-up and detailing job taxable. The Department has not, as yet, extended the logic of Bernie's to the bifurcation of these types of contracts. I see no reason why those contractors who can afford to have multiple corporations couldn't have the nontaxable clean-up work performed by a corporation other than the one that is performing taxable labor services in order to avoid the Department of Revenue's refusal to extend the application of Bernie's to services other than excavation.

6. The situation that has occurred in Johnson County is of particular concern to subcontractors because, under the new law, a Kansas contractor can hire a Missouri subcontractor at a savings. This is true because there is no local use tax in Kansas. Therefore, a Missouri subcontractor can undercut the bid of a Kansas subcontractor under identical job specifications because the Kansas subcontractor would have to bid the job with local sales tax.

While Attorney General Stephan has rendered an opinion to the effect that local units can charter out of the original construction labor services tax base, the Kansas Department of Revenue has now indicated that it will not honor the action taken by a number of cities in Johnson County and will collect local sales tax from contractors who perform labor services in those cities.

I attended a meeting last May or June in Overland Park in which I overheard a contractor indicating to another that he would definitely begin hiring Missouri subcontractors because the savings of 2% off the top on a job of any magnitude would make it worth his while. This has created a discriminatory situation under which our own subcontractors will be the losers.

7. Although another situation was not created by the enactment of the original construction labor services tax, I mention it because it has recently become apparent that the application of this interpretation causes greater confusion now that there is a taxable portion of original construction labor services. This situation is that a development contractor cannot collect and remit tax at the lower rate on any of the service items which cannot be specifically attributable to a specific "building or facility". Therefore, street lighting, paving, laying sewer mains and water mains and other similar service items are considered taxable at the full 4.9% state rate because they are not considered to be "in connection with" the construction of a specific building or facility.

This is a rather stringent interpretation by the Department of Revenue and one which, like all of the other problems created by the imposition of the new tax on the previously exempt services creates substantial confusion and uncertainty for contractors. Where is the line between sewer pipe and water line that is to benefit the development in general and that which is to benefit a particular dwelling? Can any street lighting be tied to a particular residence?

These are only some of the problems that are now being encountered by contractors. It is my understanding that the tax collection under this newly imposed tax has been very minimal. On behalf of the Home Builders of Kansas, I would urge you to restore the law to its status prior to 1992.

TESTIMONY
of the
HOME BUILDERS ASSOCIATION OF KANSAS

February 2, 1993

MADAM CHAIR AND MEMBERS OF THE COMMITTEE:

My name is Roger Schultz, owner of Schultz Construction, Inc., of Manhattan, Kansas, and Legislative Chairman for the Home Builders Association of the State of Kansas. I am appearing today to voice strong opposition to the 2.5% gross receipts tax placed on new construction by the 1992 Kansas Legislature. I would like to stress that this is a gross receipts tax instead of a tax on labor only which many of the legislators thought they were voting on.

The Home Builders Association of Kansas has contracted with Kansas University professor Dr. Darwin Daicoff, to provide statistics on the economic impact and effects on home ownership that this tax has had on the State of Kansas. Dr. Daicoff will be presenting his findings to you later today.

Last year Governor Finney and the Legislature established a Department of Housing and expanded the name of the Department of Commerce to the Department of Housing and Commerce. Nationally the government was looking at construction and housing to bring the country out of recession. The Federal Government was deeply concerned about keeping costs down and providing "affordable housing" for everyone. This "affordable housing" not only relates to "low cost housing" but housing for all walks of life. Our Governor expressed a great deal of concern for "affordable housing for all Kansas citizens". Yet that same Governor and Legislature enacted legislation, which we will see by Dr. Daicoff's study that has drastically effected home construction and affordability in the State of Kansas.

There is a great deal of confusion regarding the "guidelines" issued by the Department of Revenue. Contractors and subcontractors are not sure what they should charge because of the many variables in the system, such as city tax, county tax, remodeling % vs. new construction, etc. This creates a quagmire of expensive bookkeeping. The majority of the time we are not looking at 2.5% but a total of 4 or 5% when the city and county taxes are added on. Add to this the cost of bookkeeping and implementation and the actual expense is between 5 and 10%. This percentage may not sound like much money to you but the national average of net profit to a homebuilder is less than 5%.

On top of all this we have created unfair competition with manufactured housing being tax exempt on their inventory and site built being taxed at the existing rates. We have also created unfair competition with bordering state contractors and subcontractors not being required to pay Kansas tax if his contract is less than \$10,000.00. We have created unfair competition in contractors living within city of county jurisdictions. We must keep in mind that a general contract is made up of many subcontracts, all of which generally are under \$10,000.00.

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Each \$1 spent on new construction in Kansas generates a total of \$2.2450 in economic activity in both industries and services in the state. Each additional \$1 million spent on new construction in Kansas creates 34.7 jobs. NAHB economists advise that for every \$1,000 increase in the cost of a residence, 1% of the public is priced out of the market.

| Increase | Less Homes | Jobs Lost | Wages Lost | Personal Tax |
|----------|------------|-----------|--------------|--------------|
| \$1,000 | 200 | 335 | \$ 7,370,000 | \$270,000 |
| \$1,500 | 300 | 502 | \$11,055,000 | \$405,000 |
| \$2,000 | 400 | 670 | \$14,740,000 | \$540,000 |

Further statistical considerations are not provided for the "ripple effect" on the economy nor the amount of state expenditures for unemployment and assistance due to these loss of jobs. Current construction code revisions and construction material increases combined add significant numbers, 15% to 20% to the cost on construction. These items alone are expected to add as much as \$5,000 to the cost of a moderate house this year. Data from the Federation of Tax Administrators indicates that only 12 states tax new construction labor. 10 states tax excavating and grading on new construction sites. 14 states, including Kansas, tax remodeling labor. 3 other states join Kansas in taxing remodeling and exempting new construction labor and 2 states exempt remodeling and tax new construction labor.

Testimony of Dr. Darwin W. Daicoff before the Kansas Senate Assessment and Taxation Committee, February 2, 1993.

I have conducted an economic analysis of the Kansas construction industry. The purpose of the analysis is to determine what has happened to this industry since the imposition of a sales tax on original construction services, which took effect on July 1, 1992. This is accomplished by examining total construction activity as measured by construction permits and construction employment. Particular attention is directed to the size distribution of Kansas construction firms. The analysis concludes with a detailed review of housing construction.

Building Permits

The dollar value of construction permits issued in 33 major Kansas cities are available from the Center for Economic Development and Business Research at The Wichita State University, see Table 1. These consistent data provide a measure of construction activity (including commercial, housing, and other) from January 1989 through November 1992. It should be noted that, in general, 1992 was a better year for construction than the three prior years. However, because the focus of this economic analysis is since July 1992, a more detailed examination is needed. What is needed is a measure of how well the industry has done from July 1992 through November 1992, compared to how it had been doing earlier. For the first half of 1992, monthly construction permits averaged \$108.5 million and in the latter five months the average

was \$102.7 million. Thus, construction activity, by this measure, fell by 5.3% after the sales tax increase. This decline is not a typical seasonal factor. This fact is made clear by observing that during 1989, 1990 and 1991 average monthly construction building permit dollar values were 1.3% larger in the July-November time period than they had been in the January-June time period. Had such growth occurred in 1992 permits would have averaged \$109.9 million. Then the monthly "loss" (vs. the actual of \$102.7 million) was \$7.2 million, or \$36.0 million in total construction activity for the five months.

Employment

Kansas construction activity also can be measured by employment. Employment information is available from the Labor Market Information Services of the Kansas Department of Human Resources. Again, consistent data from January 1989 through November 1992 are employed for this analysis, see Table 2.

In 1992 construction employment showed an improvement over 1989, 1990 and 1991. Breaking 1992 into two time periods (before and after the sales tax) is necessary. For the first six months of 1992, Kansas construction employment averaged 44.1 thousand and for the next five months averaged 47.8 thousand. This is a 8.4% increase. While there was an increase in the latter part of the year, this increase was less than the increase in either 1989, 1990 or 1991; for these three years the increase averaged 12.3%. Had the July through November 1992 Kansas construction employment

increased (from the first six months of 1992) at its historical rate it would have averaged 49.6 thousand. By this measure, since the sales tax increase, 1.8 thousand construction jobs were "lost"- actual employment less historically projected.

Size Distribution

Regulations regarding the collection of the sales tax on original construction may place small Kansas construction firms at a disadvantage relative to out-of-state firms that compete for construction subcontracts. These firms are typical of SIC 17 firms and include plumbing, heating, air conditioning; painting and paper hanging; electrical work; carpentry and floor work; etc.

The U. S. Department of Commerce publishes information on the size of establishments by industry detail. These County Business Pattern data are for 1990. There are 3,617 establishments for this industry in Kansas. Their employment is 26,155; with an annual payroll of \$592 million. Most of these firms are small--2,277 (63.0% of the total) having less than 5 employees and 3,003 (83.5% of the total) have less than ten employees. Only a few firms (71 or 2.0% of the total) have 50 or more employees. Two subindustries are noteworthy in that they have a very large portion of small establishments. These are painting and paper hanging and carpentry and floor work, where 89.7% and 92.1%, respectively, of the establishments have less than ten employees.

Then, to the extent of the competitive disadvantage, there is a very large portion of existing Kansas special trade construction firms at jeopardy to out-of-state subcontractors.

Housing Units

Housing construction is a component of the construction industry that merits particular attention. Fortunately, the U. S. Department of Commerce publishes data on Housing Units Authorized by Building Permits; monthly data are available for Kansas and other states, through November 1992. These data report for more Kansas permit issuing places than the WSU data.

Influenced by lower interest rates, this component of the Kansas construction industry did better in 1992 than in 1989, 1990, or 1991. Both the number of units (single and multi unit) and dollar value (single and multi unit) exhibit an increase. During the first six months of 1989, 1990 and 1991 permits were issued for a monthly average of 650 housing units in Kansas, see Table 3. For July through November of these years the comparable figure was 9.0% larger. In 1992 a different situation prevailed. The latter five months recorded a 14.2% decline from the first six months of the year.

Had Kansas maintained the historical 9.0% increase in the July through November 1992 time period, 916 housing units permits would have been issued; the actual figure was 721. Thus, after the sales

tax change 195 housing units were "lost" per month or 974 for the five month period.

A comparison can be made between Kansas housing activity and that activity in other states. In order not to be influenced by large states some distance from Kansas and subject to quite different economic influences, this analysis consists of comparing Kansas to bordering states, where economic factors are more similar. The bordering states are Missouri, Nebraska, Oklahoma, and Colorado, see Table 4.

Housing construction activity can be measured by the total number of units, the number of 1-unit units, total dollar valuation and 1-unit dollar valuation. Comparisons can be made by expressing the Kansas statistics as a percentage of the comparable figure for each of the four bordering states and the sum of the four bordering states. A comparison can be made for the July 1992 through November 1992 time period against the prates change period of that year--January 1992 through June 1992, see Table 5. For each of the comparisons, twenty in all, Kansas housing construction was a much smaller portion of each of the states in the region and all the bordering states in the latter part of 1992. Thus, whatever economic forces were operating in the Kansas region, in the last five months of 1992 Kansas housing construction was depressed relative to housing construction in the Kansas region.

Just before the sales tax imposition, by various measures, Kansas housing construction was between 17.3 and 17.5 percent of the bordering state total. After the sales tax increase, the

Kansas share slipped to between 14.2 and 14.9 percent of the bordering states. For total housing units, the decline was from 17.5% to 14.2% and from 17.3% to 14.6% for the total housing value. For single unit housing the decline was from 17.3% to 14.4% and 17.3% to 14.9% in value.

Had the Kansas percentage remained the same after the sales tax increase as Kansas recorded in the first half of 1992, permits for 838 additional housing units (with 626 of them 1-unit) with a permit value of \$60.5 million (with 1-unit value of \$56.0 million) would have been issued between July 1992 and November 1992.

Conclusion

While it cannot be claimed that the imposition of the sales tax on construction services has been the only factor impacting the construction industry in Kansas, the new sales tax is surely a major factor. The measures employed in this analysis produce a fairly consistent pattern. It is clear that 1992 was a relatively good year for Kansas construction, at least relative to depressed years of 1989, 1990, and 1991.

However, the last part of the year, July through November, was worse (or less good) than the first six months of the year. The WSU data point to a \$36.0 million construction permit "loss". Human Resources data are consistent with a construction job loss of 1,800. A very large portion of the construction industry, where subcontracting is common, are small (less than ten employees per

firm) and may be at jeopardy. U. S. Department of Commerce data permits a comparison of Kansas to its historical trends and to regional construction activity. Based on historical Kansas housing permit information, Kansas total housing unit permits were reduced by 974. Regional comparisons produce estimates of a Kansas "lost" of 838 housing units with a permit value of \$60.5 million in the July-November 1992 time period. Then, either a historical or a regional approach produce estimates of significant "loss".

TABLE 1

DOLLAR VALUE OF KANSAS CONSTRUCTION PERMITS

| | 1989 | 1990 | 1991 | AVERAGE 1989-1991 | 1992 |
|---------|-------------|-------------|------------|----------------------|-------------|
| JAN | 93,512,775 | 84,985,859 | 37,220,018 | 71,906,217 | 102,769,275 |
| FEB | 97,014,951 | 61,748,166 | 72,772,652 | 77,178,590 | 100,552,622 |
| MAR | 109,727,994 | 110,720,547 | 78,452,389 | 99,633,643 | 98,501,013 |
| APR | 81,549,000 | 98,545,027 | 89,696,447 | 89,930,158 | 116,454,520 |
| MAY | 120,225,757 | 113,169,876 | 90,755,637 | 108,050,423 | 128,604,836 |
| JUN | 128,922,984 | 99,646,145 | 97,568,302 | 108,712,477 | 103,980,448 |
| JAN-JUN | 105,158,910 | 94,802,603 | 77,744,241 | 92,568,585 | 108,477,119 |
| JUL | 97,680,765 | 83,400,525 | 96,700,749 | 92,594,013 | 119,538,495 |
| AUG | 113,043,934 | 106,539,142 | 73,565,766 | 97,716,281 | 106,103,957 |
| SEP | 71,756,056 | 123,359,640 | 87,703,563 | 94,273,086 | 101,308,068 |
| OCT | 113,698,488 | 96,305,669 | 94,241,170 | 101,415,109 | 109,990,899 |
| NOV | 95,898,603 | 70,381,372 | 72,133,280 | 79,471,085 | 76,678,239 |
| DEC | 78,322,907 | 76,366,995 | 64,808,972 | 73,166,291 | |
| JUL-NOV | 98,415,569 | 95,997,270 | 84,868,906 | 93,093,915 | 102,723,932 |
| JUL-DEC | 95,066,792 | 92,725,557 | 81,525,583 | 89,772,644 | |
| JAN-DEC | 100,112,851 | 93,764,080 | 79,634,912 | 91,170,615 | 105,862,034 |
| RATIO | -6.41 | 1.26 | 9.16 | 1.34 | -5.30 |

SOURCE: Center for Economic Development and Business Research, Wichita State University.

RATIO is the percentage change from the first six months to the July through November time period.

TABLE 2
KANSAS CONSTRUCTION EMPLOYMENT

| | 1989 | 1990 | 1991 | AVERAGE 1989-1991 (thousand) | 1992 |
|---------|-------|-------|-------|------------------------------------|------|
| JAN | 35.2 | 36.6 | 33.7 | 35.2 | 40.5 |
| FEB | 33.4 | 36.1 | 35.5 | 35.0 | 41.1 |
| MAR | 36.5 | 38.0 | 37.4 | 37.3 | 42.6 |
| APR | 39.2 | 40.7 | 40.9 | 40.3 | 45.5 |
| MAY | 41.1 | 42.4 | 42.3 | 41.9 | 46.7 |
| JUN | 43.0 | 45.3 | 44.3 | 44.2 | 48.1 |
| JAN-JUN | 38.1 | 39.9 | 39.0 | 39.0 | 44.1 |
| JUL | 43.6 | 45.1 | 44.9 | 44.5 | 49.0 |
| AUG | 44.0 | 45.0 | 44.8 | 44.6 | 48.4 |
| SEP | 41.9 | 43.8 | 44.7 | 43.5 | 47.7 |
| OCT | 43.0 | 43.3 | 44.4 | 43.6 | 47.4 |
| NOV | 42.2 | 42.3 | 43.3 | 42.6 | 46.4 |
| DEC | 38.4 | 40.4 | 43.1 | 40.6 | |
| JUL-NOV | 42.9 | 43.9 | 44.4 | 43.8 | 47.8 |
| JUL-DEC | 42.2 | 43.3 | 44.2 | 43.2 | |
| JAN-DEC | 40.1 | 41.6 | 41.6 | 41.1 | 45.8 |
| RATIO | 12.80 | 10.16 | 13.85 | 12.27 | 8.39 |

SOURCE: Labor Market Information Services, Kansas Department of Human Resources.

RATIO is the percentage change from the first six months to the July through November time period.

TABLE 3

KANSAS TOTAL HOUSING UNIT PERMITS

| | 1989 | 1990 | 1991 | AVERAGE 1989-1991 | 1992 |
|---------|-------|------|------|----------------------|--------|
| JAN | 533 | 437 | 288 | 419 | 629 |
| FEB | 473 | 442 | 528 | 481 | 776 |
| MAR | 818 | 775 | 684 | 759 | 855 |
| APR | 785 | 820 | 780 | 795 | 924 |
| MAY | 749 | 700 | 758 | 736 | 1,021 |
| JUN | 755 | 688 | 678 | 707 | 833 |
| JAN-JUN | 686 | 644 | 619 | 650 | 840 |
| JUL | 764 | 672 | 735 | 724 | 733 |
| AUG | 697 | 685 | 610 | 664 | 723 |
| SEP | 981 | 550 | 640 | 724 | 686 |
| OCT | 809 | 691 | 634 | 711 | 730 |
| NOV | 969 | 716 | 508 | 731 | 732 |
| DEC | 879 | 352 | 597 | 609 | |
| JUL-NOV | 844 | 663 | 625 | 711 | 721 |
| JUL-DEC | 850 | 611 | 621 | 694 | |
| JAN-DEC | 768 | 627 | 620 | 672 | 786 |
| RATIO | 23.12 | 2.97 | 0.98 | 9.02 | -14.16 |

SOURCE: U.S. Bureau of the Census, Housing Units Authorized by Building Permits.

RATIO is the percentage change from the first six months to the July through November time period.

TABLE 4

KANSAS HOUSING PERMITS AS % OF BORDERING STATES

| 1992 | Total (units) | 1-unit (units) | Total (thousand dollars) | 1-unit (thousand dollars) |
|---------|------------------|-------------------|--------------------------------|---------------------------------|
| JAN | 18.54 | 19.98 | 19.99 | 21.34 |
| FEB | 19.34 | 17.55 | 17.99 | 17.93 |
| MAR | 16.77 | 16.39 | 16.67 | 16.79 |
| APR | 16.29 | 16.57 | 15.96 | 16.29 |
| MAY | 19.37 | 18.77 | 18.76 | 18.35 |
| JUN | 15.38 | 15.95 | 15.93 | 15.94 |
| JAN-JUN | 17.45 | 17.33 | 17.32 | 17.31 |
| JUL | 13.09 | 15.56 | 15.52 | 16.71 |
| AUG | 14.17 | 16.90 | 15.71 | 16.93 |
| SEP | 12.05 | 13.06 | 12.99 | 13.61 |
| OCT | 13.40 | 11.98 | 13.07 | 12.32 |
| NOV | 20.20 | 15.42 | 16.63 | 12.96 |
| JUL | 14.17 | 14.41 | 14.63 | 14.91 |

SOURCE: see Table 3.

RATIO see Table 3.

TABLE 5

KANSAS HOUSING PERMITS AS PERCENTAGE OF STATES AND REGION

| | Total (units) | 1-unit (units) | Total (thousand dollars) | 1-unit (thousand dollars) |
|--------------------------------|------------------|-------------------|--------------------------------|---------------------------------|
| January 1992 through June 1992 | | | | |
| MISSOURI | 45.05 | 47.18 | 53.66 | 55.34 |
| NEBRASKA | 142.24 | 159.99 | 186.09 | 196.47 |
| OKLAHOMA | 138.79 | 120.05 | 143.32 | 135.12 |
| COLORADO | 47.94 | 45.62 | 37.40 | 36.77 |
| BORDERING | 17.45 | 17.33 | 17.32 | 17.31 |

July 1992 through November 1992

| | | | | |
|-----------|--------|--------|--------|--------|
| MISSOURI | 39.42 | 42.35 | 48.41 | 51.06 |
| NEBRASKA | 119.29 | 142.99 | 168.83 | 174.87 |
| OKLAHOMA | 123.48 | 105.97 | 132.45 | 125.22 |
| COLORADO | 34.83 | 34.05 | 29.23 | 29.61 |
| BORDERING | 14.17 | 14.41 | 14.63 | 14.91 |

SOURCE: see Table 3.

RATIO see Table 3.

FERRELL

CONSTRUCTION OF TOPEKA, INC.

Testimony Before Senate Assessment and
Taxation Committee

SUBJECT: Sales Tax on Labor Services for
New Construction Projects
February 2, 1993

Madame Chairperson & Members of the Committee:

My name is Dean Ferrell. I am Owner and President of Ferrell Construction of Topeka, and am a past president of the Associated General Contractors of Kansas. My company is a medium sized building construction firm, performing work generally in the northeastern part of Kansas.

In 1992 the Kansas Legislature passed House Bill 2892, which included major changes to the Kansas Sales and Compensating Tax Law. Specifically, it added a 2.5% sales tax on labor services for original (new) construction of buildings. Prior to 1992, taxes on original construction were applied only to the materials incorporated in new facilities.

My purpose in appearing before you today is to express my concern about the affects this change has had on our industry and to alert you to some of the pitfalls in the way the Kansas Department of Revenue has interpreted this law.

At this time I am unable to speculate what economic affect this "added" tax has had on the building construction market; I am sure others appearing before you will provide facts and figures to support its repeal.

I do know, however, that the enforcement of this tax has placed a heavy burden on all contractors. It has become an accounting "nightmare", and the calculation of two separate taxes in our estimates has been chaotic on bid days. There simply has to be a better solution than applying two separate taxes with different rates to the same job.

The Department of Revenue has issued guidelines and formulas to assist us in calculating the new tax. By this formula, without going into detail, they are calling for a "double taxation" of certain items - specifically, form lumber, hand tools, equipment rental, etc. For these items, not only are we to pay the standard 4.9% tax for materials, we are also obligated to add the 2.5% labor services tax, as well. That's a total tax of 7.4% on certain items. In Topeka, with the local tax, this figure becomes 9.4%. And that's Double Taxation. I really don't believe the legislature intended this to happen.

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One final item which concerns me is that a general contractor who brokers everything on a project - whose own forces do not actually perform the labor services - is exempt from the added 2.5% tax. Consequently, general contractors who perform their own labor services are required to pay a 2.5% tax on its profit and jobsite overhead, while a broker contractor pays no tax on the same items. Why? Why should a broker contractor be given an unfair advantage over contractors who perform work with their own forces? This is also spelled out in the Department of Revenue guidelines. And again, I don't believe this was intended by the legislature when H.B. 2892 was passed.

In closing, I want to thank you for allowing me to speak to you today, and I urge you to search for solutions to these problems.

Thank you.

Sincerely,

FERRELL CONSTRUCTION OF TOPEKA, INC.



Dean F. Ferrell
President

DFF/tls



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816/931-2102 FAX 816/931-4617

MID-AMERICA LUMBERMENS ASSOCIATION

TESTIMONY TO THE SENATE TAX COMMITTEE

Subject: Tax on Original Construction Services

Room 519-S

February 2, 1993

Madam Chair, members of the committee, my name is Art Brown and it is my pleasure to address you today on the subject of the tax on new construction services and the impact on our lumber dealers and on the industry overall.

After considerable deliberation last session, the Legislature voted to add a 2-1/2% tax on original construction services whose fiscal note dovetailed conveniently into the amount of funding necessary to cover financial needs for the school finance package at that time.

At first blush, it would seem this added cost to residential and commercial building did little, if anything, to deter construction in the State of Kansas. While we would state that there was some improvement in areas of the State in new construction, it would be very naive to think that this type of activity in these areas is a permanent situation. We are confident that you will hear from other conferees that the prime driver in housing and commercial activity are interest rates. They were favorable this last year, and we are hopeful they will continue to be in the future. It is an area we as an industry have no control over, yet it is the most vital component of the building material industry as far as determining growth in new construction.

For our part, we are in a very precarious situation as to knowing just how much product is going to be available to our members in the upcoming year. We would not speculate to new administration policies in regard to timber supply, and I will certainly spare the committee a dissertation on our view of environmental issues in the timber growing regions of our country, which supply the softwood used in residential and commercial construction. Suffice



(Continued)

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+ Taxation*

Feb 2, 1993

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it to say, and we say this with a great deal of assurance, there will be no mandate to increase the harvest of timber on forest service land, although such an increase would hardly constitute a “blip on the radar screen,” in so far as long term timber supply to this country.

At present supply levels, this is a concern. Current buying activity is showing upward spikes in the pricing pipeline, the first time that has happened since World War II that pricing is increasing during the winter months. With this background, and realizing that the materials in a typical new house represent about 15-20% of the purchase price of a new house, one can see an increase in the cost of housing as a real possibility in the near future.

Although all areas of the State are impacted by this, no area will feel this more than Johnson County. Having lived in Kansas City all of my life until six months ago, I can tell you from personal experience that the builders in Lee's Summit, Blue Springs, Grandview, Gladstone, Kansas City North, Parkville, Riverside, Belton, Peculiar, Raytown, Independence, and Raymore, communities in which many have upgraded their schools, transportation and other community services to compete with the growth of Johnson County, will do all they can to take advantage of this impropriety. Does the 2-1/2% tax really make a difference? Why even take the chance to find out? It is just an additional expense on a structure that can be utilized by an out-of-state competitor. It is bad enough that local option taxes are not collected from out-of-state suppliers, revenue that is currently being lost to the State in huge numbers. We don't need to send future business across the state line by adding this cost to new construction.

Many business forecasts and barometers use housing starts as a guide to the health of an economy. Kansas is no different. Page 10 of this year's Economic and Demographic Report states that housing starts are one of the components used to determine economic strength in the State of Kansas.

Maybe in the short term this does not look like a hindrance to construction growth, but in the long term it may well be an item which could haunt the construction industry and the revenue it generates to the State.

(Continued)

If there is a thought on this committee to reinstate this exemption, even though we are not directly impacted by it as far as the administration of this tax, which we are told is a pure nightmare, we strongly support such action.

Our State Committee and our Board of Directors would support an increase in the State sales tax to the level of the fiscal note stated by the Revenue Department as a device to generate monies to replace this tax.

We realize this solution will not be satisfactory to all members of this committee, but the potential loss of business in an area as vital as this one is to the State of Kansas seems to us a worse scenario than a very small increase in the State sales tax. As stated earlier, why even take the chance?

I have enjoyed presenting our position to you on this issue this morning and would be glad to visit with you or answer any questions you may have.