SESSION OF 2008

SUPPLEMENTAL NOTE ON SUBSTITUTE FOR HOUSE BILL NO. 2762

As Amended by House Committee of the Whole

Brief*

Sub. for HB 2762 would make a number of changes in corporation income tax rates and income apportionment provisions; expand the ability of certain businesses with a unitary group of corporations to utilize two different kinds of tax credits; provide tax credits for certain business investments in and around nine cities damaged by disasters in 2007; and enact two new sales tax exemptions.

Corporation Income Tax Rate and Apportionment Provisions

New language would provide for greater apportionment of business income by authorizing the state to use the functional test (in addition to the current transactional test) as a method for identifying such income. Current Kansas law has been interpreted as providing only the transactional test.

A second new provision would clarify the definition of gross receipts to prevent companies from utilizing "income churning" – a practice that inflates the denominator of the sales factor of the apportionment formula by including certain extraordinary items.

Finally, the top corporation income tax rate, which is effective for taxable incomes above $50,000, would be reduced from 7.35 percent to 6.85 percent.

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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

All of these changes would be effective for tax year 2008 and thereafter.

Enhanced Ability to Share Income Tax Credits

Business and job development tax credits earned by a corporation pursuant to KSA 79-32,153 could be transferred to another member within such corporation's unitary group. High performance incentive program (HPIP) tax credits earned pursuant to KSA 79-32,160a also could be transferred to another member of a corporation's unitary group, but only relative to credits earned for tax year 2008 and thereafter.

Disaster Tax Credits

The bill also would provide income, premiums or privilege tax credits for certain qualified capital investments made in businesses located in and around nine cities (Chanute, Coffeyville, Erie, Fredonia, Greensburg, Independence, Iola, Neodesha, and Osawatomie) damaged during two specific federal disaster declarations in 2007.

Qualified capital investments, which would be defined to include investments in "construction, equipment, reconstruction, repair, enlargement, furnishing or remodeling of real property" as well as the "purchase, lease or repair of tangible personal property," would exclude investments in "inventory or property held for sale in the ordinary course of business." The credits would be available relative to investments in businesses located within the city limits of the nine cities, as well as businesses located up to one mile outside of such limits.

Taxpayers generally would be able for tax years 2007-2010 to claim non-refundable credits equivalent to 10 percent of the qualified capital investments; or refundable credits equivalent to 5 percent of such investments. All credits would be reduced by amounts equal to assistance payments taxpayers had previously received pursuant to the provisions of

KSA 75-3713e or the Southeast Kansas Business Restoration Assistance Program approved by the State Finance Council.

The Secretary of Revenue would be required to submit an annual report to the Legislature beginning in 2009 relative to the amount of refundable versus non-refundable credits claimed pursuant to the legislation.

Sales Tax Exemptions

A new sales tax exemption would be provided, effective July 1, 2008, for certain machinery, equipment and materials utilized in engineering, research and development, and product design.

Refunds would be authorized relative to state sales tax paid on the sale of certain telecommunications machinery and equipment equivalent to 25 percent of such amount paid during FY 2010; 50 percent during FY 2011; 75 percent in FY 2012; and 100 percent in FY 2013 and thereafter. Local sales taxes paid would not be refunded, and taxpayers would have to submit refund claims within one year.

Background

The original bill was introduced as a result of an interim study. The House Taxation Committee made several technical amendments to the bill's original provisions, which dealt with the corporation income tax rate and apportionment provisions. After adding additional amendments relative to the income tax credit sharing provisions; and the sales tax exemption provisions, the Committee recommended that a substitute bill be created. Some of these additional provisions also may be found in HB 2603, SB 578, HB 2739, and SB 664.

The House Committee of the Whole on March 14, 2008, amended the bill to include the disaster tax credit provisions in Sub. for HB 2640.

Based on the latest information available from the Department of Revenue, the bill's provisions would be expected to have the following impact on receipts:

($ in millions)

	FY 09	FY 10	FY 11	FY 12	FY 13
Addition of Functional Test	20.00	20.00	20.00	20.00	20.00
Income Churning Prohibition	2.50	2.50	2.50	2.50	2.50
Rate Reduction	(26.60)	(26.60)	(26.60)	(26.60)	(26.60)
HPIP Credit Sharing	(10.00)	(10.50)	(10.50)	(10.50)	(10.50)
Bus and Job Dvlp. Credit Sharing	(2.50)	(2.50)	(2.50)	(2.50)	(2.50)
R and D Sales Tax Exemption	(6.00)	(6.24)	(6.49)	(6.75)	(7.02)
Telecom Sales Tax Refunds	--	(4.00)	(8.16)	(12.24)	(16.32)
Disaster Tax Credits	(10.00)	(10.00)	(10.00)	--	--
Total Fiscal Note	(32.60)	(37.34)	(41.75)	(36.09)	(40.44)
SGF Fiscal Note	(31.86)	(36.08)	(39.95)	(33.76)	(37.58)
SHF Fiscal Note	(0.74)	(1.26)	(1.80)	(2.33)	(2.86)