

## **MINUTES**

### **SPECIAL COMMITTEE ON ASSESSMENT AND TAXATION**

August 23-24, 2001  
Room 519-S—Statehouse

#### **Members Present**

Senator David Corbin, Chair  
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 Lee Tafanelli  
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**

Kathy Damron, Waddell and Reed  
Brian Hall, KPMG  
Richard Cram, Kansas Department of Revenue  
Ed McKechnie, WATCO  
Rick Webb, WATCO  
Loren Medley, Kansas Rural Development Council

Doug Wareham, Kansas Grain and Feed Association  
Charles Swayze, Kansas Rail Users Association  
Joe Horton, Farmco, Inc.  
Joe Lieber, Kansas Cooperative Council  
Leslie Kaufman, Kansas Farm Bureau  
Tom Whitaker, Kansas Motor Carriers Association  
Don Lindsey, United Transportation Union  
Bill Maness, Oasis Outsourcing  
Terry Humphrey, Kansas Trial Lawyers Association  
Timothy A. Short, Kansas Trial Lawyers Association  
Steve Kelly, Kansas Department of Commerce and Housing

**Thursday, August 23  
Morning Session**

The meeting was called to order in Room 519-S, Statehouse, by Senator David Corbin, Chair, at 10:10 a.m. on August 23, 2001. Senator Corbin called upon Chris Courtwright, Legislative Research Department, for an overview of the following topics assigned to the Committee:

- Topic 1—Regents' Foundation income tax credits;
- Topic 2—Kansas version of the Uniform Sales and Use Tax Administration Act;
- Topic 3—The streamlined sales tax initiative as it applies to communications services;
- Topic 4—"Source state" legislation which taxes the mutual fund industry on the basis of the customer's residence;
- Topic 5—Feasibility of legislation to require local governments to tax residential and commercial natural gas based on volume consumed rather than the current system of local sales taxes;
- Topic 6—Agriculture Use Value, Review the 2001 Technical Assistance Report: Agricultural Use Value Study State of Kansas;
- Topic 7—Sales and use taxation of telecommunications and broadband equipment;
- Topic 8—Implementation of the Federal Mobile Sourcing Act;

- Topic 9—Income tax credits associated with operation of certain short-line railroads;
- Topic 10—Implications in Kansas Tax Code on Professional Employer Organizations; and
- Topic 11—Review recent Kansas Supreme Court decision in *Kansas Enterprise, Inc. v. Frantz* concerning classification of certain personal property for taxation purposes.

In addition, Mr. Courtwright distributed copies of a review of the provisions in the new federal tax law (Economic Growth and Tax Relief Reconciliation Act of 2001) which was placed on the Internet by Commerce Clearing House ([Attachment 1](#)). He briefly discussed the significant changes in tax law as outlined in the handout, noting that the changes will be phased in over the next decade. The following provisions were included in the handout: lower ordinary income tax rates, tax relief for married couples, tax rates of higher-income taxpayers, expanded tax benefits relating to children, new and bigger breaks for education, employer-provided tuition help, and retirement related tax measures. Mr. Courtwright went on to discuss the impact of the Economic Growth and Tax Relief Reconciliation Act of 2001 on the Kansas State General Fund (SGF). In this regard, he distributed copies of estimates regarding the cumulative impact on income tax, sales tax, and Kansas estate tax revenues, noting that the information was compiled with the assistance of the Kansas Department of Revenue ([Attachment 2](#)). He pointed out that, cumulatively, \$122 million less income tax will be collected than anticipated when the 2001 Legislature adjourned. Mr. Courtwright also noted that the federal estate tax provisions would have no impact on Kansas because of lack of prospective conformity in Kansas Estate Tax Act.

Senator Corbin opened the public hearing on Topic 4, “Source state” legislation which taxes the mutual fund industry on the basis of the customer’s residence (HB 2061). He called upon Mr. Courtwright to present background information on the topic ([Attachment 3](#)). Mr. Courtwright noted that HB 2061 was based on a similar law in effect in Missouri for investment fund service companies. He explained that HB 2061 would provide an exception to the three factor income apportionment formula for investment funds service companies. He noted that the bill was referred to a subcommittee after a public hearing, and the subcommittee asked that four issues be addressed by proponents relative to the differences from Missouri’s law. Mr. Courtwright noted that the proponents subsequently responded with suggested amendatory language to address the subcommittee’s concerns. However, the suggested amendments were not considered by the full committee prior to the end of the session. He called attention to a packet of information which includes the fiscal note on HB 2061, the subcommittee report, and a copy of the bill ([Attachment 4](#)).

Kathy Damron, representing Waddell and Reed Financial, Inc., testified in support of HB 2061. She began by noting that Waddell and Reed is headquartered in Kansas and

conducts considerable business in the state. She explained that Waddell and Reed has been on its own for only two years after being spun off from an Alabama-based insurance company. She further explained that, after researching its tax situation and possible remedies, Waddell and Reed concluded that the most logical approach to the situation would be to recommend a change in Kansas statutes similar to a change made in Missouri law in 1997, often referred to as “source-state taxation.”

Ms. Damron went on to say that the subcommittee appointed after the hearing on HB 2061 examined two areas identified by the Department of Revenue:

1. Could the Secretary of Revenue grant Waddell and Reed tax relief under provisions of KSA 79-3288; and
2. How would implementation issues be addressed?

In this regard, she called attention to a copy of a letter from the Secretary of Revenue attached to her written testimony in which the Secretary indicates that it is beyond his scope of authority to grant tax relief as envisioned in the bill. Ms. Damron noted, with the issue of obtaining administrative relief no longer viable, the issue was returned to the Legislature in early April of 2001 for further consideration. She commented that the timing could not have been worse because at that time lawmakers were scrambling to find ways to address a \$200 million budget shortfall. However, in her opinion, taxation of mutual fund companies should be viewed in the context of a long-range strategic approach to retain and develop growth in an important industry. She called attention to a packet of letters in support of “source-state taxation” from Stilwell Financial, the Overland Park Chamber of Commerce, and Eveans, Bash, Magrino & Klein, Inc. (Attachment 6).

Ms. Damron emphasized that mutual fund industry is highly competitive, and Kansas’ taxes puts Waddell and Reed at a disadvantage to its competitors in other states. She informed the Committee that Waddell and Reed is considering relocating across the state line where the source-state taxation provides significant tax relief. She believes that, regardless of the final decision made by Waddell and Reed regarding its headquarters, Kansas can take a strategic step forward in economic development by making the suggested change in its tax structure.

Brian Hall, KPMG, summarized a report prepared by KPMG entitled, “Analysis of Competitive Landscape of Mutual Fund Industry Prepared on Behalf of Kansas Advocates for Source-State Legislation for Investment Advisors” (Attachment 7). He explained that the analysis compares a Kansas mutual fund company to mutual fund companies in other states, especially in Missouri. He briefly discussed the reasons that the mutual fund industry as a whole is becoming more competitive.

Mr. Hall explained that there are two methodologies for taxation of mutual fund companies. One method is taxation based upon customer residency, or source-state

apportionment. The other method, which is used in the State of Kansas, is based on the cost of performance, which sources revenues according to the location of the infrastructure of the business. He said the net effect of the infrastructure method is that, for a multi-state business domiciled in the State of Kansas, the revenues that are generated in 50 states would be sourced back to Kansas because the bulk of the infrastructure exists in Kansas. Whereas, in a source-state apportionment state, the income would be apportioned for the purpose of taxation according to the residency of the shareholders. Mr. Hall said there are ten states with laws specific to the apportionment of mutual fund income. He noted that this trend began in the early 1990s, and 80 percent of the top 25 mutual fund companies are domiciled in states with source-state apportionment. In his opinion, Kansas must adopt source-state legislation in order to remain competitive in terms of attracting and retaining mutual fund companies.

Richard Cram, Kansas Department of Revenue, discussed the fiscal impact of HB 2061 as submitted during the 2001 Legislative Session. He noted that, based on information supplied by Waddell and Reed, it was determined that passage of the bill would reduce the State General Fund by approximately \$3.84 million. He noted further that Waddell and Reed estimated that tax receipts could be reduced by approximately \$4 to \$6 million, and the Department agrees with that fiscal estimate (Attachment 8). Mr. Cram informed the Committee that Waddell and Reed is working with the Department to address the administrative problems identified by the Department at the hearing on the bill. With this, the public hearing on Topic 4 was closed.

The meeting was recessed for lunch at 12:10 p.m.

### **Afternoon Session**

Chair Corbin called the meeting to order at 1:35 p.m., at which time he opened a discussion on Topic 5, feasibility of legislation to require local governments to tax residential and commercial natural gas based on volume consumed rather than the current system of local sales taxes (SB 233). He called upon Mr. Courtwright for background information on Topic 5.

Mr. Courtwright explained that SB 233, as amended, would have exempted (until July 1, 2002) from local sales taxation those natural gas sales for residential and agricultural use. He said fiscal information on the bill indicated that local sales tax revenues would have been expected to be reduced by approximately \$11.5 million per year. He noted that proponents of SB 233 argued that it would help provide relief for consumers who were paying record natural gas prices, and it would prevent local units of government from receiving a windfall in sales tax receipts due to the winter price spike. In addition, proponents noted that the bill is a step toward the uniformity in state and local sales tax bases currently being sought in the multi-state streamlined sales tax project. He described action on the bill during the 2001

Legislative Session (Attachment 9). A copy of the supplemental note on SB 233, along with a copy of the bill was distributed to the Committee (Attachment 10). Mr. Courtwright also called attention to data prepared by the Department of Revenue showing a dramatic increase in local sales tax receipts on residential natural gas sales from \$7 million in 2000 to \$12 million in 2001 (Attachment 11). He pointed out that a portion of the increased sales tax receipts on natural gas sales is not due to increased prices but rather to increased usage of natural gas due to the cold weather.

Senator Corbin opened the public hearing on Topic 9, income tax credits associated with operation of certain short-line railroads (HB 2586). He noted that HB 2586 passed the House during the 2001 Legislative Session and was referred to the Senate Assessment and Taxation Committee. He called upon Mr. Courtwright to present further background information.

Mr. Courtwright noted that HB 2586, as amended by the House Committee on Transportation, would provide a refundable income tax credit for tax years 2002 through 2021 equal to the total amount attributable to the retirement of bonds issued by a single city port authority. The amount of the credits claimed would be limited to \$0.5 million in any one fiscal year. He reported that a concurrent resolution enacted by the 2001 Legislature approved the creation of the City of Pittsburg Port Authority, and the resolution noted that the economic prosperity and well-being of the City of Pittsburg would be enhanced by the creation of a port authority (Attachment 12). Mr. Courtwright distributed a copy of HB 2586 along with a copy of the supplemental note (Attachment 13).

Ed McKechnie, WATCO Companies, Inc., (located in Pittsburg, Kansas) testified in support of HB 2586. At the outset, he explained that WATCO owns the South Kansas and Oklahoma Railroad (SK&O) and the Kansas and Oklahoma Railroad (K&O). He introduced Rick Webb, WATCO, who also testified in support of HB 2586 (Attachment 14). Mr. Webb pointed out that WATCO is a Kansas based company and followed with a brief history of WATCO, noting that currently WATCO has locations in 17 states from Washington to Florida, and it has six short-line railroad operations. He emphasized WATCO is striving to become more efficient and to provide better customer service. He explained that the K&O Railroad serves Kansas agriculture; however, 60 percent of the SK&O Railroad cars move industrial products, and 40 percent of the cars move agriculture products. He informed the Committee that, within two years, the two railroads will merge. Mr. Webb discussed the constant infrastructure needs that short-line railroads experience, stressing his opinion that rural communities will face the loss of rail service if infrastructure problems are not addressed immediately.

Mr. McKechnie resumed his testimony with a discussion of the primary issues facing short-line railroads. He pointed out that an important issue is the maintenance of tracks, primarily because Class I railroads began reducing maintenance before lines were sold and because rail cars are becoming larger.

Mr. McKechnie noted that, because there has been considerable abandonment of tracks in central and western Kansas in the last few years, there has been a public focus on the future of short-lines. He explained that, during the fall of 2000, the Kansas Department of Transportation (KDOT) approached WATCO regarding short-line railroad issues in central Kansas. At that time, Omnitrax laid out a plan to consider abandoning 700 miles of track in central and western Kansas. WATCO began negotiations with Omnitrax to acquire the Central Kansas Railroad (CKR). In a final agreement reached in April of 2001, WATCO accessed \$11.3 million in KDOT funds over seven years to acquire CKR. In return, the state received a service agreement for SK&O and K&O railroads. Each year, WATCO will file with KDOT a service agreement, a maintenance plan, and an overall plan for which WATCO customers can hold the company accountable. Mr. McKechnie explained that the bottom line is, if WATCO does not live up to their plan, KDOT can fine WATCO \$1,000 per day for each separate violation. In addition, he noted that an abandonment moratorium is in place until December of 2002.

In conclusion, Mr. McKechnie, said the state has the opportunity to end contested rail abandonment in central and western Kansas by approving the refundable income tax credit in HB 2586. He contended that abandonment will be necessary if the bill is not passed. He explained that the bill authorizes an annual, refundable, income tax credit for the K&O Railroad, which would generate \$6.1 million for track improvements to upgrade lines using a 20-year repayment schedule. He noted that the money would be used to upgrade feeder portions of the lines which are in danger of being abandoned if funding is not made available. He explained that WATCO would invest more than \$60 million in the first ten years to maintain and improve the rail, and the state and local investment would be \$10 million. Mr. McKechnie said, according to KDOT, by investing \$10 million now, a \$179 million annual impact on state and local units of government will be avoided.

Loren Medley, Vice Chair of the Kansas Rural Development Council (KRDC), distributed copies of testimony in support of HB 2586 from the Executive Director of KRDC, Steve Bittel, who was unable to attend the meeting. In his written testimony, Mr. Bittel outlines the reasons he believes Kansas should join with WATCO to form a partnership that will ensure growth in rural areas. In addition, he discusses how keeping rail lines open will help traffic safety on rural roads, KRDC's role in the development of a comprehensive rural transportation plan, and the past history of tax credits for port authorities. In conclusion, Mr. Bittel lists five threats to the viability of short-line railroads which have been identified by Dr. Michael Babcock, a professor at Kansas State University (Attachment 15).

Mr. Medley explained that KRDC identifies barriers to rural development and attempts to eliminate the barriers. He noted that the abandonment of rail track has been a long-standing problem in rural areas, continually causing problems with the efficient movement of grain to markets. He said that he first became involved in the solution to the problem of rail abandonment in August of 1998. As he began to look at the issue, he found that over 1,800 miles of rail were abandoned during the years 1980 to 1998, while at the same time grain production continued to increase. His research indicated that rail lines most at risk of being abandoned were owned by one company; therefore, the only way to stop the

abandonment of track was to acquire the whole track. In November of 1999, KRDC met with Rick Webb to discuss the issue. Mr. Medley commented that Mr. Webb's tenacity brought closure to the purchase of 900 miles of railroad previously owned by Omnitrax, a Denver based company, and news of the railroad purchase brought tremendous relief for shippers in central and western Kansas (Attachment 16).

Doug Wareham, Kansas Grain and Feed Association, testified in support of HB 2586, noting that his organization supports the continuation of rail service to all current service points where past use has been demonstrated and a need for continued service is exhibited. Mr. Wareham believes the WATCO purchase of CKR is good news for his organization's shipping members, and he requested that the Committee help facilitate maintaining rail service to the many Kansas rural communities served by those rail lines (Attachment 17).

Charles Swayze, General Manager of the Farmers Coop Equity Company (FCE) of Isabel, Kansas, and representing the Kansas Railroad Users Association (KRUA), followed with further testimony in support of HB 2586. He explained that FCE has grain elevators formerly served by the CKR, and the CKR did not give the service FCE needed to serve the farm producers in south central Kansas. Mr. Swayze commented that CKR's lack of maintenance indicated an intentional down grading for abandonment. He informed the Committee that WATCO (K&O) took over service to his elevators on June 30, and the K&O has given FCE better service in its month and half ownership than the CKR did in six months last year. Because K&O is customer oriented, FCE has been able to obtain lower freight rates. In his opinion, it is essential that K&O obtain funding to help maintain their tracks up to a 286,000 pound loading level. In conclusion, Mr. Swayze pointed out that poor rail service and rail abandonment cause companies to turn to trucks to move their products, and as a result, country roads and bridges take a pounding. He said KRUA supports HB 2586 because it will help retain long-term rail service for Kansas, and it will provide funds needed to improve tracks which currently can carry rail cars at a speed of only five miles per hour (Attachment 18).

Joe Horton, Farmco, Inc., which is located in Tribune, Kansas, gave further testimony in support of providing funding for the maintenance of quality rail service for western Kansas to its eastern Kansas markets. He explained that Farmco's shipment of grain by rail declined from 1,663 cars in 1998 to 231 cars in 2000. In June of 1999, Farmco filed a complaint with the Surface Transportation Board against the CKR, alleging it failed to deliver guaranteed rail cars. On August 6, 2001, Farmco reached an agreement with K&O, and the complaint was dismissed. He said Farmco was impressed with the expeditious manner the agreement was reached, and the board of directors feels it now has a railroad with which it can work in the future to explore new and better ways for Farmco to utilize rail service (Attachment 19).

Joe Lieber, Kansas Cooperative Council, testified in support of HB 2586. He noted that over half of the members of the Kansas Cooperative Council handle grain for their members, and many of them use railroads to ship the grain. For this reason, the Kansas Cooperative Council was pleased to hear that WATCO purchased lines in Kansas and will



provide service to over 50 locations of its members. In addition, he noted that Kansas Cooperative Council is pleased that WATCO issued a moratorium on the abandonment of tracks for 18 months as this allows an opportunity to preserve central and western Kansas rail transportation service (Attachment 20).

Leslie Kaufman, Kansas Farm Bureau (KFB), presented a public policy statement in support of HB 2586, noting that maintaining efficient and effective rail service in Kansas is vital to the Kansas agriculture industry. KFB strongly urged the state to provide tax incentives and other appropriate assistance to railroad companies to upgrade rail lines and provide long-term service to shippers. In conclusion, Ms. Kaufman said KFB is encouraged by WATCO's plans for maintaining rail service to a significant portion of the state, and KFB believes WATCO is committed to operating rail lines for the long term (Attachment 21).

Tom Whitaker, Kansas Motor Carriers Association (KMCA), testified in opposition to HB 2586. At the outset, he noted that KMCA supported the adoption of the resolution which allowed the creation of a port authority to help develop the former CKR and noted that the authorization will provide \$3.677 million in capitol improvements through property tax abatements. However, he is concerned that, under the provisions of HB 2586, the state would be obligated for a refundable income tax credit of \$500,000 per year for 20 years (\$10 million total) whether or not the railroad made one penny in taxable income. He believes it is bad public policy for the state to invest in a private transportation company without any guarantee of a return on the investment. Furthermore, he noted that the *Kansas Constitution* prohibits the state from using general property tax revenue or general obligation bonds to fund internal improvements for economic development purposes. He pointed out that, although the State of Kansas would not be issuing bonds, it would be providing unencumbered revenue for the retirement of such bonds. In his opinion, HB 2586 creates an anticompetitive climate between transportation modes by subsidizing private rail transportation over truck transportation (Attachment 22).

Don Lindsey, United Transportation Union, testified in opposition to HB 2586. He reasoned that the loss in revenue created by the bill will have to be made up by taxpayers. He noted that any increase in taxes caused by the loss in revenue would work a hardship on many citizens who are living on fixed incomes. In his opinion, with the current budget constraints facing the state, any erosion in the tax base would be ill advised. He believes that, if WATCO's operating plan is sound, it should have no problem in obtaining investment capital from federal or private sectors (Attachment 23).

There being no further persons wishing to testify on Topic 9, the public hearing was closed, and the meeting was adjourned at 4:25 p.m.

## Friday, August 24

Chair Corbin called the meeting to order at 9:10 a.m. at which time he called upon Mr. Courtwright to present background information on Topic 2, the Kansas version of the Uniform Sales and Use Tax Administration Act (SB 252). Mr. Courtwright explained that SB 252 would authorize the Department of Revenue to become a signatory to the multi-state streamlined sales and use tax agreement and make preparations for its implementation, which would not occur until such time as the Legislature takes further action to bring the state's laws into compliance with the agreement. The Department would be required to identify all changes in law and rules and regulations necessary to meet the agreement's compliance requirements. The bill would also clarify that the Secretary of Revenue or his designee is authorized to represent Kansas before other states participating in the Streamlined Sales Tax Project. Mr. Courtwright also discussed legislation enacted in 2000, the "Streamlined Sales Tax System for 21<sup>st</sup> Century Act" (Attachment 24). For the Committee's information, a copy of SB 252 was distributed (Attachment 25).

Chair Corbin informed the Committee that he serves on the National Conference of State Legislators' executive committee on the Streamlined Sales Tax Project, and the committee has met three times this year. He noted that there are currently 20 states participating.

Mr. Cram presented a report on the current status of the Streamlined Sales Tax Project and related legislation (Attachment 26). As background information, he began with a review of sales and use tax law in Kansas and followed with a discussion of the complications surrounding the collection of use tax on remote sales to consumers. He went on to give an overview of the Streamlined Sales Tax Project, which he explained responds to the concerns of merchants about the difficulties in dealing with different state's sales tax laws and to state and local government concerns about loss of revenues from remote retail sales by mail-order, telephone, and the Internet. Mr. Cram noted the goal of the Streamlined Sales Tax Project is to make administration of state sales and use tax laws more uniform, efficient, and less burdensome on multi-state merchants. He followed with a report on the status of the project and an update on Congressional action linked to the moratorium on Internet access taxation (Internet Tax Freedom Act).

In conclusion, Mr. Cram said the Streamlined Sales Tax Project has made great strides the past year and continues to build momentum. He reported that the Streamlined Sales Tax Agreement is moving closer to implementation, and the project is testing technology using actual sales transactions. He noted that Kansas needs to pass SB 252 next session in order to have voting rights on any changes in the Agreement and to make progress toward joining the Agreement. Following the conclusion of his presentation, Mr. Cram answered several questions from Committee members regarding the Agreement, the implementation of the Streamlined Sales Tax System, and the tax sourcing rules.

Chair Corbin opened the public hearing on Topic 10, implications in Kansas tax code on professional employer organizations (SB 121), and called upon April Holman, Legislative Research Department, for background information on the topic (Attachment 27). Ms. Holman called attention to a copy of the supplemental note on Substitute for SB 121 (Attachment 28) and a copy of the bill (Attachment 29) which had been distributed to Committee members. At the outset, she defined a professional employer organization (PEO) as a business organization that contracts with small business owners to provide comprehensive human resource services through a co-employment arrangement. She explained that Topic 10 relates to PEOs and proposed legislation which would codify the relationship between a PEO and the business and employees for whom they provide services. She explained that the tax implications in SB 121 fall into two areas:

1. Identifying the responsible party for income tax withholding; and
2. Identifying the employer for tax and tax incentive treatment.

Ms. Holman outlined the changes made to the original bill by the Senate Commerce Committee and informed the Committee that, according to the official fiscal note, passage of SB 121 would have no fiscal effect on the state.

Bill Maness, Oasis Outsourcing in Wichita, testified in support of SB 121, noting that PEOs represent a new and rapidly expanding industry that has proven to be extremely beneficial to small and mid-sized businesses and their employees in Kansas and in other states. He explained that, by the use of co-employment, small business owners can relieve themselves of the management of payroll, tax reporting and payment, workers compensation coverage, employee benefits, and human resource assistance. After describing the benefits of a co-employment relationship, Mr. Maness noted that the original SB 121 was designed to address the common issues necessary to assure the conformity of the PEO industry with the state's other statutory provisions and to recognize the status of the industry. He said he concurs with the substitute bill, which scaled down the original bill considerably and includes tax treatment language as proposed by the Department of Revenue (Attachment 30). For the Committee's information, Mr. Maness distributed copies of a packet of information entitled, "All About PEOs," (Attachment 31).

Terry Humphrey, Kansas Trial Lawyers Association (KTLA), testified in opposition to Substitute for SB 121. KTLA has concerns about the bill's effect upon civil law, liability, and the Workers Compensation Act. Ms. Humphrey contended that the bill would create unnecessary rights and immunities for PEOs. KTLA's position is that, beyond clearing up current language regarding the tax issues, it is best to define the relationship between PEOs and their business clients in contract, not statute (Attachment 32).

Tim Short, KTLA, followed with further testimony in opposition to Substitute for SB 121. His concerns relate to two areas of law not related to taxation:

1. Workers compensation law; and
2. Civil liability to third parties.

He outlined the reasons he believes the bill could have serious negative impact in those two areas of law and recommended that the portion of the bill relating to workers compensation be deleted. He discussed reasons KTLA is concerned about the impact the bill may have on employment law. In summary, KTLA believes passage of the bill would create confusion and uncertainties which are not in the best interest of Kansas employers, workers, or consumers (Attachment 33).

Mr. Cram informed the Committee that the Department of Revenue requested that SB 121 be amended to add language to clarify the status of PEOs already operating in Kansas and to resolve certain tax issues. He explained that the language addresses a question that now exists as to whether the client of a PEO can treat the assigned workers as employees for purposes of determining "qualified business facility employees" and claiming the "qualified business facility" income tax credit under KSA 2000 Supp. 79-32, 153 *et seq.* The language also addresses the question of whether the payroll for the assigned workers should be included in the client's payroll factor under KSA 79-3283 for purposes of apportioning the client's multi-state business income to Kansas and calculating the client's corporate income tax liability (Attachment 34).

Steve Kelly, Kansas Department of Commerce and Housing, testified in support of the concept of SB 121. He noted that the bill was written to address a business trend which recently has become more commonplace in the business world. He pointed out that the employees addressed in the bill are not temporary employees but rather long-term employees that staff the business operation on an ongoing basis. The business has simply chosen to utilize the services of a PEO to provide human resource services and support (Attachment 35).

There being no other persons wishing to testify on Topic 10, the public hearing was closed, and the meeting was adjourned at 11:20 a.m.

The next meeting is scheduled for September 27-28, 2001.

Prepared by Shirley Higgins  
Edited by April Holman

Approved by Committee on:

September 28, 2001