# MINUTES

## SPECIAL COMMITTEE ON ASSESSMENT AND TAXATION

November 14, 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 Jeff King
Representative Steve Lukert
Representative Virgil Peck
Representative Jeff Whitham

### Staff Present

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

### Conferees

Alan Conroy, Director, Kansas Legislative Research Department
Richard Cram, Kansas Department of Revenue
Alan Dinkel, City Manager of Hoisington
Mark Burkhart, Ash Grove Cement

### Others Attending

See attached list.

## Morning Session

Chairperson Barbara Allen called the Special Committee on Assessment and Taxation to order at 10:12 a.m. for the purpose of finalizing the Committee reports for presentation to the 2008 Legislature.

Chris Courtwright, Kansas Legislative Research Department, reviewed the revised State General Fund Receipts for FY 2008 and FY 2009 (Attachment 1). For FY 2008, the estimate was increased by $160.5 million, or 2.9 percent, above the previous estimate. The initial estimate for FY 2009 is $6.170 billion, 7.9 percent above the newly revised FY 2008 figure of $5.717 billion.

Although the Kansas economy has been growing at a relatively healthy rate during 2007, indications are that the rate of growth is slowing substantially during the final quarter of the calendar year. The level of uncertainty for 2008 appears to be much higher than it has in the past, largely as a result of high energy prices and tight housing and credit markets. Estimates of nominal Kansas Personal Income (KPI) growth for 2008 and 2009 reflect the impact of the growing economy, but at a slower rate.

Mr. Courtwright reviewed the State General Fund Receipts, showing an actual increase of 11.3 percent in FY 2007, a decrease of 1.6 percent in FY 2008 (due to transfers), and a 7.9 percent increase in FY 2009.

Alan Conroy, Director, Kansas Legislative Research Department, reviewed the latest State General Fund Profile for Actual FY 2007 through Projected FY 2011 (Attachment 2). The profiles included Actual FY 2007, Revised FY 2008 (current year), Projected FY 2009 (budget year), and Projected FY 2010 and 2011.

Actual receipts collected in FY 2007 were $87.8 million, or 1.5 percent above the final estimate. Individual income taxes were $59.3 million, or 2.2 percent above the estimate. Corporation income taxes exceeded the estimate by $22.4 million, or 5.3 percent, and retail sales taxes were $62,000, or 0.0 percent below the estimate.

Expenditures were $25.1 million less than the total approved by the 2007 Legislature. The ending balance is the highest ever at $935 million. Mr. Conroy went on to review FY 2008 and FY 2009 projected income and expenditures. Discretionary spending in FY 2009, 2010, and 2011 was not included in the profile.

During discussion, Mr. Conroy said the employer rate paid in 2009 for KPERS will be 7.75 percent. Local Ad Valorem Tax Reduction Fund (LAVTRF) transfers will begin again in FY 2010 and are included in the projections. Substantial increases in education funding were discussed.

Mr. Courtwright addressed **Topic 1—Corporation Income Tax Shelters** (Attachment 3). He reviewed the background of the issue and possible Committee options. 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. The “Dillmore amendment” to HB 2495 would include three base broadening/tax shelter elimination provisions presented by the Kansas Department of Revenue (KDOR), and provide an additional 0.5 percent of rate reduction in the surtax. Under this amendment the changes in corporation income tax would allow greater apportionment of business income; clarify the definition of “gross receipts” so as to avoid churning; and eliminate tax shelters established through captive insurance companies.

During discussion of Topic 1, Richard Cram, KDOR, said KDOR is working on draft legislation for the income exemption piece. Representative Lukert pointed out that Kansas is one of few states that allow churning, and he felt it should be abandoned. Senator Lee recommended that the Committee continue to examine loopholes and revenue-neutral options to assist in lowering the base rate. She felt there is not room for decreasing income, based on budget projections. Senator Donovan said it would be better to look at the total corporate rate as opposed to a lower rate only for companies that consider relocating in Kansas. Senator Brownlee and Representative Lukert concurred with Senator Donovan's comment. In response to Senator Brownlee, Mr. Courtwright said he would provide fiscal information on what would happen if the one-half percent cut was applied to the base rate, one-fourth percent was cut from the surtax rate, and the base were increased to $100,000. Representatives King and Holland and Senator Lee would like more information before endorsing tax shelters and loopholes. Representative Frownfelter said Kansas should be more competitive with surrounding states.

*Representative Holland moved that a Committee bill be drafted to implement the base broadening/tax shelter elimination provisions presented by KDOR, and to provide an additional 0.5 percent of rate reduction in the surtax beginning in tax year 2009, and those dollars be reallocated to cut the corporate surtax accordingly in a revenue-neutral fashion. Representative Frownfelter seconded the motion, and <u>the motion passed</u>.*

Martha Dorsey, Kansas Legislative Research Department, reviewed **Topic 2—Sales Tax Exemptions** (<u>Attachment 4</u>). Ms. Dorsey presented the background on sales tax exemptions in Kansas.

Representative Lukert, Chairperson of the Topic 2 Working Group of the Special Committee on Assessment and Taxation, reviewed the Working Group proposal (<u>Attachment 5</u>). He said the proposal was a start to stop the bleeding of the tax-base erosion. The Group proposed sales tax exemptions be limited to organizations that meet the qualifications of 501(c)(3) organization, sales of tangible personal property and services purchased by a 501(c)(3) be subject to sales tax except when using federal or state funds, and certain specified sales of tangible property or services be exempt. Organizations exempt from sales and use tax prior to the effective date would be required to reapply for exempt status when their current exemption certificate expires. The fiscal impact of the proposal would be a net $10 million gain in revenue.

Discussion was held on the proposal. Religious organizations would no longer be exempt on their purchases. Steve Brunken, KDOR, said the biggest effect would be on churches and PTOs. They would fall off since they do not get 50 percent of their funding from a government entity. The final decision on an organization's exemption status would be made by KDOR, based on legislative direction. Several Committee members expressed concern about the religious organization exemption being cancelled. Senator Brownlee said it is important that KDOR's guidelines are placed in rules and regulations to keep everything clarified. She expressed concern about the requirement that 50 percent of the organization's operating budget must be from Federal and State funds. Representative Lukert said the general feeling was non-profits that are supported by the government would just be taxing something already being paid for. He said the vast majority of churches would see a minimal impact. Senator Donovan and Representative King said they appreciated Representative Lukert's work on this working group, but felt current law concerning churches and religious organizations was acceptable.

*Representative King moved that the Committee express its strong support of a firm, fixed policy of granting tax exemptions in the future, leaving exemptions already granted in place. Representative Whitham seconded the motion.*

*Representative Lukert made a substitute motion, seconded by Representative Wilk, to grandfather in faith-based institutions, and all other non-profits would be subject to the new policy as presented by the Working Group. The motion failed.*

*A vote was taken on Representative King's original motion, and the motion passed.*

*Senator Brownlee made a motion that the ad hoc working group continue to meet and come up with a scope statement to Post Audit for action. Representative Bowers seconded the motion, and the motion passed.*

The Committee recessed from 12:15 to 1:05 p.m.

## Afternoon Session

Chris Courtwright reviewed **Topic 3—Property Tax Payment Date**. Current property tax law allows taxpayers the option of paying the first half of their liability by December 20 and the second half by May 10 of the next year. This proposal would allow additional bunching by allowing taxpayers to pay their entire property tax liability in January of the following year. Representative Wilk said this issue was quite complex with changing dates and other issues. Additional bunching can already be accomplished by paying a minimum penalty after the first of the year.

*Representative Wilk moved, and Representative King seconded, a motion to take no action on Topic 3. Motion carried.*

Jarod Waltner, Kansas Legislative Research Department, reviewed **Topic 4—Property Tax Deferral** (Attachment 6). This proposal would allow certain taxpayers at least 65 years of age to defer the real property taxes on their homestead property. Mr. Waltner provided information on property tax deferral programs in other states (Attachment 7).

Representative Holland, Chairperson of the Property Tax Deferral Working Group, reported on the group's recommendations (Attachment 8). He provided a copy of HB 2298 from which their work was taken (Attachment 9). Recommendations include: (1) claims must be filed with KDOR by April 15; (2) the person has lived in the Homestead for at least 10 years; (3) the deferred taxes, liens and principal remaining on taxpayers' mortgages cannot be greater than 80 percent of market value; and (4) the maximum request deferred amount is not more than $2,500. A separate lien shall be filed for each valid claim for deferral, and KDOR will pay the county treasurer the amount deferred.

During discussion, the following points were clarified. The Homestead Tax refund and this deferral are totally independent of each other. Since there seems to be a very small participating rate in other states, Representative Holland felt there would be a small fiscal impact. The restriction of not allowing escrow account participants was removed.

*Representative Holland made a motion to take the working group report and have it drafted into a Committee bill, then have it introduced in the House of Representatives. Representative Lukert seconded the motion, and the motion passed.*

Mr. Courtwright reviewed a tax bill draft on the Kansas/Missouri property tax deductibility issue. Representative Wilk said he had been working with Gordon Self, Office of the Revisor of Statutes, on a bill draft to create a reciprocity agreement with other states on how Kansas figures property tax. Conceptually they are trying to get a suspension of the law or a refund in writing from Missouri; however, the bill would address all surrounding states.

*Representative Wilk moved to introduce a bill creating a reciprocity agreement as described and have it be introduced in the House of Representatives. Senator Brownlee seconded the motion and the motion passed.*

Mr. Courtwright addressed **Topic 5—Income Tax Withholding** (Attachment 10). Current withholding tax law grants the Secretary of KDOR a good deal of discretion in establishing the state withholding tables.

*Senator Lee moved the Committee recommend that the Kansas Department of Revenue continue to improve its efforts to make all Kansas taxpayers aware of their ability to adjust their state income tax withholding amounts. Representative Peck seconded the motion, and the motion passed.*

Richard Cram, KDOR, said there is a new K4 form for new and existing employees that more accurately reflects withholding rates for Kansas taxpayers.

**Topic 6—Local Sales Tax Authority** was reviewed by Martha Dorsey, Kansas Legislative Research Department (Attachment 11). This proposal would grant counties additional local sales tax authority. During discussion, it was noted this tax would not be additional, but is intended to replace property taxes for community colleges. Senator Donovan said Shawnee County did this for Washburn University, and it seems to be working well.

Senator Brownlee moved to amend HB 2532 to include allowing community colleges under the authority of the county to offset property taxes, and to allow the offset of property tax with the sales tax. Representative Frownfelter seconded the motion. After discussion, Senator Brownlee withdrew her motion, and Representative Frownfelter withdrew his second.

*Senator Schmidt moved to take no action on Topic 6—Local Sales Tax Authority. Senator Lee seconded the motion and the motion carried.*

**Topic 7—Relief for Storm-Damaged Property** was reviewed by Ms. Dorsey (Attachment 12). A letter to the Committee from Governor Sebelius requesting consideration of legislation that would extend a sales tax exemption to businesses in counties affected by the flooding in Southeast Kansas was received (Attachment 13). Property tax relief and local government assistance are the issues the Committee was given to address.

Senator Schmidt reported all 18 members of the Legislature who represent disaster areas concurred with the following long-term recovery recommendations:

- New housing development grant program;
- Post-disaster recovery zone;
- Housing assistance, including loan guarantees, and other similar issues;
- Green space development assistance; and
- Senior housing enrichment.

Alan Dinkel, City Manager of Hoisington, served as Chairperson of a working group composed of legislators and others to review the recent natural disasters suffered by Kansas communities in 2007 and make recommendations to the Committee on needed assistance. He reviewed the Executive Summary (Attachment 14) and White Paper (Attachment 15) of the working group. He gave background information and said the issues were reduction in tax base, loss of utility revenue, FEMA funds delay, insurance coverage, statutory constraints, and impediments to recovery. The group recommended state budgetary assistance, state revolving fund loan and grant program, eminent domain in disaster areas, suspension of the operation of statutes, creation of possibilities and incentives for consolidation and cooperation, and a blue ribbon panel to study the issues more thoroughly.

Senator Schmidt commended the working group on its report. Most of the suggestions made are outside the scope of this Committee. He recommended the document be forwarded to Representative Lee Tafanelli, Chairperson of the Disaster Relief and Recovery Special Committee, with the urging of this Special Committee to adopt and assemble this information. Representative Wilk concurred with Senator Schmidt and requested this working group be kept in place so committees may come back to it for information. Senator Lee said the Disaster Relief and Recovery Special Committee is only making recommendations, according to Chairperson Tafanelli.

*Senator Schmidt moved and Representative Frownfelter seconded a motion that the working group document be referred to the Disaster Relief and Recovery Special Committee members and indicate there are items of merit to be considered, and the Taxation Committee will take up the reduction in tax base issue. Motion carried.*

Senator Brownlee suggested an idea might be to suspend penalties for those who did not pay property tax on destroyed properties after a disaster. Senator Lee said that would address the property taxpayers' issue, but not the local government issue, and more data is needed to propose a specific fix. Greensburg needs help for three to five years, depending on how fast the town rebuilds. Senator Lee said a slider provision might help rebuild local funds. Southeast Kansas can be handled the same way, but on a smaller scale. She volunteered to work with Senator Schmidt and Representative Dennis McKinney to make a recommendation by the time the 2008 Session starts. Representative Wilk said the first step is to get a bill introduced in January so work can begin. This can be done conceptually by asking for introduction of a bill that addresses the issue. Also, a request for a bill for sales tax exemption for reconstruction in Coffeyville and Kiowa County could be made. No action was taken by the Committee, but the Committee referred the issues back to the Disaster Relief and Recovery Special Committee.

Committee members concurred a positive statement should be included in the Committee report that action needs to be taken on the reduction of tax base and sales tax exemption issue, and residential property taxes for people. This work must be done within the constitutional framework.

*Senator Brownlee moved the Committee introduce a bill to waive penalties for late payment of taxes for those in a Federal disaster area whose home or business was destroyed. Representative Wilk seconded the motion, and the motion carried.*

**Topic 8—Corporation Income Tax Credits** was reviewed by Mr. Courtwright (Attachment 16). Under current law, the Kansas Director of Taxation may allocate credits between two or more businesses owned or controlled by the same interests. With High Performance Incentive Program (HPIP) income tax credits, only the company generating the credit within the unitary group is allowed to claim the credit. KDOR Secretary Wagnon confirmed over $400 million in HPIP credits currently are being carried forward by corporations unable to use them in the current tax year.

Mark Burkhart, Ash Grove Cement, said his group is still looking at language in a proposed bill (Attachment 17). He said he did not know how much of his product was shipped out of state.

Richard Cram, KDOR, clarified the HPIP is earned and only the entity that earned it is entitled to use that HPIP credit.

Senator Schmidt said he would like to find a way to be helpful to the Huhtamaki's expansion in DeSoto, Kansas. He heard them say they wanted cash flow to make the expansion. When it became apparent no one was following up on the Huhtamaki issue, Senator Schmidt put together some suggested HPIP income tax credit redemption elements (Attachment 18). Discussion followed. Senator Schmidt said his concept is to provide review of jobs and economics versus investment. Senator Donovan is concerned about making anything retroactive. Senator Brownlee said allowing $100 million in credits for a $4 billion investment makes good sense. She felt Huhtamaki's credit would more than pay for itself, but it should be prospectively, not retroactively, allowed. She said part of the issue is that various states just offer cash to businesses, so that is what Kansas is competing with for new business or for expansions. Gordon Self said there are probably other consequences if HPIPs are allowed for the unitary organization. Representative Frownfelter said he thought if the return on the investment is there and urgency is an issue, an answer should be given quickly to Huhtamaki. Senator Lee said KDOR Secretary Wagnon was working with Secretary of Commerce David Kerr on a pot of money to give out for new or expanded construction. She said HPIP is only for large companies with a high threshold and a team of accountants to figure it out. Senator Brownlee said the Joint Committee on Economic Development would be willing to finalize the issue at its December meeting. The Committee concurred that they take the position on whatever policy decided on to take its own path, and not address the unitary issue.

*Senator Schmidt suggested Committee language that Huhtamaki's individual circumstances should be handled as an individual circumstance and other issues be handled separately. Senator Brownlee seconded the motion and the motion passed*. This should be done early in the 2008 Legislative Session.

*Senator Lee moved, and Representative Frownfelter seconded, a motion to take no action on the unitary issue. Motion carried.*

Representative Wilk requested confirmation assuming that if HPIPs were allowed to flow unitarily, there would be no other consequences on the tax return. Staff will provide the information.

**Topic 9—Property Tax on New Residential Property** was reviewed by Mr. Courtwright (Attachment 19). Chairperson Allen requested an Attorney General opinion on the issue, but no response has yet been received (Attachment 20).

*Representative Wilk moved the Committee embrace the concepts in HB 2543 and request the home builders and appraisers work together to come up with a bill in January, along with the Attorney General opinion, and then refer the bill to the House Taxation Committee. Senator Lee seconded the motion and the motion passed.*

During discussion, it was noted by John Federico that a model home is considered a "spec" home, not an occupied residence. Senator Brownlee said model homes should be treated as occupied because they utilize public services.

*Representative Wilk moved and Senator Lee seconded to correct the spelling of David Holtwick's name, and then approve the minutes of the October 24-25 meeting. Motion carried.*

The meeting adjourned.

Prepared by Judy Swanson
Edited by Martha Dorsey

Approved by Committee on:

January 16, 2008
(Date)