Approved: March 23, 2011

MINUTES OF THE HOUSE TAXATION COMMITTEE

The meeting was called to order by Chairman Richard Carlson at 3:36 p.m. on February 16, 2011, in Room 783 of the Docking State Office Building.

All members were present except:
Representative Denning-excused
Representative Frownfelter-excused
Representative Schwab-excused

Committee staff present:
Gordon Self, Office of the Revisor of Statutes
Scott Wells, Office of the Revisor of Statutes
Chris Courtwright, Kansas Legislative Research Department
Michael Wales, Kansas Legislative Research Department
Marla Morris, Committee Assistant
Allen Jeffus, Office Assistant

Conferees appearing before the Committee:
Secretary Nick Jordan, Kansas Department of Revenue
Secretary Pat George, Kansas Department of Commerce
Richard Cram, Kansas Department of Revenue
Dr. Art Hall, Center for Applied Economics, KU School of Business
Stan Ahlerich, President, Kansas, Inc.
Gary Allerheiligen, Kansas Society of CPA's
Dennis Lauver, Salina Area Chamber of Commerce
Betty Nelson-Ekey, CBIZ
Sheila Lenson, Associated Wholesale Grocers, Inc. (AWG)

Others attending:
See attached list.

Bill Introductions:

Representative McCray-Miller moved introduction of a committee bill to allow counties to add up to a one-half percent tax for the funding of children's programing. The motion was seconded by Representative Dillmore. The motion carried.

Chairman Carlson opened the hearing on **HB 2317- Authorizing expensing of investment expenditures as a deduction in calculating Kansas income tax liability and IMPACT program changes.**

The Chairman directed the Committee to the Kansas Department of Revenue Fiscal Note on **HB 2317** located in their daily packet (Attachment 1).

Committee members were asked to hold questions until Revisor Self, Secretary Jordan, Secretary George, Richard Cram (KDOR), and Dr. Art Hall had completed their testimonies.

Gordon Self, Office of the Revisor of Statutes, briefed the Committee on **HB 2317**. Revisor Self explained **HB 2317**, requested by the Secretary of Revenue and Secretary of Commerce on behalf of Governor Brownback, is referred to as Expensing and IMPACT bill.

Secretary Nick Jordan, Kansas Department of Revenue, directed his testimony in support of **HB 2317**, to Governor Brownback's economic growth plan (Attachment 2).

Secretary Pat George, Kansas Department of Commerce, supports passage of **HB 2317**. The Commerce Department feels this legislation will make Kansas a more attractive state to locate a business, and provides the necessary incentive to make capital investment and expand a business (Attachment 3).

Richard Cram, Kansas Department of Revenue explained the mechanics of the expensing process, and unitary group usage of the Kansas expense deduction. His testimony included a balloon amendment, technical in nature, to replace the term "Kansas taxable income"with the term with the term "Kansas net income before expensing or recapture" in Section 2(a) and (e), (Attachment 4).

Dr. Art Hall, Center for Applied Economics, KU School of Business presented a technical primer on Governor Brownback's proposal. The primer offered explanations of various aspects of the proposal that were implemented in **HB 2317** (Attachment 5). He provided the Committee with a copy of the KU School of Business publication "Expensing: A Competitive Leap for Kansas Tax Policy" (Attachment 6).

Stan Ahlerich, President, Kansas, Inc., testified in support of **HB 2317**. His testimony concerned input obtained from 19 meetings, held throughout the state, with representatives from Kansas companies of all sizes (Attachment 7).

Gary Allerheiligen, Kansas Society of CPA's, representing 2,600 members, presented neutral testimony on **HB 2317**. He expressed concerns with the proposed legislation and offered technical amendment recommendations to the Committee (Attachment 8).

Dennis Lauver, Salina Area Chamber of Commerce, offered neutral testimony on **HB 2317** (Attachment 9). His testimony summarized these responses to proposals in **HB 2317** from a number of Salina area employers:

- The HPIP program is effective and is valued.
- Making the state more neutral in decision making is a great idea
- A cash based program will be a very effective tool that will stimulate jobs and capital investment
- Eliminating the sales tax will stunt growth
- There is a sense the deduction expensing concept will disproportionally help very large employers and may have limited impact

Betty Nelson-Ekey, CBIZ testified in opposition to **HB 2317**, urging the Committee to keep the investment threshold at $50,000 (Attachment 10). She expressed concern that the proposed raise would prevent small to mid-sized companies from qualifying for the program's investment credit.

Sheila Lenson, Associated Wholesale Grocers, Inc. (AWG), presented testimony opposing **HB 2317**. The AWG proposed that the current programs be retained, specifically HPIP with its sales tax exemptions (Attachment 11).

Chairman Carlson, held the hearing on **HB 2317** open, to continue at 3:30 p.m., Thursday, February 17, 2011, in Room 783 of the Docking State Office Building.

The meeting was adjourned 4:55 p.m.

HOUSE TAXATION COMMITTEE

DATE: February 16, 2011

NAME	REPRESENTING
Natalie Bright	KSCPA
Christy Caldwell	Topeka Chamber
Sheila Lenson	Assoc. Wholesale Grocers
Paje Routhier	Hein Law Firm
Colin Curtis	Sandstone Group
Bernie Koch	KEPC
Michelle Butler	Cap Strategies
Gary Allerheiligen	KSCPA
Mary MacBain	KS Society of CPAs
Dennis Wilson	Salina Chamber/Commerce
Cheryl Hayward	KS Society of CPAs
Mike Murray	Capitol Advantage
Jack Clark	Ash Grove Cement
[illegible]	KS Chamber
Mary Jane Stankiewicz	KARA
Gene Meyer	Kansas Reporter
Jim Gardner	Hickam PA
Dan Murray	NFIB
Sandy Braden	Hallmark

HOUSE TAXATION COMMITTEE

DATE: February 16, 2011

NAME	REPRESENTING
Greg Swan	Hallmark

From: Richard.Cram@kdor.ks.gov
Sent: Tuesday, February 15, 2011 6:37 PM
To: Chris Courtwright; Marla Morris; Gordon Self; sean.tomb@budget.ks.gov
Subject: HB 2317 fiscal note
Attachments: pic15006.jpg

----- Forwarded by Richard Cram/Revenue/KDOR on 02/15/2011 06:35 PM -----

2011 House Bill 2317b Fiscal Note
Introduced as a House Bill

Fiscal Note Development

Bill Assigned: 02/14/2011

Responses Due: 02/16/2011

Note Due to Budget: 02/17/2011

Status: Approved by Secretary

Prepared By: Steve A Stotts

Preliminary Completed: 02/15/2011

Reviewed by P&R: 02/15/2011

Approved by Secretary: 02/15/2011

Sent to Budget:

Fiscal Impact: Passage of this bill would not impact fiscal year 2012 and 2013 state general fund revenue. The job creation program fund would receive about $5.3 million in fiscal year 2012 and $52.2 million in fiscal year 2013.

Administrative Impact: There will be administrative costs associated with this bill. When those costs have been estimated a revised fiscal note will be issued.

House Taxation
Date: 2-16-11
Attachment: 1

Fiscal Note

MEMORANDUM

To:
Division of Budget

From: Kansas Department of Revenue

Date: 02/15/2011

Subject: House Bill 2317
Introduced as a House Bill

Brief of Bill

House Bill 2317, as introduced, in new section one creates the job creation program fund. Expenditures from the fund shall be for the purpose of promoting job creation and economic development by funding projects related to: (1) Major expansion of an existing Kansas commercial enterprise; (2) potential location in Kansas of the operations of major employer; (3)award of a significant federal or private sector grant which has a financial matching requirement; (4)potential departure from Kansas or the substantial reduction of the operations of a major Kansas employer; (5)training or retraining activities for employees in Kansas companies; (6)potential closure or substantial reduction of the operations of a major state or federal institution; (7)projects in counties with at least a 10% population decline during the period from 2000 to 2010; or (8)other unique economic development opportunities.

All expenditures from the fund shall be made in accordance with appropriation acts on vouchers approved by the secretary of commerce.

New Section 2 provides that for tax years beginning after December 31, 2011 taxpayers may elect to take an expense deduction for Kansas tax purposes for the cost of tangible property placed in service during the taxable year. Property eligible for depreciation under MACRS in section 168, except residential rental property, nonresidential real property, any railroad grading or tunnel bore or any other property with an applicable recovery period in excess of 25 years and computer software as defined in section 197(e)(3)(B). If an election is made the amount of the expense deduction shall equal the difference between the depreciable amount for federal purposes and the amount of bonus depreciation claimed under section 168(k) but without regard to any expense deduction for property under section 179. The election shall be made by the due date of the return and shall be irrevocable.

If the amount of expense deduction exceeds the taxpayer's taxable income, the excess may be carried forward until the total amount is used.

If the property is sold and would cause recapture under federal rule, then the expense deduction shall be subject to recapture and treated as Kansas taxable income.

The situs of the property shall be the physical location of the property.

If the property is mobile, the situs shall be the physical location of the business operations from where the property is used or based.

Any member of a unitary group may elect to take an expense deduction for an investment made by any member of the group, provided that the amount calculated may only be deducted from the Kansas taxable allocated to Kansas by such member making the election.

If a taxpayer elects to expense any investment under this bill, the taxpayer shall not be eligible for any tax credit, accelerated depreciation, or deduction for such investment. The credits are the high performance incentive program credit, research and development credit, alternative fuel vehicle credit, swine facility improvement credit, historic preservation credit, refinery credit or accelerated depreciation; oil or gas pipeline or accelerated depreciation; integrated coal or coke gasification nitrogen fertilizer plant credit or accelerated depreciation; biomass-to-energy plant credit or accelerated depreciation; integrated coal gasification power plant credit; renewable electric cogeneration facility credit or accelerated depreciation; biofuel storage and blending equipment credit or accelerated depreciation; carbon dioxide capture equipment credit; or film production credit.

New Section 3 provides that after December 31, 2011, no credits may be earned through the Kansas enterprise zone act or the job expansion and investment tax credit act.

Section 4 amends K.S.A. 74-50,104 to provide that any project funded by the job creation program fund does not qualify for funding under this section.

Section 5 amends K.S.A. 74-50,106 to provide that any project funded by the job creation program fund does not qualify for funding under this section.

Section 6 amends K.S.A. 74-50,107 to provide that beginning on July 1, 2011, 2% of withholding collections be credited as follows: 1) an amount necessary to meet obligations of the debt services for the IMPACT program repayment fund; 2) an amount to the IMPACT program services fund for administration; and)3 any remaining amounts to the job creation program fund.

Beginning July 1, 2011 on an annual basis, the secretary of revenue shall determine the savings realized from the elimination, modification or limitation of credits in subsection (g) of section 2, section 3, section 4, and subsection (cc) of K.S.A. 79-3606. The savings shall be transferred to the job creation program fund.

Section 7 amends K.S.A. 74-50,109 to provide that any unencumbered balance in the IMPACT program repayment fund to the IMPACT program services fund or the job creation program fund.

Section 8 amends K.S.A. 74-50,110 to provide that no bonds shall be issued for IMPACT projects after December 31, 2011.

Section 9 amends K.S.A. 74-50,111 provides that the secretary of commerce shall report annually the activities of the department related to the administration of the job creation program fund.

Section 10 amends K.S.A. 74-50,132 to allow the HPIP credit for tax years before January 1, 2017.

Section 11 amends K.S.A. 79-32,160 to allow the business and job development income tax credit for tax years commencing before January 1, 2012. For HPIP credits starting in Tax Year 2012, the current $50,000 minimum investment threshold is increased to $5 million, and the credit applies to qualifying investment in excess of $5 million. The Secretaries of Commerce and Revenue are authorized address transition situations during 2012. The HPIP credit will sunset in Tax Year 2017.

Section 12 amends K.S.A. 79-32,206 business machinery and equipment tax credit for property taxes paid would no longer apply starting in Tax Year 2012.

Section 13 amends K.S.A. 79-3606 to provide that this sales tax exemption would end effective January 1, 2012 for projects qualifying for the business and job development credit, which will end in Tax Year 2012. The enterprise zone sales tax exemption for HPIP-qualified projects will end as of January 1, 2017, to coincide with the sunset of the HPIP credit.

Section 15 repeals K.S.A. 74-50,151 and 74-50,152 effective January 1, 2012.

The effective date of this bill is on publication in the statute book.

Fiscal Impact
Passage of this bill would not impact fiscal year 2012 and 2013 state general fund revenue. The job creation program fund would receive about $5.3 million in fiscal year 2012 and $52.2 million in fiscal year 2013.

New Sections 1 and 2:

Implement Kansas expensing deduction @5% discount rate:

FY 2012	FY 2013
($6) million	($47.4) million

Section 11:

Repeal B&J credit effective TY 2012:

FY 2012	FY 2013
minimal	$5 million

Raise minimum investment threshold for HPIP to $5 million and provide 10% credit only for amount of investment exceeding $5 million, effective TY 2012:

FY 2012	FY 2013
minimal	$6.8 million

Section 12:

Repeal BM&E refundable credit effective TY 2012

FY 2012	FY 2013
$0	$37 million

Section 13:

Repeal enterprise zone sales tax exemption for B&J starting Jan. 1, 2012

FY 2012	FY 2013
$10 million	$49.5 million

Section 14:

Repeal KEOIF effective Jan. 1, 2012

FY 2012	FY 2013
$1.3 million	$1.3 million

Net Total Revenue Savings to be made available for job creation program fund:

FY 2012	FY 2013
$5.3 million	$52.2 million

Administrative Impact

There will be administrative costs associated with this bill. When those costs have been estimated a revised fiscal note will be issued.

Administrative Problems and Comments

Taxpayer/Customer Impact

Legal Impact

Approved By:

(Embedded image moved to file: pic15006.jpg) Nick Jordan Secretary of Revenue

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Sam Brownback, Governor

TESTIMONY
House Taxation Committee
February 16, 2011
House Bill 2317
by
Secretary of Revenue Nick Jordan

The Governor's Economic Growth Tax Policy

In his inaugural state of the state address a few weeks ago, Gov. Brownback named economic growth in Kansas as his top priority, and he urged us to work together to create the framework for more private sector jobs – and more earnings for Kansas families. In that spirit, a key component of the Governor's economic growth plan is the elimination of corporate tax subsidies enjoyed by only a few as we move toward a tax structure that will help all businesses in our state grow. That is what we are here to discuss today.

Taxation is a claim the government makes on the economic value created by the private sector. The more the government taxes an economic activity, the less that activity will take place.

To expand its economy, Kansas needs to minimize the taxation of activities related to risk-taking and the process of economic competition. We must sustain an environment in which entrepreneurs, businesses and innovation thrive. Our policy should encourage the growth of capital and investment.

From a public policy analysis, we should distinguish between the terms "economic growth" and "economic development" because people mistakenly use the terms interchangeably. Simply stated, economic development constitutes the many interrelated economic processes that culminate in economic growth – particularly the component of growth driven by improved labor productivity.

To maximize economic growth we must recognize that every business, every innovation and every entrepreneur matters. The initiatives described in this testimony strive to motivate all manner of people to commit their time and treasure to Kansas soil. The initiatives seek to increase the overall volume of new business starts and business expansions. Our policy challenge centers on establishing a business environment that induces the maximum amount of business birth and expansion without bias related to the size or type of business.

In a recent speech, Richard Fisher, president and CEO of the Federal Reserve of Dallas, said:

> "A look within the United States makes clear the overriding influence of fiscal and regulatory policy. Monetary policy is uniform across the 50 states; the base rate of interest paid on a business or consumer loan or a mortgage in Michigan, California, Ohio or here in New York is the same as that paid in Texas. Yet there is a reason that Michigan and California each lost more than 600,000 jobs over the past decade while Texas added more than 700,000 over the same period. There is a reason that the population of Ohio grew by only 183,000 residents over the past 10 years, while Texas grows by that number every five and a half months. There is a reason, as reported in this morning's *Wall Street Journal*, college graduates – the best and brightest of the successor generation – are leaving New York and Cleveland and Detroit and moving to Austin, Texas. There is a reason Texas now houses more Fortune 500 headquarters than any other state in the union.
>
> "That reason has nothing to do with monetary policy. It has everything to do with the taxation and fiscal and regulatory policy of the states. The cost of capital does not explain the different economic performances of the states; the cost of doing business has everything to do with those differences. However well-meaning tax and regulatory initiatives in the laggard states may have been when they were conceived and levied, they have had unintended consequences that have led to economic underperformance and job destruction.
>
> "Recent data make clear that the risks of a double-dip recession and deflation have ebbed and that economic growth and job creation are beginning to flow. Yet the ships of job-creating investment remain, for the most part, tied to the docks, or, worse, choose to sail for foreign ports where tax and regulatory conditions are more favorable."

Tax policy plays a central role in economic development policy. Over the decades, Kansas has enacted a variety of tax policies intended to advance economic development. Many of them provide a meaningful economic incentive to make new investments and create new jobs. And almost all of the policies provide meaningful incentive to a small number of worthy businesses to the exclusion of hundreds of thousands of other worthy businesses.

For example, in tax year 2008, 162 taxpayers claimed the High Performance Incentive Program credit; 635 claimed the business and job development credit; and 13,510 received business machinery and equipment credits. Compare these numbers with the 221,000 enterprises in Kansas that stand to benefit from tax policies that incentivize private investment more broadly.

The legislation before you would exponentially increase the number of potential businesses benefiting from smart changes to our tax code and encourage far more investment and growth in the private sector.

Our approach is designed to balance programs for attracting and expanding larger businesses with benefits for the thousands of small businesses in Kansas.

HIGH PERFORMANCE INCENTIVE PROGRAM (HPIP)

HPIP, with its 10 percent tax credit for investments and the sales tax exemption for HPIP related work, has proved attractive to many of our larger companies. There is a $50,000 investment threshold to qualify. In the Governor's proposal, we are changing only one aspect of HPIP, which would raise the threshold to $5 million. This figure was determined by reviewing the investment levels of larger companies in Kansas.

BUSINESS INVESTMENT EXPENSING

Expensing relates to the calculation of business income tax. Whenever a business makes a capital investment, it is allowed to take a deduction against income tax for the depreciation of the investment. Expensing is one form of depreciation deduction, and it allows for an immediate deduction of the full investment amount instead of requiring a prescribed schedule of smaller deductions over multiple years.

Expensing, properly implemented, is a tax policy that treats all businesses equally. By allowing business taxpayers to capture the time value of money related to an investment, expensing results in uniform income tax treatment for investments of all types and sizes.

Expensing shifts the time value of money from the state government to businesses undertaking investment. The shift explains the economic development "incentive." It improves the expected rate of return on every investment. This initiative seeks to make the investment-related tax incentive logically consistent and universally available rather than ad hoc.

The implementation of expensing in this plan is somewhat unique from a tax practitioner's perspective. It seeks to provide the full value of expensing to Kansas business investors, which is not provided by the depreciation procedures allowed by federal tax law. It is important to note here that, while the deduction generated by the Governor's expensing plan is not the equivalent of "full expensing" as practitioners would interpret it in a federal tax context, this would *not* decouple Kansas from the federal system.

The recent federal tax package included one year of full expensing. The Kansas expensing proposal would go into effect after the expiration of the federal program. At this time, we would be the only state known to have expensing. The proposal would result in approximately $47 million dollars available for investment in Kansas.

DEPARTMENT OF COMMERCE JOB CREATION FUND

The Kansas IMPACT program, along with savings from the elimination of certain tax credits, would be converted to a multi-million dollar fund that can be used to close economic development deals. This "job creation fund" is designed to strengthen state incentive programs and give the Secretary of Commerce and Governor flexibility to make prudent decisions to close a deal on a prime economic growth opportunity without adding additional debt to the state.

Considered together, the move away from certain limited tax credits combined with the implementation of expensing, HPIP adjustments, and the job creation fund forms a thoughtful ***economic growth package*** that balances the needs of larger businesses with the needs of tens of thousands of small- to mid-sized businesses in our state.

Thank you, Mr. Chairman and members of the committee.

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Pat George, Secretary

Department of Commerce

Sam Brownback, Governor

Testimony on House Bill 2317
to
The House Taxation Committee
by Secretary Pat George
Kansas Department of Commerce
February 16, 2011

Thank you for the opportunity to testify before you this morning on HB 2317

The Department of Commerce is focused on bringing jobs to the State of Kansas. Creating an environment that is inviting to businesses looking to relocate to Kansas is critical in moving forward. In order to become more attractive to these companies, the state must reduce the taxation of activities related to commerce, in order to encourage innovation and the development of new products and services. Encouraging and expanding investment is what this legislation is all about.

Historically, Kansas has had a tax policy that encouraged growth, but was not inclusive of all businesses that deserved to be supported through economic development incentives. The expensing legislation that we are discussing today will treat all businesses equally by allowing business taxpayers to capture the time value of money related to an investment. This is an incentive to business by transitioning the expected rate of return on the investment from state government to the organization that makes the investment.

House Taxation
Date: 2-16-11
Attachment: 3

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February 16, 2011

House Taxation Committee

Briefing on Expensing Provisions in House Bill 2317

Presented by Richard Cram

Chairman Richard Carlson and Members of the Committee:

House Bill 2317 will provide a new expense deduction to all Kansas businesses for certain qualifying machinery and equipment, as well as canned computer software, placed into service (first made available for use in the business), starting in Tax Year 2012. It also calls for the repeal or limitation of certain tax credits, exemptions and programs now available only to a limited number of businesses in order to reserve sufficient revenue to cover the fiscal impact of this new deduction, as well as provide funding for the new job creation program fund.

Expense Deduction

House Bill 2317 provides businesses that invest in machinery and equipment depreciable under the Modified Accelerated Cost Recovery System (MACRS) in section 168 of the Internal Revenue Code, or canned software as defined in section 197 of the Internal Revenue Code, an expense deduction against Kansas taxable income. The property must be located in Kansas to qualify for the expense deduction.

The Kansas expense deduction, when added to the present value of the depreciation deductions provided under federal income tax law, equals the full value of the cost of the machinery and equipment placed into service.

Present value is the current worth of a future sum of money or stream of cash flows given a specified rate of return. One dollar in your wallet now has a value of one dollar, and it is worth more to you than a dollar received a year from now. If you could earn 5% interest on an investment and you invested one dollar today, it would be worth $1.05 a year from now. Thus, the "present value" of $1.05 received a year from now is only $1.

The federal depreciation rules provide a stream of depreciation deductions, depending on the applicable recovery period for the type of property and the applicable depreciation method. For example, a computer is considered "five-year property," and is normally subject to the 200% declining balance method of depreciation under IRC Section 168. For a computer placed into service in the business in Tax Year 2012 with a cost of $10,000 and 5-year applicable recovery

House Taxation
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the Kansas expense deduction for a $10,000 computer placed into service in Tax Year 2012 would be .116 times $10,000 = $1,160.

If the business is claiming IRC Section 168(k) 50% bonus depreciation in Tax Year 2012, that amount must be subtracted from the depreciable cost of the computer before the Kansas expensing deduction is calculated: $10,000 -$5,000 = $5,000. The amount of the Kansas expense deduction in this situation is: $5,000 times .116 = $580.

If the business is claiming IRC Section 179 expensing for this computer, then no subtraction is made from the depreciable cost before multiplying that times the applicable factor to compute the Kansas expense deduction: $10,000 times .116 = $1,160 is the Kansas expense deduction.

The Kansas expense deduction is a post-apportionment deduction. For a multi-state business, this means the deduction is applied after the income has been apportioned to Kansas.

For example, if a corporation does business in both Missouri and Kansas and has property, payroll and sales in both states, the corporation's total multi-state business income (i.e., its federal taxable income after any applicable Kansas modifications) will be apportioned to Kansas for Kansas income tax purposes, based on the application of the 3-factor formula, which takes the average of 3 fractions: Kansas payroll divided by the corporation's payroll everywhere, Kansas property divided by property everywhere, and Kansas sales divided by sales everywhere. The average of those three fractions determines the corporation's Kansas apportionment factor, which is multiplied by the corporation's federal taxable income after Kansas modifications to compute the corporation's Kansas taxable income.

In our example, assume the multi-state corporation has Tax Year 2012 federal taxable income after Kansas modifications of $200,000 and has placed in service a computer with a cost of $10,000. In computing federal taxable income, the corporation would already have subtracted any applicable federal depreciation or expensing deductions. If the corporation were claiming IRC Section 179 expensing, it would have already taken a federal expensing deduction of $10,000. If the corporation were claiming 50% bonus depreciation, it would have already taken the normal MACRS deduction of $2,000 plus the 50% bonus depreciation deduction of $5,000.

Assume the corporation has a Kansas apportionment factor of .25. Now its Kansas taxable income can be computed: .25 times the federal taxable income with Kansas modifications = .25 times $200,000 = $50,000. If the corporation had claimed no federal bonus depreciation and had instead claimed an IRC Section 179 expense deduction of $10,000 on the federal return, the Kansas expense deduction would be $10,000 x .116 = $1,160 and claimed against Kansas taxable income of $50,000. By taking the Kansas expensing deduction after apportionment, the corporation receives the full benefit of the deduction: from Kansas taxable income of $50,000, the Kansas expense deduction of $1,160 is subtracted, and Kansas income tax liability is computed on $48,840 income: 4% tax on $48,840, for total of $1,954 in Kansas corporate income tax is due.

Any unused expense deduction may be carried forward until fully claimed in future tax years.

prior to that date would still be subject to personal property tax, and K.S.A. 79-32,206 currently provides a refundable tax credit for 25% of the personal property tax paid on business machinery and equipment/

The enterprise zone sales tax exemption (K.S.A. 79-3606(cc)) exempts from sales tax purchases of materials, machinery, equipment, and labor for the construction, reconstruction, enlargement or remodeling of a business facility when the requirements of the business & job development credit or the HPIP credit are met. Under House Bill 2317, this sales tax exemption would end effective January 1, 2012 for projects qualifying for the business and job development credit, which will end after Tax Year 2011. The enterprise zone sales tax exemption for HPIP-qualified projects will end as of January 1, 2017, to coincide with the sunset of the HPIP credit.

The Kansas Economic Opportunity Initiative Fund (KEOIF) would be repealed effective January 1, 2012, and any moneys in that fund are to be transferred to the new job creation program fund.

Fiscal Estimate Breakout
The fiscal estimates for the various components of House Bill 2317 are broken out as follows:

Implement Kansas expensing deduction @5% discount rate:

FY 2012	FY 2013
-$6 million	-$47.4 million

Repeal B&J credit effective TY 2012:

FY 2012	FY 2013
minimal	+$5 million

Raise minimum investment threshold for HPIP to $5 million and provide 10% credit only for amount of investment exceeding $5 million, effective TY 2012:

FY 2012	FY 2013
minimal	+$6.8 million

Repeal enterprise zone sales tax exemption for B&J starting Jan. 1, 2012

FY 2012	FY 2013
+$10 million	+$49.5 million

Repeal BM&E refundable credit effective TY 2012

FY 2012	FY 2013
0	+$37 million

Repeal KEOIF effective Jan. 1, 2012

FY 2012	FY 2013
+$1.3 million	+$1.3 million

Net Total Revenue (to be reserved for the new job creation program fund)

FY 2012	FY 2013
+5.3 million	+52.2 million

Table B-1. Table of Class Lives and Recovery Periods

Asset class	Description of assets included	Class Life (in years)	Recovery Periods (in years) GDS (MACRS)	ADS
	SPECIFIC DEPRECIABLE ASSETS USED IN ALL BUSINESS ACTIVITIES, EXCEPT AS NOTED:			
00.11	**Office Furniture, Fixtures, and Equipment:** Includes furniture and fixtures that are not a structural component of a building. Includes such assets as desks, files, safes, and communications equipment. Does not include communications equipment that is included in other classes.	10	7	10
00.12	**Information Systems:** Includes computers and their peripheral equipment used in administering normal business transactions and the maintenance of business records, their retrieval and analysis. Information systems are defined as: 1) Computers: A computer is a programmable electronically activated device capable of accepting information, applying prescribed processes to the information, and supplying the results of these processes with or without human intervention. It usually consists of a central processing unit containing extensive storage, logic, arithmetic, and control capabilities. Excluded from this category are adding machines, electronic desk calculators, etc., and other equipment described in class 00.13. 2) Peripheral equipment consists of the auxiliary machines which are designed to be placed under control of the central processing unit. Nonlimiting examples are: Card readers, card punches, magnetic tape feeds, high speed printers, optical character readers, tape cassettes, mass storage units, paper tape equipment, keypunches, data entry devices, teleprinters, terminals, tape drives, disc drives, disc files, disc packs, visual image projector tubes, card sorters, plotters, and collators. Peripheral equipment may be used on-line or off-line. Does not incude equipment that is an integral part of other capital equipment that is included in other classes of economic activity, i.e., computers used primarily for process or production control, switching, channeling, and automating distributive trades and services such as point of sale (POS) computer systems. Also, does not include equipment of a kind used primarily for amusement or entertainment of the user.	6	5	5
00.13	**Data Handling Equipment; except Computers:** Includes only typewriters, calculators, adding and accounting machines, copiers, and duplicating equipment.	6	5	6
00.21	**Airplanes (airframes and engines), except those used in commercial or contract carrying of passengers or freight, and all helicopters (airframes and engines)**	6	5	6
00.22	**Automobiles, Taxis**	3	5	5
00.23	**Buses**	9	5	9
00.241	**Light General Purpose Trucks:** Includes trucks for use over the road (actual weight less than 13,000 pounds)	4	5	5
00.242	**Heavy General Purpose Trucks:** Includes heavy general purpose trucks, concrete ready mix-trucks, and ore trucks, for use over the road (actual unloaded weight 13,000 pounds or more)	6	5	6
00.25	**Railroad Cars and Locomotives, except those owned by railroad transportation companies**	15	7	15
00.26	**Tractor Units for Use Over-The-Road**	4	3	4
00.27	**Trailers and Trailer-Mounted Containers**	6	5	6
00.28	**Vessels, Barges, Tugs, and Similar Water Transportation Equipment, except those used in marine construction**	18	10	18
00.3	**Land Improvements:** Includes improvements directly to or added to land, whether such improvements are section 1245 property or section 1250 property, provided such improvements are depreciable. Examples of such assets might include sidewalks, roads, canals, waterways, drainage facilities, sewers (not including municipal sewers in Class 51), wharves and docks, bridges, fences, landscaping shrubbery, or radio and television transmitting towers. Does not include land improvements that are explicitly included in any other class, and buildings and structural components as defined in section 1.48-1(e) of the regulations. Excludes public utility initial clearing and grading land improvements as specified in Rev. Rul. 72-403, 1972-2 C.B. 102.	20	15	20
00.4	**Industrial Steam and Electric Generation and/or Distribution Systems:** Includes assets, whether such assets are section 1245 property or 1250 property, providing such assets are depreciable, used in the production and/or distribution of electricity with rated total capacity in excess of 500 Kilowatts and/or assets used in the production and/or distribution of steam with rated total capacity in excess of 12,500 pounds per hour for use by the taxpayer in its industrial manufacturing process or plant activity and not ordinarily available for sale to others. Does not include buildings and structural components as defined in section 1.48-1(e) of the regulations. Assets used to generate and/or distribute electricity or steam of the type described above, but of lesser rated capacity, are not included, but are included in the appropriate manufacturing equipment classes elsewhere specified. Also includes electric generating and steam distribution assets, which may utilize steam produced by a waste reduction and resource recovery plant, used by the taxpayer in its industrial manufacturing process or plant activity. Steam and chemical recovery boiler systems used for the recovery and regeneration of chemicals used in manufacturing, with rated capacity in excess of that described above, with specifically related distribution and return systems are not included but are included in appropriate manufacturing equipment classes elsewhere specified. An example of an excluded steam and chemical recovery boiler system is that used in the pulp and paper manufacturing equipment classes elsewhere specified. An example of an excluded steam and chemical recovery boiler system is that used in the pulp and paper manufacturing industry.	22	15	22

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Session of 2011

HOUSE BILL No. 2317

By Committee on Taxation

2-11

AN ACT concerning taxation; relating to IMPACT program, withholding, requirements, limitations; income tax deductions, expensing of investment expenditures; income tax credits; sales tax exemptions; creating job creation program fund, administration, expenditures; amending K.S.A. 2010 Supp. 74-50,104, 74-50,106, 74-50,107, 74-50,109, 74-50,110, 74-50,111, 74-50,132, 79-32,160a, 79-32,206 and 79-3606 and repealing the existing sections; also repealing K.S.A. 2010 Supp. 74-50,151 and 74-50,152.

Be it enacted by the Legislature of the State of Kansas:

New Section 1. (a) There is hereby created in the state treasury the job creation program fund. The secretary of commerce, in consultation with the secretary of revenue and the governor, shall administer the fund. All expenditures from the fund shall be for the purpose of promoting job creation and economic development by funding projects related to: (1) Major expansion of an existing Kansas commercial enterprise;

(2) potential location in Kansas of the operations of major employer;

(3) award of a significant federal or private sector grant which has a financial matching requirement;

(4) potential departure from Kansas or the substantial reduction of the operations of a major Kansas employer;

(5) training or retraining activities for employees in Kansas companies;

(6) potential closure or substantial reduction of the operations of a major state or federal institution;

(7) projects in counties with at least a 10% population decline during the period from 2000 to 2010; or

(8) other unique economic development opportunities.

(b) All expenditures from the fund shall be for the purposes described in subsection (a) and shall be made in accordance with appropriation acts upon warrants of the director of accounts and reports issued pursuant to vouchers approved by the secretary of commerce or the secretary's designee.

New Sec. 2. (a) For taxable years beginning after December 31, 2011, a taxpayer may elect to take an expense deduction from Kansas ~~taxable~~ income allocated or apportioned to this state for the cost of the

net

before expensing or recapture

Implementation of Expensing in Kansas:
A Technical Primer on Governor Brownback's Proposal

Art Hall, Executive Director
Center for Applied Economics, KU School of Business

Presented to the House Committee on Taxation
February 15, 2011

Statement of Policy:

Provide to business investors in Kansas the economic value of fully-accelerated depreciation that the federal government tax laws do not provide (but in addition to the economic value provided by federal tax laws for so-called Section 179 property).

The proposed expensing procedure is an option not a requirement. Some taxpayers may choose, for compelling business reasons, to follow federal depreciation procedures only.

Scope

- <u>All business taxpayers</u> shall have an automatic option to expense (immediately write-off for the year placed in service) any eligible investment. The expensing procedure amounts to an additional income tax deduction in Kansas over and above the deductions available for federal income tax purposes.
- The expensing provision applies to any <u>non-real estate</u> investment that can be depreciated for federal income tax purposes.
- There are <u>no restrictions or caps</u>, given the definitions and implementation procedures outlined in the bill.
- Unlimited carry-forward of unused deductions.
- For multi-divisional businesses, the "unitary group" can take the deduction on behalf of investments made by any member of the group.

What is "Expensing"?

- Expensing is a procedure related to the calculation of business income tax. Whenever a business makes a capital investment (whether equipment or structure), it is allowed to take a deduction against income tax for the depreciation of the investment. Expensing is one form of depreciation deduction.
- Expensing is a pro-investment tax policy that does not subsidize businesses. It simply allows them to capture an investment's full time value of money.
- Expensing, properly implemented, is a tax policy that treats *all* businesses equally.

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Comparison of Expensing and Tax Credits
Hypothetical Business Operating Solely within Kansas

Assume a $100,000 Investment in 7-Year Property

Federal Depreciation (200% Declining Balance)								
Year	1	2	3	4	5	6	7	8
Dollars	14,290	24,490	17,490	12,490	8,930	8,920	8,930	4,460

Examples:

Furniture and fixtures for a call center
Agricultural machinery
A new natural gas gathering pipeline
Manufacturing equipment for many industries

		Year 1 Income Tax Calculation		
		Full Expensing	**Brownback Expensing**	**HPIP Tax Credit**
1	Gross Receipts	500,000	500,000	500,000
2	Less: Cost of Goods Sold	310,000	310,000	310,000
3	Less: Federal Depreciation (on above investment)	14,290	14,290	14,290
4	Equals: Net Profit (Federal Taxable Income)	175,710	175,710	175,710
5	Plus: Kansas Additions to Federal Taxable Income	0	0	0
6	Less: Kansas Deductions from Federal Taxable Income	0	0	0
7	Equals: Apportionable Business Income to Kansas	175,710	175,710	175,710
8	Less: Kansas Expensing Deduction	100,000	15,100 *	0
9	Equals: Kansas Taxable Income	75,710	160,610	175,710
10	Kansas Income Tax (at 4% + 3.05% Surtax over $50,000)	3,813	9,798	10,863
11	Less: HPIP Tax Credit (10%)	0	0	5,000
12	Equals: Kansas Tax Liability	3,813	9,798	5,863

* Uses Kansas Adjustment Factor as explained below.

- This example shows the accounting and tax difference related to expensing and the HPIP investment tax credit (which applies to qualifying investments above $50,000).
- For the example, so-called "full expensing" is the most valuable to a taxpayer; HPIP is next. That is because each delivers more than the time value of money—they, in whole or in part, double count the value of the federal depreciation benefits.
- The Brownback proposal achieves the stated policy goal: it shifts only the time value of money to the taxpayer based on the federal depreciation benefits. It improves the expected investment return, but it does not subsidize like "full expensing" or HPIP.

Expected Rate of Return on Identical Hypothetical Investments (7-Year Property, Full Value of Incentive Captured in Year 1)			
	$1 Million Investment	**$100,000 Investment**	**$50,000 Investment**
No Credit or Expensing	9.20%	9.20%	9.20%
Full Expensing (7.05% Tax Rate)	11.19%	11.19%	11.19%
Brownback Expensing (7.05% Tax Rate)	**9.63%**	**9.63%**	**9.63%**
HPIP Investment Tax Credit	11.92%	10.60%	9.20%

- The goal of an investment incentive is to increase the expected return on investment (ROI). The baseline in this example is a 9.20% after tax investment return assuming no credits or deductions.
- No doubt a 10% tax credit increases expected ROI the most, once the investment is large enough to trivialize the $50,000 HPIP threshold.
- Expensing can become more competitive with HPIP if Kansas decides to go to "full expensing." Of course, like HPIP, this subsidizes business rather than removing the tax penalty imposed by fixed depreciation schedules. The higher the discount rate (that is the larger the Kansas Adjustment Factor), the closer ROI will get to "full expensing."
- Expending treats every business equally—regardless of the size of the investment. A stated policy goal.
- HPIP applies to a few dozen companies a year; expensing to tens of thousands—with no permission required. Relative to HPIP, Brownback expensing will help increase the expected rate of return on an addition $6-7 billion of annual investment—in other words, every business, not the several hundred million dollars of investment made by select businesses.

Formulas for Calculating Taxpayer Value	
Full Expensing	Investment Amount x Tax Rate
Brownback Expensing	Investment Amount x Kansas Adjustment Factor x Tax Rate
HPIP Investment Tax Credit	(Qualifying Investment Expenditure - $50,000) x 10%

Additional Examples of Taxpayer Value
(HPIP subsidizes; Brownback Expensing removes tax penalty)

$50,000 Investment

Property Class	Expensing Deduction 5% Factor	Taxpayer Value: Corporate Rate 7.05%	Taxpayer Value: Top Individual Rate 6.45%	HPIP
3-Year	3,731	263	241	0
5-Year	5,794	408	374	0
7-Year	7,547	532	487	0
10-Year	9,889	697	638	0

$100,000 Investment

Property Class	Expensing Deduction 5% Factor	Taxpayer Value: Corporate Rate 7.05%	Taxpayer Value: Top Individual Rate 6.45%	HPIP
3-Year	7,463	526	481	5,000
5-Year	11,587	817	747	5,000
7-Year	15,095	1,064	974	5,000
10-Year	19,777	1,394	1,276	5,000

$1,000,000 Investment

Property Class	Expensing Deduction 5% Factor	Taxpayer Value: Corporate Rate 7.05%	Taxpayer Value: Top Individual Rate 6.45%	HPIP
3-Year	74,629	5,261	4,814	95,000
5-Year	115,874	8,169	7,474	95,000
7-Year	150,946	10,642	9,736	95,000
10-Year	197,772	13,943	12,756	95,000

Implementation: Understanding the Kansas Adjustment Factor

The key—and novel—implementation feature of the proposal relates to the "Kansas Adjustment Factor," which is described in the example below. Kansas, like many states, piggybacks on the procedures in the federal income tax code. This fact makes the implementation of expensing in Kansas slightly more complicated than it would be at the federal level. In brief, it would require a Kansas business tax preparer to spend about 5-10 minutes to perform one additional calculation.

The purpose of the additional calculation is to keep undisturbed the Kansas procedure of using federal taxable income as the starting point for Kansas corporate income tax calculations (and federal adjusted gross income as the starting point for proprietorships, partnerships, and S-Corporations). These starting-point measures of income already have federal depreciation built in.

An Example: Calculating the Kansas Adjustment Factor

- Federal depreciation procedures rely on a set of prescribed rules.
- When a business taxpayer makes a capital investment, the tax preparer must make a decision about (1) how to classify the property for depreciation purposes and (2) what depreciation method to use. Once the tax preparer makes those decisions, all of the details about the depreciation schedule become known.
- The suggested implementation plan for expensing in Kansas relies on the decision that the tax preparer makes for federal depreciation purposes.

Acme Call Centers has a state-of-the-art facility in Hays, Kansas. Acme purchases $500,000 worth of new furniture to expand its call center. The CFO of Acme knows that furniture is classified as a 7-year form of property for federal depreciation purposes. She decides to use the 200% Declining Balance depreciation method (employing the half-year convention).

Acme Call Centers' Federal Depreciation Deduction Schedule								
Year	1	2	3	4	5	6	7	8
Dollars	71,450	122,450	87,450	62,450	44,650	44,600	44,650	22,300

- Kansas expensing amount if there were no federal depreciation rules: $500,000
- Kansas expensing amount under the proposal: $500,000 x 0.151 = $75,500.

The proposal would provide Acme an additional $75,500 income tax deduction—in Year 1 only. That amount captures the time value of money difference between the federal depreciation schedule and the full expensing amount of $500,000.

Where did the 0.151 number come from? Based on the implementation plan, it is a number that will be published as part of the law or published by the Kansas Department of Revenue. A Kansas Adjustment Factor will be published to correspond to each type of property classification and depreciation procedure (which will result in a table that easily fits on one page).

The actual number derives from taking the difference between the investment amount ($500,000, in this case) and the discounted present value of the federal depreciation schedule (years 2-8) using an interest rate of eight percent (5%). Mathematically, the adjustment factor of 0.151 remains invariant for any investment in 7-year property that a taxpayer depreciates using the 200% Declining Balance method under the half-year convention.

The same procedure used in the Acme Call Centers example would apply for any investment made in Kansas. Different adjustment factors would apply to the several different combinations of property classifications and depreciation methods available to taxpayers under the federal tax rules.

Derivation of the Kansas Adjustment Factor for the Acme Example

The property has a 7-year classification, but the schedule actually has 8 installments.

Present Value of Federal Depreciation Schedule (at 5% rate of interest, Year 1 not discounted):

$$424{,}500 = \frac{71{,}450}{(1.0)^1} + \frac{122{,}450}{(1.05)^2} + \frac{87{,}450}{(1.05)^3} + \frac{62{,}450}{(1.05)^4} + \frac{44{,}650}{(1.05)^5} + \frac{44{,}600}{(1.05)^6} + \frac{44{,}650}{(1.05)^7} + \frac{22{,}300}{(1.05)^8}$$

Difference between Full Investment Amount and Present Value:
$500,000 – $424,500 = $75,500

Calculation of Kansas Adjustment Factor (Invariant to Investment Size):
$75,500 ÷ $500,000 = 0.151

<u>Adjustment Procedures Related to Federal Rules for Accelerated ("Bonus") Depreciation</u>

- The implementation goal of the proposal is to allow Kansas expensing to "flex" with changes in federal law to maintain the Kansas policy goal stated above.
- Two categories of federal law interact with each other and the Kansas proposal: Section 179 of the IRS code and bonus depreciation.
- The following example uses the law as embodied in the Small Business and Jobs Act (Sept. 27, 2010)—and extrapolates to the federal expensing provision expected to be law for 2012:
    - Section 179 ("small business" expensing). In tax years 2010 and 2011, companies can expense up to $500,000 of qualifying property, as long as the purchase price does not exceed $2 million. For every dollar a price tag exceeds $2 million, the allowable expensing amount drops by one dollar. So, an investment of $2.5 million and over may not expense under Section 179. (These threshold amounts are likely to drop after 2011.)

- For 2010, qualifying investments can take so-called "bonus depreciation." The rules for 2010 allow for 50% bonus depreciation. The bonus depreciation rules can be combined with Section 179 rules. (New federal law for 2011 will likely allow 100% rather than 50% bonus depreciation.)

The table below shows the general formula for Kansas expensing proposal as it interacts with the two federal procedures (assuming the same property classification characteristics as the Acme example, but different investment outlays).

Investment Amount	Allowable Sec. 179 Expensing	Allowable Bonus 50% Depreciation	Brownback Expensing Expensing Formula with 50% Bonus Depreciation
500,000	500,000	0	500,000 x 0.151 = 75,500
2,000,000	500,000	750,000	(2,000,000 - 750,000) x 0.151 = 188,750
2,500,000	0	1,250,000	(2,500,000 - 1,250,000) x 0.151 = 188,750
5,000,000	0	2,500,000	(5,000,000 - 2,500,000) x 0.151 = 377,500

- The Kansas proposal makes no adjustment for Section 179, but does make an adjustment for bonus depreciation rules.
- With 50% bonus depreciation, Kansas would still offer value to the investor greater than what the federal rules allow: the stated policy goal of providing the economic value of 100% accelerated depreciation.
- With federal 100% bonus depreciation (as is expected for the tax year 2011 only), Kansas expensing would be eliminated for investments too large for Section 179 rules (per the policy intent) but would automatically renew when the federal rules expire or revert.

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Supporting Regional Economic Development through Analysis and Education

Expensing: A Competitive Leap for Kansas Tax Policy

By Arthur P. Hall, Executive Director, Center for Applied Economics.

Kansas is on a roll when it comes to good tax policy. One simple, inexpensive step can sustain the momentum and produce a competitive leap in terms of bang for the buck: Permit all businesses to take an immediate income tax write-off for new investments made in Kansas. This step—called "expensing"—would complement the recent competitive reforms related to property and franchise taxation—and further distinguish Kansas as a go-to destination for capital investment, a key driver of high-wage jobs. As a bonus, expensing would make taxes fairer, because it results in equal tax treatment among businesses of all types and sizes.

The existence of an income tax makes the Kansas government a *de facto* silent partner in every Kansas business. In light of this partnership, the appropriate tax policy question is this: Does the government want to act like a partner that invests in the business or a partner that draws cash out of the business whenever possible?

Kansas income tax law, because it operates as an extension of U.S. income tax law, makes the Kansas government act like a cash-hungry partner rather than an investment-driven partner. Expensing would reverse the situation and turn the government into an investment-driven partner—for the economic benefit of all Kansans.

Economic Fundamentals

Well-constructed tax policy does not interfere with taxpayers' decision-making calculations. Economists refer to this outcome as "tax neutrality." It represents a challenging goal for policymakers to attain. Most tax instruments influence economic decision-making.

Fortunately, policymakers can attain the goal of tax neutrality with regard to the income tax treatment of saving and investment. Unfortunately, most income tax systems in the U.S. do not attain this worthy goal. Instead, they create an inherent tax bias against saving and investment. No one intended this destructive outcome. It is a historical artifact that has endured from the economically misinformed structure of the first income tax laws.[1]

In the modern-day economy, saving and investment represent the same thing from different perspectives. Virtually all saving becomes an investment somewhere in the world. Few people—in developed economies, at least—store cash under their mattress. Saved funds tend to flow to where they earn the highest (risk-adjusted) rate of return.

From a business perspective, the income tax bias against investment is embedded in the (frequently arcane) rules associated with capital cost recovery—that is, the rules associated with the depreciation of capital investments. Expensing is a little used depreciation procedure (sometime called cash-flow depreciation) that removes the tax bias—and greatly simplifies income tax administration for both the taxpayer and the tax authorities.

The Bias of Double Taxation

The income tax bias against saving and investment results from an inherent double counting—and, therefore, double taxation—that results from an economically flawed definition of taxable income. To grasp the mechanics of this double counting, focus on the equal sign in the present value formula shown in *Exhibit 1*. This formula is a foundational

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element of finance. It indicates that the economic value of an investment can be represented in one of two equivalent ways—as a point-in-time value (*PV*) or as a flow-through-time value (*CFs*). The formula is embedded in financial calculators for analyzing investments, pricing financial products, or calculating loan payments.

Exhibit 1: The Present Value Formula

The Foundation of Investment Analysis

$$PV = \frac{CF_1}{(1+r)^1} + \frac{CF_2}{(1+r)^2} + \frac{CF_3}{(1+r)^3} + \frac{CF_4}{(1+r)^4} + \frac{CF_5}{(1+r)^5}$$

- The formula above depicts a 5-year investment. A 30-year investment would have 30 elements on the right-hand side of the formula.
- *PV* stands for "present value." It represents the market value (or perhaps purchase price) of an investment, regardless of whether the investment is a machine, a building, a stock, or a bond.
- *CF* stands for "cash flow." It represents the cash flow that an investment generates, like profits, dividends, interest, rent payments, or capital gains. Normally, investments are valued using free cash flow, the cash flow available to the investment owner after all investment-related costs have been paid, including taxes.
- *r* stands for the "discount rate," which is often the interest rate or the expected rate of return on an alternative investment. The quantity (1+*r*) is raised to a power that represents time. A fundamental tenet of finance is that a dollar received immediately is more valuable than a dollar received in the future. Thus, future cash flows are "discounted."
- Two basic types of investment analysis flow from the above equation: First, **net present value** equals *PV* (with an assigned value for *r*) minus the cost of an investment; if the result is positive, the investment will be evaluated positively. Second, **internal rate of return** equals the value of *r* that equates the estimated values of *CF* with the known (or estimated) cost of an investment. Investors typically want to make investments with the highest internal rate of return.

The mathematical equality represented by the present value formula means that double counting occurs when money represented on both sides of the equal sign counts as taxable income. The same economic value is taxed twice: double taxation. Taxing money represented by the left-hand side of the formula (the money paid for an investment) effectively means that the tax authority is pre-taxing money represented by the right-hand side of the equation (the money generated by the investment). Alternatively, taxing the money represented on right-hand side of the equation is effectively a deferral of taxation on the money represented by the left-hand side.

An example related to retirement saving will help make the double tax problem clearer, because U.S. income tax law has eliminated the problem for personal retirement investments, when channeled through approved procedures. In the United States, people typically save for retirement using individual retirement accounts (IRAs) and employer-sponsored retirement plans, like 401(k)s. Generally, people have a choice between two types of IRAs—traditional IRAs or Roth IRAs (named after the late U.S. Senator, William V. Roth). Both types of IRAs solve the double tax problem but in different ways (401(k)s solve the problem the way traditional IRAs do).

Suppose someone wanted to save for retirement by investing in a bond (or a mutual fund that offered the bond). Using the 5-year present value formula in *Exhibit 1*, if the interest rate is eight percent (8%) and the bond promised to pay \$1,000 at the end of each year, one bond would cost almost \$4,000. The money to make the investment came from salary or small business earnings, which is subject to income tax. A traditional IRA allows the saver to immediately write-off the \$4,000, eliminating tax on the left-hand side of the present value formula; the \$1,000 interest payments on the right-hand side will be taxed later. A Roth IRA does not allow for an immediate write-off, so it taxes the \$4,000 on the left-hand side of the present value formula; but the \$1,000 interest payment will never be subject to income tax. A person that buys the bond without using approved retirement saving procedures must pay income tax on the \$4,000 and the \$1,000 payments—a double tax on money used for saving.

Expensing operates just like a traditional IRA—for businesses. Expensing eliminates the double taxation of business investment by allowing for an immediate income tax

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write-off of the money used for investment.[2] A business investment and the bond investment example described above have the same finance fundamentals. Of course, there are practical differences. The pay-off provisions of a bond are set by contract. The pay-off provisions of a business investment are risky and uncertain; businesspeople must estimate them based on experience and expectations.

Expensing Removes Tax Bias: A Simple Example

The force of habit creates perhaps the biggest obstacle to acknowledging the bias of double taxation. The common way people think about the idea of income—encoded into the income tax laws a century ago—forces them to see IRAs and expensing as a grant of privilege rather than a liberation from penalty.

A different type of example further reveals the penalty-removal perspective of expensing. *Table 1* illustrates the cash flow of a hypothetical $100,000 investment using two different income tax rules for capital cost recovery—straight-line depreciation and expensing. The example assumes that the investment will generate $30,000 of free cash flow (pre-tax income) per year for five years. The income tax rate is seven percent (7%). *Table 1* also reports the rate of return on the investment—the internal rate of return, calculated using the present value formula in *Exhibit 1*—based on the different rules.

Table 1
The Tax Implications of Depreciation versus Expensing

		Straight-Line Depreciation		Expensing	
	No Tax	Tax Owed	After Tax	Tax Owed	After Tax
Investment	-100,000	0	-100,000	-7,000	-93,000
CF 1	30,000	700	29,300	2,100	27,900
CF 2	30,000	700	29,300	2,100	27,900
CF 3	30,000	700	29,300	2,100	27,900
CF 4	30,000	700	29,300	2,100	27,900
CF 5	30,000	700	29,300	2,100	27,900
Rate of Return	15.24%		14.24%		15.24%

Note the different rates of return reported in *Table 1*. This result captures the essence of the tax bias that results from current income tax rules. The straight-line depreciation rule results in a rate of return one percentage point lower than the no-tax and expensing scenarios. This differential measures the penalty (double tax) on investment. The expensing rule generates a rate of return equal to the no-tax scenario; it generates income tax revenue for the government but attains tax neutrality. (An investment tax credit equal to seven percent (7%) has economic properties identical to the expensing scenario.)

The expensing rule—full tax write-off of the investment in the year in which the business makes it—attains tax neutrality because it does not tax the quantity on the left-hand side of the equal sign defining the present value formula. The straight-line depreciation rule (or any other depreciation rule that has guided U.S. income tax policy) permits taxation on both sides of the present value formula.

Expensing expresses a policy consistent with a government that wants to behave as an investment-driven silent partner. Depreciation expresses a policy consistent with a government that wants to behave as a cash-hungry silent partner. (Note that the government's tax stream under the expensing scenario generates a 15.24 percent rate of return, a rate identical to the taxpayer's, indicating a genuine partnership.)

Table 1 illustrates this viewpoint in the "Investment" line. The economic value of any income tax write-off is the write-off amount times the tax rate ($100,000 x 7% = $7,000)—the government's participation in the investment. By not taxing the investment amount—that is, by effectively reducing the after-tax cost of the investment in a manner consistent with the taxation of future income—the expensing rule preserves the no-tax pattern of costs and benefits. The depreciation rule, even though it results in a lower annual tax liability, only crudely approximates the pattern of costs and benefits.

As a practical matter, the economic elegance of the expensing rule holds only if the taxpayer can realize the full benefit of the write-off in the investment year. Under standard administrative procedures related to deductions, this outcome will not prevail if the taxpayer has an insufficient level of taxable income in the investment year. However, in a real-world scenario of uncertain cash flows and graduated tax rates, providing for an unlimited carry-forward of unused deduction amounts offers a sound administrative solution.

A Note on "Tax Expenditures"

Stanley S. Surrey, a U.S. Treasury official, coined the term "tax expenditure" in the 1960s. He wanted to draw attention to the many elements of the U.S. tax code that simulated spending programs by reducing tax liabilities in exchange for engaging in specified economic activities. The Kansas Department of Revenue produces an annual report on Kansas tax expenditures.

The concept of tax expenditure is useful, but it can be misapplied. Many tax expenditure items in the income tax code manifest themselves as items that pervert the tax base from what people believe to be the proper definition of a comprehensive income tax base. The problem comes when people define as a tax expenditure (special tax preference) policy steps that correct the economically flawed concept of income built into the traditional definition of a comprehensive income tax base. For example, many tax analysts view the deductions allowed for contributions to individual retirement accounts as tax expenditures; but they actually represent the correct income tax treatment of saving. Likewise, many analysts will put the label of tax expenditure on expensing, because it deviates from the historical practices of capital cost recovery (see Appendix); but expensing (or economically equivalent tax credits) represent the correct income tax treatment of capital investment.

Here is an example relevant to Kansas. Kansas law grants a 10 percent investment tax credit to qualifying business taxpayers. The Kansas Department of Revenue identifies this credit as a tax expenditure. However, this identification is only partially correct.

Removal of a penalty should not count as a privilege. The expensing procedure eliminates a penalty—the inherent double tax on capital investment. The top corporate tax rate in Kansas is 7.35 percent (the top partnership and S-Corporation rate is 6.45 percent). The value of a deduction is equal to the tax rate times the deduction, so expensing is economically equivalent to a tax credit rate equal to a taxpayer's marginal tax rate. Accordingly, the tax expenditure component of the Kansas investment tax credit equals 2.65 percent of the investment for corporations (3.55 percent for partnerships and S-Corporations) not the full 10 percent.

Appendix: A Brief History of Tax-Related Depreciation Accounting[3]

People have understood the income tax bias against saving and investment for a long time. They have also understood how certain capital cost recovery procedures (depreciation rules) can either exacerbate or mitigate the bias. That the problem has endured for decades in light of this understanding offers a case study in how difficult it is to change complex administrative systems once they begin.

The tax-bias problem started largely as a result of historical accident, inexperience-based ignorance, and intellectual fashion at the time lawmakers codified the U.S. income tax. Kansas inherited the problem when it adopted the income tax in 1933. The federal system had functioned for about 20 years by then. Like most states, Kansas piggybacked (and continues to piggyback) on federal law.

Depreciation accounting, as a business practice, was not widespread before the implementation of the income tax. The advent of the income tax, which embraced the practice, helped codify it and accelerate its acceptance. This history helps explain why business people largely accepted the procedures promulgated by the Bureau of Internal Revenue (now the Internal Revenue Service) without giving much thought to the economic consequences of their actions. The income tax had operated for several decades before savvy business managers began to keep at least two sets of books—one for the tax authorities and one for business decision-making.[4]

Depreciation accounting generated a lot of controversy among accountants during the latter half of the 19th century. The theory and practice began developing in the 1830s with the advent of capital-intensive industry—particularly railroads and public utilities. In general, the controversy pitted those practitioners committed to the age-old practice of realization (booking income or expenditures when validated by an actual transaction) against those that wanted to reckoned depreciation (wear and tear) as a bookkeeping operation. From the viewpoint of income tax administration, the tax bias against business investment might have not materialized if the realization side had prevailed.

The controversy over depreciation accounting generated a few lawsuits that made it to the Supreme Court. The Court decisions generally reflected the state of professional opinion at the time the cases were heard. The Court rejected the concept of depreciation accounting in cases heard in 1876 and 1878; opined that the concept deserved consideration in a case heard in 1899; and acknowledged the concept in a case heard in 1909. Somewhat coincidently, in the same year, the concept became codified into U.S. tax law with the Corporation Tax Act of 1909—the same year

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that Congress submitted to the states for ratification the 16th Amendment to the Constitution (which authorized an income tax).

Depreciation accounting became a feature of the Tariff Act of 1913—essentially, the beginning of the income tax in the United States. The Revenue Act of 1918 specifically stipulated, for the first time, that certain compliance procedures—depreciation accounting among them—must harmonize with generally accepted accounting procedures.

The authors of a 1989 U.S. Treasury study titled "A History of Federal Tax Depreciation Policy" nicely set up the relevance of accounting protocols for the economics of investment:

> Depreciation controversies have most often centered on the suitability of depreciable lives [of tangible assets] and methods used by taxpayers. . . . Originally, taxpayers were given considerable discretion in the choice of depreciable lives, asset salvage values, and depreciation accounting methods. However, this policy ultimately placed a costly burden on the Bureau of Internal Revenue and taxpayers to verify the "reasonableness" of the deductions taken. Over time, administrative and statutory changes lessened this burden by creating more uniform depreciation rules. Today, most property is depreciated using a small number of recovery periods established by statute; salvage value is no longer a factor in the determination of depreciation deductions for most property; and the method of allocating deductions over recovery periods is prescribed by statute. Consequently, taxpayer discretion with respect to tax depreciation has been virtually eliminated.[5]

The creation of pre-defined rules and timetables may have reduced compliance costs, but they created economic distortions. It undermined the fundamental precepts of depreciation accounting, which sought to accurately match the time flow of wear and tear with income generation. The arbitrary timetables altered the economic analysis of cash flows. Expensing (sometimes referred to as cash-flow depreciation) represented a viable alternative that promised even greater administrative simplification without the economic distortions.

The federal government's demand for tax revenue perhaps best explains the motive responsible for codifying pre-defined timetables—and promulgating the notion that expensing (or other accelerated depreciation methods) represented a tax preference rather than economically superior tax policy. Making depreciation timetables longer, under the rationale of better matching the "useful lives" of capital investments—created a larger business income tax base in the short run. The bias toward long depreciable lives became further entrenched when adherence to the pre-defined timetables became a regular feature of income tax audits. The burden of proof shifted to the taxpayer to demonstrate why a particular capital asset did not fit into the prescribed timetable. Disparities in administration—given auditor discretion—exacerbated the tax-bias problems.

By the mid-1950s, a growing number of tax scholars, business people, and lawmakers began to recognize the economic problems with the existing tax depreciation methods.[6] (Marginal tax rates of more than 50 percent made the problems much worse.) The legislative tendency was to grant businesses more operational latitude and faster depreciation methods. The Internal Revenue Code of 1954—the first major re-write of the income tax code—explicitly allowed for accelerated depreciation methods. The record shows that lawmakers consciously intended for the 1954 changes to improve the economics of investment.

Many sophisticated commentators began to argue that it made no sense to keep the timetable depreciation methods in place. Accelerated depreciation methods simply represented administratively complex measures to mitigate the negative economics of an anachronistic (and mistaken) set of rules. Expensing—100 percent acceleration of depreciation—offered the best economics (and the simplest administration). Economist Vernon L. Smith, native son of Wichita, Kansas and 2002 Nobel Laureate in Economics, argued in a scholarly journal in 1963:

> The common practice is to permit capital costs to be written off or depreciated over time in accordance with some specified set of tax depreciation rules. We will show that this practice leads to bias in the form of investment decision rules different from those prevailing in the absence of a tax, that the bias is likely in the direction of delaying optimal investment timing, and that such biases can be

removed by expensing investment outlays in the computation of taxable income. . . .Our analysis suggests that the write-offs should be fully accelerated, not to give anyone an advantage, but to eliminate an existing disadvantage in the sense that investment decision rules are distorted.[7]

Yet lawmakers have never taken this compelling step. The system has remained wedded to depreciation timetables that will always produces some degree of distortion because of the inherent double tax on investment. The year before Smith published the findings quoted above, the Kennedy Administration enacted the first of a seemingly never-ending set of income tax reforms that have created complexity, uncertainty, and often self-contradictory policies related to investment.

The Revenue Act of 1962 liberalized depreciation rules and enacted the first-ever investment tax credit. The Tax Reform Act of 1969 sought to improve the economics of the depreciation rules on the one hand yet on the other hand further enshrined accelerated depreciation as a tax preference in the context of the Alternative Minimum Tax. The Tax Reform Act of 1981 enacted an entirely new set of accelerated depreciation measures, which were modified in 1982 and 1984. The Tax Reform Act of 1986 (such a significant set of reforms that it created the Internal Revenue Code of 1986) modified depreciation rules yet again and terminated the ever-varying investment tax credit. Depreciation issues surfaced again as a policy concern around 2000.[8] The only change to result from this concern was "bonus depreciation," enacted in 2002.

Throughout history, expensing as a universally applicable cost recovery procedure has arisen as a logically consistent alternative only in the context of radical tax reform. There is one *ad hoc* exception—the (capped and limited) expensing provisions for small businesses embodied in Section 179 of the Internal Revenue Code. Kansas law conforms to Section 179.

Endnotes

1 For a detailed discussion of the issues involved, see Arthur P. Hall, "Competing Concepts of Income and the Double Taxation of Saving," Technical Report 05-0926, Center for Applied Economics, School of Business, University of Kansas, September 2005. Available at: http://cae.business.ku.edu

2 A responsible discussion of expensing must address the issue of the prevailing income tax deduction for interest expense. Under a debt-finance scenario, using the present value formula approach, one can see that the money used for investment does not derive from (potentially) taxed earnings. The interest deductions that come later reduce the level of taxable cash flow generated by the investment. However, the interest deduction argument does not address the inherent double tax problem. Additionally, tax analysts have always known that the interest deduction creates a bias toward debt finance rather than equity finance.

3 This section draws liberally from: David W. Brazell, Lowell Dworin, and Michael Walsh, "A History of Federal Tax Depreciation Policy," OTA Paper 64, Office of Tax Analysis, U.S. Treasury Department, May 1989. Available at: http://www.treasury.gov/offices/tax-policy/library/ota64.pdf

4 Joel Dean, "Four Ways to Write Off Capital Investment: Management Should Have a Wider Tax Choice," *The Journal of Business*, Vol. 29 (2), April 1956, pp. 79-89.

5 Brazell, *supra* note 3, pp. 1-2.

6 Dean, *supra* note 4; Robert R. Milroy, Donald F. Istvan, and Ray M. Powell, "The Tax Depreciation Muddle," *The Accounting Review*, Vol. 36(4), October 1961, pp. 539-547.

7 Vernon L. Smith, "Tax Depreciation Policy and Investment Theory," *International Review of Economics*, Vol. 4(1), January 1963, pp. 81 & 91.

8 C. Eugene Steuerle, "Is it Time to Rationalize Depreciation Policy?" *Tax Notes*, August 20, 2001, p. 11109. Available at: http://taxpolicycenter.org/publications/template.cfm?PubID=9701

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Testimony of Kansas, Inc.
House Taxation Committee
Expensing and IMPACT Legislation

My name is Stan Ahlerich, currently serving as President of Kansas, Inc. and I am speaking in support of this legislative initiative.

Kansas, Inc. by statute is tasked with developing a statewide strategic plan. We developed such a plan over a year long process in 2007. As a part of that planning process we held 19 meetings geographically dispersed over the state with business men and women that represented companies of all sizes. Consistently we heard that there was a feeling that there was a real disparity between what a few large companies receive in the way of tax credits or exemptions and what the small to medium sized businesses received.

Out of those meetings a central theme arose from our strategic plan, as a state wide policy-"every business matters" not just a few. Building on that belief, the plan suggested that a new way of looking at economic development should be to get the state out of the business of picking winners and losers and instead provide an "environment" where all businesses could have a fair and equal opportunity to place their capital, both dollars and human, in our state.

The Governor's economic growth plan embraces many of the thoughts learned through our strategic planning process and even builds on them to a greater degree. The administration's initiative toward building an environment where every business matters is comprehensive by design. In the past, the state's economic development model and initiatives have be done in a piece meal approach and segregated, not a criticism but factual.

An environment that is conducive to fostering business expansion and attraction must address several aspects. Two key aspects are capital and human resources.

With the expensing initiative, this specifically addresses the attraction of capital to our state and for companies within the state to place their treasures here.

Previous innovative legislation such as the PEAK statute has provided an avenue to help businesses with the human resource component.

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February 16, 2011

KSCPA Kansas Society of CPAs

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HB 2317
Testimony Before the House Committee on Taxation
Gary C. Allerheiligen, CPA, Immediate Past President

Chairman Carlson and Members of the Committee:

I am Gary Allerheiligen, Immediate Past President of the Kansas Society of CPA's (KSCPA). We have 2,600 members in the state of Kansas in public accounting, business, industry, government, and education.

We are here today to offer our expertise in answering questions of the committee about how HB2317 might impact the businesses CPAs serve. Our leadership reviewed the proposed legislation and met by conference call. After much discussion, the position of the KSCPA leadership on this bill is currently neutral.

Our concerns with the proposed legislation includes:

1. The potential complexity of implementing the expensing provision.
2. The combination of the change in the HPIP credit and the expensing provision in the same legislation.
3. The substantial jump from $50,000 to $5 million investment to receive the HPIP credit, even with a 2-year "pipeline."
4. The discontinuation of the Business & Jobs Development Credit will negatively impact small businesses.

Our recommendations are:

1. Reduce the HPIP threshold and use a tiered approach to phasing in this change.
2. Classify any unused expense not taken in the current year as a Net Operating Loss carry forward rather than as a deduction, which would reduce some of the complexity.
3. New Section 2 should clarify how schedule f tables will be applied in the event the section 179 election has been made.

. Thank you for your time and I will be happy to answer any questions.

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Salina
Area Chamber of Commerce
120 W. Ash, P.O. Box 586 • Salina, KS 67402-0586 • 785-827-9301 • fx 785-827-9758 • www.salinakansas.org

House Tax Committee Testimony re: HB 2317
February 16, 2011

Chairman Carlson and members of the Kansas House Tax Committee, I am Dennis Lauver, President & CEO of the Salina Area Chamber of Commerce.

I provided detailed information about the HB 2317 and its provisions to a number of Salina area employers.

Here is a summary of the five general responses I received:

1. **The HPIP program is effective and is valued**. *A move to simplify the program is welcome. However, the other proposed changes will reduce its utility.*

- A 1,000 employee manufacturer headquartered in Salina with a global customer based observed they have used the HPIP credit for many years to allow them to continue to invest in their multiple Kansas manufacturing facilities. If they do not make their products more efficiently each year, they run the risk of losing out to an increasing overseas competition. Raising the threshold from $50,000 to $5,000,000 will effectively eliminate this tool for them and many Kansas businesses. They told me "If you truly believe that our best growth is going to be from existing business then the threshold needs to allow existing Kansas medium and small business a chance to participate in the credit. We cannot imagine that many Salina employers will be able to use HPIP at the new proposed investment level. We understand that money must come from somewhere, but perhaps there is a more moderate middle ground that still recognizes the need to encourage growth." Instead of increasing the threshold 100 times, perhaps a more 10 times increase is appropriate.

- A Salina firm has used HPIP to expand and help increase employment from 30 to 140 people. The new HPIP proposal advocates a five million dollar expansion minimum. Only one of recent expansions would have qualified at that level because they expanded in several smaller additions and machinery acquisitions. 100 percent of the $1,700,000 dollars of Kansas Income tax saved by the firm thru HPIP was put on their shop floor. The owner said "I cannot stress enough how important this program is to us and my sincere appreciation to the State of Kansas for implementing this program *in its current condition*. We have expanded from one industrial laser to twelve, the cost of each ranging from $500,000 to $1,200,000, we have added 210,000 sq foot of warehouse and manufacturing space from approximately 40,000 sq foot."

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- One business owner (135 employees) observed that "if this change encourages existing business to re-invest in itself and/or new businesses to look at Kansas as a 'friendly' then I would support it. However if it can result in larger companies that tend to reinvest at much higher levels to leverage it into an advantage over smaller competitors I would not support it. Suffice to say, this change would need to assure a level playing field for all companies it would serve. I don't think it will influence small businesses in their decision to come to Kansas. It may affect the large corporations

Overall, I think there is a positive intent to the bill. However, I'm concerned enough about unintended consequences, that I encourage some additional changes. Therefore, at this point, we are neutral on the bill...*and I'm really anxious to be in a position where we can aggressively support HB 2317.*

General observations about tax policy and economic development

I lifted the following directly from a Fox News story earlier this week. I think it is relevant to this discussion.

It's recently become an article of faith for many governors as they try to attract jobs: raising taxes during a recession is a nonstarter, choking off growth and damaging a state's fragile economic

But there's a catch to the anti-tax, pro-business rhetoric: Businesses consider a range of factors when deciding where to locate, including the quality of schools, roads and programs that rely on a certain level of public spending and regulation. And evidence suggests there is little correlation between a state's tax rate and its overall economic health.

"Concerns about taxes are overstated," said Matt Murray, a professor of economics at the University of Tennessee who studies state finance. "Labor costs, K-12 education and infrastructure availability are all part of a good business climate. And you can't have those without some degree of taxation."

States' tax rates also do not predict their resilience during an economic downturn. While high-tax states such as New York, New Jersey and California have been clobbered by the current recession, so too have states that pride themselves on low tax rates, including Nevada, Texas and Arizona.

TESTIMONY OF CBIZ
HOUSE COMMITTEE ON TAXATION
OPPOSITION TO HB #2317
FEBRUARY 16, 2011

Mr. Chairman and members of the Committee on Taxation. My name is Betty Nelson-Ekey representing CBIZ and the numerous Kansas businesses our firm supports. CBIZ is a professional services company, providing a comprehensive range of business services to our clients. I am the Managing Director of the Tax Incentives Group in CBIZ's State and Local Tax Practice. I stand before you today in opposition to House Bill #2317 because it would sunset the High Performance Incentive Program (HPIP), which includes the 10% investment credit and sales tax exemption, in 5-years while raising the investment threshold to $5,000,000. Currently 322 companies in 54 counties, which is over half of the Kansas counties, participate in the HPIP program and with the proposed legislation, only 10% of these companies will continue to qualify for the investment tax credit. By raising the investment threshold to 100 times its current level, the Governor is preventing small to mid-sized companies from qualifying for the program's investment credit.

CBIZ participates in several Kansas tax incentive programs that we view as essential to our business. In July 2003, CBIZ moved approximately 540 employees to Kansas from out of state. The sole and decisive factor in relocating to Kansas was the tax incentives that the state offered, which included HPIP, the Business and Job Credit, sales tax exemption, and the IMPACT program. Without the presence of these tax incentives, our relocation to Kansas from out of state **would not have happened**. As a service-oriented company with highly-paid employees, the proposed expensing plan and subsequent repeal of HPIP and other tax programs will have a markedly unfavorable impact on our business. I submit the attached exhibit as evidence of the adverse effect of the proposed expensing plan.

My opposition to this bill extends beyond the interests of my own company. As a consultant in the field of Tax Incentives, I am truly concerned about the disadvantage the proposed elimination of these beneficial programs will have on the economic growth and development of the state of Kansas. The elimination of HPIP as well as the other credit programs will place Kansas at a substantial disadvantage when attempting to recruit and retain businesses. Economic Developers and representatives from the surrounding states have already communicated to me their view of Kansas' proposed legislation as a windfall to their own states' economic prosperity. Without the persuasive influence of HPIP and sales tax exemptions, states

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such as Missouri and Oklahoma can offer comparably far more lucrative incentives to businesses.

As a recruitment tool, the proposed expensing plan lacks viability. The expensing program merely accelerates the timing of an existing deduction. There is no parallel in replacing the elimination of a tax liability with a deduction. Any potential financial benefit of the expensing plan will be difficult to quantify on a proposal to a prospective business. The regard for the plan as a true incentive is further diminished by offering the program to all business sectors, including retail. For instance, I pose the question: why should a small manufacturer or software developer that (1) pays higher than average wages; (2) generates greater than 50% of revenue from out of state; and (3) extensively trains their workforce, not receive a greater incentive than the Kentucky Fried Chicken or liquor store that is purchasing equipment?

I would suggest that if HPIP must be phased out, then existing companies who have previously been HPIP certified as well as those companies that have been offered HPIP as part of their formal incentive proposal from the state be allowed to retain the current $50,000 investment threshold throughout the duration of the phase out period.

I would strongly urge you to defeat this legislation.

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Exhibit as part of the Testimony of Betty Nelson-Ekey

Kansas Proposed Legislation
Current Incentives vs Expensing Comparison

	Machinery & Equipment			Building	
Investment in:					
Machinery & Equipment	1,000,000			-	
Building	-			3,000,000	
Current Incentives:					
HPIP Tax Credit	95,000			295,000	
Sales Tax Exemption	83,000			-	
Total Current Incentives	178,000			295,000	
Benefit of Expensing:					
Assumptions:					
Interest Rate	5.0%			8.0%	
Depreciable Life - M&E	7	MACRS + 50% Bonus			
Depreciable life - Building				39.5	Years Straight Line
	Corporate	Individual		Corporate	Individual
Kansas Tax Rate	7.00%	6.45%		7.00%	6.45%
Machinery & Equipment:					
Current Deduction Tax Benefit	70,000	64,500		-	-
Present Value of Depreciation Tax Benefit with MACRS / 50% Bonus	(65,953)	(60,771)		-	-
Value of Expensing M&E	4,047	3,729		-	-
As a % of Investment	0.40%	0.37%		0.0%	0.0%
Building:					
Current Deduction Tax Benefit	-	-		-	-
Present Value of Depreciation Tax Benefit	-	-		-	-
Value of Expensing Building	-	-		-	-
As a % of Investment	0.0%	0.0%		0.0%	0.0%
Value of Expensing	6,041	5,566			
Cost of Proposed Legislation	(173,953)	(174,271)		(295,000)	(295,000)

Note: Assumes taxpayer can currently utilize credits and deductions.
Federal legislation passed 12/17/10 provides for 100% expensing for 2011.

TESTIMONY OF ASSOCIATED WHOLESALE GROCERS, INC
HOUSE COMMITTEE ON TAXATION
OPPOSITION TO HB #2317
FEBRUARY 16, 2011

Mr. Chairman and members of the Committee. My name is Sheila Lenson representing Associated Wholesale Grocers, Inc (AWG). AWG is the second-largest retailer-owned grocery wholesaler in the United States. AWG and its subsidiaries provide over 1,900 retail member stores in 24 states with a complete assortment of grocery products and general merchandise items and produces the *Best Choice* and *Always Save* brands of grocery products. We submit this written testimony to you in opposition to House Bill #2317 because in 5 years, it eliminates the High Performance Incentive Program (HPIP), which includes the sales tax exemption, while immediately increasing the investment credit threshold from $50,000 to $5,000,000.

AWG has been HPIP certified since 2002 and greatly relies on the benefits the HPIP program offers our company. Through the HPIP program, our company earns a sales tax exemption and we utilize these tax savings to invest in the continuous education and training of our workforce. We also invest the savings in efficiencies to improve our cooperative's operations in order to better serve our retailers. AWG supplies approximately 180 family-owned grocery stores throughout Kansas while employing nearly 1,100 employees. Even given the size of our company, we rarely make investments in excess of $5,000,000. In 2009, our investment was approximately $4.4 million. Therefore our company, along with 90% of the other currently HPIP certified companies, will be excluded from earning a tax credit during the sunset period of the HPIP Program.

We propose that the current programs be retained, specifically HPIP with its sales tax exemptions. If expensing is a fair equivalent to the current programs as the Governor suggests that it is, then high performing companies should be allowed to choose between the current programs or expensing. Our company will choose to continue with the HPIP program. The expensing program is based solely on capital investments and offers **no sales tax savings**. Furthermore, I would appeal to you that companies currently HPIP certified be allowed to retain the $50,000 investment threshold.

We would strongly urge you to defeat this legislation.

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