SESSION OF 2002

SUPPLEMENTAL NOTE ON SENATE BILL NO. 501

As Amended by House Committee of the Whole

Brief*

SB 501, as amended, would make an exception to the three-factor corporation income tax apportionment formula; expand tax credits that offset a portion of property taxes actually and timely paid on business machinery and equipment; expand a property tax exemption for certain "low-cost" items of machinery, equipment, materials, and supplies; provide an income tax credit for certain low-income senior citizens designed to offset a portion of property tax liability; and redefine "resident trust" for income tax purposes.

Corporation Income Tax Apportionment

The bill would provide an exception to the three-factor income apportionment formula for investment funds service corporations relative to the Kansas corporation income tax. Under the bill, an investment funds service corporation maintaining its primary headquarters and operations in Kansas or operating a branch facility employing at least 100 individuals on a full-time equivalency basis in the state would receive favorable tax treatment in the form of a single factor formula as opposed the three-factor formula (based on property, payroll, and sales) generally used in calculating the Kansas corporation income tax. The bill would allow such corporations to elect to have income apportioned to Kansas based on the number of shares owned by resident shareholders divided by the total number of shares owned by all shareholders. If the investment funds service corporation is a part of a unitary group, only the business income attributable to the investment funds service corporation would be eligible for the favorable tax treatment and not business income of the entire unitary group. To be eligible for the favorable tax treatment, the taxpayer would be required to maintain or increase the number of employees in

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***Supplemental notes are prepared by the Legislative Research Department and do not express legislative intent. The supplemental note and fiscal note for this bill may be accessed on the Internet at http://www.kslegislature.org/cgi-bin/fulltext/bills.cgi existence at the time the taxpayer first makes the election to use the new formula. An investment funds service company electing to avail itself of the apportionment option would also be subject to a "clawback" provision stipulating that any such taxpayer no longer qualifying within five years would have increased liability for the next taxable year equivalent to the amount of foregone revenues during the period of time that the special apportionment methodology was in effect. In tax year 2002, the bill would provide only half of the difference between the current apportionment formula and the new formula for investment funds service corporations. The new formula would be fully phased in for tax year 2003.

Tax Credit Expansion

The bill would expand the income, privilege, and premiums tax credits pursuant to KSA 2001 Supp. 79-32,206 that offset a portion of property taxes actually and timely paid on business machinery by increasing the percentage of such taxes eligible for the credit from 15 to 18 percent for property tax year 2003; to 22 percent for property tax year 2004; to 25 percent for property tax year 2005; to 30 percent for property tax year 2006; to 35 percent for property tax year 2007; and to 40 percent for property tax year 2008 and thereafter.

Property Tax Exemption Expansion

The bill also would expand the property tax exemption in KSA 2001 Supp. 79-201w for certain items of machinery, equipment, materials, and supplies with original retail cost when new of $250 or less to include such items with original retail cost when new of $500 or less in tax years 2003 and 2004; and to include such items with original retail cost when new of $1,000 or less for all tax years beginning in tax year 2005.

The bill also would amend KSA 79-301 to clarify that taxpayers need not comply with requests of county or district appraisers to list property which is not subject to taxation.

Income Tax Credit for Property Taxes Paid by Low-Income Senior Citizens

The bill would provide refundable income tax credits beginning in tax year 2002 equivalent to certain percentages of property taxes actually and timely paid upon the principal dwellings of low-income individuals who are 65 years of age or older.

Specifically, such individuals with a measure of income determined by Kansas adjusted gross income minus Social Security disability benefits and plus income from interest or dividends earned on public sector obligations or securities, state and city KPERS retirement benefits, certain board of public utility retirement benefits, and federal civil service and military retirement benefits would be eligible for income tax credits if such measure is $30,000 or less.

Qualifying individuals with income of $0 to $10,000 would receive a credit equivalent to 30 percent of property taxes paid; qualifying individuals with income over $10,000 to $20,000 would receive a credit equivalent to 20 percent of property taxes paid; and qualifying individuals with income over $20,000 to $30,000 would receive a credit equivalent to 10 percent of property taxes paid.

Individuals claiming this new credit would be ineligible to also claim refunds pursuant to the Homestead Property Tax Refund Act.

Income Tax Treatment of "Resident Trusts"

The bill also would redefine "resident trust" for income tax purposes to include trusts created by wills of decedents who at the time of death are domiciled in the state; trusts created by or consisting of property of persons domiciled in the state on the date the trusts become irrevocable; trusts administered in the state; trusts with property located in the state; and trusts with beneficiaries domiciled in the state.

Background

The subject matter of SB 501 first appeared in 2001 HB 2061. This bill was referred to interim study and the Special Committee on Assessment and Taxation recommended that the Legislature approve new legislation that would provide, effective for tax year 2002, favorable tax treatment for investment funds service corporations but with a provision that phases in the fiscal impact over two years. SB 501 was subsequently introduced by the Special Committee on Assessment and Taxation.

The Senate Commerce Committee held hearings on SB 501 at which time representatives of the Kansas City Area Development Council, the Department of Commerce and Housing, the Overland Park Chamber of Commerce, and Waddell and Reed Financial, Inc. offered testimony in support of the bill. The Senate Committee referred the bill to a subcommittee to review amendments proposed by the Department of Revenue, including the addition of provisions taking into consideration whether the investment fund services company is part of a unitary group. The subcommittee recommended the Department of Revenue amendments and also an amendment expanding the favorable tax treatment to investment funds service corporations with a branch office and at least 100 employees in Kansas. The Senate Committee adopted the subcommittee amendments.

The Senate Committee of the Whole amended the bill to include the requirement that a taxpayer maintain or increase its number of employees after electing to use the new formula. The Senate Committee of the Whole also amended the bill to reflect the Senate Commerce Committee's intent to allow an investment funds service corporation to elect to use the new formula if it maintains its primary headquarters and operations in Kansas, and to remove references to language which the Department of Revenue testified could add uncertainty to the law.

The Division of the Budget reports that passage of SB 501 would reduce state revenues by $2,000,000 in FY 2003. This amount would increase to $4,000,000 in FY 2004 and the out years once the new formula is fully phased in.

The House Taxation Committee amended the bill to clarify that an investment funds service company seeking to qualify for the new apportionment formula would have to employ the 100 individuals "on a full-time equivalency" basis; to provide that "residence" be defined as the fund shareholder's primary residence "or principal place of business"; and to add the provisions of HB 2714 as amended by the House Committee of the Whole.

The House Committee of the Whole amended the bill to include the income tax credit for property taxes paid by low-income senior citizens, income tax treatment of resident trusts, and the clawback provision for the investment funds service corporation income tax apportionment.

Based on the very latest information available, the bill would have the following impact:

($ in millions)

FY	Inv. Funds Service Co. Apportion.	Tax Credit Expansion	School Finance Local Effort	State Building Funds	Income Tax Credit for Seniors	Total Impact
2003	($2.000)	--	--	--	($0.924)	($2.924)
2004	($4.000)	($5.324)	($0.250)	($0.019)	($0.924)	($10.517)
2005	($4.000)	($13.665)	($0.435)	($0.033)	($0.924)	($19.057)
2006	($4.000)	($21.473)	($1.029)	($0.077)	($0.924)	($27.503)
2007	($4.000)	($35.431)	($1.480)	($0.111)	($0.924)	($41.946)
5-Yr. Total	($18.000)	($75.893)	($3.194)	($0.240)	($4.620)	($101.947)

A fiscal note on the resident trust provisions indicated that they would be expected to increase SGF receipts by an indeterminate amount.