Approved: February 22, 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 9, 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, Senator Wisdom

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: Dr. Charles Krider, Institute for Public Policy and Business Research, University of Kansas
Bernie Koch, Wichita Chamber
Bob Totten, Kansas Contractors Association
Karen France, Kansas Association of Realtors

Others attending: See attached list

Senator Langworthy called the committee's attention to the minutes for January 28, February 1, 2, and 3, 1993.

Senator Bond moved the minutes be approved. Motion seconded by Senator Reynolds. Motion carried.

Senator Langworthy asked the committee to review the testimony of Gordon Garrett, Commercial Property Association of Kansas. (Attachment 1)

SB 2--Property tax exemptions and abatements for economic development purposes
Re Proposal No. 1
SB 69--School district property tax levies excluded from city and county economic development exemptions.

Dr. Charles Krider, Institute for Public Policy and Business Research, University of Kansas, spoke in support of **SB 2** and **SB 69.** (Attachment 2) He gave some background information on tax laws and spoke of **SB 440,** enacted in 1990, which imposed some restrictions on cities and counties seeking to grant exemptions. He said he supports additional restrictions on the ability of cities to grant tax abatements and listed his reasons. He also talked about tax exemptions in the surrounding states and in the region compared with Kansas. He called the committee's attention to the two charts at the end of his prepared testimony. He was asked if his testimony was his opinion or the result of a study, and he said it is their opinion from the research of national studies. He was asked by the committee to recommend some changes and he said he would be willing to look at that. He was also asked about the 45 day allowance for the Department of Revenue to analyze the abatements, and he said he would hope that it would not take that long. There were questions about the use of the word "approval" rather than "advisory" in regard to the analysis by the Department of Revenue. He said he would look at that and report back to the committee. He said he was not advocating additional taxes on businesses.

Labor Services--original construction

Bernie Koch, Wichita Chamber, spoke from his prepared testimony. (Attachment 3) He asked the committee

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

to remove the 2.5 percent sales tax on labor involved in original construction. He said the tax has caused much confusion in the construction industry and he feels it does have an impact on the comprehensive highway plan. He said because of the problems it has caused they support removal of this sales tax.

Bob Totten, Kansas Contractors Association, said he represents more than 330 contractors and association members in the construction industry. He requested the 2.5 percent sales tax on the labor involved in the construction of roads and highways around the state be removed. (Attachment 4) He said he did not believe it was the intent of the legislature to have the highway contractors affected by this law but this is the way it has been interpreted. He said this law has also caused a lot of additional paperwork for the contractors, as well as the Department of Revenue.

Karen France, Kansas Association of Realtors, presented a prepared testimony. (Attachment 5) She said there have been a number of jobs lost because of this sales tax and also there has been a decline in the number of building permits granted. She requested the committee look at what revenue is being gained compared to the jobs lost and revenue in taxes from that loss.

Senator Lee asked what she would suggest to replace the revenue from the sales tax on original construction and she suggested an increase in sales tax and income tax.

The meeting adjourned at 11:55 a.m.

The next meeting is scheduled for February 10, 1993.

GUEST LIST

COMMITTEE: Senate ASSESSMENT & TAXATION DATE: Feb 9, 1993

NAME (PLEASE PRINT)	ADDRESS	COMPANY/ORGANIZATION
ROGER SCHULTZ	MANHATTAN, KS	KANSAS HOMEBUILDERS
JEFF RUSSELL	TOPEKA	UNITED TELS
Don Schnacke	Topeka	KIOGA
Mary Camarato	Topeka	Frahm
HAROLD PITTS	"	AARP-CCTF
[illegible]	[illegible] LAWRENCE	KU
BILL JARRELL	WICHITA	BOEING
MARK A. BURGHART	TOPEKA	REVENUE
Steve Stotts	"	"
MARK CIARDULLO	TOPEKA	REVENUE
[illegible]	Lawrence	[illegible]
Don Sefert	Olathe	City of Olathe
Janet Stubbs	Topeka	HBA of Ks.
Bob Totten	Topeka	Ks Contractors
BEV BRADLEY	TOPEKA	KS ASSOC of Counties
Mary Ellen Conlee	Wichita	Ks. Assoc. for Sm. Busi.

Gordon T. Garrett
Vice President -
Legal Counsel

CPAK
Commercial Property
Association of Kansas

February 9, 1993

COMMERCIAL PROPERTY ASSOCIATION OF KANSAS

TESTIMONY BEFORE THE

SENATE COMMITTEE ON ASSESSMENT AND TAXATION

BY

Gordon T. Garrett, V.P. and Legal Counsel

Madame Chair and members of the Committee -

My name is Gordon T. Garrett, and I represent CPAK. The membership of this association includes commercial developers, both large and small, and owner and occupants of commercial buildings.

We wish to speak in support of the repeal of the tax upon original construction services.

As you have already heard excellent testimony and many valid reasons to repeal this tax from others, I will confine my statement to the impact of this tax on commercial development.

As other conferees, we cannot provide accurate statistical data on how this tax may have inhibited commercial development - but logic tells you that its true. If its not true now - it certainly will be in the future.

Aside from the fact that this tax puts Kansas at a competitive disadvantage with other states, and the fact that it is an administrative nightmare, we think this tax inhibits commercial development and new commercial buildings primarily in two ways.

For construction jobs to be created, and construction is a very important part of our economy, a developer or owner must actually make the decision to build something and then get the financing to do it. This tax is just one more negative factor in a

214 S.W. 7th Street - Topeka, KS 66603 - 913-232-0486 - FAX 913-233-5659

Senate Assessment + Taxation
February 9, 1993
attachment 1-1

commercial feasibility decision. (This tax simply is inflationary regarding construction costs.)

1. To obtain financing on any commercial project in this climate is extremely difficult. To the extent that this tax raises the cost of the project, it simply makes financing all the more difficult. Federally Insured Lenders now have regulations that they can loan no more than 75% of the cost of a commercial real estate project.

2. Most commercial developments in Kansas in the next few years will almost certainly be small developments. Single users, restaurants, small office buildings, etc. There probably will not be big speculative projects like we witnessed in the 1980's. This tax will undoutedly inhibit small commercial projects as their bottom line feasibility is narrower than a large project. In effect, this tax may help discourage small developments which are probably the only ones we will see in Kansas for awhile.

Commercial construction is down significantly in Kansas since reappraisal and classification took effect. This tax on original constructin exacerbates an already unhealthy tax burden on commercial real estate.

New commercial construction is very important to our states economy in a number of ways. It not only creates and provides jobs, but new commercial construction greatly increases the value of our tax base. With new spending pressures coming from every direction our tax base must be continually expanded if we are to hold in check dramatic mill levy increases.

If this tax stops just one small office building, industrial building, or strip shopping center all of Kansas is a loser. This sales tax is collected just <u>once</u>, but a building that is constructed pays property tax every year, not counting the sales and income taxes the occupants would pay.

We think this tax should be repealed.

Thank you for the opportunity to speak and I will be happy to answer any questions.

PROPERTY TAX ABATEMENT POLICY

Testimony by

Charles E. Krider
Professor, School of Business
Director of Business Research

on behalf of the

Institute for Public Policy and Business Research
University of Kansas

Anthony L. Redwood
Professor of Business and Executive Director

Prepared for the

Senate Assessment and Taxation Committee

February 9, 1993

Senate Assessment & Taxation
February 9, 1993
attachment 2-1

Introduction

Madame Chair and Committee members, thank you for the opportunity to testify, on behalf of the Institute, regarding the use of property tax abatements, and in particular, on S.B. 2 and S.B. 69. It is our view, based on Institute research, that additional restrictions on property tax abatements are needed and that Kansas should seek to develop a tax abatement policy that would lead to the eventual abolishment of such incentives in the state and region.

Background

In 1986, Kansas voters approved a constitutional amendment, Article 11, section 13, that gave local governing bodies the authority to exempt from all ad valorem taxation for up to 10 years all or any portion of the appraised value of buildings, land, and tangible personal property belonging to manufacturers, interstate commerce companies or research and development companies. Tax abatements were applicable to new companies as well as existing businesses that were expanding if new employment was created as a result. The authority to grant such abatements was detached from the issuance of industrial revenue bonds.

The purpose of this legislation was to enable Kansas communities to compete on equal footing with communities in other states. At that time, over 32 states allowed for similar, if not more generous (e.g. Missouri), exemptions and most did not tie the abatements to IRBs. Kansas allowed for a moratorium on land and capital improvements and equipment only if purchased with IRBs. As the federal income tax exclusion on interest earnings from IRBs was being phased out, it was recognized that the number of IRBs issued in Kansas would decline, thereby limiting local jurisdictions' opportunities to offer tax abatements. Without the option to grant tax abatements detached from the issuance of IRBs, Kansas communities would be disadvantaged relative to competing communities in other states. This abatement policy was driven by the broader economic development strategy with respect to taxation, namely to neutralize tax and incentives as factors affecting business development and to compete and foster growth on the basis of non-tax factors.

At that time, it was also recognized that allowing for local option tax abatements could encourage unproductive competition among local governments within the state and thus unnecessarily erode their fiscal capacity. Since the passing of the 1986 amendment, subsequent Legislatures have exercised their right to limit the granting of property tax abatements, in large part, due to such unproductive competition and tax base erosion. Of importance, was S.B. 440, enacted in 1990, which imposed several restrictions on cities and counties seeking to grant the exemptions. S.B. 440 requires that:

1. cities and counties, prior to granting an exemption, develop and adopt official policies and procedures, including the preparation of a cost/benefit analysis for each exemption and procedures for monitoring compliance of businesses receiving the exemption;

2. cities and counties hold public hearings prior to granting an exemption, following published notice and written notice to the affected school districts;

3. the Board of Tax Appeals approve the exemptions;

4. cities and counties certify annually that the qualifying conditions continue to exist; and

5. exemptions cannot be granted to property which has been previously subject to tax or has been granted previous exemptions without a "factual determination" by cities and counties that such an exemption is necessary to retain jobs in the state.

Need for Additional Restrictions

We support additional restrictions on the ability of communities in Kansas to grant tax abatements. Kansas was never intended to be the leader with respect to tax abatements in the region, rather abatements were reluctantly authorized in order to prevent Kansas communities from being at a disadvantage relative to communities in other states. Additional restrictions are needed for the following reasons.

1. A comparative study of taxation in the region completed in 1992 showed that Missouri, Kansas, and Oklahoma offer the most generous abatements in our area (see Table 2). Missouri provides tax abatements for real estate improvements, including new buildings, in enterprise zones and in blighted areas. Tax exemptions may range as high as 100 percent, and may extend for 25 years. Almost any industry qualifies for exemption.

   Kansas allows local governments to abate up to 100 percent of property tax liabilities for 10 years for new and expanding industries. Abatements under Kansas constitutional provisions are limited to property used in manufacturing, research and development, and warehousing. However other industries qualify for abatement when development is financed by IRBs. Kansas extends abatements to machinery and equipment in addition to real estate (buildings and land). In contrast, many states, including Missouri, limit abatements of real estate only.

   Oklahoma guarantees 100 percent tax exemptions for 5 years for qualified new and expanding firms in manufacturing, research and development, and computer services. As in Kansas, the abatements extend to land and equipment as well as structures. But the abatement period is only half as long as in Kansas.

   Several states structure property tax abatements so that the percentage abated declines over time. These states include Iowa in our region and also Indiana and New York. Declining abatements have the distinct advantage of targeting assistance to the critical start-up period of the firm, when financial capital is probably most scarce. Those firms that are successful, that is, those that stay in business, ease into payment of the full property tax.

2. Kansas communities continue to provide tax abatements to firms which would have located or expanded in the community anyway, without an abatement.

3. The results of the cost/benefit analyses prepared by communities are often ignored. Decisions as to whether or not an exemption should be granted appear to be based on other factors, e.g. politics, if the cost-benefit analyses yield negative results.

4. Tax abatements continue to shift the tax burden from 'tax abatement recipients' to existing businesses in Kansas, and may drive out existing firms which are ineligible in one community but eligible in another.

5. Tax abatements appear to favor larger companies. Small companies are less able to capitalize on the availability of business incentives in general due to a relative lack of knowledge and political clout.

6. The property tax abatement policy in general continues to represent a piecemeal and self-defeating approach to dealing with relatively high property taxes on industry.

Support for S.B. 2

S.B. 2 recommends several, specific restrictions that would apply to both IRBs and economic development abatements. While they are not as restrictive as we are advocating, we support them in principle. In the absence of tighter restrictions, we agree that;

1. exemptions shall not include property currently on the tax rolls;

2. businesses should be required to reimburse local government units when they fail to meet the qualifying conditions which were agreed to prior to granting the exemption or abatement; and

3. a cost-benefit analysis shall be prepared by the governing unit and submitted to the Department of Revenue for approval prior to granting the exemption.

Support for S.B. 69

Two arguments support limiting the ability of local governments to abate the school portion of the property tax (32 mills in 92).

First is the issue of incentives. Given that abatements are allowed, they should only be issued when the benefits clearly outweigh the costs. But under the current school finance plan, the school district bears only a small fraction of the cost when an abatement is granted, at least in communities that have no local option school tax. This distorts the benefit-cost calculations for local decision makers.

Put another way, the current school finance plan lowers the price of abatements from the local point of view. Basic economics would lead us to expect that when the price goes down, quantity goes up. We would expect communities to increase the amount of abatement activity. There is no guarantee that the abatements benefit the state as whole once the cost of school finance is taken into account.

A second issue is that of fairness. The use of abatements varies widely by area. Communities that offer substantial abatements keep their assessed property valuation artificially low. Hence they qualify for more state aid than would otherwise be the case. There is no indication that these same communities also generate significantly more than their normal share of the sales and income taxes that go to finance state aid.

Additional Restrictions

Ultimately, the ideal tax climate would be one where all states abolished tax abatements. Obviously, this is an ambitious goal, and one that will take a strong leader to initiate. We are recommending that Kansas take the lead in disarmament, in concert with other states in the region. As this may be politically impossible to accomplish all at once, it could involve a gradual, phasing out process in which Kansas incorporated further restrictions (even more restrictive than our neighbors) on granting tax abatements to indicate our willingness to eventually abolish them all together. Additional restrictions could include:

1. Abatements could only be granted for expansion or attraction of new firms creating a significant, defined number of jobs.

2. Abatements could not be offered for purchasing new machinery and equipment to replace outdated machinery and equipment, or for real estate undergoing remodeling. Firms normally replace outdated equipment and remodel outdated buildings, and they should not receive abatements for normal operations.

3. Abatements could be phased out over 10 years. For example, 100% abatement in YR 1, 90% YR 2, and so on. This type of schedule would have less impact on the tax base as firms began to phase in property tax payments.

4. Communities granting abatements could be required to live within a cumulative cap on the total dollar amount of abatements granted. For example, while this is not a concrete recommendation, a cap of 10% of a community's total property tax base could be used. This would require communities to allocate abatements to those firms most worthy, rather than granting abatements for all possible circumstances.

   It is very clear that some communities use tax abatements much more intensely that do others (See attached Table 1). The data concerning this point are not perfect by any means. Among other problems,they include some proposed abatements that were denied for technical reasons. Nevertheless, they show the great variation across communities in the use of abatements. On average, we estimate that property abated for economic development purposes (constitutional and IRB) is about 3.5% of total Kansas taxable property.

Conclusion

Until the state considers abolishing tax abatements all together, additional restrictions are needed. Even with such restrictions, communities will still be able to offer abatements, but they will be less costly to state and local governments.

While we are advocating additional restrictions, our intent is not to raise taxes on business. To the extent that such restrictions do increase the tax burden on firms and inhibit their competitiveness, there should be an offsetting reduction in other business taxes.

Table 1
Economic Development Tax Abatements by County
IRB and Constitutional

	Abatements 1987-92	Taxable Property 1991	Percent
ALLEN	700,000	260,149,040	0.3%
ATCHISON	3,928,203	296,242,150	1.3%
BARTON	10,167,431	723,917,068	1.4%
BOURBON	7,608,871	267,592,167	2.8%
BROWN	1,691,614	232,764,230	0.7%
BUTLER	92,789,375	1,190,135,512	7.8%
CHEROKEE	3,126,020	369,729,364	0.8%
CLOUD	202,400	201,016,821	0.1%
COWLEY	22,328,953	757,816,961	2.9%
CRAWFORD	30,892,119	578,872,223	5.3%
DICKINSON	1,642,509	401,028,093	0.4%
DONIPHAN	15,819,100	158,741,678	10.0%
DOUGLAS	95,777,823	2,194,243,645	4.4%
ELLIS	575,672	735,724,906	0.1%
ELLSWORTH	494,079	183,281,014	0.3%
FRANKLIN	10,161,877	438,681,541	2.3%
GEARY	2,388,094	504,730,892	0.5%
GOVE	300,000	134,257,957	0.2%
GRANT	5,134,000	913,774,058	0.6%
GREENWOOD	425,000	186,277,619	0.2%
HARPER	1,616,500	228,820,546	0.7%
HARVEY	9,285,380	695,475,585	1.3%
JEFFERSON	2,800,000	363,464,917	0.8%
JEWELL	85,000	102,715,515	0.1%
JOHNSON	102,397,664	16,894,104,770	0.6%
KINGMAN	6,676,769	312,696,457	2.1%
LABETTE	4,098,552	367,866,599	1.1%
LEAVENWORTH	10,029,200	1,295,174,273	0.8%
LINCOLN	850,000	90,831,405	0.9%
LOGAN	86,000	106,064,160	0.1%
LYON	1,348,323	690,731,413	0.2%
MARION	3,388,930	273,638,073	1.2%
MARSHALL	500,000	245,202,508	0.2%
MCPHERSON	83,459,485	781,387,373	10.7%
MIAMI	737,599	536,422,111	0.1%
MITCHELL	517,500	157,324,427	0.3%
MONTGOMERY	24,258,626	769,375,252	3.2%
NEMAHA	504,499	240,848,826	0.2%
NEOSHO	382,017	284,845,164	0.1%
OSAGE	4,800,000	313,741,310	1.5%
OTTAWA	765,000	138,894,373	0.6%
POTTAWATOMIE	10,409,480	1,007,584,203	1.0%
PRATT	465,950	316,098,272	0.1%
RENO	19,937,565	1,533,950,743	1.3%
REPUBLIC	155,999	152,188,815	0.1%
RICE	4,845,315	297,486,445	1.6%
SALINE	6,142,268	1,247,725,425	0.5%
SEDGWICK	1,034,864,204	11,471,595,925	9.0%
SEWARD	15,000,000	708,438,084	2.1%
SHAWNEE	86,530,354	4,746,499,388	1.8%
SHERMAN	1,455,624	205,322,862	0.7%
SUMNER	4,568,335	561,554,685	0.8%
THOMAS	3,250,000	271,387,949	1.2%
WASHINGTON	177,792	169,345,338	0.1%
WILSON	5,400,000	194,757,991	2.8%
WOODSON	20,010	101,327,240	0.0%
WYANDOTTE	869,295,428	3,387,882,620	25.7%
KANSAS TOT	2,627,258,508	75,865,735,709	3.5%

Note: Data from testimony presented by Board of Tax Appeals 8-92. Data include abatements applied for by not granted.

Table 2
Property Tax Abatements in Region

State	Extent of Tax Abatement	Eligibility Requirements
Colorado	Local option for property tax "incentive" payment in enterprise zones. Limited to increase in value of property due to new or expanding business. Abatements rarely used. Limited to 50% of taxes on personal property only for up to 4 years.	Must be a qualified new or expanding business facility located in enterprise zone.
Iowa	Local option to abate local property taxes on value added to industrial real estate. Max. abatement: YR 1: 75% YR 2: 60% YR 3: 45% YR 4: 30% YR 5: 15%.	Limited to new construction of industrial real estate, research service facilities, warehouses, distribution centers. Also applies to new industrial equipment and machinery (which are considered part of real estate in Iowa).
Kansas	Local option to exempt all or any portion of buildings, land, added improvements, and machinery and equipment for new or expanding firms. Exemptions last for no more than 10 years after opening of new business or completion of expansion. Property financed with industrial revenue bonds may be exempt for up to 10 years.	Limited to property of new or expanding businesses used for 1) manufacturing; 2) research and development; or 3) storing goods or commodities which are stored or traded in interstate commerce. No restrictions on types of firms qualifying for exemption with industrial revenue bonds.
Missouri	Under Urban Redevelopment programs: up to 100% of improvements to real property may be tax exempt for up to 25 years. Under Enterprise Zone programs: 50%-100% of value of improvements to real property will be abated up to 25 years.	Improvements to real property must occur in blighted areas of cities with populations over 4,000 in Jackson and St. Louis counties, 2,500 elsewhere in state. For enterprise zone exemption, any industrial or commercial firm, or firm renting/leasing residential property to low or moderate income persons qualifies. Applied to real estate improvements only.
Nebraska	15 year tax abatement for agricultural processors investing at least $10 million and hiring at least 100 new workers.	Agricultural processing only.
Oklahoma	New and expanding facilities are 100% exempt from property tax for 5 years. Included in exemption are land, buildings, improvements, structures, machinery, equipment, and other personal property used directly in the manufacturing process. Also: machinery and equipment used in oil and gas production are exempt.	Limited to manufacturing, research and development, and those computer service and data processing facilities that obtain at least 80% of their revenue from out of state. Applies to new and expanding firms. Exemption for equipment applies only if such equipment results in a net increase in employment.

SOURCES: Information provided by individual state departments of revenue and commerce and state statutes.

TESTIMONY OF BERNIE KOCH
WICHITA AREA CHAMBER OF COMMERCE

SENATE ASSESSMENT AND TAXATION COMMITTEE
January 27, 1993

Members of the committee, I'm Bernie Koch with The Wichita Area Chamber of Commerce. Thank you for the opportunity to testify today on the issue of original construction labor services sales tax.

My organization supports repeal of the 2.5% state sales tax that was applied to original construction services last legislative session. It has obviously caused much confusion in the construction industry.

Philosophically, it is a tax on an important component of growth. Construction indicates growth in most cases. Our overall strategy as a state has been to encourage growth. New construction will result in an increase in our property tax base in Kansas, both residential and commercial. On one hand, we want that to happen, but on the other we are discouraging it by applying a sales tax to new construction services. That seems inconsistent.

The other problem with this new sales tax which has not been widely discussed is that it does have an impact on the comprehensive highway plan. As the legislature considered a sales tax on new construction services in the 1992 session, I clearly remember some members asking if this would affect the highway program. The clear answer and, I believe, the intent of the legislature, was that it not affect the highway program.

Shortly after the legislature adjourned, the Revenue Department came out with guidelines for applying this new sales tax. Those guidelines say the sales tax on new construction services does apply to subcontractors on state let road projects. It apparently does not affect subcontractors or prime contractors on city or county road projects.

One of the important issues for some lawmakers during debate on the 1989 highway plan was the encouragement of participation by minority contractors. My understanding is that most minority contractors tend to be subcontractors.

For these reasons, the confusion caused by the tax, the inconsistencies as applied to highway construction, and particularly because it is a tax on growth, which we want to encourage, we support removal of the sales tax on original construction services.

Thank you for the opportunity to testify.

Senate Assessment + Taxation
February 9
attachment 3

THE KANSAS CONTRACTORS ASSOCIATION, INC.

1923 - 1993

70 YEARS OF EXCELLENCE

316 SW 33RD ST PO BOX 5061
TOPEKA KS 66605-0061
PHONE (913) 266-4152
FAX (913) 266-6191

TESTIMONY

BY THE KANSAS CONTRACTORS ASSOCIATION

BEFORE THE SENATE ASSESSMENT AND TAXATION COMMITTEE

REGARDING

SALES TAX ON ORIGINAL CONSTRUCTION

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

My name is Bob Totten and I am the Public Affairs Director for the Kansas Contractors Association. Our association represents more than 330 heavy, highway, and municipal utility contractor and association member firms in the Kansas construction industry.

I am here today to ask that you remove the 2 and a half percent sales tax on the labor involved in the construction of roads and highways around the state. This tax was imposed last year as part of the School Finance Bill and raises approximately 2 and a half million dollars in revenue for Kansas.

Senate Assessment + Taxation
February 9, 1993
attachment 4-1

Our association believes this tax was inadvertently added to the school finance measure and we do not believe the intent of the Legislature was to have it affect the highway industry. It has caused a tremendous inconvenience to our highway contractors due to its interpretation.

For one thing, when the tax was implemented, the revenue department had a difficult time in explaining which items were taxable and which were not. It was not until sometime in August that our contractors got the right information for their operations.

Secondly, it has also caused a lot of additional paperwork to our contractors, as well as the Revenue Department. Our contractors have to determine what tax has to be collected on what projects, what materials, and whether it should be collected at all. As you may realize, sales tax on materials is 4.9 percent .. there is no tax on excavating dirt, and now there is a 2.5% tax on labor .. unless the project is tax exempt.

In addition, this tax actually only affects the sub-contractors of our industry. Prime contractors normally are not charged tax since they are doing work for the state .. and the state cannot impose a tax on itself. As a result, sub-contractors on projects do charge a sales tax for the work they do for the prime contractor. What that means to you and me is our highway projects cost the state a little more money because of this tax.

For example, when a prime bids on a job, he includes the costs incurred by his sub-contractors. Sub-contractors now must submit bids including the sales tax on labor. As you can see, when the state pays for a highway job, instead of just paying for the project it is also now paying for the sales tax on labor. That means money that was designated to build roads is now being diverted to pay taxes which then goes into the school finance funding process.

As I mentioned, we believe it was not the intent of the Legislature last year to include the highway industry in the taxing process. When the matter was discussed both in conference committee and on the Senate floor, the question was asked whether the highway program would be affected, and in both cases, it was said it would not be affected. But after the measure was passed, it was determined the highway industry would be taxed.

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

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

1/27/93

KANSAS ASSOCIATION OF REALTOR

REALTOR®

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

TO: THE SENATE ASSESSMENT AND TAXATION COMMITTEE

FROM: KAREN FRANCE, DIRECTOR, GOVERNMENTAL AFFAIRS

DATE: FEBRUARY 2, 1993

SUBJECT: SALES TAX ON NEW CONSTRUCTION

Madame Chairman and members of the committee, thank you for the opportunity to testify. On the behalf of the Kansas Association of REALTORS® I appear today to renew our opposition to the collection of sales tax on the labor involved in new construction.

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

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

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

Senate Assessment + Taxation
February 9, 1993
attachment 5-1

While the number of building permits issued in 1992 increased over the previous year, we must look to the state line counties which must compete with neighboring states. I believe other conferees have been able to demonstrate for you the great impact our sales tax has had on assisting the building industry in neighboring counties by sending business across the state line.

The fiscal note projection for this exemption last year was approximately $39 million. Yet, the state has been able to collect only a small portion of the projected "gold mine". We predicted last year that such a tax would not collect those projected amounts. We pointed out that the projection was based upon the flawed presumption that the same number of homes would be built in Kansas.

We question, once again, the public policy for placing the sales tax on new construction. It certainly cannot be an economic development argument, because sending new construction across the state line can hardly be interpreted as having positive economic impacts. This sales tax exemption was just as important for economic development as the other sales tax exemptions which were not touched last year, such as the exemptions for machinery and equipment and for farm machinery.

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

We know the prospect of raising $39 million by the removal of this exemption looked appealing because it was so large, at a time when the Legislature was looking for money. However, we are asking you to re-examine the decision made last year in light of the actual dollar amounts collected over the past six months and in light of the "flight" of business to other states and most important in light of the pressing need for job creation in the state. We ask you to re-instate the sales tax exemption for the labor involved in new construction.

Thank you again for the opportunity to testify.