MINUTES

SPECIAL COMMITTEE ON ASSESSMENT AND TAXATION

September 25-26, 2007
Room 519-S—Statehouse

Members Present

Senator Barbara Allen, Chairperson
Representative Kenny Wilk, Vice-Chairperson
Senator Janis Lee, Ranking Minority Member
Senator Karin Brownlee
Senator Les Donovan
Senator Derek Schmidt
Representative Elaine Bowers
Representative Stan Frownfelter
Representative Tom Holland
Representative Steve Lukert
Representative Virgil Peck
Representative Jeff Whitham

Member Absent

Representative Jeff King

Staff Present

Chris Courtwright, Kansas Legislative Research Department
Martha Dorsey, Kansas Legislative Research Department
Gordon Self, Office of the Revisor of Statutes
Scott Wells, Office of the Revisor of Statutes
Judy Swanson, Committee Assistant

Conferees

Steve Stotts, Kansas Department of Revenue
Randall Allen, Executive Director, Kansas Association of Counties
Representative Pat George
Sheila Frahm, Executive Director, Kansas Association of Community College Trustees
Sandy Praeger, Kansas Insurance Commissioner
Representative Dennis McKinney

Senator Derek Schmidt
Senator Janis Lee
Mark Beck, Kansas Department of Revenue
Don Moler, League of Kansas Municipalities
Bret Glendening, City Manager, City of Osawatomie
Jeffrey Morris, City Manager, City of Coffeyville,
John Federico, Federico Consulting
Phil Perry, Director of Governmental Affairs, Home Builders Association of Greater Kansas City
Tim Underwood, Executive Vice-President/CEO of Home Builders Association of Greater Kansas City
Mike Brown, President, Brown Midwest
Ann Brandau-Murguia, Executive Director, Argentine Neighborhood Development Association
Paul Welcome, Johnson County Appraiser
Mark Burkhardt
Mark Meads, Ash Grove Cement Company
Joan Wagnon, Secretary, Kansas Department of Revenue
Marlee Carpenter, Kansas Chamber of Commerce and Industry
Senator Julia Lynn
David Anderson, Mayor of DeSoto
John O'Dea, Executive Vice-President of Finance, Huhtamaki Americas
Robert Marcusse, CEO, Kansas City Area Developmental Council
Earline Sells, Treasurer, Huhtamaki Americas
Representative Nile Dillmore
Shirley Sicilian, General Counsel, Multistate Tax Commission
Mike Boekhaus, Kansas Department of Revenue
Lucky DeFries, Kansas Chamber of Commerce and Industry

Others Attending

See attached list.

Tuesday, September 25
Morning Session

Chairperson Allen called the meeting to order at 10:12 a.m. and welcomed all in attendance. Committee members and staff introduced themselves. Vice-Chairperson Wilk and Senator Lee also made short opening remarks.

Chris Courtwright, Kansas Legislative Research Department, presented an overview of the topics to be discussed by the Committee (Attachment 1).

- Corporate income tax shelters;
- Sales tax exemptions;
- Property tax payment date;
- Property tax deferral;
- Income tax withholding;
- Local sales tax authority;

- Relief for storm-damaged property;
- Corporation income tax credits; and
- Property tax on new residential property.

Mr. Courtwright then presented the Legislative Adjustments to Consensus Estimates for FY 2007 and FY 2008 (Attachment 2). FY 2007 receipts came in $88 million above final estimate. So far in FY 2008, actual receipts are running a bit below estimates. Sales and use taxes are almost $9 million below estimate. Mr. Courtwright will make a spreadsheet for the Committee to include future tax cut amounts in FY 2009 and FY 2010. He will meet with Alan Conroy and bring the report to the October Committee meeting. The farm economy should be an issue this year per Representative Lukert, since it has been such a good agriculture year. In response to Senator Brownlee, Steve Stotts, Kansas Department of Revenue (KDOR), will get information on how many people are late or are not paying their taxes.

Martha Dorsey, Kansas Legislative Research Department, reviewed Topic 6—Local sales tax authority (Attachment 3). The Committee's charge is explicitly to review the current formulas for distributing county-wide sales tax revenues. In 1970, the Legislature granted local sales tax authority to cities and counties. In 2006, uniformity to local sales tax provisions relating to cities by reducing the number of classes of cities to one was restored. All cities in the new, single class were granted authority to levy sales taxes of up to 2 percent for general purposes and up to 1 percent for special purposes. Any special purpose taxes levied must sunset after ten years. During Committee discussion, Ms. Dorsey said both city and proposed county recommendations require a vote of the public. Senator Lee requested documentation on how Johnson County distributes its general and sales tax, since it is different than the rest of the counties in the state.

Randall Allen, Executive Director, Kansas Association of Counties (KAC), testified the KAC supports allowing Kansas counties the right to impose a county-wide sales tax for general purposes in an amount not to exceed 2 percent, and a special purpose county-wide sales tax in an amount not to exceed 1 percent (Attachment 4). Revenue from a county-wide sales tax not earmarked for a special dedicated purpose is apportioned among the county government and the cities within the county. Many Kansas counties impose both general and dedicated county-wide sales taxes. The current county sales tax laws are a patchwork quilt. During discussion, Senator Lee expressed concern this proposal could bring sales tax to a total of 11.3 percent. The highest sales tax currently collected in Kansas is 8.925 percent. Mr. Allen said both cities and counties have to come before the Legislature to get authority to raise sales tax, with the exception of health care.

Although the topic of community colleges was not assigned to the Special Committee, Representative Pat George requested it be reviewed. There was a measure in the Appropriations Committee last session where Wichita State University wanted to transfer funding from property tax to sales tax. It would have been subject to public vote, and it would have been on top of current sales tax.

Sheila Frahm, Executive Director, Kansas Association of Community College Trustees, presented sales and property tax data as it relates to Kansas community colleges (Attachment 5). She requested review and consideration of a sales tax option to offset property taxes to fund community colleges. Committee discussion followed with Ms. Frahm. It would be an additional sales tax. Representative Wilk said the long-term tax mix must be considered. All 19 community colleges are in agreement with this proposal. Community colleges are local entities, not owned by the state.

Steve Stotts, KDOR, presented a table showing the estimated impact to Kansas of Missouri's decision to disallow non-resident Missouri taxpayers an itemized deduction of their state's property taxes (Attachment 6). Kansas returns showed 139,828 tax filers claiming a credit for taxes paid to other states, and of those returns, 87,446 itemized their deductions. If Kansas enacts legislation doing what Missouri did, it would receive approximately $2,522,507 in increased taxes. The tax burden does not change, just the distribution between what taxes go to Kansas and what taxes go to Missouri. Missouri's new law causes Kansas to lower estimates for income tax receipts by $5 million. Representative Wilk requested the Attorney General see if this might be about to be thrown out in federal court. Last week, Representative Wilk visited with the author of the Missouri legislation and was told the policy change came about because of Missouri's problem with Illinois. Missouri had no problem with Kansas. Representative Wilk said Missouri is working on a change that would only apply to states which do not have reciprocity agreements. He explained they are working to get something in place for 2007 tax return filings.

A letter was received from Robert Vancrum, Greater Kansas City Chamber of Commerce, giving opposition to Missouri tax legislation and making suggestions (Attachment 7).

The Committee recessed from noon to 1:35 p.m.

Afternoon Session

Sandy Praeger, Kansas Insurance Commissioner, provided the Committee with the testimony she gave before the U. S. Subcommittee on Housing and Community Opportunity regarding all-perils insurance coverage (Attachment 8). The biggest misconception about homeowner insurance is flood insurance. Flood insurance can be purchased regardless of where you are located. FEMA has paid $2.7 million in claims in Kansas.

Martha Dorsey reviewed Topic 7—Relief for storm-damaged property (Attachment 9). The Legislature did four things for Greensburg following its tornado:

- Provided a sales tax exemption related to certain purchases made to restore or reconstruct businesses located in Kiowa County;
- Enacted a new business restoration assistance grant program for counties with at least 25 percent of their tax base destroyed as a result of a natural disaster;
- Granted the State Finance Council new authority to approve the transfer of up to an additional $25 million from the State General Fund to the State Emergency Fund; and
- Granted the State Finance Council authority to extend the disaster declaration related to Kiowa County beyond October 31, 2007 up to January 14, 2008.

Representative Dennis McKinney and Senator Derek Schmidt co-testified regarding relief efforts for their communities which were damaged by the May tornado and the July flood (Attachment 10). The survival of many of the cities impacted by these disasters relies upon the ability to rebuild their local economies. They recommended several steps the Legislature could take to assist in rebuilding those local economies:

- Extend the tax breaks granted to Greensburg for business reconstruction in Greensburg to businesses impacted by the flooding in Southeast Kansas;

- Implement site level Community Development Block Grant aimed solely at housing. Without adequate housing, many citizens will leave the disaster areas;
- Encourage economic activity in the affected areas by giving a 10 percent business investment tax credit for two to three years in areas that received a federal disaster declaration related to these two particular disasters; and
- Appropriate enough money to allow Kansas to pull down the maximum available in federal mitigation funds.

There is a need for the Legislature to respond to the long-term recovery needs of both areas of the state, and it needs to be a non-partisan effort by both disaster areas, both political parties, and both Houses of the Legislature. They are working on a complete package to be presented within a month. The long-term recovery needs to be focused on, as well as the immediate needs. Kansas needs to be creative and bold with new ideas to experiment with, and also with ideas that have been around for awhile. In response to Representative Wilk, Representative McKinney said the grant program is working fairly well so far. The Kansas Department of Revenue has been excellent in distributing the funds. Senator Schmidt said KDOR has been excellent to work with; however, in his area there is some uncertainty about the program having enough money to fund the needs. He said businesses are asking to "make it simple and make it certain." This challenges the state, because the state then loses control.

Representative McKinney said the local governments are out of money, and cannot come up with their 15 percent needed for matching federal funds. He said for citizens to be able to buy flood insurance, the national flood insurance program must be participated in by the local entity (county or city). He looked at Hoisington's recovery from a tornado and thinks it is a good case study to follow. Senator Schmidt pointed out that Neosho Falls, following the 1951 flood, became a virtual ghost town, so that city should be a model to study and not follow. Representative McKinney said it is difficult to keep track of all the donations to Greensburg. Senator Schmidt testified they are trying to identify holes in the programs. Community housing needs are not being met, and it is almost impossible to meet the gaps in cost of new construction. There is not much available for business assistance, and no incentive to fill the economic gaps. Representative McKinney said a key question is how to get the workforce back into Greensburg. He said Kansas' response was second to none in responding to their disaster.

Senator Janis Lee testified that she and Senator Anthony Hensley were concerned about property tax issues in the Greensburg area (<u>Attachment 11</u>). There is a potential of serious property tax dollar deficits in 2009, 2010, and several years thereafter. She asked the Committee to monitor and give consideration to a formula similar to the Siegfreid slider as a method of replacing property tax revenues lost as a result of the tornado for the City of Greensburg and Kiowa County. The slider effort by the state may need to continue for five to six years. Because local officials have been completely consumed with their responsibility of putting the town back together enough to begin to allow the rebuilding of commerce, they have not had time to think this far ahead. She also suggested including looking at these property tax issues for the area that was affected by the floods. During discussion, Mark Beck, KDOR, testified as to what other states are doing. In Texas sometimes a reassessment is allowed, but it is by local option. Oklahoma allows an income tax credit. Senator Lee said she and Senator Hensley will come back to the Committee with a specific recommendation after conferring with Senator Schmidt and Representative McKinney.

Don Moler, League of Kansas Municipalities, testified the main problem is where the money will come from to fund the local efforts (<u>Attachment 12</u>). Because most landowners in Greensburg will be asked to pay property taxes on properties which no longer exist, it is a reasonable expectation that some of the property owners will decline to pay their property taxes, or choose to simply walk away from the property and establish a home or business elsewhere. The valuations within the City of Greensburg will be dramatically reduced in 2008. Also, local sales tax is largely eliminated since retail outlets have disappeared. Housing is an aspect to be considered, since citizens may choose to move elsewhere rather than rebuild. State programs should be put in place for future disasters. Mr. Moler reported the League of Kansas Municipalities presented $115,276.84 to the City of Greensburg from a fund raising drive they held for Greensburg.

Bret Glendening, City Manager of the City of Osawatomie, testified Osawatomie's city fund balances simply do not provide necessary and financially prudent funds to pay the bills associated with the 2007 flood, and as a result of these bills the City was forced to issue no-fund warrants (Attachment 13). He requested the Legislature consider authorizing a municipality the ability to establish a line of credit at a bank and make periodic draws as bills from a declared natural disaster are submitted. Osawatomie is wrestling with its abandoned property. When a structure is abandoned and the owner of the property refuses to do anything with the property, he would like the city to have the authority to follow its standard condemnation procedure AND simultaneously take possession of the property.

Jeffrey Morris, City Manager of the City of Coffeyville, gave an update on the problems they are having following the flood disaster (Attachment 14). The City will lose sales tax revenue due to the number of businesses impacted by the flood, which included six of the seven hotels, a grocery store, five restaurants, and four convenience stores. Another impact will be the loss of property tax base. It is estimated the tax base may decrease by as much as $15.8 million in appraised value, which equates to $2.1 million in assessed valuation. FEMA has provided some help to residents in regard to housing, and Coffeyville Resources is offering to purchase homes impacted by the oil release at 110 percent of pre-flood fair market value, however there is a substantial gap in the value of the homes that were lost and the cost of new home construction. Only three businesses have reopened since the flood, and the fear is that many will decide it is not worth it to start over. Coffeyville had a housing shortage prior to the flood. Now it is at the crisis level. The majority of the homes impacted by the flood will never be inhabited again. He requested the Committee consider special legislation to assist residents and businesses in response to the numerous natural disasters that have struck Kansas this year. Included with Mr. Morris's testimony were his September 6 testimony and presentation to the Disaster Relief and Recovery Special Committee.

Written testimony was received from Paul Sasse, City Manager of Independence, reviewing the damage they received from the flood and outlining their current needs (Attachment 15).

A letter from Doug Vieux was received asking for equal benefits throughout the state for disaster victims (Attachment 16).

At the request of Representative Wilk, Don Moler agreed to coordinate meetings and get people to make suggestions that the Committee could use as a starting point for the Committee's legislation requests. Mr. Moler said he will try to have a report and suggestions ready for the November Committee meeting. He will give an interim update at the October Committee meeting. Senator Brownlee suggested perhaps flood areas could have a housing authority which could actually build houses. The City of Stockton currently is doing this. She also suggested creating under the KDFA a revolving loan which would allow them cash more quickly.

Chairperson Allen appointed Senator Brownlee to serve as Committee liaison on Mr. Moler's special committee.

The Committee recessed from 3:05 to 3:15 p.m.

Chris Courtwright reviewed Topic 9—Property tax on new residential property (Attachment 17). Under the provisions of HB 2543, which was introduced in the 2007 Legislative Session, newly constructed residential property which has never been occupied could not be assessed as improved real property until occupancy occurs or until January 1 of the second year following the year in which improvements were completed. It would provide that certain newly constructed single and multi-family (four units or less) residential property which is owner occupied be assessed for the balance of the tax year relative to a pro-rated valuation system.

John Federico, Federico Consulting, made opening remarks supporting Kansas Homebuilders. This bill is a work in progress. Kansas City homebuilders are taking the lead on the issue. He has visited with many associations about the bill.

Phil Perry, Director of Governmental Affairs, Home Builders Association of Greater Kansas City, presented an illustration of the timeline of the current law and the proposed legislation (Attachment 18). A letter was submitted from the law firm of Lathrop & Gage stating they did not think HB 2543, if enacted, would be unconstitutional (Attachment 19).

Tim Underwood, Executive Vice President/CEO of Home Builders Association of Greater Kansas City, testified the proposed legislation would begin the assessment of property taxes on a newly constructed home on the first day of the month following the closing date for a new homeowner. It also would eliminate the inventory tax on model homes and speculative homes built in Kansas and would remove the confusing current system used that assesses property taxes based upon an arbitrary and complicated percentage of a home's completion (Attachment 20). The current property tax system poses a disincentive to home builders.

Mike Brown, President of Brown Midwest, said as a home builder, this is one of the most difficult times his industry has faced (Attachment 21). He felt this legislation would make Kansas housing more affordable and more attainable for consumers. As a Johnson County builder, the current system for property taxes on new homes impacts business even more. Missouri has a property tax law similar to the proposed legislation, which results in loss of new home sales to Missouri. The bill would help alleviate the burden of rising housing costs in Kansas and would bring more business to Kansas.

Ann Brandau-Murguia, Executive Director of the Argentine Neighborhood Development Association, testified affordable housing for the families of Wyandotte County is a constant challenge, and she felt this proposed legislation would be a boost for affordable housing throughout the state (Attachment 22).

During Committee discussion, Mr. Perry said he will address suggested changes to the bill at a later time. Tony Folsom, KDOR, will testify at the October Committee meeting. Senator Donovan said he sympathized with the builders and understands why there is fairness in the proposal. In the case of a four-plex, each unit would be plated separately. If built for rental, the property would go on the tax roles immediately. Mr. Brown said it takes 150-180 days to build a house, and now takes approximately six months to close the sale. Conferees were willing to consider applying the change to single family dwellings only.

In Kansas, builders are paying more fees than builders are paying in Missouri, *i.e.*, excise taxes, lower building permits, and lower water hook ups, among other things. Representative Lukert said he is not convinced this would be good legislation for the consumer, but a better bill for the builders. Gordon Self, Office of the Revisor of Statutes, said there is a constitutional question with this bill. There also is an issue whether this bill would violate the uniform and equal valuation.

Chairperson Allen asked Paul Welcome, Johnson County Appraiser, for his remarks concerning the bill. Mr. Welcome said there are issues with the proposed legislation. It would require a separate classification twice a year, and then the appeal process would become an issue. He believes it is unconstitutional. He agreed to testify at a later date. Defining occupancy also is an issue. The law has been in effect in Missouri since 1997.

Being no further business, the Committee adjourned at 4:35 p.m.

Wednesday, September 26
Morning Session

Chairperson Allen reconvened the Committee at 9:05 a.m.

Although not on the Committee agenda, Senator Donovan wanted to make the Committee aware there is a possibility that the Kansas Department of Transportation (KDOT) will experience a shortfall of funds in FY 2009. They may be shorted $140 million which has already been built into the KDOT budget. If that happens a curtailing of projects will result, and this Committee might be called upon to do something in that case.

Chris Courtwright reviewed Topic 8—Corporate income tax credits (Attachment 23). Under current law, the Kansas Director of Taxation may allocate credits between two or more businesses owned or controlled directly or indirectly by the same interests, if it is determined such allocation is necessary to clearly reflect income or to prevent tax evasion. Chairperson Allen received a communication from a company that stated with respect to High Performance Incentive Program (HPIP) income tax credits, under current KDOR policy, only the company generating the credit within the unitary group is allowed to claim the credit. KDOR has been asked to begin assembling the information necessary to provide a fiscal note relative to any proposed change in law that would authorize broader utilization of the HPIP credits. KDOR Secretary Wagnon said she does not have the numbers of how much corporate income is paid through ownership of other corporations, *i.e.*, LLCs. She said the data could be gathered by looking at Federal data. Senator Donovan said he thought it would be a significant amount.

Secretary Wagnon briefed the Committee on corporate income tax (Attachment 24). The current rate structure is 4 percent rate on Kansas taxable income, with a surtax of 3.35 percent on Kansas taxable income above $50,000. The corporate income tax is the third largest tax revenue source for the State General Fund. The April 2007 Consensus Revenue Estimate for FY 2008 corporate income tax receipts is $372.95 million. KDOR receives approximately 30,000 corporate income tax returns per year. The top 400 corporate income taxpayers account for about 80 percent of the corporate income tax revenue.

Mark Burkhardt, representing clients, said he would get written testimony to the Committee. HPIP is a 10 percent tax credit if companies meet stringent requirements. The unitary business principle is a number of related businesses working together. He requested to the State if one of the companies utilizes the HPIP, that it could be applied to the unitary group. He is willing to work with KDOR to come up with a compromise bill. This would apply only to companies that have a Kansas liability.

Mark Meads, Ash Grove Cement Company, testified they request legislation that would clarify that any credits earned under HPIP may be allocated among members of a unitary group of companies filing a combined report for corporate income tax purposes in Kansas (Attachment 25).

KDOR Secretary Wagnon said the law does not currently allow for this type of allocation. Two issues must be addressed: (1) change the law, and (2) pay for it. There are over $400 million in unused HPIP credits. If this provision were passed, it would cost approximately $20 million initially. Once the credits are awarded, they are not an asset. If the policy were changed, there is a chance the $400 million would be redeemed. Representative Wilk expressed concern about how much the fiscal note would be if this were enacted. Mike Boekhaus, KDOR auditor, said the entity earning the credit has the largest liability in Kansas. Secretary Wagnon said there is $20 million built into the budget profile annually that represented credits that are out there. She said there are approximately 70 companies that claim HPIP credits. She would like to see simplification of HPIP law so companies can more easily claim the credits. Senator Brownlee requested a written explanation from Secretary Wagnon explaining why the Department of Revenue feels they do not currently have authority to allocate HPIP tax credits among members of a unitary group.

Marlee Carpenter, The Kansas Chamber, testified the Chamber supports clarifying the current tax credit statute and allowing the use of tax credits within a unitary group. They believe the current tax credit system should be modified and certain inequities like this one be clarified (Attachment 26).

Senator Julia Lynn testified she appreciated the opportunity to discuss tax issues with the Committee (Attachment 27). She requested the Committee help Huhtamaki Americas expand their company in Kansas.

David Anderson, Mayor of DeSoto, testified a Huhtamaki expansion would mean a great deal to his community (Attachment 28). The city has offered them a 100 percent tax abatement for ten years, and will make a $4.9 million addition to their wastewater infrastructure, and a $1.4 million improvement to the water infrastructure. They would do this because the direct immediate benefit to the city is in the electric franchise fee tax. That would amount to almost a 15 percent increase in general fund revenue. He urged the Committee to pass legislation that will create economic expansion for the State of Kansas. Senator Allen requested Mayor Anderson bring an actual draft of legislation he would like considered back to the Committee.

John O'Dea, Executive Vice President of Finance, Huhtamaki Americas, Inc., said his company is a global consumer packaging business with annualized sales of approximately $3 billion, employing 15,000 worldwide (Attachment 29). Huhtamaki currently employs 440 people at its DeSoto location, and payroll exceeds $22 million per year. He provided the Committee with a summary of monetary cash incentive programs offered by 29 states. In response to Chairperson Allen, he said he would work with whomever he needed to work with on drafting detailed legislation that would be beneficial to his company expanding in Kansas. He wanted tax credits to be refundable. KDOR Secretary Wagnon said the Department of Commerce and KDOR will bring suggestions on language back to the Committee.

Robert Marcusse, CEO, Kansas City Area Developmental Council, said companies are invited to come to Kansas, and the State tells them it will do its part by providing help with job training, or by offering tax incentives (Attachment 30). In some cases, however, the company does all they are asked, but because of its corporate tax structure, it cannot use the promised tax credits. He said he is only asking for legislation to help make Kansas competitive in the race for investment and jobs by fixing a good program that sometimes does not work as intended.

Earline Sells, Treasurer of Huhtamaki Americas, reiterated they want to have refundable HPIP credits.

Marlee Carpenter, The Kansas Chamber, testified the Chamber supports these tax changes (Attachment 31). Business tax reductions are supported by The Chamber.

Committee discussion was held.

- Earline Sells said time is of the essence to Huhtamaki Americas as they make a decision concerning their expansion, but she could not give a timeframe due to company privacy;
- Secretary Wagnon said there is $25 million unused in the Impact Fund that could be used to give cash incentives;
- Secretary Wagnon said the State is not capturing a part of the payroll tax;
- Senator Schmidt suggested considering capturing a portion of their increased payroll tax to buy back their credits at a later date;
- Secretary Wagnon said a better option would be to take the Impact Fund and convert that into cash;
- In response to Senator Brownlee, Secretary Wagnon said there were no recent changes to make the program broader; and
- Senator Brownlee volunteered to work with Secretary Wagnon and others to see if this could be accomplished.

Chris Courtwright reviewed Topic 1—Corporation income tax shelters (Attachment 32). Current Kansas corporation income tax structure imposes a rate of 4.0 percent on taxable income of $50,000 or less; and of 7.35 percent on taxable income in excess of $50,000. Proposed legislation would reduce the top corporation income tax rate to 6.95 percent in tax year 2008; and to 6.75 percent in tax year 2009. In addition, the Dillmore amendment would make three changes in the corporation income tax that would allow extra relief in the top corporate rate.

- Greater apportionment of business income;
- Clarify gross receipts definition to avoid churning; and
- Eliminate tax sheltering via captive insurance companies.

Representative Nile Dillmore testified his amendment would accomplish making an additional 0.5 percent reduction from the original bill's proposed 6.75 percent rate revenue neutral, because it would close some tax loopholes generating an additional $22-$23 million (Attachment 33). Kansas needs to find ways to broaden its tax base, so it can lower tax rates. He said his amendment would take a great deal of political courage as it would shift the burden to those who are not paying their fair share and simultaneously reduce the rate for all payers in the same rate class.

Shirley Sicilian, General Counsel, Multistate Tax Commission, provided some national context for the expansion of the definition of "business income" and a clarification that the sales factor does not include returns of principal from short-term investments (Attachment 34). 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 distortion, and the possible incentive it creates for further distortion through further shortening the term of investment, has prompted many jurisdictions to exclude the return of principal from the sales factor.

Mike Boekhaus, Kansas Department of Revenue, clarified Business/Nonbusiness Income (Attachment 35). Kansas uses the transactional test to determine if business income is subject to apportionment, and that excludes extraordinary transactions not occurring in the regular course of the taxpayer's business. It excludes large non-Kansas transactions. All other states imposing an income tax have broader definitions of business income that would include those transactions in their income tax base. Committee discussion followed.

Marlee Carpenter, The Kansas Chamber, said the Kansas business climate needs attention. She said the language is a tax increase for businesses, and The Chamber does not support it. The corporate income tax needs to be reduced. Lucky DeFries, The Kansas Chamber, said the Chamber supports rate reduction, but does not want to transfer the price. They also are discussing the HPIP issue with KDOR, and he is encouraged by this discussion. In response to Senator Lee, Mr. DeFries said administration proposed was for the corporate reduction, which affects only large businesses, not small businesses. Ms. Carpenter said the Chamber is as opposed to this as it was during the session if taken by itself, but they are willing to talk to KDOR about a general tax package. Mr. DeFries said it is advantageous to out-of-state corporations over in-state corporations. Senator Brownlee questioned why the State just did not lower the corporate tax rate across the board. Secretary Wagnon said this fiscal impact is $20 million, and if the tax was lowered across the board there would not be much of an impact. Ms. Carpenter disagreed with Representative Frownfelter that The Kansas Chamber only represented large businesses.

Representative Holland asked Secretary Wagnon if Kansas were to lower the surcharge, would that make it even with Missouri. She said Missouri allows a deduction to lower net income, and there would still be differences in the law between the two states. Missouri's base is broader than Kansas; therefore they can afford a lower rate. She said theoretically the broadest base and lowest rate would be the best way to go, but implementation becomes a problem. The tax rate does not seem to be nearly the problem as the usability of the Kansas tax credits. Ms. Wagnon said Missouri's tax base is broader than Kansas because of non-business income and they use transactional and functional income tests.

In response to Representative Peck, Secretary Wagnon said she feels Kansas has the ability to implement through rules and regulations two of the three Dillmore amendment pieces.

Secretary Wagnon explained Department of Revenue suggestions for closing corporate income tax loopholes (Attachment 36).

- Change the current law to allow full apportionment of business income;
- Eliminate opportunities for abuse and litigation by clarifying the definition of the "sales factor" to avoid "churning" of income; and
- Eliminate planning opportunities for "captive" insurance companies.

Chairperson Allen asked Committee members to let Mr. Courtwright know if there was anything in particular they wanted on the October meeting agenda. She also requested conferees get their testimony to the Legislative Research Department in advance of the meetings.

Being no further business, the meeting adjourned at 11:28 p.m.

Prepared by Judy Swanson
Edited by Martha Dorsey and Chris Courtwright

Approved by Committee on:

October 25, 2007
(Date)