

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE

The meeting was called to order by Chairperson David Corbin at 10:45 a.m. on March 20, 2003, in Room 519-S of the Capitol.

All members were present except: Senator Donovan

Committee staff present: Chris Courtwright, Legislative Research Department
April Holman, Legislative Research Department
Gordon Self, Revisor of Statutes Office
Shirley Higgins, Committee Secretary

Conferees appearing before the committee: Brian Cox, Attorney, Kansas Department of Revenue
Bill Waters, Attorney, Property Valuation Division
Mark Beck, Director, Property Valuation Division

Others attending: See attached list.

Senator Corbin called the Committee's attention to the minutes of the March 19 meeting. Senator Oleen moved to approve the minutes of the March 19, 2003, meeting, seconded by Senator Clark. The motion carried.

Senator Corbin announced that, although the meeting was called for discussion and possible action on the inheritance tax, no action would be considered due to the fact that **SB 94**, abolishing the inheritance tax, was pulled from the Senate General Orders and re-referred to the Assessment and Taxation Committee for the purpose of considering amendments to add an enforcement provision and to make it revenue neutral. A copy of the proposed amendments will be distributed to committee members before the next meeting scheduled for March 24. He informed the Committee that another previously heard bill, **SB 148**, enacting the Kansas Estate Tax, will be the subject of an interim study.

Senator Oleen reported that she received an answer to a question she raised at a previous meeting as to the amount of inheritance tax which has been collected to date. The Department of Revenue informed her that 12 taxpayers have asked for an extension. However, because taxpayers still have nine months before estate taxes are due, the fiscal note information is somewhat cloudy at this point in time. For the Committee's information, Senator Corbin distributed a copy of the Department's response to other questions concerning estate tax issues. (Attachment 1)

The Committee's attention was turned to a previously heard bill, **SB 29**, concerning corporation code amendments and franchise fees. Senator Corbin reminded that Committee that, during a discussion of the bill at the March 19 meeting, Melissa Wangemann, legal counsel for the Secretary of State, suggested amendments to address concerns expressed by the Committee. He called attention to copies of the proposed amendments drafted by Ms. Wangemann. (Attachment 2) Gordon Self, Revisor of Statutes Office, explained that first amendment would strike language in Section 81 on page 95 regarding share holders' equity, and the second amendment would add a provision for collection of data by the Secretary of State.

Senator Goodwin moved to amend SB 29 as suggested by Ms. Wangemann, seconded by Senator Buhler. The motion carried.

Senator Clark moved to recommend SB 29 favorably for passage as amended, seconded by Senator Oleen. The motion carried.

Senator Corbin opened a discussion on **HB 2005**, which concerns income tax credit for property taxes paid on railroad machinery and equipment. He noted that Senator Oleen raised questions at the March 19 hearing concerning pending railroad litigation related to the bill. Bill Waters, attorney for the Property Valuation Division, distributed copies of a memorandum containing background information on the Railroad Revitalization and Regulatory Reform Act of 1976, commonly called the 4-R Act. The memorandum notes that Kansas was involved in some of the earliest 4-R litigation in the early 1980s. (Attachment 3)

CONTINUATION SHEET

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE at 10:45 a.m. on March 20, 2003, in Room 519-S of the Capitol.

Senator Lee asked how passage of the bill as amended by the House could be justified since it has a \$1.3 million fiscal note in 2004 and a \$1.4 million fiscal note in 2005. In response, Mr. Hubbell, representing Kansas Railroads, stated that he estimates that the fiscal note on the bill will be \$800,000 or \$900,000. Senator Clark noted that, if the state loses the lawsuit, the state will experience an \$8 million "hit" in 2004.

Senator Oleen commented that Mr. Hubbell indicated in previous testimony that pending railroad litigation would result in a tax refund in addition to a tax credit if the railroad wins. In response, Brian Cox, an attorney for the Kansas Department of Revenue, reported that in litigation in Federal District Court captioned *Union Pacific Railroad vs. Stephen Richards, Secretary, Kansas Department of Revenue*, the Secretary filed a Motion to Dismiss for Failure to State a Claim. The plaintiff responded to the motion, and the Department filed a reply brief on March 19. The brief raises a question as to whether the statute at issue, K.S.A. 79-32-206, in fact violates the federal 4-R Act. The Department claims that the statute does not violate the 4-R Act and raises procedural issues, including whether this law properly permits suit against the state in federal court, a constitutionally based argument. The Department also raises a question about the proper party defendant in this case. Mr. Cox said that he does not foresee oral arguments being held in this case. He could not say when a decision from the judge could be expected.

Bill Waters, attorney for the Property Valuation Division, responded to questions from Senator Lee regarding his memorandum on the 4-R Act and the assessment rate of business machinery and equipment compared to rate used for railroads. He pointed out that the theory of the 4-R Act is absolute equal treatment between the railroads and the other property that the state assesses as commercial and industrial property.

Senator Lee recalled that, during a conference committee meeting last year concerning a drafting error in related bill, legislators were assured the lawsuit would be dropped if the bill passed that year. Although the bill passed, the lawsuit has not been dropped. In light of this, Senator Lee moved to amend HB 2005 by removing the language amended into it by the House Taxation Committee on page 1, lines 31, 33, and 34.

Committee discussion followed regarding the effect of Senator Lee's motion. Senator Lee clarified that the House amendment created a fiscal note for the bill because it made the credit available to railroads at the 15 percent level for tax years 2003 and 2004, two years earlier than previous legislation. She explained that her motion returns the bill to its original intent to not let the tax credits go to state assessed utilities other than railroads, starting in 2005. Staff confirmed that, if the bill is not passed, the unanticipated fiscal impact will be at least \$42 million beginning in Fiscal Year 2006. Senator Taddiken seconded Senator Lee's motion. The motion carried.

Senator Lee moved to recommend HB 2005 favorably for passage as amended.

As requested by Senator Oleen, Mr. Hubbell clarified that the federal case concerns what happens in the future, and the "back year" tax is being appealed with the Board of Tax Appeals. The appeal proceeding has been stopped. However, if the railroads go forward with the appeal and are successful, the credit will go back to 1998, resulting in the estimated \$8 million fiscal note.

Senator Goodwin seconded Senator Lee's motion. The motion carried.

The meeting was adjourned at 11:25 a.m.

The next meeting is scheduled for March 24, 2003.

SENATE ASSESSMENT AND TAXATION COMMITTEE
GUEST LIST

DATE: March 20, 2003

NAME	REPRESENTING
J. P. SMALL	KOCH INDUSTRIES, INC
Leslie Kaufman	Ks Farm Bureau
Edd Johnson	KLA
Fariba Pouraryan	Sec. of State
J. Chubb	SOS
Kathy Olsen	Ks Bankers Assn.
Deann Williams	KMCA
Bill Brady	Ks Gov't Consulting
George Peterson	HTN
Trista Curzydo	Ks Bar Assn.
Hal Hudson	NFIB/KS
J. Brian Cox	Kan. Dept. of Revenue, Legal Services Bureau
Bill Waters	PVD KDOR
Mark Burk	KDOR
Stephen R. Hahnel	Town & Country Railroads
Ann Burkus	DOB



K A N S A S

JOAN WAGNON, SECRETARY

DEPARTMENT OF REVENUE
POLICY AND RESEARCH

KATHLEEN SEBELIUS, GOVERNOR

March 20, 2003

To: Senator David Corbin

From: Richard Cram

Re: Response to Questions Concerning Estate Tax Issues

1. Senate Bill 148, including the amendments proposed by the Department, does not include the use value and conservation easement language contained in the federal estate tax law. Can the Department prepare additional amendments to Senate Bill 148 to include them?

Response: The amendments proposed to Senate Bill 148 do include a use value provision, in that use valuation could be used by an estate that uses it on the federal estate tax return. If the estate is below the federal threshold, no use value would be available. The reason these provisions were excluded by the working group of estate planning attorneys and Department staff when Senate Bill 148 was originally drafted was because of their complexity, the difficulty in administration, and the fact that their primary utility goes to decrease federal estate tax liability. The federal estate tax rates begin at 37%, increasing to 49%. The Kansas estate tax rates, under the state credit, maximize at 16%. For an estate that is below the federal estate tax filing threshold, the likelihood that the use value provisions or conservation easement provisions will actually save an estate significant money, after subtracting the substantial costs and restrictions in pursuing them, seems minimal. However, the use value and conservation easement language in the federal estate tax law could be added to Senate Bill 148.

2. If the federal estate tax law use value and conservation easement provisions were amended into Senate Bill 148, would that change the fiscal note?

Response: No. Because of the fact that these provisions would likely benefit few, if any, taxpayers, we do not believe the fiscal impact would be changed. However, these provisions would be difficult to administer, for the few taxpayers who might attempt to use them.

3. Are the tax rate tables in the amendments to Senate Bill 148 proposed by the Department correct and fiscally neutral with the existing Kansas "pick-up" estate tax?

Response: They are essentially fiscally neutral. However, because they are based on the rate schedule for the state estate tax credit published in I.R.C. Section 2011, on which the current Kansas "pick-up" estate tax is also based, they have some of the same problems. An estate just below the filing threshold will have no tax liability. However, as the estate value moves above

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*Senate Assessment & Taxation
3-20-03
Attachment 1*

the filing threshold, the tax liability may go from zero liability to a fairly substantial liability very quickly. The rate schedule needs further revision, if it is to be revenue neutral as to the current Kansas "pick-up" estate tax, but impose tax only on the value of the estate above the filing threshold at gradually increasing rates.

4. The Department needs to provide the Revisor a proposal to replace the current succession tax with a Class C inheritance tax, which would be in addition to the existing Kansas "pick-up" estate tax.

Response: We have provided the Revisor with such language and will work with and assist the Revisor on this as needed.

5. Explain why the fiscal note on House Bill 2097 has changed so significantly.

Response: House Bill 2097 proposes to match the Kansas estate filing thresholds up with the current federal estate tax filing thresholds, and conform to the current federal estate tax law, except that the federal estate tax law provision calling for the phase-out (25% a year until full phase out in 2005) of the state inheritance/estate tax credit (I.R.C. Subsection 2011(b)(2)) is to be disregarded. This was intended to preserve the Kansas "pick-up" estate tax, to some extent, although using the much higher federal filing thresholds. When the Department prepared its initial fiscal note, a provision in the current federal estate tax law was overlooked. That provision, I.R.C. Section 2011(f), states: "This section [2011] shall not apply to the estates of decedents dying after December 31, 2004." This means that Section 2011, upon which the state inheritance/estate tax credit is based, disappears effective 2005. Instead, at the federal level, an estate will receive a deduction for state inheritance/estate taxes paid, as provided at I.R.C. Section 2058. Because the Kansas "pick-up" estate tax is tied to the "maximum credit allowable by section 2011," the Kansas "pick-up" estate tax will also disappear entirely in 2005, when Section 2011 is no longer applicable. Thus, the fiscal impact of House Bill 2097 will mean the loss of all Kansas "pick-up" estate tax revenue by FY 06.

RON THORNBURGH
Secretary of State



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Topeka, KS 66612-1594
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STATE OF KANSAS
MEMO

TO: CHAIRMAN DAVE CORBIN, SENATOR GRETA GOODWIN
FROM: MELISSA WANGEMANN, LEGAL COUNSEL
DATE: 19 MARCH 2003
RE: SB 29; AMENDMENT TO REQUIRE REPORTING OF
CORPORATE PARENT/SUBSIDIARY RELATIONSHIPS

Per Senator Goodwin's request, I have drafted language to add to SB 29; which would require reporting of parent and subsidiary information to the Secretary of State at the time of filing the corporate annual report. Any parent corporation holding more than 50% interest in another business entity will list those subsidiary entities on its annual report. The Secretary of State will capture this information from the annual report.

Aside from this amendment, the committee will also want to adopt an amendment deleting section 81 of the bill, to eliminate the negative fiscal impact caused by that provision.

I apologize that I will be unable to attend tomorrow's committee meeting, as I will be out of town. The Deputy of our Business Services Division, Fariba Pouraryan, will be attending, should you have any questions.

1 income tax act.

2 (g) "Subsidiary entity" means an entity in which a corporation holds
3 more than 50% equity ownership.

4 Sec. 82. K.S.A. 2002 Supp. 17-7503 is hereby amended to read as
5 follows: 17-7503. (a) Every domestic corporation organized for profit shall
6 make an annual report in writing to the secretary of state, stating the
7 prescribed information concerning the corporation at the close of busi-
8 ness on the last day of its tax period next preceding the date of filing, but
9 if a corporation's tax period is other than the calendar year, it shall give
10 notice thereof to the secretary of state prior to December 31 of the year
11 it commences such tax period. The reports shall be made on forms pre-
12 scribed by the secretary of state. The report shall be filed at the time
13 prescribed by law for filing the corporation's annual Kansas income tax
14 return, except that if any such corporation shall apply for an extension of
15 time for filing its annual income tax return under the internal revenue
16 service or under subsection (c) of K.S.A. 79-3221, and amendments
17 thereto, such corporation shall also apply, not more than 90 days after
18 the due date of its annual report, to the secretary of state for an extension
19 of the time for filing the report and an extension shall be granted for a
20 period of time corresponding to that granted under the internal revenue
21 code or K.S.A. 79-3221, and amendments thereto. Such application shall
22 include a copy of the extension application to filed with the income tax
23 authorities. The report shall contain the following information:

- 24 (1) The name of the corporation;
- 25 (2) the location of the principal office;
- 26 (3) the names and addresses of the president, secretary, treasurer or
27 equivalent of such officers and members of the board of directors, with
28 the residence address of each;

29 (4) the number of shares of capital stock issued and the amount of
30 capital stock paid up and the par value per share of each class of capital
31 stock having a par value and the number of shares of each class of stock
32 without par value which the corporation is authorized to issue;

33 (5) the number of shares of capital stock issued, ~~and~~ _____ strike

34 (6) the nature and kind of business in which the corporation is en-
35 gaged, and _____ add "; and "

36 ~~(6) a list of stockholders owning at least 5% of the capital stock of the~~
37 ~~corporation, with the post office address of each.~~ _____ add

38 (b) Every corporation subject to the provisions of this section which
39 holds agricultural land, as defined in K.S.A. 17-5903, and amendments
40 thereto, within this state shall show the following additional information
41 on the report:

42 (1) The acreage and location listed by section, range, township and
43 [location listed by section, range, township and] county of each lot,

(7) if the corporation is a parent corporation holding more than 50% equity ownership in any other business entity registered with the Secretary of State, the name and identification number of any such subsidiary business entity.

1 tract or parcel of agricultural land in this state owned or leased by or to
2 the corporation;

3 (2) the purposes for which such agricultural land is owned or leased
4 and, if leased, to whom such agricultural land is leased;

5 (3) the value of the nonagricultural assets and the agricultural assets,
6 stated separately, owned and controlled by the corporation both within
7 and without the state of Kansas and where situated;

8 (4) the total number of stockholders of the corporation;

9 (5) the number of acres owned or operated by the corporation, the
10 number of acres leased by the corporation and the number of acres leased
11 to the corporation;

12 (6) the number of acres of agricultural land, held and reported in
13 each category under provision (5), state separately, being irrigated; and

14 (7) whether any of the agricultural land held and reported under this
15 subsection was acquired after July 1, 1981.

16 (c) The report shall be signed by its president, secretary, treasurer or
17 other officer duly authorized so to act, or by any two of its directors, or
18 by an incorporator in the event its board of directors shall not have been
19 elected *executed in accordance with the provisions of K.S.A. 17-6003, and*
20 *amendments thereto*. The fact that an individual's name is signed on such
21 report shall be prima facie evidence that such individual is authorized to
22 sign the report on behalf of the corporation; however, the official title or
23 position of the individual signing the report shall be designated. This
24 report ~~will~~ shall be dated and subscribed by the person as true, under
25 penalty of perjury.

26 (d) At the time of filing such annual report it shall be the duty of
27 each domestic corporation organized for profit to pay to the secretary of
28 state an annual franchise tax in an amount equal to \$2 for each \$1,000 of
29 the corporation's shareholder's equity attributable to Kansas, except that
30 no such tax shall be less than \$40 or more than \$5,000. The amount of
31 any such franchise tax paid by the corporation to the secretary as provided
32 by this subsection shall not be disclosed by the secretary.

33 Sec. 83. K.S.A. 2002 Supp. 17-7504 is hereby amended to read as
34 follows: 17-7504. (a) Every corporation organized not for profit shall make
35 an annual report in writing to the secretary of state, stating the prescribed
36 information concerning the corporation at the close of business on the
37 last day of its tax period next preceding the date of filing, but if a cor-
38 poration's tax period is other than the calendar year, it shall give notice
39 thereof to the secretary of state prior to December 31 of the year it
40 commences such tax period. The reports shall be made on forms pre-
41 scribed by the secretary of state. The report shall be filed on the 15th day
42 of the sixth month following the close of the taxable year, except that such
43 corporation may apply to the secretary of state not more than 90 days

1 after the due date of its annual report for an extension of the time for
2 filing the report, and an extension shall be granted for a period of time
3 corresponding to that granted under the internal revenue code or K.S.A.
4 79-3221, and amendments thereto. The report shall contain the following
5 information:

- 6 (1) The name of the corporation;
- 7 (2) the location of the principal office;
- 8 (3) the names *and addresses* of the president, secretary and treasurer,
9 *or equivalent of such officers*, and the members of the board of directors,
10 *with the residence address of each governing body*;

11 (4) the number of memberships or the number of shares of capital
12 stock *authorized and issued* ~~and the amount of capital stock paid up.~~

add "; and "
add

13 (b) Every corporation subject to the provisions of this section which
14 holds agricultural land, as defined in K.S.A. 17-5903, and amendments
15 thereto, within this state shall show the following additional information
16 on the report:

17 (1) The acreage and location ~~listed by section, range, township and~~
18 *[location listed by section, range, township and]* county of each lot,
19 tract or parcel of agricultural land in this state owned or leased by or to
20 the corporation;

(5) if the corporation is a parent corporation holding more than 50% equity ownership in any other business entity registered with the Secretary of State, the name and identification number of any such subsidiary business entity.

21 (2) the purposes for which such agricultural land is owned or leased
22 and, if leased, to whom such agricultural land is leased;

23 (3) the value of the nonagricultural assets and the agricultural assets,
24 stated separately, owned and controlled by the corporation both within
25 and without the state of Kansas and where situated;

26 (4) the total number of stockholders *or members* of the corporation;

27 (5) the number of acres owned or operated by the corporation, the
28 number of acres leased by the corporation and the number of acres leased
29 to the corporation;

30 (6) the number of acres of agricultural land, held and reported in
31 each category under paragraph (5) of this subsection (b), stated sepa-
32 rately, being irrigated; and

33 (7) whether any of the agricultural land held and reported under this
34 subsection was acquired after July 1, 1981.

35 (c) The report shall be ~~signed by its president, secretary, treasurer or~~
36 ~~other officer duly authorized so to act, or by any two of its directors, or~~
37 ~~by an incorporator in the event its board of directors shall not have been~~
38 ~~elected~~ *executed in accordance with the provisions of K.S.A. 17-6003, and*
39 *amendments thereto.* The fact that an individual's name is signed on such
40 report shall be prima facie evidence that such individual is authorized to
41 sign the report on behalf of the corporation; however, the official title or
42 position of the individual signing the report shall be designated. This
43 report ~~will~~ *shall* be dated and subscribed by the person as true, under

1 penalty of perjury.

2 (d) At the time of filing such report, each nonprofit corporation shall
3 pay an annual privilege fee of \$40 for all tax years commencing after
4 December 31, 2001.

5 Sec. 84. K.S.A. 2002 Supp. 17-7505 is hereby amended to read as
6 follows: 17-7505. (a) Every foreign corporation organized for profit, or
7 organized under the cooperative type statutes of the state, territory or
8 foreign country of incorporation, now or hereafter doing business in this
9 state, and owning or using a part or all of its capital in this state, and
10 subject to compliance with the laws relating to the admission of foreign
11 corporations to do business in Kansas, shall make an annual report in
12 writing to the secretary of state, stating the prescribed information con-
13 cerning the corporation at the close of business on the last day of its tax
14 period next preceding the date of filing, but if a corporation operates on
15 a fiscal year other than the calendar year it shall give written notice thereof
16 to the secretary of state prior to December 31 of the year commencing
17 such fiscal year. The report shall be made on a form prescribed by the
18 secretary of state. The report shall be filed at the time prescribed by law
19 for filing the corporation's annual Kansas income tax return, except that
20 if any such corporation shall apply for an extension of time for filing its
21 annual income tax return under the internal revenue service or under
22 subsection (c) of K.S.A. 79-3221, and amendments thereto, such corpo-
23 ration shall also apply, not more than 90 days after the due date of its
24 annual report, to the secretary of state for an extension of the time for
25 filing the report and an extension shall be granted for a period of time
26 corresponding to that granted under the internal revenue code or K.S.A.
27 79-3221, and amendments thereto. Such application shall include a copy
28 of the *extension* application ~~to~~ *filed with the* income tax authorities. The
29 report shall contain the following facts:

30 (1) The name of the corporation and under the laws of what state or
31 country ~~organized it is incorporated;~~

32 (2) the location of its principal office;

33 (3) the names *and addresses* of the president, secretary, treasurer, *or*
34 *equivalent of such officers*, and members of the board of directors, ~~with~~
35 ~~the residence address of each;~~

36 (4) the number of shares of capital stock ~~issued and the amount of~~
37 ~~capital stock paid up and the par value per share of each class of capital~~
38 ~~stock having a par value and the number of shares of each class of stock~~
39 ~~without par value which the corporation is authorized to issue;~~

40 (5) the number of shares of capital stock issued; ~~and~~ _____

Strike

41 (6) the nature and kind of business in which the company is engaged
42 ~~and its place or places of business both within and without the state of~~
43 ~~Kansas;~~ _____

add "; and "

1 ~~(6) the value of the property owned and used by the company in~~
2 ~~Kansas, where situated, and the value of the property owned and used~~
3 ~~outside of Kansas and where situated, and~~

4 ~~(7) the corporation's shareholder's equity attributable to Kansas.~~ _____ add

5 (b) Every corporation subject to the provisions of this section which
6 holds agricultural land, as defined in K.S.A. 17-5903, and amendments
7 thereto, within this state shall show the following additional information
8 on the report:

9 (1) ~~The acreage and location listed by section, range, township and~~
10 **[location listed by section, range, township and]** county of each lot,
11 tract or parcel of agricultural land in this state owned or leased by or to
12 the corporation;

13 (2) the purposes for which such agricultural land is owned or leased
14 and, if leased, to whom such agricultural land is leased;

15 (3) the value of the nonagricultural assets and the agricultural assets,
16 stated separately, owned and controlled by the corporation both within
17 and without the state of Kansas and where situated;

18 (4) the total number of stockholders of the corporation;

19 (5) the number of acres owned or operated by the corporation, the
20 number of acres leased by the corporation and the number of acres leased
21 to the corporation;

22 (6) the number of acres of agricultural land, held and reported in
23 each category under paragraph (5) of this subsection (b), stated sepa-
24 rately, being irrigated; and

25 (7) whether any of the agricultural land held and reported under this
26 subsection was acquired after July 1, 1981.

27 (c) ~~The report shall be signed by its president, secretary, treasurer or~~
28 ~~other officer duly authorized so to act, or by any two of its directors, or~~
29 ~~by an incorporator in the event its board of directors shall not have been~~
30 ~~elected executed in accordance with the provisions of K.S.A. 17-6003, and~~
31 ~~amendments thereto.~~ The fact that an individual's name is signed on such
32 report shall be prima facie evidence that such individual is authorized to
33 sign the report on behalf of the corporation; however, the official title or
34 position of the individual signing the report shall be designated. This
35 report will be dated and subscribed by the person as true, under penalty
36 of perjury.

37 (d) At the time of filing its annual report, each such foreign corpo-
38 ration shall pay to the secretary of state an annual franchise tax in an
39 amount equal to \$2 for each \$1,000 of the corporation's shareholder's
40 equity attributable to Kansas, except that no such tax shall be less than
41 \$40 or more than \$5,000. The amount of any such franchise tax paid by
42 the foreign corporation to the secretary as provided by this subsection
43 shall not be disclosed by the secretary.

(7)) if the corporation is a parent corporation holding more than 50% equity ownership in any other business entity registered with the Secretary of State, the name and identification number of any such subsidiary business entity.



K A N S A S

JOAN WAGNON, SECRETARY

DEPARTMENT OF REVENUE
DIVISION OF PROPERTY VALUATION

KATHLEEN SEBELIUS, GOVERNOR

MEMORANDUM

TO: David R. Corbin, Chairman
Senate Assessment & Taxation Committee

FROM: Bill Waters
Division Attorney (PVD)

DATE: March 20, 2003

SUBJECT: 4-R Act

This memorandum is designed to provide background information on the "Railroad Revitalization and Regulatory Reform Act of 1976¹," commonly called the "4-R Act." It will be limited to the 4-R Act's effect on property taxation.

Since February 5, 1979, the property taxation of railroads has been governed by the 4-R Act. The 4-R Act was part of Congress' effort to revitalize the railroad industry and to prevent property tax discrimination against the railroads by favoritism towards other state commercial and industrial property. Highly summarized, the 4-R Act requires railroad property to be assessed for property tax purposes at a rate no higher than the ratio to fair market value that other "commercial and industrial property" in the state is assessed.

The 4-R Act defines "commercial and industrial property" as "property, other than transportation property and land used primarily for agricultural purposes or timber growing, devoted to a commercial or industrial use and subject to a property tax levy." The federal definition differs in several aspects from the definition of "commercial and industrial property" contained in art. 11, § 1 of the Kansas Constitution. For example,

¹ Although the 4-R Act was enacted in 1976, its effective date was postponed until February 5, 1979.

the federal definition of "commercial and industrial property" includes commercial vacant lots and apartment buildings whereas the state's definition does not.

Article 11, § 1 of the Kansas Constitution classifies railroad property as public utility property, and effectively adopts the provisions of the 4-R Act with respect to railroads. The Kansas Constitution requires railroad property "be assessed at the average rate all other commercial and industrial property is assessed." The "average rate all other commercial and industrial property is assessed" is not simply the percentage of fair market value that "commercial and industrial property" is required to be assessed under Kansas law. For example, commercial and industrial real property is required to be assessed at 25% of fair market value under Kansas law. This does not mean, however, that railroad real property is then assessed at 25% of fair market value. Several adjustments must be made to the state prescribed rate to comply with the 4-R Act. First, other property that the 4-Act defines as "commercial and industrial" property must be added and weighted at its Kansas assessment rate, *e.g.*, commercial vacant lots at 12% and apartment buildings at 11.5%. Second, it is the actual assessment rate of "commercial and industrial property," not the statutory assessment rate, that must be used to assess railroad property. To determine the actual assessment rate of "commercial and industrial property," adjustments must be made to reflect any under-valuation of commercial and industrial property. Under-valuation can result from appraisers under-valuing commercial and industrial property and it also results from the fact that the Kansas' Constitution prescribes that some subclasses of commercial and industrial property are to be valued at other than fair market value. For example, commercial and industrial machinery and equipment is required to be valued at a depreciated retail cost when new. The process of determining the true assessment ratio is mathematical and largely a clerical function.

Kansas, in the early 1980s, was involved in some of the earliest 4-R litigation. Virtually all property tax issues under the 4-R Act have long been settled between Kansas and the railroads. Each year, after ratio study data² is available, the mathematical process of determining the assessment rate for railroad property is determined and agreed upon by the Department of Revenue and the railroad companies operating in Kansas.

² The Kansas real estate ratio study act is at K.S.A. 79-1485 *et seq.*