MINUTES

SPECIAL COMMITTEE ON ASSESSMENT AND TAXATION

October 18-19, 2001
Room 519-S—Statehouse

Members Present

Representative John Edmonds, Vice Chair
Senator Barbara Allen
Senator Karin Brownlee
Senator Les Donovan
Senator Janis Lee
Representative David Huff
Representative Dennis Pyle
Representative Bonnie Sharp
Representative Joe Shriver
Representative John Toplikar
Representative Jonathan Wells

Staff Present

Chris Courtwright, Kansas Legislative Research Department
April Holman, Kansas Legislative Research Department
Don Hayward, Revisor of Statutes Office
Shirley Higgins, Committee Secretary

Conferees

Ed McKechnie, WATCO
Richard Cram, Kansas Department of Revenue
Kathy Damron, Waddell and Reed
Charles Ranson, Kansas, Inc.
Mark Beck, Property Valuation Division
Leslie Kaufman, Kansas Farm Bureau
Allie Devine, Kansas Livestock Association
Rick Stuart, Kansas County Appraiser's Association
John Peterson, National Organization of PEOs

Conferees (continued)

Audrey Langworthy
Marlee Carpenter, Kansas Retail Council & Kansas Chamber of Commerce and Industry
Jeff Levin, Varney's Book Store
Don Moler, League of Kansas Municipalities
Judy Moler, Kansas Association of Counties
Ron Hein, Kansas Soft Drink Association
Mike Reecht, AT&T

Thursday, October 18
Morning Session

The meeting was called to order in Room 519-S, Statehouse, by Representative John Edmonds, Vice Chair, at 10:00 a.m. on October 18, 2001, at which time he turned the Committee's attention to Topic 9, shortline railroad income tax credits (HB 2586). Chris Courtwright, Legislative Research Department, reviewed the draft Committee report, which describes the legislative action on HB 2586 and HCR 5032, outlines the fiscal note on HB 2586, and summarizes the public hearing on Topic 9 held in August (Attachment 1).

Ed McKechnie, WATCO Companies, Inc., updated the Committee on the progress made by the Kansas & Oklahoma Railroad (K&O) in preserving 700 miles of track in western Kansas. He noted that related information is outlined in a handout with the following headings: Marketing Review, Synergies Between the K&O and the SK&O Railroad, New Business in Process, Operational Review, Operational Challenges, Operational Outlook, Government Affairs, and Need for Tax Abatement Remains (Attachment 2). He emphasized that HB 2586 would provide needed capital to avoid abandonment of several rail corridors listed on the last page of his handout. He pointed out that the capitalized tax credit would allow $6.5 to $6.8 million in necessary infrastructure. He noted that the Department of Transportation estimates that there is a 53 to 1 cost benefit ratio per year for the income tax credit. He commented that the provision of additional resources to preserve the rail line would solve a number of problems concerning rail abandonment and rail service in central and western Kansas in the long term.

There being no other persons wishing to speak with regard to Topic 9, Representative Edmonds turned the Committee's attention to Topic 4, investment service company apportionment (HB 2061). Mr. Courtwright presented the draft Committee report, which notes that HB 2061 was based on a similar law in effect in Missouri. The report also outlines the administrative concerns expressed by the Department of Revenue and summarizes the testimony given at the public hearing in August (Attachment 3). At the conclusion of his review, Mr. Courtwright called the Committee's attention to a letter from Richard Cram, Kansas Department of Revenue, in response to Senator Lee's request at the August meeting for more information regarding the portion of his testimony under the heading "Administrative Problems and Comments" (Attachment 4). Mr. Cram stood in response to questions from the Committee regarding the Department's concerns, which relate to the difference between the single factor apportionment proposal in HB 2061 and the Missouri version.

Kathy Damron, representing Waddell and Reed, distributed copies of proposed amendments to HB 2061 prepared by Waddell and Reed to address the Department's concerns (Attachment 5). She noted that Waddell and Reed has no objection to the Department offering further amendments if necessary. Mr. Cram commented that the proposed amendments may have unintentional consequences for other investment groups. He said the Department is willing to work further with Waddell and Reed to ensure that the proposed amendments fit all companies. With this, Representative Edmonds closed the discussion on Topic 4, noting that the topic will be discussed further at the November meeting.

Representative Edmonds called upon Mr. Courtwright for an update on HB 2219, which suspends until the 2003 Legislative Session an existing requirement that Kansas, Inc. prepare an annual report evaluating the cost effectiveness of various economic development tax incentives (Attachment 6). Mr. Courtwright noted that the bill was passed during the 2001 Legislative Session after Kansas, Inc. reported that it was difficult to prepare a meaningful report because the Department of Revenue is statutorily barred from sharing confidential taxpayer records with Kansas, Inc. He explained further that the provisions of HB 2219 require that Kansas, Inc. meet with the Department of Revenue during the summer of 2001 to develop language to amend the confidentiality statutes and submit the agreed upon language to the 2002 Legislature for approval. In conclusion, Mr. Courtwright noted that, although the Legislative Coordinating Council did not charge the Committee to review this topic, Kansas, Inc. requested permission to appear before the Committee to report on the status of the discussions with the Department.

Charles Ranson, Kansas, Inc., reported that representatives of Kansas, Inc. and the Department of Revenue have met several times following the enactment of HB 2219. He commented that a change in the method of collecting data from taxpayers will probably elicit a negative response. However, without sufficient data from taxpayers, it is almost impossible to accurately determine cost effectiveness of credits and exemptions claimed. He pointed out three reasons he believes the Department's current questionnaire on the utilization of credits and exemptions for economic development purposes is flawed. He suggested that a separate line item entry be added to the income tax form to show the specific amount claimed for economic development credits or exemptions along with a requirement that the taxpayer complete a separate schedule with questions which would document the legitimacy of the claim and the results achieved by the investment. In this regard, he called the Committee's attention to samples of proposed questionnaires attached to his written testimony (Attachment 7).

Mr. Cram commented that both Kansas, Inc. and the Department understand the problem with the data collection process currently in place, but they have different solutions. He went on to present background information on HB 2591, which is similar to HB 2219 (Attachment 8). He noted that only corporate income taxpayers are required to complete an economic development incentive questionnaire under current law. He explained that the

Department's collection of information is incomplete because some corporations do not prepare and file the questionnaire as directed, and there is an opportunity for error if Department personnel inadvertently fails to identify and pull the questionnaire from filed tax returns. To address the problems associated with the data collection procedures, the Department proposes to modify its procedures so that it can provide Kansas, Inc. a complete and accurate list of names and addresses of all taxpayers claiming the economic development incentive tax credits for each tax year. Kansas, Inc. could then use the information in conducting its own surveys to develop its annual report. Mr. Cram noted that the Department's proposal would require modifying the current taxpayer information confidentiality rules to allow the Department to provide Kansas, Inc. with the list of names and addresses.

As to Kansas, Inc.'s proposal, Mr. Cram noted that it will involve administrative costs well in excess of $1 million, whereas the cost to the Department to develop its proposal would be approximately $5,000 for programming costs and $1,000 for schedule form changes. In addition, he noted that Kansas, Inc.'s proposal incorporates the same opportunities for error as in the existing procedure. In conclusion, Mr. Cram commented that both the Department and Kansas, Inc. would appreciate any assistance from the Committee in developing a plan which satisfies the objectives of the legislation. Following his testimony, both he and Mr. Ranson responded to comments and questions by the Committee regarding the proposed methods of collecting data and the confidentiality issue.

The meeting was recessed for lunch at 11:50 a.m.

Afternoon Session

Representative Edmonds called the meeting to order at l:30 p.m., at which time he called the Committee's attention to data prepared by the Department of Revenue entitled "New Rate If Exemption Repeal Has Neutral Effect On Receipts," which he had distributed for informational purposes (Attachment 9). He then opened the public hearing on Topic 6, agricultural land use valuation for property tax purposes (SB 129), and called upon Mr. Courtwright for background information on SB 129, as amended by the Senate Committee of the Whole. Mr. Courtwright outlined the various amendments which were suggested by the Senate Assessment and Taxation Committee and the Senate Committee of the Whole. In addition, he pointed out that the bill would have an impact on local efforts for school finance, and the fiscal note from the Department of Revenue on the original bill indicated that at least one part of the bill could be expected to increase valuation on a statewide basis (Attachment 10).

Mark Beck, Director, Property Valuation Division, distributed copies of a portion of the report entitled *Technical Assistance Project, Agricultural Use Value Study* which was conducted by the International Association of Assessing Officers (IAAO) (Attachment 11). To indicate the scope of the report, he called attention to the table of contents and the executive summary. He discussed the six recommendations resulting from the study and reported the progress the Property Valuation Division has made in addressing each of the issues. He pointed out that the summary of the use valuation estimation process in Kansas found on page 32 states, "Overall, the value estimation process that is being done in Kansas is a meticulous, time consuming effort that does an excellent job of determining the relative value of agricultural properties." He noted that the full report includes a summary of rural property valuation in 30 other states. Staff previously distributed a copy of the full IAAO report to Committee members (Attachment 12).

Leslie Kaufman, Kansas Farm Bureau (KFB), followed with testimony regarding SB 129 (Attachment 13). She began by emphasizing that KFB strongly supports the assessment of agricultural land based on the ground's ability to produce an income and that the continuation of this approach to valuing agricultural land is essential in maintaining a strong agricultural economy in Kansas. She went on to express KFB's support of the concept of establishing a review board as outlined in SB 129 to approve an appraiser's application of adverse influence factors to valuations. She also noted that a provision in SB 129 regarding the calculation of agriculture use value on pastureland continues to be an area of concern for many KFB members.

Allie Devine, Kansas Livestock Association (KLA), testified in support of the use value appraisal of agricultural land (Attachment 14). She noted that use value appraisal is based upon an earnings or capitalization approach, which KLA believes is the most consistent and fair method of measuring the value of agricultural land. In support of KLA's position, Ms. Devine presented the history of valuation of agricultural land, quoting from Robert C. Suter's, *The Appraisal of Farm Real Estate*. She pointed out the similarity of Mr. Suter's description of a basic farm value system to KSA 79-1476. She commented that the system was designed to give a long-term, stable value to agricultural lands. At this point, she distributed copies of a historical review entitled "The History of Kansas Use Value Appraisal" which was prepared by the Division of Property Valuation for the 2000 KLA convention (Attachment 15). She called the Committee's attention to the list of changes made to use value since 1996, noting that the Department gives no reasons for the changes. In her opinion, the Department of Revenue should be required to document the reasons. Ms. Devine went on to discuss KLA's concerns regarding the changes to use value appraisal implemented by the Department of Revenue. She concluded with a report on KLA's reaction to the issues and recommendations in the IAAO report.

Rick Stuart, representing the Kansas County Appraiser's Association (KCAA), testified in opposition to SB 129 (Attachment 16). Mr. Stuart explained that KCAA opposes the provision on page 2, lines 35 to 40, which would establish one county value per acre for all pasture or rangeland regardless of the quality. He contended that the change would be regressive in that below average quality land would increase and average quality land would decrease. KCAA also opposes the provision on page 3, lines 18 to 22, which establishes an agricultural use influence factor approval board. KCAA objects to this provision on the grounds that it would develop another level of bureaucracy and would put in place a board which would substitute their opinion over the opinion of professional soil scientists.

There being no others wishing to testify on SB 129 or related issues, Representative Edmonds turned the Committee's attention to Topic 5, local sales tax on natural gas (SB 233). Mr. Courtwright reviewed the draft Committee report, which includes a list of policy options (Attachment 17). Representative Edmonds confirmed with staff that the current version of SB 233 places a one year moratorium on all sales of natural gas made before July 1, 2002. Committee discussion followed regarding a proposal to use revenue from a new state tax based on the volume of natural gas sold to help replace local resources lost as a result of a repeal of the local sales tax on natural gas. Questions arose regarding a method to determine the amount of revenue which would need to be replaced. It was suggested that the Committee request the Department of Revenue to supply data on the average volume of residential natural gas usage in areas that apply a sales tax and the average amount of local sales tax generated. Mr. Cram noted that the Department has no data on the volume of natural gas sales, and, due to a system conversion, the Department has no sales tax records prior to January 1999. Steve Johnson, Kansas Gas Service, informed the Committee that Kansas Gas Service, which serves 70 percent of the state, remits sales tax for the 340 cities it serves and has a record of the volume of natural gas sold to those cities. He offered to attempt to retrieve the requested information from Kansas Gas Service computer records. With this, the discussion on Topic 5 was closed.

Representative Edmonds called attention to the minutes of the September meeting. Representative Sharp moved to approve the minutes of the September 27-28, 2001, meeting, seconded by Senator Lee. The motion carried.

The meeting was adjourned at 3:30 p.m.

Friday, October 19

Representative Edmonds called the meeting to order at 9:00 a.m. at which time he called upon April Holman, Legislative Research Department, to present the draft Committee report on Topic 10, professional employer organizations (PEOs) (Attachment 18). The report summarizes the provisions of Sub. for SB 121 dealing with taxation and reviews the public hearing on the topic held in August.

John Peterson, representing the National Organization of Professional Employer Organizations, distributed copies of Sub. of SB 121, noting that it was crafted by the Senate Commerce Committee (Attachment 19). Mr. Peterson testified in support of the taxation language found in Section 3(c), which clarifies that qualifying tax credits and the employment factor of the apportionment formula would remain with the primary business should such business enter into a co-employment agreement with a PEO.

Representative Edmonds explained that Sub. for SB 121 passed the Senate too late in the 2001 Legislative Session to allow time for the House Labor and Industry Committee to consider provisions and issues not related to taxation. After commenting that it would be appropriate for the Special Committee on Assessment and Taxation to prepare a recommendation on the taxation language in the bill, he read proposed language for the "Conclusions and Recommendations" portion of the report recommending the passage of the provisions in Section 2 (definitions) and Section 3(c) during the 2002 Legislative Session (Attachment 20).

Senator Donovan moved to adopt the language suggested by Representative Edmonds for the Committee report on Topic 10, seconded by Representative Sharp. The motion carried.

Representative Edmonds opened the public hearing on Topic 2, streamlined sales tax (SB 252), and called upon Mr. Cram for an update on the pilot project and related Congressional action (Attachment 21). Before discussing the status of the pilot project, Mr. Cram explained that SB 252 is Kansas' version of the Uniform Sales and Use Tax Administration Act, and Kansas must pass the Act before it can become a governing state with voting rights on future changes in the Streamlined Sales and Use Tax Agreement. He noted that the bill also authorizes the Department to continue to participate in the Streamlined Sales Tax Project if it is extended beyond 2001. At the conclusion of his report, he pointed out that, if Congress approves a two year extension of the moratorium on Internet access fees and discriminatory taxes, states involved in the Streamlined Sales Tax Project will have an opportunity to demonstrate progress in the sales tax simplification effort and continue raising the issue of Congressional authorization for states to impose use tax collection duties on remote retailers.

Representative Edmonds called attention to an update on the estimates of state and local sales tax losses from e-commerce in a memorandum from Mr. Courtwright (Attachment 22). Attached to the memorandum was a copy of a study conducted by the University of Tennessee's Center for Business and Economic Research analyzing revenue losses by state and local governments resulting from their inability to collect sales taxes on e-commerce transactions from remote sellers. Mr. Courtwright noted that the latest figures for Kansas suggest that the e-commerce loss for 2001 is at least $71.2 million. Committee discussion followed regarding the method used to compile the statistical information in the report. In response to a request for clarification of the statistical term "trend loss," Mr. Cram explained that the term represents the erosion of the sales tax base from factors other than e-commerce sales, such as a shift to consumption services or the continued granting of exemptions.

Audrey Langworthy, former chair of the Streamlined Sales Tax Task Force, followed with testimony on the streamlined sales tax issue (Attachment 23). She emphasized that the multi-state streamlined effort concerns equity in use tax collection, not an additional revenue source for states. She followed with a summary of equity issues in the collection of local use taxes. She noted that the enactment of SB 252 simply would authorize the Department of Revenue to retain a seat at the table and become a signatory to the agreement and prepare for its potential implementation, which could not occur until such time as the Legislature takes further action to bring the state's laws into compliance with the agreement. Senator Langworthy expressed her strong support for the passage of SB 252 because, in her opinion, it is very important that Kansas becomes a governing state in the preparation of the agreement. In conclusion, she pointed out that use tax is due and owing under current law, but states lack the ability to enforce the law uniformly and effectively.

Marlee Carpenter, representing the Kansas Retail Council (KRC) and the Kansas Chamber of Commerce and Industry (KCCI), testified in support of the Streamlined Sales Tax Project, but expressed some concerns about the project (Attachment 24). She noted that KCCI's support for the project should not be construed as support for all the proposals resulting from the project. With regard to SB 252, Ms. Carpenter said members of KCCI and KRC support the bill because it is important that companies that operate in the state have a voice at national meetings.

Jeff Levin, co-owner of Varney's Book Store in Manhattan, testified in support of the Streamlined Sales Tax Project and SB 252 (Attachment 25). As a business owner, he asks for a level playing field. He noted that he is required by law to collect sales tax on all sales (including Internet sales). However, two well-known, major retailers that have nexus in Kansas are not required to collect sales tax on their Internet sales simply because they created a different out-of-state business entity for Internet sales. To illustrate the competitive disadvantage, he compared copies of Internet orders taken by the two companies with copies of Internet orders taken by Varney's. He noted that an average text book order is approximately $600, and the sales tax Varney's must collect on text book orders significantly affects text book sales.

Committee discussion followed regarding the circumstances described by Mr. Levin wherein companies with nexus in Kansas avoid collection of sales taxes on Internet sales by establishing a separate corporation. Representative Edmonds asked Mr. Cram if he could assist in the drafting of a bill for introduction in the 2002 Legislative Session to prohibit this business practice. In response, Mr. Cram assured the Committee that the practice has not gone unnoticed by the Department of Revenue. He noted that the issue is currently being investigated by several other states and there are various stages of litigation in different parts of the country. He commented that, no matter what legislation is crafted to address the issue, the courts will end up determining what is or is not physical presence in the state. In his opinion, it would be difficult to pass a law to address the issue in a manner which would not result in litigation challenging the new law as unconstitutional under the commerce clause of the *United States Constitution*.

Don Moler, League of Kansas Municipalities (LKM), informed the Committee that LKM has been involved in the streamlined sales tax initiative since its inception and supports SB 252. He went on to say that LKM strongly supports a sales tax system which is equitable for merchants who operate from brick and mortar locations as well as those who operate via the Internet. LKM believes the streamlined sales tax initiative is a first step towards equitable sales taxation for all Kansans (Attachment 26).

Judy Moler, Kansas Association of Counties, testified in support of SB 252. She noted that the passage of the bill would give Kansas a continuing place at the table as various issues surrounding taxation of Internet sales are discussed. She pointed out that any suggested changes in current state tax law would be brought to the Kansas Legislature to be acted upon (Attachment 27).

Ron Hein, representing the Kansas Soft Drink Association, informed the Committee that, although the Kansas soft drink industry does not oppose the larger goal of retail tax simplification or legislation to permit Kansas to participate in the Streamlined Sales Tax Project, it does oppose the Project's decision to define "soft drinks" separately from "food." He contended that soft drinks are a food and should be considered within the definition of "food" for sales tax purposes. In support of his contention, he cited federal and court rulings which determined that soft drinks are food. Furthermore, he maintained that a separate definition for food conflicts with the objective to simplify the tax system. In his opinion, by isolating soft drinks from the food definition, the Project is essentially setting tax policy. He noted that this is a policy decision which should be made by states participating in the Project (Attachment 28). Mr. Hein distributed copies of the Streamlined Sales and Use Tax Agreement as approved on December 22, 2000 (Attachment 29), pointing out that the uniform definitions set out in the Agreement define only specific types of tangible property such as clothing, food, or soft drinks. In his opinion, the definitions are inappropriate in light of the failure to define other types of tangible personal property.

Representative Edmonds called the Committee's attention to written testimony in support of the Streamlined Sales Tax Project submitted by William Dvorak, Tax Director for AT&T (Attachment 30). Mike Reecht, AT&T, stood to note that Mr. Dvorak's testimony refers to another application of the Project, the simplification of sales and use tax compliance and administrative burdens through increased uniformity and more efficient compliance processes. With this, the public hearing on Topic 2 was closed.

The meeting was adjourned at 11:35 a.m. The next meeting is scheduled for November 13-14, 2001.

Prepared by Shirley Higgins
Edited by April Holman

Approved by Committee on:

November 13, 2001