

MINUTES OF THE HOUSE GOVERNMENT EFFICIENCY COMMITTEE

The meeting was called to order by Representative Mike Burgess, Chair, at 3:30 p.m. on January 24, 2011, in Room 546-S of the Capitol.

All members were present except:

Representative Judith Loganbill - Excused  
Representative Louis Ruiz - Excused

Committee staff present:

Julian Efird, Legislative Research  
Iraida Orr, Legislative Research  
Katherine McBride, Revisor of Statutes  
Rena Jefferies, Revisor of Statutes  
Linda Herrick, Committee Assistant

Conferees appearing before the Committee:

Katrin Osterhaus, Legislative Post Audit

Others attending:

(see attached list.)

Chair Burgess asked if there were any bills to be introduced. There were no bills.

The chair noted that attendance was low last Thursday due to the snow storm. No action was taken during that meeting.

Katrin Osterhaus, Principal Auditor, Legislative Post Audit, was introduced and gave a briefing on audit findings on tax credits, sales tax exemptions, and property tax exemptions. Ms. Osterhaus had provided an audit summary in advance of the meeting and a performance audit report for each of the three topics noted above. The one-page summary (Attachment 1) provided the high level findings for the three audits. The full legislative post audit reports can be obtained from the State Legislative Post Audit Department at [www.kansas.gov/postaudit](http://www.kansas.gov/postaudit).

Ms. Osterhaus then reviewed the main points in each of the three audit reports, beginning with the tax credits. (Attachment 2)

The next audit was relative to sales tax exemptions. (Attachment 3)

The last audit addressed by Ms. Osterhaus was property tax exemptions. (Attachment 4)

Chair Burgess thanked Ms. Osterhaus for her presentation to the committee.

Chair Burgess then asked for a report from the leaders of the working groups on prioritized budget, performance measurements, and rainy day fund.

The chair asked if there was any other business, and there was none.

The next meeting is scheduled for Tuesday, January 25, 2011. The meeting was adjourned at 4:29 p.m.

# HOUSE GOVERNMENT EFFICIENCY COMMITTEE

3:30 p.m.

Room 546-S, Capitol Building

## GUEST LIST

DATE: Jan 24, 2011

NAME	REPRESENTING
Derek Hen	HEN LAW FIRM
Leslie Kaufman	Ks Coop Council
Kristen Johnston	Ks. State Historical Society
Kent Eckles	KS Chamber
TED HENDEL	CS
Kary Kleck	Bright & Carpenter
Christy Davis	Friends of Kansas Preservation
Bernie Koch	KRPC
Rob Clum	Rebie Solofsky
Ashley Sherard	Lenexa Chamber
Jennifer Brunning	OP Chamber
Tom Knapke	Friends of Historic Preservation
Mark Tallman	KACB

## LEGISLATIVE DIVISION OF POST AUDIT - AUDIT SUMMARY

Good morning, Mr. Chair, and members of the Committee! I'm here today to present the three tax audits we conducted last year. I brought along extra copies if you need them. With permission of the Chair, I will summarize each audit, which will take about 10 minutes each.

The high level findings of the three audits are as follows:

- **Kansas has increased the number and scope of available tax credits and tax exemptions over the last quarter century.** These policy decisions have reduced the state's tax base significantly, which in turn reduces collectable tax revenues. Various Legislative or Review Committees have studied the tax system in recent years, and again in 2010, with hopes to improve and simplify it.
- **A number of legitimate reasons exist for allowing entities or transactions not to be taxed.** Generally speaking, the fairest tax system is one that can be uniformly applied, to the broadest base of people, goods and services. Good tax policy states that exemptions from taxation should be the exception not the rule. In addition, when granting exceptions, policymakers should consider whether the benefit to the public is worth the lost revenue, or worth asking other taxpayers to pay more to make up the difference.
- **With regard to the State's 47 tax credits, we found eight credits that could be repealed as they appear not to be achieving their purpose.** Seven additional credits appear to be structured more generously compared to other State's credits. Policy makers should reevaluate another 12 tax credits to determine whether they provide a good balance between funding needs and public policy goals.
- **With regard to the State's 99 sales tax exemptions, our main finding was that similar types of taxpayers receive unequal treatment.** This is something that contradicts good tax policy.
- **With regard to the State's 100 property tax exemptions, the biggest problem we found is that Kansas lacks good information on how much the State is losing from those exemptions.** We also found a handful of exemptions that provide a larger exemption than constitutionally required or that could result in unequal treatment of taxpayers.
- **To improve Kansas tax preference structure, we recommended for the Legislature to:**
  - evaluate and address the findings in these three reports
  - develop a broad tax policy to guide future decisions on credits and exemptions,
  - strengthen the system for evaluating tax credits and exemptions in the future.

House Government Efficiency  
Date: 1-24-2011  
Attachment: 1-1



# Legislative Post Audit Performance Audit Report Highlights

Highlights

## Kansas Tax Revenues, Part I: Reviewing Tax Credits

### Report Highlights

February 2010 • 10PA03.1

#### **Audit Concern**

*With the proliferation of credits over the years, legislators have expressed an interest in knowing whether some of those credits still are needed, or whether they have outlived their original purposes*

#### **Other Relevant Facts for Question 1**

*Kansas currently has 47 tax credits and two refund programs available to individuals, corporations, financial institutions, and insurance companies. Such credits can be refundable, non-refundable, carry-forward, or transferable.*

*A total of 13 credits were enacted between 2006 and 2009. These credits cost the State about \$400,000 in 2007, but many hadn't been used yet. These include many credits passed as part of the State's energy development initiative. Because so little information was available about these credits, it's too soon to know whether they will be effective at meeting the Legislature's policy goals.*

*The Department processes most tax returns and credits, but the Insurance Department processes all returns and credits that apply to insurance companies.*

**AUDIT QUESTION 1:** *Does Kansas have tax credits that aren't accomplishing their intended purpose or have outlived their usefulness?*

#### **AUDIT ANSWER and KEY FINDINGS:**

- Tax credit and refund programs cost the State \$669 million in forgone revenues for tax year 2007.
- Eight credits and one refund program (costing \$446.3 million in 2007) clearly appeared to be accomplishing the Legislature's policy goals.
- Eight credits (costing less than \$100,000 in 2007) appeared to be likely candidates for repeal, primarily because of minimal or declining use. These include tax credits for agritourism liability insurance, a single city port authority, abandoned well plugging, swine facility improvement, child day care assistance, and three tax credits designed to encourage contributions to low-income Kansans.
- Six credits and one refund program (costing about \$100 million) appeared to be accomplishing their purposes but were more generous than some other states or credits. For example, Kansas' tax credit for angel investors is 50%, while many states' tax credit rates are 25% or less. Others we identified: the homestead property tax refund and tax credits for earned income, research and development, child dependent care, and community service contributions. These credits could be modified to bring them more in-line with others.
- The Legislature may want to re-evaluate the remaining 12 credits (costing about \$122.5 million). Among the reasons why: some have fairly minimal use, likely don't cause the actions being taken, are significantly more expensive than expected, may cause competitive inequities, or provide a 100% credit. For all these credits, we identified considerations that could support keeping, modifying, or repealing them, depending on the Legislature's policy goals.
- Kansas lacks a strong system for reviewing and evaluating tax credits, and the Department of Revenue's tax database system has a number of data reliability issues. Those issues included duplicate tax credits being reported, changes needed because of amended returns, taxpayer errors, and data entry errors.

House Government Efficiency  
Date: 1-24-2011  
Attachment: 2-1



## **We Recommended**

- We recommended that future tax credits include a measurable public purpose, a mechanism for collecting information for assessing whether the purpose has been met, and a sunset provision that would allow a periodic review. We also recommended that the Legislature consider any changes it may want to make to the credits we identified as potential candidates for being repealed, modified, or re-evaluated, and consider removing confidentiality provisions about who benefits from tax credits and by how much, as some other states have done.
- We recommended that the Department of Revenue make the changes needed to improve the accuracy of tax credit information it provides to the Legislature, and that it incorporate tax return and credit information processed by the Insurance Department.

## **Agency Response:**

*The Department agreed with all the recommendations addressed to it, and indicated it had implemented or initiated steps that should help address the problems we identified with the accuracy of the tax credit database. The Department also agreed with our conclusions about the various tax credits, with the possible exception of the Single City Port Authority Tax Credit.*

## **Other Relevant Facts for Question 1** *(continued)*

*For tax year 2007, those credits totaled almost \$75 million. That information generally isn't included with the other tax credit information the Department of Revenue publishes.*



**AUDIT QUESTION 2:** What transferable tax credits exist in Kansas, and are they a cost-effective means of generating money to fund certain types of projects or causes?

**AUDIT ANSWER and KEY FINDINGS:**

- Only 4 of the 47 tax credits currently available in Kansas are transferable—Angel Investor, Community Service Contribution, Deferred Maintenance, and Historic Preservation.
- The first three transferable credits appear to be a cost-effective way of generating money from the State's perspective, because all the money the State loses in forgone revenues goes to the project or activity the State is subsidizing. Transferring these credits has no effect.
- The Historic Preservation Tax Credit isn't a cost-effective way to generate money from the State's perspective. On average for the credits that have been transferred (211 of 569), only 85¢ went to the project for every dollar the State gave up. That information is summarized in the figure.

**Figure 2-6**

**Money Generated for Historic Preservation Projects As a Result of the Tax Credits For Tax Years 2001-2009 (amounts shown in millions)**

Tax Year	Total Amount of Tax Credits Issued (number of projects)	Amount Transferred (number of projects)	Amount paid for Initial Transfer (a)	Cost Ratio of Transferred Credits
2001	\$0.4 (6)	\$0.011 (1)	\$0.009	\$0.80
2002	\$2.3 (36)	\$1.9 (9)	\$1.5	\$0.83
2003	\$6.1 (59)	\$5.8 (23)	\$4.8	\$0.82
2004	\$4.8 (66)	\$4.3 (22)	\$3.3	\$0.77
2005	\$11.2 (87)	\$10.6 (37)	\$8.8	\$0.83
2006	\$5.1 (111)	\$4.1 (37)	\$3.5	\$0.86
2007	\$8.7 (95)	\$7.7 (40)	\$6.8	\$0.88
2008	\$15.1 (70)	\$14.3 (29)	\$12.6	\$0.89
2009 (b)	\$4.4 (39)	\$2.4 (13)	\$2.1	\$0.89
<b>Total</b>	<b>\$58.1 (569)</b>	<b>\$51.1 (211)</b>	<b>\$43.4</b>	<b>\$0.85</b>

(a) We only reviewed the initial transfers since those determine whether the credit is cost-effective for the State. The reader should be aware that many of these credits are being transferred multiple times.

(b) Data includes tax credits issued only for the first nine months of 2009.

Source: LPA analysis of Kansas Department of Revenue data

**Audit Concern**

Legislators have expressed an interest in knowing whether transferable tax credits represent an effective use of taxpayer dollars.

**Other Relevant Facts for Question 2**

Information produced by the Department of Revenue hasn't captured all credits taxpayers are claiming.

Department records only recorded \$2.3 million of the \$4.3 million in credits claimed for the Historic Preservation Credits we reviewed, and were understated by more than \$373,000 for the Angel Investor Tax Credits we reviewed. Such understatements weren't isolated to tax credits that were transferred.

Initially, the estimated cost of the Historic Preservation Tax Credit was about \$1 million a year. Preliminary figures show that these credits had exceeded \$10 million in 2008. For 2010 and 2011 only, the Legislature capped the credit at \$3.75 million a year, but it's possible the cost for this credit still will exceed those statutory caps.

**We Recommended**

- We recommended the Legislature consider options for restructuring how it provides funding to historic preservation projects to ensure its spending is cost-effective. We also recommended the Legislature consider imposing limits on the amount of credit that can be awarded because it's so much more expensive than the Legislature initially expected.



**DO YOU HAVE AN IDEA FOR  
IMPROVED GOVERNMENT EFFICIENCY OR COST SAVINGS?**

If you have an idea to share with us, send it to [ideas@lpa.ks.gov](mailto:ideas@lpa.ks.gov), or write to us at the address shown. We will pass along the best ones to the Legislative Post Audit Committee.

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Barbara J. Hinton,  
Legislative Post Auditor

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# Legislative Post Audit Performance Audit Report Highlights

Highlights

## Kansas Tax Revenues, Part II: Reviewing Sales Tax Exemptions

### Report Highlights

February 2010 • 10PA03.2

#### Audit Concern

*Legislators have expressed an interest in knowing whether some sales tax exemptions should be considered for elimination.*

#### Other Relevant Facts

*Over the years, the percent of State revenues provided by sales taxes has declined from 51% in fiscal year 1980 to 49% in fiscal year 2009.*

*Most sales tax exemptions don't have a measurable purpose. In essence, they subsidize the operations of all entities granted the exemption by lowering their costs of doing business, or by making it "easier" for people to buy their products.*

*Many sales tax exemptions were created or expanded in recent years, including 12 new or expanded exemptions in 1998, 8 in 2001, and 25 in 2006 and 2007.*

*13 of the State's 99 sales tax exemptions account for \$4.1 billion or 96% of the forgone sales tax revenue. In all, 6 of those 13 exemptions ensure that goods are taxed only at the final point of sale, or avoid taxation of governmental entities. Those 6 exemptions cost about \$3.4 billion.*

**AUDIT QUESTION:** *Does Kansas Have Sales Tax Exemptions that Potentially Should Be Considered for Elimination?*

#### AUDIT ANSWER and KEY FINDINGS:

- Kansas currently has 99 sales tax exemptions costing the State an estimated \$4.2 billion in fiscal year 2009.
- Sales tax exemptions in several areas aren't in line with good tax policy because they provide unequal treatment for similar types of taxpayers. For example,
  - exemptions for 44 specifically named non-profit organizations or associations, costing about \$2.2 million annually
  - exemptions for non-profits such as hospitals and nursing homes but not their for-profit counterparts
  - an exemption for coin-operated laundries, but not other laundry or coin-operated businesses
- Some of the costliest sales tax exemptions enacted as a matter of public policy relate to machinery and equipment (\$231 million), educational/youth activities (\$58.5 million), labor services (\$182 million), utilities (\$136 million), and health care (\$70 million). Although there may be good public policy reasons for having such exemptions, they significantly erode the State's tax base.
- Recently, many sales tax exemptions have been expanded to exempt "sales by" or "purchases made on behalf of" certain organizations. Such provisions broaden those entities' exemptions, are looser and more at-risk of abuse, and don't distinguish between isolated/occasional sales and ongoing sales.
- The Legislature hasn't adopted broad policy goals regarding the types of organizations, services, or activities it wants to exempt from sales taxes, making it difficult to have a consistent basis for deciding which exemptions have merit and should be continued.

House Government Efficiency

Date: 1-24-2011

Attachment: 3-1



## We Recommended

- We recommended that the Legislature review the sales tax exemptions noted above to determine what changes if any should be made. We also recommended that the Legislature consider establishing a broad sales tax policy outlining the types of sales it wants to exempt and developing criteria regarding what fits within that broad policy.

**Agency Response:** *The Department of Revenue generally concurred with the report's findings and recommendations.*

### DO YOU HAVE AN IDEA FOR IMPROVED GOVERNMENT EFFICIENCY OR COST SAVINGS?

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# Legislative Post Audit Performance Audit Report Highlights

Highlights

## Kansas Tax Revenues, Part III: Reviewing Property Tax Exemptions

### Report Highlights

March 2010 • 10PA03.3

#### Audit Concern

*Legislators have expressed an interest in knowing whether some property tax exemptions should be considered for elimination.*

#### Other Relevant Facts

*All property is placed into two classes—real property (land and buildings) or personal property (e.g. boats, cars, household belongings).*

*The Kansas Constitution requires certain property to be exempt from taxation, and allows the Legislature and local government to exempt additional property.*

*The number of property tax exemptions in Kansas has increased from 42 in 1985 to 100 exemptions currently.*

*Many property tax exemptions were created or expanded in recent years, including seven in 1992, five in 2001, and 21 exemptions between 2005 and 2007, many of which are business-related.*

*A rise in the number of property exemptions can shift the tax burden to a smaller group of taxpayers. Tax revenues based on residential real estate have grown faster than any of the other major property category. In 2008, tax revenues*

**AUDIT QUESTION:** *Does Kansas have property tax exemptions that potentially should be considered for elimination?*

#### AUDIT ANSWER and KEY FINDINGS:

- More than half of Kansas' 100 statutory property tax exemptions relate to those that are specified in the Kansas Constitution. The rest are based on policy choices made by the Legislature.
- Kansas lacks good information about the financial impact property tax exemptions have on the State and local governments.
- We identified a number of property tax exemptions the Legislature may want to re-evaluate:
  - Six property tax exemptions are broader than the Constitution requires:
    - Household goods and personal effects
    - Parsonages
    - Non-profit community housing development organizations
    - Non-profit community service organizations
    - Certain buildings owned by private non-profit universities or colleges
    - Property used by alumni organizations
  - Four property tax exemptions aren't in-line with good tax policy because they provide unequal treatment for similar types of taxpayers:
    - an exemption for farm structures used to store hay, but not for other structures used to store inventory, products, and other goods
    - an exemption for aircraft that are used to generate income, but not for other forms of transportation used to create income such as taxi cabs or delivery trucks
    - an exemption for antique aircraft, but not other antique property such as cars
    - an exemption for low oil production implemented in 1992, to subsidize those businesses when oil prices were at a record low
- Several property tax exemptions for machinery and equipment that were enacted in 2006 have significantly eroded the local tax base. These exemptions were expected to cost counties more than \$400 million in property taxes over the first five years. We estimated that these exemptions cost the State \$5 million in property tax revenues in fiscal year 2008; and those losses are estimated to increase to almost \$19 million by 2012.

House Government Efficiency

Date: 1-24-2011

Attachment: 4-1



## We Recommended

- We recommended that the Legislature review the property tax exemptions noted on the front page to determine what changes, if any, should be made. We also recommended that the Legislature consider establishing a broad property tax policy outlining the types of property it wants to exempt and developing criteria regarding what fits within that broad policy.

**Agency Response:** The Department of Revenue had no issues with the report's findings and recommendations.

## Other Relevant Facts

(continued)

*from residences made up 47% of all property tax revenues (up from 38% in 1994).*

*According to the U.S. Census Bureau data, local governments in Kansas derive roughly 76% of their tax revenues from property taxes.*

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