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House Committee on Taxation

Testimony in Support of HB 2212

by Michael Hale, For the Kansas Department of Revenue

Chairman Johnson and Members of the Committee:

HB 2212 amends the multi-state tax compact at K.S.A. 4301 to eliminate the Article Three election provision. This will inhibit taxpayers from using the compact provisions to supersede specific Kansas statutes within the Kansas income tax act. This amendment brings Kansas into alignment with nearly every state that has addressed the issue of whether it is proper to use the election under the compact rather than specific tax code provisions through either statutory amendment or litigation.

HB 2212 also updates "business income" under the compact to mirror K.S.A. 79-3271(a) enacted by the 2008 legislature.

Additionally, HB 2212 amends the definition of "sales" under the compact to mirror the definition of "sales" under 79-3271(h) and K.S.A. 79-3285as enacted by the 2008 legislature.

HB 2212 further limits allocable non-business income to the total non-business income received that is in excess of any related expenses that have been allowed as a deduction during the income year, which is how the income tax act limits allocable non-business income. This mirrors K.S.A. 79-3274.

These latter three amendments bring the current compact language into sync with their related provisions in the Kansas income tax act. These amendments correct the oversight of failing to amend the compact at the same time as the income tax provisions were amended.

The final amendments of HB 2212 bill clarify:

1) that the compact is merely supplemental to the Kansas income tax act;
2) that the compact is not an alternative method to allocate or apportion income or classifying income in a manner that is inconsistent with the Kansas income tax act;
3) any future amendments to the Kansas income tax act will be deemed to have repealed retroactively any conflicting provisions in the compact; and,
4) that any conflicts between the compact and the income tax act shall be resolved in favor of the income tax act.

The above sections operate prospectively only.

Last, new section 1 of HB 2212 prohibits the filing of an amended return claiming an election under article three of the compact, that treats sales in a manner that is inconsistent with K.S.A. 79-3271(h) and 79-3285, as amended by chapter 182 of the 2008 Session Laws of Kansas, or treats business income in a manner that is inconsistent with K.S.A. 79-3271(a), as amended by chapter 182 of the 2008 Session Laws of Kansas. This section simply clarifies that a taxpayer cannot take advantage of an act of omission when the income tax act was amended, but not the compact.

There should be little to no significant legal or fiscal effect with this bill as introduced.

There is no support for the idea that the legislature intended to lower the tax rates for business in 2008, while broadening the tax base under K.S.A. 79-3271(a), 79-3271(h) and 79-3285, while at the same time allowing the compact to be used as an alternative to avoid specific Kansas income tax act. This bill corrects prior oversights and precludes such an outcome. In reality, HB 2212 establishes the equilibrium that should have been in place all along.

After my presentation on February 4 to the committee, several of you asked if I could provide an example of what recycled or "churned" investment capital might look like, and why the 2008 legislature amended the income tax statutes at K.S.A. 79-3271(h) and 79-3285 to block inclusion of this type of activity from appearing in the sales factor. Below are two examples, one without "churned" overnight investment, and one with one year of "churned investment."

This is the first example from my January 29, 2019, presentation to you while walking you through the Repatriation and GILTI effect on Kansas corporate taxation. The sales and factors related to sales are highlighted for your convenience.

StevLesJim Corp.

2018 Income from Five Corporations in the Unitary Group	$12,000,000

	Property	Payroll	Sales
Kansas Only	$2,300,000	$900,000	$15,000,000
Unitary Group	$280,000,000	$283,000,000	$12,000,000,000

KS Property factor	0.00821	
KS Payroll Factor	0.00318	
KS Sales Factor	0.00125	
Total KS Factor	0.004214833	This is the percent that can be attributed to KS activity
KS Tax at 7% With Apportionment	$3,540	$12 million times .004214833 times 7%

So, assume that SteveLesJim have been investing idle funds to be used for a major corporate expansion in the next five years. Over the past five years, it has been able to set aside a total of $20,000,000 for that expansion. In 2018, they were able to move that $20,000,000 between banks in London, New York, Los Angeles, and Hong Kong. Transfers of this cash from institution to institution is done twice a day, every day for 365 days in 2018. The cash is transferred between banks via electronic transfer. We will assume a steady rate of 3% to keep the math simple.

$20,000,000 invested for a year at a simple interest of 3% would yield $600,000 in interest income for the year. This would be considered "sales." So, if SLJ place those "churned funds in its sales factor, what would that look like in our example?

Total income	12,000,000			12,000,000		
	Property	Payroll	Sales	Property	Payroll	Sales
Kansas	2,300,000	900,000	15,000,000	2,300,000	900,000	15,000,00
Unitary Total	280,000,000	283,000,000	12,000,000,000	280,000,000	283,000,000	26,600,000,00
Percent	0.82142857%	0.31802120%	0.12500000%	0.82142857%	0.31802120%	0.05639098%
Avg Percent	0.42148326%			0.39861358%		
Kansas income	50,578			47,834		
KS Tax @ 7%	3,540			3,348		

Sales Factor Components	Per Federal 1120	Diff.	Sales Churning
Sales	11,999,400,000	0	11,999,400,000
Net dividends	0	0	
Interest	600,000	0	600,000
Rents	0	0	
Royalties	0	0	
Intangible assets net gains/losses	0	0	
Intangible assets-proceeds		14,600,000,000	14,600,000,000
Tangible assets-proceeds	0	0	
Other income	0	0	
Total income	12,000,000,000	14,600,000,000	26,600,000,000

So, as you can see, by re-investing the same dollars over and over twice daily, every day, and designating each roll-over as a "sale," SLJ was able to trim about 6% off their tax liability to Kansas. Imagine when these "investments" are in the 100s of billions of dollars nightly.