

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE

The meeting was called to order by Chairman Barbara Allen at 10:40 A.M. on February 25, 2008 in Room 519-S of the Capitol.

All members were present except:

Derek Schmidt- excused

Committee staff present:

Gordon Self, Office of Revisor of Statutes

Chris Courtwright, Kansas Legislative Research Department

Scott Wells, Office of Revisor of Statutes

Ryan Hoffman, Kansas Legislative Research Department

Judy Swanson, Committee Assistant

Conferees appearing before the committee:

Senator Chris Steineger

Karl Peterjohn, Kansas Taxpayers Network (Written only)

Dan Morgan, The Builders' Association (Written only)

Alan Cobb, Americans for Prosperity (Written only)

Whitney Damron, City of Topeka

Others attending:

See attached list.

Hearing on **SB 625–Sales tax exemption for materials and services purchased by contractor for the state capitol restoration project** was opened. Chris Courtwright, Kansas Legislative Research Department (KLRD) gave a brief overview of the bill.

Senator Chris Steineger explained why he requested introduction of **SB 625**. (Attachment 1) If the bill is enacted, the State of Kansas will save approximately \$8.6 million in spending over the next three years. In addition, SGF revenues will decrease approximately \$6.1 million, for a net gain to the state of approximately \$2.5 million. The state would not be paying \$2.5 million to local governments in sales tax. Senator Steineger said it would be good to consider exempting future state restoration projects, such as the Kansas Board of Regents projects. Topeka local government (City, Shawnee County, Washburn University) is the big loser if **SB 625** is enacted.

Written testimony in support of **SB 625** was received from:

Karl Peterjohn, Kansas Taxpayers Network (Attachment 2)

Dan Morgan, The Builders' Association (Attachment 3)

Alan Cobb, Americans for Prosperity (Attachment 4)

Whitney Damron, City of Topeka, opposed **SB 625**. (Attachment 5) The bill is a 180 degree change in state policy regarding the payment of local sales taxes on state building projects and is targeted only at the City of Topeka. It will have a significant impact upon the residents of the City and the County. Topeka is appreciative of the fact the state capitol is located in the City, but there are costs to providing services. Mr. Damron said the bill would be an unfair change in state policy designed to negatively impact only the City of Topeka, Washburn University and Shawnee County. Comprehensive hearings on this tax policy issue should be held that take into account all state projects, not simply one project in Topeka. Mr. Damron will provide the number of state employees living in Topeka or Shawnee County as requested by Senator Lee.

The hearing was closed.

A briefing on **SB 648–corporate income taxation changes relating to apportionment of net income, business income and surtax on corporations–was** held.

James Bartle, General Counsel, Kansas Department of Revenue (KDOR), explained a proposal to broaden the definition of “business income”. A Special Committee on Assessment and Taxation issued a recommendation to change the definition of business income to include both the functional and transactional tests. (Attachment 6) The reason for this recommendation was to make it possible to reduce the corporate

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income tax rate or provide some other form of tax relief. Codification of the functional test will bring Kansas into conformity with other states and prevent the under-inclusion and over-inclusion of income in computing the tax liabilities of corporations with operations in several states.

Mike Boekhaus, KDOR, gave examples of income taxes collected by Missouri and Kansas assuming business and non-business definitions are the same among states, as well as when they differ among states. (Attachment 7) When the definition of non-business income is different among states, the tax consequence for companies differs greatly.

Shirley Sicilian, General Counsel for the Multistate Tax Commission, said Kansas is the only state that uses only a “transactional test”. (Attachment 8) She explained how the expansion of the definition of “business income” would be beneficial to the state. She discussed the clarification that return of principal from investment of working capital is not included in the sales factor. This issue arises when a taxpayer is engaged in selling goods or services that generate large sums of excess cash on a short-term basis. The problem with a rule that includes the return of principal in the sales factor is that it distorts the apportionment of a taxpayer’s income. The magnitude of potential distortion can be huge, as shown by a recent California case involving Microsoft Corporation.

Joan Wagon, Secretary of KDOR, said when this issue arose, it was her goal to modernize Kansas corporate income tax. She said Kansas is way out of step with other states in the area of how business income is treated. In the past ten years, Kansas has lost more than 10,000 C corporations because of favorable tax treatment at the federal level. Secretary Wagon said **SB 648** would be revenue neutral. If enacted **SB 648** would include changing the qualification rule for HPIP to allow the entire unitary group to claim HPIP credit rather than only the company which actually earned the income. She said there is agreement between the business community and KDOR on the language in **SB 648**.

Secretary Wagon gave an update to analysis of Kansas corporate income tax dated October 14, 2004, to reflect tax year 2005 sample data. (Attachment 9) The recent revenue trend is very encouraging, but for tax year 2005 there is some disparity between the various industry sectors in the proportion of tax liability that is reduced or eliminated by tax credits through participating in business incentive tax credit programs. The manufacturing sector generated the largest portion of taxable income and corporate income tax receipts. The retail sector generated the next largest share. Out of the top 20 B&J credit claimants in tax year 2005, seven were in manufacturing and 13 in retail and other. Secretary Wagon concluded manufacturers continue to utilize the business tax credit programs heavily, and for tax year 2005, the manufacturing sector also generated the largest share of taxable income and corporate income tax receipts.

During discussion, Secretary Wagon said most companies would be affected by **SB 648**. In response to Senator Donovan, she said corporate income tax is on a downslope this year, but personal income is higher.

Senator Apple made a motion to approve the minutes of February 19, 20 and 21 Committee meetings. Senator Jordan seconded the motion, and the motion passed.

Senator Apple said he is working on an amendment re the proposed sales tax exemption for county fairs. County fairs organized under the 4-H and county extension statutes are currently sales tax exempt. He would like to see a fiscal note for sales tax exemption on ticket sales only for all county fairs. Richard Cram will work on a revised fiscal note for that exemption. Senator Apple said he thought a change to place all county fairs under the extension statute would be problematic.

Senator Donovan agreed to get language to Revisor Gordon Self concerning the sales tax exemption for the Guadalupe Clinic Wine Festival.

Being no further business, the meeting adjourned at 11:40 a.m. The next meeting will be February 26.