MINUTES

SPECIAL COMMITTEE ON ASSESSMENT AND TAXATION

September 27-28, 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

Mike Taylor, City of Wichita
Richard Cram, Kansas Department of Revenue
Don Moler, League of Kansas Municipalities
Linda Terrill, Neill, Terrill, and Embree, L.L.C.
Mark Beck, Director, Property Valuation Division, Department of Revenue
Clay C. Blair III, Kansas Board of Regents

John Cmelak, Verizon Wireless
Mark Beshears, Sprint
Amy Yarkoni, Cingular
Mike Reecht, AT&T Wireless
Robert J. Fasel, SBC Communications

Thursday, September 27
Morning Session

The meeting was called to order in Room 519-S, Statehouse, by Senator David Corbin, Chair, at 10:10 a.m. on September 27, 2001. Senator Corbin opened the public hearing on Topic 5, local sales tax on natural gas.

Mike Taylor, City of Wichita, presented requested information on Wichita's use of volumetric franchise fees for natural gas (Attachment 1). He explained that the volumetric franchise fee was designed under a deregulated business environment to eliminate inequities between competitors and restore equal treatment of all customer classes. Under a volumetric franchise fee arrangement, third party sellers of natural gas pay a franchise fee based on the volume of gas they ship through the pipes under city right-of-way. Mr. Taylor noted that the franchise fee is a negotiated, contractual amount utilities agree to pay for the use of public land. He pointed out that, because utilities are allowed to itemize the franchise fee on the customer's bill, it creates the perception that a franchise fee is a special city tax. He went on to discuss the difference between a sales tax and a franchise fee. He observed that totally eliminating the 1 percent local sales tax on residential natural gas in Wichita would hardly be noticed by consumers, but later they could end up paying the price through increased property taxes and reduced services.

Mr. Taylor reported that, for every dollar the City of Wichita collects in franchise fees for natural gas, 20 cents is paid back for all municipal facility gas bills. He noted that the franchise fee applies to all natural gas sales, but the 1 percent local sales tax applies only to residential natural gas sales. He pointed out that the citizens of the county voted to impose the 1 percent local sales tax on themselves. He informed the Committee that, in a normal year, $310,000 would be collected countywide from the 1 percent sales tax on natural gas. Based on the distribution formula, the City of Wichita's portion would be approximately $232,000. However, in the winter of 2001, the local sales tax brought in $430,000, and the City of Wichita received an additional $70,000. He noted that the City of Wichita's January 2000 gas bill for all of its facilities was $106,000, but the bill for January 2001 jumped to $209,000. Therefore, while it could be argued that the City of Wichita took in a windfall of $70,000, the city actually paid out substantially more for natural gas.

Senator Corbin called the Committee's attention to a letter from the City Manager of Lawrence, Kansas, regarding requested information on the city's natural gas franchise agreement. A copy of the franchise agreement is attached to the letter (Attachment 2). He also called attention to written testimony concerning Topic 5 submitted by Randy Allen, Kansas Association of Counties. Mr. Allen notes that the segment of the local sales tax base directly attributable to residential natural gas sales is significant. He concludes that exempting natural gas sales from the local sales tax base would result in a shift in the local tax burden to agricultural and business users of natural gas as well as to property taxpayers as a whole (Attachment 3).

In response to a request made by the Committee at the August meeting, Richard Cram, Kansas Department of Revenue, distributed statistical information on local natural gas sales tax collections by region (Attachment 4). He explained that, due to confidentially laws, the Department could not provide detailed statistical information on sales tax revenues of cities and counties to the Committee. Therefore, the Department assembled statistics according to state regions, which are outlined on a map included in the handout. Mr. Cram explained that the data begins with the fourth quarter of 1999 because data prior to that time is not reliable due to a system conversion. He also noted that the data should be viewed in terms of trends rather than the exact dollar figures shown because electric sales were included in some reporting locations and the data for western Kansas is incomplete. He pointed out that the data on local sales tax collections on natural gas by region indicate that the fourth quarter of 2000 and first quarter of 2001 stand out as exceptions to a basic pattern. He noted that there was an increase in both the consumption and the price of natural gas during that period of time. Mr. Cram also briefly discussed the following information included in his handout:

- A chart on natural gas production and sales for Kansas from 1998 through May 2001 prepared by the U.S. Department of Energy;

- A bar graph prepared by the Kansas Department of Revenue to reflect the commercial and residential natural gas consumption shown on the chart;

- A chart on gas prices for Kansas from 1996 through May 2001 prepared by the U.S. Department of Energy; and

- A graph prepared by the Kansas Department of Revenue reflecting residential natural gas prices shown on the chart.

Don Moler, League of Kansas Municipalities, voiced his concern that the reduction or removal of the local sales tax on natural gas sales would have a negative effect on the ability of local governments to adequately fund their operations and continue to provide the many services which are expected of Kansas local governments. He noted that local governments are funded by property taxes, sales taxes, and demand transfers from the state, all of which have been subject to reduction in recent years. He urged the Committee to consider his concerns in its deliberations (Attachment 5).

There being no others wishing to testify, Senator Corbin closed the public hearing on Topic 5 and called upon April Holman, Legislative Research Department, for background information on Topic 11, property tax on rental equipment (Attachment 6). Ms. Holman noted that the topic relates to a Supreme Court Case, *Kansas Enterprises, Inc. v. Sedgwick County et al.*, which concerns a taxpayer that both rents and sells machinery and equipment. She explained that the taxpayer paid personal property tax under protest, claiming a property tax exemption on the basis that it was merchant's inventory under Article 11 of the *Kansas Constitution* and KSA 79-201m. She outlined the action by the State Board of Tax Appeals, the results of the appeal to the district court, and the Kansas Supreme Court ruling. Following her report, Ms. Holman and Don Hayward, Revisor of Statutes Office, responded to questions from the Committee regarding the Supreme Court's findings.

Chris Courtwright, Legislative Research Department, reported that Mark Beck, Director of the Property Valuation Division, Department of Revenue, was asked to provide data on the fiscal implications of statutorily expanding the property tax exemption for rental property. He distributed copies of the tables Mr. Beck prepared for the Committee (Attachment 7).

Linda Terrill, representing Neill, Terrill and Embree, L.L.C., explained that her firm primarily represents taxpayers, and she often gives speeches about property tax across the United States. She noted that she discussed the court case cited by Ms. Holman in a recent speech to the Kansas Society of Certified Public Accountants. For the Committee's information, she distributed copies of her syllabus of the case (Attachment 8). In reviewing the case, she pointed out that the Supreme Court found, "The problem with the taxpayer's business is that its entire inventory is available for rent or sale. The taxpayer does not segregate its inventory in rental inventory or sale inventory. This means that when the taxpayer purchases an item for inventory, it does not know whether it will sell it during the year or whether it will rent it numerous times before sale." In Ms. Terrill's opinion, this case means that the entire inventory of car dealers, retailers with rental inventory, and businesses that do not keep separate records could be subject to property tax. Following her testimony, Ms. Terrill responded to questions from Committee members regarding the possible introduction of clarifying legislation.

For the Committee's information, staff previously distributed copies of the syllabus of the case prepared by the Kansas Supreme Court (Attachment 9).

The meeting was recessed for lunch at 12:15 p.m.

Afternoon Session

Senator Corbin called the meeting to order at 1:55 p.m., at which time he opened a discussion on Topic 6, valuation of agricultural land for property tax purposes (SB 129), and called upon Mr. Beck for an explanation of the formula used in the valuation of agricultural land.

At the outset, Mr. Beck distributed copies of KSA 79-1476, and discussed the language in lines 32 through 83 which deals with the general direction for use valuation, the classification system for land devoted to agricultural use, and the mathematical formula for the valuation process (Attachment 10). Upon completing his review of the statute, Mr. Beck referred to his handout entitled "Kansas Agricultural Land Valuation" (Attachment 11) as he explained the formula used in the valuation of crop and grass land and answered questions from Committee members. Committee discussion followed regarding fair market value and use value. Mr. Hayward noted that the change from fair market value to use value with regard to agricultural land was put in place in 1985.

For the Committee's information, staff previously distributed copies of SB 129 as amended by the Senate Committee of the Whole and the supplemental note on the bill (Attachment 12).

Senator Corbin opened the public hearing on Topic 1, Kansas Regents' Foundation income tax credits (HB 2569) and called upon Mr. Courtwright for background information. Mr. Courtwright called attention to a copy of HB 2569 and the supplemental note which had been distributed to Committee members (Attachment 13). He briefly reviewed the supplemental note.

Clay Blair, Chairman of the Kansas Board of Regents, noted that the creation of the Regents' income tax credit is one of the highest priorities for the Board. He believes that this is an innovative approach which will empower the Board to accomplish things never done before. He informed the Committee that a number of donors have been approached and commitments are being secured. He emphasized that the proposed tax credit is revenue neutral because the tax credits the state gives to the Foundation will be deducted from the funds appropriated to the Board of Regents the following year (Attachment 14). Following his testimony, Mr. Blair answered questions from the Committee regarding the program and the administration of the tax credits.

There being no others wishing to testify, the public hearing on Topic 1 was closed, and the meeting was adjourned at 3:45 p.m.

Friday, September 28

Senator Corbin called the meeting to order at 9:15 a.m., at which time he called upon Mr. Cram for an update on Topic 2, streamlined sales tax. Mr. Cram distributed copies of a memorandum which includes an overview of the background of the Streamlined Sales Tax Project, the status of the pilot project, the latest congressional actions, and a 2001 time line chart on the project (Attachment 15). He noted that Wisconsin passed streamlined sales tax legislation since he last reported to the Committee in August. With regard to the pilot project, he noted that it is expected to run through the end of the year, if not longer; however, statutory authority for Kansas to participate in the project will expire at the end of this calendar year. He reported that the sales tax simplification efforts of participating states continue to move forward, although immediate congressional action on simplification issues appears unlikely due to a change in priorities after the September 11 terrorist attacks.

Senator Corbin opened the public hearing on Topic 8, federal mobile sourcing act, and called upon John Cmelak, representing Verizon Wireless, to present his company's views on legislation that would bring Kansas' tax statutes into conformity with the federal Mobile Telecommunications Sourcing Act (MTSA) (Attachment 16).

Mr. Cmelak began by defining "sourcing" as allocating revenues to a taxing jurisdiction in a way that makes sense. He went on to discuss the reasons that the mobility of wireless services and telecommunications made the sourcing of wireless services and revenues for tax purposes very complicated. He explained that the wireless industry met with representatives from government groups and developed a new nationwide, uniform method of sourcing wireless revenues. The result of their efforts was the MTSA, which was signed into federal law on July 28, 2000. Mr. Cmelak discussed the concept of place of primary use and state level databases, both of which he considers to be key components of the MTSA. He emphasized that the MTSA does not change the ability of states and localities to tax wireless revenues.

Mr. Cmelak also discussed the reasons he believes it is important that Kansas pass conforming legislation before the MTSA becomes effective in August 2002. In this regard, he called attention to statutory amendments suggested by the telecommunications industry attached to his written testimony. He pointed out that the provision regarding customer tax refunds in Section 4 (d) is not included in the MTSA. He explained the section provides that, before a customer may file a class action lawsuit against a mobile telecommunications service provider for an erroneous tax billing, the customer must notify the service provider of the error and allow the provider an opportunity to remedy the error.

In conclusion, Mr. Cmelak pointed out that a copy of the federal act is attached to his written testimony, and he noted that currently only 13 states have passed legislation to conform. The telecommunications industry is hopeful that all states will conform before the August 2002 deadline. Following his presentation, he answered Committee questions regarding the customer's choice of a primary source and the use of a state database.

Mark Beshears, appearing on behalf of Sprint PCS, testified in support of legislation implementing the MTSA (Attachment 17). He emphasized that Sprint PCS strongly supports the customer remedy provision outlined by Mr. Cmelak. He noted that Sprint currently is paying approximately $500,000 per state for billing errors even though it has invested millions of dollars to correct its billing system and software. He explained that the problems that occur are due to human error and multiple jurisdictions. He feels that the company should be given an opportunity to correct inaccurate tax billings and make refunds before customers take legal action.

Amy Yarkoni, representing Cingular wireless, stood in support of the testimony given by Mr. Cmelak and Mr. Beshears. Mike Reecht, AT&T, stood to report that Darrell Bell, a representative of AT&T Wireless, was unable to attend the meeting and testify as planned. He noted that Mr. Bell supports conforming legislation. There being no others wishing to testify, the public hearing on Topic 8 was closed.

Senator Corbin opened the public hearing on Topic 7, sales tax on telecom and broadband equipment. Mr. Reecht testified in support of the passage of legislation which would establish an exemption from the sales and use tax for purchases of equipment used in the provision of telecommunications and broadband services. He views the tax exemption as a competitive element in attracting telecommunication companies to place new facilities in the state or upgrade old networks. He discussed the following factors he feels the Committee should consider: economic development, Kansas tax policy for other equipment, the growing demand for broadband services, the portability of broadband equipment, and double taxation of the telecommunications industry (Attachment 18).

Robert J. Fasl, SBC Communications, testified in support of the sales tax exemption proposed by AT&T. He explained that one of the obstacles that SBC has experienced in deploying broadband and DSL Internet access is the high cost, which includes state and local taxes. He noted that exempting purchases of telecommunications equipment from sales tax would free up capital to purchase more equipment and services. He highlighted the difference between broadband and narrowband, noting that downloading from a PC with broadband is significantly faster. He pointed out that broadband access will be beneficial for neighborhoods as well as businesses. In his opinion, the AT&T proposal will give Kansas a competitive edge (Attachment 19).

Following his testimony, Mr. Fasl answered questions regarding the availability of DSL access for Kansas homeowners. He explained that DSL is available in any area within 3,000 feet of a central office, but a neighborhood gateway must be installed for areas outside that 3,000 foot area. He described the gateway equipment as being the size of a refrigerator. Because the gateway is usually placed above ground, deployment is often complicated by opposition to placing the gateway on a street in the right-of-way area.

Mr. Beshears followed with further testimony in support of AT&T's proposed sales tax exemption for telecom and broadband equipment (Attachment 20). He commented that the slow down in the economy and the deterioration in the capital markets have caused Sprint to take a closer look at its future capital spending plans. He noted that the sales tax exemption would free up cash which would help Sprint make necessary improvements in its network, remain competitive, and expand service offerings to new markets. He emphasized that the telecommunications infrastructure is vital to state and regional economic growth.

Mr. Cmelak gave final testimony in support of the AT&T proposal (Attachment 21). He contended that Kansas' current imposition of sales tax on telecommunications equipment and machinery inhibits investment in telecommunication networks. He pointed out that companies might choose to invest in nearby states where telecommunications equipment is exempt. In conclusion, he stated, "Now is the perfect time to send a signal to telecommunications providers that Kansas wants and needs their investment dollars."

The Committee questioned Mr. Cmelak with regard to the probability of Verizon building facilities in Kansas if a sales tax exemption for telecommunication equipment is passed. Mr. Cmelak commented that the tax climate of a state is one of several factors that Verizon considers when planning to build a new regional facility. He also noted that Verizon would probably not deploy services to rural areas in Kansas, but indicated that it may do so if given an incentive. He noted that, if the exemption is passed, he could tell his network that Kansas' climate for telecommunication equipment and machinery is favorable. With this, the public hearing on Topic 7 was closed.

Senator Corbin called the Committee's attention to the minutes of the August meeting. *Representative Sharp moved to approve the minutes of the August 23-24, 2001, meeting, seconded by Representative Shriver. The motion carried.*

The meeting was adjourned at 11:00 a.m.

The next meeting is scheduled for October 18-19, 2001.

Prepared by Shirley Higgins
Edited by April Holman

Approved by Committee on:

October 18, 2001