KANSAS ASSOCIATION OF REALTORS®

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To: House Taxation Committee

Date: February 16th, 2017

Subject: Opposition to HB 2315.

Honorable Chairman Johnson and members of the House Taxation Committee:

On behalf of the Kansas Association of REALTORS® (KAR), thank you for the opportunity to provide some written comments in opposition to HB 2315, which would single out "passive" types of income for taxation and significantly increase the cost of doing business in Kansas by imposing extravagant filing fees on certain for-profit entities.

KAR represents over 8,500 members involved in both residential and commercial real estate and has advocated on behalf of the state's property owners for over 95 years. REALTORS® serve an important role in the state's economy and are dedicated to working with our elected officials to create better communities by supporting economic development, a high quality of life and providing affordable housing opportunities while protecting the rights of private property owners.

<u>Fee Increases</u>

Sections 3 through 9 of SB 175 increases the filing fees for various for-profit entities. For domestic and foreign for profit corporations, the annual report fee paid to the Kansas Secretary of State's Office would increase from $40.00 to $200 – a 400% fee increase. Furthermore, for domestic limited liability companies, domestic and foreign limited partnerships, and domestic and foreign limited liability partnerships, the filing fee would not only increase 400% to $200 every year, each member or partner with a greater than 5% ownership interest would pay an additional $200 fee each on top of the annual report fee.

It has been said that this will get the physician, lawyers, and the accountants to pay an additional fee when they benefit from the pass-through exemption. However, the committee needs to be cognizant, that this fee increase would apply to anyone choosing to conduct business under one of the proscribed entities regardless of size or income. To put this in perspective, consider a multi-generational, family owned business (such as a farming or cattle operation) it is common to have three or more owners with over 5% ownership, with the mom, dad, and child(ren) owning shares. This is common for management and succession planning purposes to bring family members into the business and transition the business from one generation to the next. Currently, a multimember LLC would pay $40 a year with their annual report to the Secretary of State. With this hypothetical business, under SB 175, the annual filing fees would increase to $800 ($200 annual report fee + $600 fees for Husband, Wife and Child owners) – a 1900% increase. Compounding this, is that many small businesses consist multiple entities with one entity owning property and another being the operations entity.

Additionally, this fee increase is substantial to the single-member limited liability company (LLC) that has only one owner. Section 5, subparagraph (c) indicates that an LLC shall pay a $200 fee at the time it files the annual report. Section 5, subparagraph (h) requires that every LLC shall pay an additional $200 fee for each member owning 5% or more. For a single-member LLC, the owner would pay $200 with the filing under (c) and an additional fee of $200 under (h) for themselves as member owning more than 5% for a total of $400. This is an increase of 900% on the annual filing fee paid when filing an annual report. Proponents will have you thinking that this is a minor amount for the physicians, lawyers, and accountants to pay in exchange for their non-wage income tax exemption. However, think about the contractors, landscapers, house cleaners, and other small entrepreneurs who are getting started where imposition of these filing fees would be a significant disincentive to entity choice.

SB 175 simply sets an extravagant, ongoing "fixed" cost that will be burdensome on our Kansas small businesses and is regressive in failing to take into account size or income of the entities exposed to these fees. SB 175 would put a cost so high, that for many it would be cost prohibitive to form an entity, opting to remain a sole proprietor. Kansans should have the choice of entity that is best suited for their personal and business needs, rather than having the burdens of SB 175 make the choice for them.

It is obvious that the intent behind raising these filing fees is to generate increased revenue for the state general fund. However, it is important to consider why businesses pay filing fees to the Secretary of State in the first place.

In regards to business entities, the Secretary of State's Office is the filing center for various organic documents, annual reports, changing resident agent or registered office and additional amendatory filings. Simply, the Secretary of State serves as the record custodian for Kansas businesses and those doing business in the state, so that if a member of the public is harmed by a business, there is sufficient information on record to locate the proper parties to seek redress.

It is accepted that the State of Kansas may reimburse itself for the cost regulating a business under its general police power. However, the SB 175 fees go well beyond the cost of storing, maintaining and making accessible business records. As such, fees that exceed the Secretary of State's reasonable cost of regulating businesses would go beyond the State's police power and likely fall under the State's authority to levy taxes under Article 11, Section 1 of the Kansas Constitution.

Before moving forward with increases to annual report filing fees, this committee should be briefed on the constitutionality of such provisions as they relate to the State's ability to charge fees under its police power and whether fees charged in excess of the State's actual, reasonable cost violate Article 11, Section 1 of the Kansas Constitution.

<u>Taxation of "Passive Income"</u>

In the Governor's original income tax reform proposal, the Legislature generally exempted all income from state income taxes that was received by various "pass through" entities under schedules C, E, and F on their federal income tax returns. Current Kansas tax law provides absolutely no distinction between "active" and "passive" income for the purposes of determining when income is exempt under the "pass through" exemption.

However, language found Section 11(f) would differentiate between "active" and "passive" income and would subject all qualifying business income from rents and royalties reported on schedule C, E, or F to Kansas income taxation. We feel that differentiating between "active" and "passive" income would impose additional complexities on Kansas taxpayers and unfairly single out one form of income for taxation.

Property owners contribute to the Kansas economy by investing their resources each year to maintain and improve their property through the purchase of goods and services from other Kansas businesses and individuals. Furthermore, property owners pay significant property taxes to state and local governments. By singling out this form of income, the State of Kansas will provide disincentives for investors to keep or expand their real property investments in Kansas. Additionally, differentiating between "active" and "passive" income only injects complexity into an already complex tax system for the average taxpayer to determine their Kansas income tax burden, driving up the cost of tax compliance.

Conclusion

In closing, KAR would respectfully request that the House Taxation Committee oppose the provisions of this bill that seek to impose significant tax increases on Kansas small businesses and property owners.

We acknowledge that the Kansas Legislature is considering additional sources of state revenue in order to balance the State's budget. However, KAR believes that any changes to tax policy should affect all businesses equally and not target certain types of entities for questionable fee increases or single out specific types of income for taxation. Tax policy should be fair and equal and not have a disproportionate impact on select Kansas taxpayers.

KAR would ask that you reject the provisions contained in SB 175, specifically the amendments in Sections 3 through 9 and Section 11. Thank you for the opportunity to provide the committee with written comments regarding the proposals set out in SB 175.

Respectfully submitted,

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