MINUTES

SPECIAL COMMITTEE ON ASSESSMENT AND TAXATION

October 17-18, 2005
Room 519-S—Statehouse

Members Present

Representative Kenny Wilk, Vice Chairman
Senator Pat Apple
Senator Les Donovan
Senator Janis Lee
Senator Roger Pine
Representative Virginia Beamer
Representative Pat George
Representative Kasha Kelley
Representative Bruce Larkin
Representative Arlen Siegfreid
Representative Tom Thull

Members Absent

Senator Barbara Allen, Chairman
Representative Tom Holland

Staff Present

Chris Courtwright, Legislative Research Department
Martha Dorsey, Legislative Research Department
Gordon Self, Office of the Revisor of Statutes
Rose Marie Glatt, Committee Secretary

Conferees

Joan Wagnon, Secretary of Revenue, Kansas Department of Revenue
Richard Cram, Director, Policy and Research, Kansas Department of Revenue
Mark Beck, Director, Property Valuation Division, Kansas Department of Revenue
Dr. John Wong, Hugo Wall School of Urban and Public Affairs, Wichita State University
Bob Vancrum, private citizen
Bernie Koch, Wichita Chamber of Commerce
Marlee Carpenter, Kansas Chamber of Commerce
Don Moler, League of Kansas Municipalities

Don McNeely, Kansas Automobile Dealers' Association
Ken Daniels, Midway Wholesale
Sue Blechl, Emporia Public Library/Kansas Library Association
Kerrie Bacon, Kansas Commission on Disability Concerns
Pete Doll, YMCAs of Kansas
Diane Oakes, Girl Scout Councils of Kansas
Wade Ferguson, Kansas Health and Fitness Association
George McCrary, Kansas Health and Fitness Association - Baldwin City
Karleigh Venreman, Kansas Health and Fitness Association - Pittsburg
David Owens, Homeless Come Home
Representative Shari Weber
Patricia Biggs, Kansas Sentencing Commission
Dr. Richard Kendall, MS, Kansas Department of Corrections
Phillip Cosby, private citizen
Reverend Doug Burford, Ward Parkway Presbyterian Church
Gregg Motley, Executive Director, National Coalition for the Protection of Children & Families
John Ivan, Adult Entertainment Industry (AEI)

Others Attending

See attached list.

Monday, October 17
Morning Session

The meeting was called to order at 10:00 a.m. by Representative Kenny Wilk, Vice Chairman, who welcomed the Committee back to Topeka for a busy two-day meeting.

Topic 1 – Property Tax Valuation of Historic Property

Chris Courtwright provided background information requested at the September meeting, at which time the Committee questioned whether it was possible for historic properties, such as the Terwilliger Home, on the historic Santa Fe Trail, to be handled under the Kansas Neighborhood Revitalization Act (NRA) instead of a constitutional amendment. He distributed a memorandum regarding information on the NRA, passed by the Legislature in 1994 (Attachment 1).

The NRA program is similar to tax increment financing, except that local units may choose whether or not to participate. Rebates have been growing significantly in the last few years and a 2002-2003 comparative summary shows 14 counties have designated the entire county as Neighborhood Revitalization zones (Attachment 2). A 1996 Attorney General's opinion suggested that the full jurisdiction designation may not be lawful. Discussion followed regarding the legislative intent of the NRA program and how it has actually been utilized relative to that intent. Mark Beck stated that there are very few rules in the act and that the specifics are left to the local governing bodies.

The Committee recommended that after review of the Nebraska constitutional amendment and the Kansas income tax credit and NRA policies, a constitutional amendment in Kansas was not necessary at this time.

The Committee also recommended that the Legislature review the NRA program and conduct an in-depth study of potential changes. The appropriateness of the name of the program was questioned due to its varied applications. A memorandum on the amount of federal and state historic preservation tax credits also was distributed (Attachment 3).

Topic 2 – Analysis of State and Local Tax Policy

Chris Courtwright explained statistics from the Kansas State Treasurer relating to the growth of Kansas state and local bonded indebtedness from $7.581 billion in June, 1990 to $21.138 billion in June 2004 (Attachment 4). The Vice Chairman requested that an updated report relative to June 2005 be obtained from the State Treasurer's office as soon as it is released.

Chris Courtwright briefed the Committee on areas of taxation from the updated (FY 2005) version of the *Kansas Tax Facts* (copy on file - Kansas Legislative Research Department). Kansas state and local government net tax revenue totaled $10.008 billion in FY 2005, which equated to $3,658 per capita and to 11.80 percent of Kansas personal income in CY 2004.

His review included an explanation of the table of state and local taxes; highlights of FY 2005; increases in state tax revenue; and a Kansas tax burden comparison report. He noted that while the state raises more taxes than local units, it is the local governments that continue to spend most of the tax revenue. The recent rate of growth in local taxes, especially property taxes, rebounded somewhat in FY 2005 after coming off two years of more modest growth. Property taxes in FY 2005 increased by about 6.5 percent, or $187 million, with schools accounting for $120 million of the increase. In FY 2005, state tax revenue totaled $5.885 billion, which was an increase of $425 million, or 7.78 percent, above collections in FY 2004.

Secretary Wagnon called attention to the 11 tax policy objectives, recommended by the 1995 Governor's Tax Equity Task Force, *Kansas Tax Facts* (page 6), and questioned how the continuing increase of Kansas' debt can be reconciled with those objectives. KDOR has contracted for an upcoming study, by Dr. Bart Hildreth, Regents Distinguished Professor of Finance in the Hugo School, Wichita State University, on the subject of state and local government debt affordability, to be completed by June 2006. The study will be available through the Kansas Advisory Council for Intergovernmental Relations (KACIR).

Discussion followed regarding the fiscally responsible policy goals for Kansas compared to its current trend that continues to add to the state's indebtedness. The Vice Chairman recommended that due to the seriousness of the issue, the Committee's report should reflect its concerns and refer to Dr. Hildreth's comprehensive forthcoming study. The appropriate committees subsequently should be made aware of current and future trends.

The Secretary stated that if current trends continue, there will be continued erosion of the tax base, resulting in higher tax rates; less equity among the groups of taxpayers; less competitiveness and more taxpayer discontent; and more special groups requesting exemptions.

She reviewed six recommendations for further study (Attachment 5).

- Tax Commission - Initiate a special commission to study the erosion of the tax base, through property and sales tax exemptions; and recommend uniform guidelines that the Legislature would vote up or down.

- Modernize corporate income tax - The current system is 50 years old and may need to be changed to reflect today's standards.

- Revisit property taxation of business machinery and equipment - The practice of exempting machinery and equipment would represent a property tax shift on to other classes of property or a major impact on the State General Fund (SGF) if it were to be financed through expansion of the existing income tax credit.

- Protect the withholding (income) tax - This is the only stable and consistently growing tax base left. A policy question exists about whether it is appropriate to give a special exemption to a specific entity or industry in order to provide an incentive for economic development.

- Estate Tax - After the federal government decides what changes they will make, the state needs to look at the future of the Kansas tax.

- Fix the city sales tax uniformity problem.

The Secretary concluded by reviewing a number of ongoing studies, which include studies on state and local debt, erosion of the tax bases, and the effectiveness of the tax incentives and the current corporate income tax structure. These reports will provide additional tools to help determine the policy framework for the future of taxation.

Afternoon Session

Dr. John Wong gave a power point presentation on the Elasticity of Major Tax Sources Over Time (Attachment 6).

In response to questions on the reasons behind the declining elasticity problem and recommendations on how to correct it, Dr. Wong gave the following responses:

- Kansas' tax policies are based on historic behavior and historic trends. One reason for the decline in elasticity is that the economy today is much different than it was in the 1930s when the sales and income taxes were imposed. As the economy and technology continue to change, government has to keep an eye on those things that are generating economic activity and recognize that is where the resources in the private market are going. When the economy changes and the tax structure does not, a lag in revenues is likely to occur until the tax structure has been adapted to reflect the new reality.

- The decline in the economy is the problem, the elasticity is but an indicator that the economy is changing. As the tax rate increases on the declining base, it may accelerate the deterioration of that base. Kansas is in an onerous position because of the structure of its economy, being heavily invested in agriculture and manufacturing. As we continue to transition through services into technology-based activities, the effect will be even more dramatic than states that are less reliant on those factors.

- Taxing services has not been a traditional means of revenue in most states due to the services' potential mobility and lobbying of special interest groups. The contribution of services in comparison to goods relative to economic activity is expected to continue to grow, causing the elasticity of the sales tax base to continue to erode.

Bernie Koch, Wichita Metro Chamber of Commerce, recommended that the Legislature consider eliminating the personal property tax on business machinery and equipment to help contain the escalating costs associated with business and stop the trend of out-sourcing jobs to other countries (Attachment 7). He noted that 11 states do not have any property tax on manufacturing machinery and equipment. He also distributed copies of a report on "Machinery Investment as a Key to American Growth" (Attachment 8).

Marlee Carpenter, Kansas Chamber of Commerce, encouraged the Legislature to look at a pro-growth business tax policy that would encourage capital investment and job creation in the state. She stated that the Kansas economy is growing at a slower pace than the rest of the country (Attachment 9). She agreed to provide copies of a report from the Council on State Taxation and the accounting firm of Ernst and Young on *"How Much Does Business Pay in Taxes*" for any interested Committee members. Senator Lee requested: (a) a list of items on which businesses are taxed and (b) a further breakdown and explanation on the Small Business Survival and Tax Foundation State Business Climate indices. Ms. Carpenter agreed to provide that information.

Don Moler, League of Kansas Municipalities, reviewed the history of three bills introduced during the 2003 Legislative Session. The League believed that those three measures would have allowed for increasing the diversity of local revenue sources and would have helped provide some replacement revenues for local units still suffering as a result of the elimination of the demand transfers. He urged the Legislature to take a serious look at giving local governments the tools to finance their own operations (Attachment 10). The Vice Chairman requested information relating to the revenue elasticity of the property tax. Staff agreed to check on availability of the information.

Discussion followed regarding the willingness of state and local entities to engage in serious dialogue regarding major changes in the state's fundamental tax policies. Representative Thull requested information from business conferees on success stories from states that rank higher than Kansas in attracting new businesses to their states.

Topic 3 – Motor Vehicle Taxes

Chris Courtwright distributed information relating to several requests made at the September meeting, including (a) 2004 Real and Personal Property Value and Tax Summary Statewide, and (b) 2004 Motor Vehicle Valuation and Tax (Attachment 11). Mark Beck, Property Valuation Division (PVD) Director, explained and answered questions on the valuation process.

Richard Cram distributed a memorandum, prepared by Steve Neske, on the impact upon motor vehicle tax collections, based on a fee schedule requested by Senator Donovan during the 2005 Legislative Session (Attachment 12). The scenario reflected what the revenue picture would look like and how it would affect certain values of vehicles in various classes if the current system were changed over to a fee schedule. Discussion followed regarding how Kansas' current vehicle valuation schedules do not correctly reflect fair market value.

Don McNeely, Kansas Automobile Dealers' Association, reviewed the history of motor vehicle taxes in Kansas and the ramifications those taxes have had on new vehicle registrations (Attachment 13).

Tuesday, October 18
Morning Session

Vice Chairman Wilk distributed copies of a Kansas, Inc., report on Indicators of the Kansas Economy (IKE), October 2005 (Attachment 14). The goal of the project was to identify critical variables that would explain the current condition of the state economy relative to the entire United States, as well as those states surrounding Kansas. The report includes 21 variables with an additional five to be included in future releases. This information provides a consensus around common indicators for use in prioritizing long-term goals. A chart on real Gross Domestic Product (GDP) projections from 2004 though 2015 for 12 countries was also distributed (Attachment 15).

Topic 6 – Tax Lien Certificates

Martha Dorsey, Legislative Research Department, distributed information relating to requests made in September. She explained a comparison of procedures followed in Kansas and Iowa on delinquent property taxes and tax lien certificate provisions for the central region states (Attachment 16). Gordon Self, Office of the Revisor of Statutes, gave a review of SB 45 (Attachment 17). A memo on "Lien priority/redemption by mortgagee" from Bill Waters of the Kansas Department of Revenue (KDOR) also was distributed (Attachment 18).

Bob Vancrum, private citizen, testified that the current system of collecting delinquent taxes was ineffective and said that a new system needed to be developed to be more equitable. He reviewed the procedure used in Iowa. He stated that Wyandotte County continued to be interested in pursuing SB 45, which relates to collection via civil suit, as an additional tool to pursue long-term abusers of the delinquent tax system. He suggested that tax liens represented an alternative concept that the Committee may wish to recommend to the 2006 Kansas Legislature.

Ken Daniels, CEO, Midway Wholesale, testified in opposition to the sale of tax liens on Kansas property. He said that the idea could have many unintended consequences, one of which would be that developers and building owners may have to pay all of the taxes in advance, resulting in cash flow difficulties (Attachment 19).

Topic 2 – Tax Treatment of Not-for-Profit Entities

Chris Courtwright reviewed the policy questions on not-for-profit entities and property tax exemptions and explained new materials that had been distributed: (a) average county levies on tangible property valuation (Attachment 20); (b) 2004 taxes levied for 2005 by cities, provided by the League of Kansas Municipalities (Attachment 21); (c) 2005 estimated school district mill rates, from the Kansas State Department of Education (Attachment 22); and (d) a KDOR memo providing an overview on sales tax exemption certificates - tax exempt entities (Attachment 23).

Mark Beck, PVD, distributed data on tax exemptions by reason and county (Attachment 24). He explained the value of governmental exemptions in relationship to all exemptions, and pointed out that the subtotal for government does not include schools. He also explained a map that represented the percentage of exemptions against the total appraised value in each county and a list of major exemptions by county (Attachment 25).

Sue Blechl, Emporia Public Library/Kansas Library Association, testified in support of HB 2221, a bill that would exempt libraries and friends-of-library groups from paying sales tax on book sales and other fund-raising projects (Attachment 26). She added that the state had estimated that the fiscal note would be $50,000.

Kerrie Bacon, Kansas Commission on Disability Concerns, requested that the Legislature maintain existing property tax exemptions for many non-profit organizations (Attachment 27). She said that these non-profit organizations help fill in the gaps left by numerous state programs. She added that such entities tend to operate on tight budgets, and any increased burden from property taxation could force many to shut down or cut back on the delivery of services.

Pete Doll, YMCA's of Kansas, appeared before the Committee to provide background information on the tax exemptions for the YMCA's of Kansas. He reviewed their charitable mission, which is to put Christian principles into practice through programs that build a healthy spirit, mind, and body for all. He summarized by saying that the policy in Kansas reflects the tax policy in nearly all 50 states (Attachment 28).

Diane Oakes, Girl Scout Councils of Kansas, spoke to the Committee on behalf of the 12 Girl Scout Councils in Kansas, regarding their concern over a potential change in tax policy for these small volunteer-led organizations (Attachment 29). She estimated that the sales tax exemption has a benefit of approximately $450,000 to more than 41,000 girls across the state, and she stated that it was a prudent investment for the state.

Wade Ferguson, President of Kansas Health and Fitness Association (KHFA), Overland Park, provided information about KHFA, which is comprised of 70 health clubs in over 30 communities in Kansas. He introduced two members of the Association who joined him at the podium.

George McCrary, KHFA member from Baldwin City, testified for the elimination of the sales tax on membership dues for health club members of for-profit health clubs. He urged passage of HB 2204, a bill presented in the 2005 Session, that would eliminate the tax inequity between not-for-profit and for-profit associations relative to health club membership dues (Attachment 30).

Karleigh Venreman, KHFA member from Pittsburg, appeared before the Committee to address the issue of unequal treatment of members of adult health fitness clubs. She said that not-for-profit health clubs compete directly against tax-paying clubs, and it is not fair for Kansans who receive the same services from different locations to be treated unequally (Attachment 31).

Topic 4 – Excise or Licensure Tax–Sexually Oriented Businesses

Richard Cram explained a memo prepared by KDOR that identified 20 businesses that are currently operating in Kansas that would be subject to the proposed excise tax on sexually explicit material. The fiscal impact is estimated at $1 million (Attachment 32).

Representative Shari Weber explained that she supported this kind of tax because of her legislative experience with corrections and juvenile justice. The conferees following her would present information for both the statistical side and programmatic side of this issue. She requested the Committee's favorable consideration regarding the introduction of legislation to impose a licensure or excise tax on sexually oriented businesses in Kansas and to tie that tax to the expenses incurred from the negative effects of sexually oriented businesses (Attachment 33).

She also distributed the following materials: (a) Juvenile Correctional Programs and Costs For Sexual Offenders (Attachment 34); (b) State Efforts to Deal with Sex Offenders, Kansas Legislative Research Department (Attachment 35); and (c) *Juveniles Who Have Sexually Offended,* an article from 2001 National Criminal Justice Reference Service (Attachment 36).

Patricia Biggs, Executive Director, Kansas Sentencing Commission, presented statistics on the number of adult felony offenders who have been convicted of sex offenses from 1997 through the current year. Included is a list of offenses that are considered in the category of sex offenses and data on the number of convictions that were given prison or probationary sentences (Attachment 37).

Dr. Richard Kendall, MS, provided background on the state program for sex offender treatment in four state institutions and on out-patient services for approximately 700 offenders currently on parole. He explained the 18-month program provided during incarceration and the supervisory period during parole (Attachment 38).

He responded to three questions:

- How many sex offenders were child victims of sex offenses? Although the research results are conflicting, he estimated the percentage among the Kansas population of convicted sex offenders was 25 to 30 percent.

- How many instances of pedophilia go unreported, as compared to actual convictions of pedophiles? He described, in a typical incest case, a person with a first-time conviction might have offended against anywhere from one to 200 victims.

- Is there a connection between sex offenders and the use of sexually oriented businesses? He stated that while using sexually oriented material does not itself cause the behavior, it frequently sets up a cycle that can ultimately lead to sex offending.

Phillip Cosby, Abilene, described his past two years as a lecturer to thousands of Kansans on the dangers that the sex industry poses for the state. He has worked with criminal prosecution for zoning ordinances in many Kansas cities and stated that the excise tax proposal is a new method of addressing the dangers of this issue. He advised the Committee that a packet of information had been previously sent to them that included a CD on the studies of several cities on the negative secondary effects the sex industry has had on their community.

He gave a power point presentation on: (1) profitability of the sex industry; (2) legal precedent to protect communities; (3) negative secondary effects; (4) general blight in a community; (5) individual effects; and (5) political resolve and popular support. Included in his testimony are numerous reports on the subject (Attachment 39).

Reverend Doug Burford, Ward Parkway Presbyterian Church, Kansas City, testified that scientific research has begun to confirm that someone who regularly feeds on images and stories of extramarital sex, promiscuity, orgies, adultery, violent sexual attacks, demeaning sexual acts, and bestiality is more likely to engage in some of those behaviors than is someone who does not view those images. He said that pornography and sexually oriented businesses harm the soul, the family, and society, and he urged the Committee to enact and enforce laws that limit pornography in the state (Attachment 40).

Gregg Motley, Executive Director, National Coalition for the Protection of Children and Families (NCPCF), gave testimony about his 19- year addiction to pornography and sexually oriented businesses and the help he received through resources and organizations promoted by NCPCF. He provided background on his education and career choices that led to his decision to serve as the administrator of the local chapter of NCPCF. He delineated the many destructive effects of pornography in a community and urged the Committee to pass a tax to enable the public sector to continue to fight pornography (Attachment 41).

John Ivan, Adult Entertainment Industry (AEI), appeared as an opponent to the proposed excise tax on sexually explicit businesses. He stated that only Utah has passed a law imposing an excise tax, and noted that it is limited to escort services and strip clubs and does not apply to adult bookstores and adult stores. His testimony included a July 20, 2005, report on "Contradictory and Inconclusive Findings" prepared by Bruce McLaughlin Consulting Service, Inc. (Attachment 42).

In conclusion he requested the Committee consider the following four issues:

- The proposed excise tax does not address material which is sold through the internet or through satellite or cable television.

- Since a number of mainstream video stores have a separate room or area containing adult videos, how would the proposed excise tax be enforced against those businesses?

- Any admission fee imposed on the customer entering a video or book store constitutes an unconstitutional prior restraint on free speech.

- The Kansas Legislature will not be able to prove a compelling state interest sufficient to justify the infringement upon constitutional rights.

Vice Chairmanman Wilk closed the public hearing and stated that discussion would continue, followed by any recommendations the Committee would want to make, at the November meeting.

Senator Donovan moved that the minutes of the September 15-16, 2005, meeting be approved, and Representative Kelley seconded. Motion passed.

The meeting was adjourned at 1:00 p.m. The next meeting is November 9-10, 2005.

Prepared by Rose Marie Glatt

Edited by Chris Courtwright

Approved by the Committee on:

November 9, 2005
(date)