MINUTES

SPECIAL COMMITTEE ON ASSESSMENT AND TAXATION

November 14, 2002
Room 519-S—Statehouse

Members Present

Representative John Edmonds, Chair
Senator David Corbin, Vice Chair
Senator Janis Lee, Ranking Minority Member
Senator Barbara Allen
Senator Les Donovan
Senator Mark Taddiken
Representative Deena Horst
Representative David Huff
Representative Nancy Kirk
Representative Bruce Larkin
Representative Bill Light
Representative Bonnie Sharp

Staff Present

Chris Courtwright, Kansas Legislative Research Department
April Holman, Kansas Legislative Research Department
Gordon Self, Revisor of Statutes' Office
Gary Deeter, Committee Secretary

Conferees

Richard Cram, Director, Policy and Research, Kansas Department of Revenue
Terry Kimes, Mize Houser and Company
Neal Sharma, CEO, Digital Evolution Group
Bill Waters, Tax Attorney, Kansas Department of Revenue
Robert Miller, Wabaunsee County Appraiser
Randl Rivers, Superintendent, Mill Creek Valley USD 329
Joleen Rankin, County Appraiser, Dickinson County
Delton Gilliland, Osage County Attorney
Steve Rein, Rush County Personal Property Manager

Vic Miller, Attorney
Sharon Pittman, Morris County Appraiser
Leslie Kaufman, State Director, Kansas Farm Bureau Public Policy Division

Others Attending

See attached list.

Thursday, November 14, 2002
Morning Session

The Chair called the final meeting of the Committee to order at 9:00 a.m. Chris Courtwright summarized the latest Consensus Estimating Group report (Attachment 1). He said the shortfall in State General Fund revenues is now estimated to be $363.5 million, or 8 percent below the March 2002 estimate, the reduction caused primarily from decreases in sales and individual income tax revenues. He said in light of the latest estimate, the Legislature must begin the FY 2004 budget with a much lower base. Attachment 2 provides a history of past current-year revisions in revenue estimates.

Senator Corbin briefed the Committee on the Streamlined Sales Tax Implementing States (SSTIS), a multi-state agreement to create a uniform system for collecting sales tax on nearly $3.5 trillion in retail transactions annually (Attachment 3). He said 31 states voted to approve the project, noting that two further steps are needed to implement the process: Congress needs to lift the moratorium on Internet access taxes; and 10 states, comprising at least 20 percent of the total population of states with a sales tax, must approve the agreement. Senator Corbin cautioned that, because of initial start-up costs, the Kansas Legislature should draft legislation that complies with the agreement but postpones the effective date until Congress lifts the moratorium, thereby initiating an immediate revenue stream. He said some changes from the present sales tax statutes would be necessary, such as the sourcing rule, which would need to be modified to provide for the collection of tax based upon the taxing jurisdiction at the point of delivery of a product. Richard Cram, Kansas Department of Revenue (KDOR), said KDOR is preparing a package of relevant legislation for the 2003 Session.

The Chair noted that, through SB 39, the 2002 Legislature repealed a sales tax exemption on custom computer software. He then opened a hearing on that subject. Terry Kimes, Mize Houser and Company, reviewed two Kansas Supreme Court decisions which held that custom software was not tangible personal property and not subject to KSA 79-3603. He said that KDOR's interpretation of custom software may exceed statutory authority and that the new tax is having a deleterious effect on the business community (Attachment 4). He observed that large companies can develop software in-house and avoid sales tax; thus, smaller companies relying on outside consultants to develop software applications are unfairly penalized by the tax. He added that consulting fees for custom computer software are similar to other professional fees which are not taxed, producing another inequity.

Answering a question regarding the projected $15 million revenue from the tax, Mr. Cram said it would be difficult to isolate the anticipated revenue stream and verify the estimate.

Neal Sharma, CEO, Digital Evolution Group, spoke in opposition to the tax on custom software (Attachment 5). He said the service of his firm is one of the few professional services subject to sales tax in Kansas, stating that the tax makes it more difficult for him to compete with Missouri firms who are not subject to such a tax. He observed that the tax gives Kansas a negative image regarding technology, saying that the present tax model is based on the industrial age, not the information age. He said the tax is especially onerous for small and mid-sized businesses which have no in-house software development staff. In response to Committee questions, Mr. Cram replied that the Legislature defined software as tangible personal property, that the price of OTS (off-the-shelf) software includes development costs, and that 12-15 states presently tax custom software. He said that custom software developed elsewhere and sold to a Kansas company is subject to the compensating use tax. The Chair closed the hearing.

Bill Waters, attorney for KDOR, reviewed the history of exempting farm machinery and equipment from property taxes (Attachment 6). He said the 1982 originating statute (KSA 79-201j) required "exclusive use" to trigger the exemption. The 1997 Legislature included commercial feedlots within the statutory exemption and removed "exclusive use" from the law since that test was no longer required under the exemption provided in the *Kansas Constitution*. When the Board granted an exemption to Lietz Construction because they used their construction equipment 75-80 percent for farm soil conservation, Wabaunsee County appealed the decision to the Kansas Supreme Court, whose decision supported BOTA. However, BOTA denied Furney Construction an exemption for construction equipment and two over-the-road motor carriers an exemption for their semi-trailers, using the following test:

- Is the machinery or equipment considered "traditional" farm machinery or equipment as defined by K.S.A. 79-201j?
- Is the machinery or equipment "actually and regularly" used in a farming or ranching operation?

An individual or company must answer yes to both questions to qualify for an exemption.

The Chair opened a public hearing on farm machinery property tax exemptions. Robert Miller, Wabaunsee County Appraiser, estimated that his county lost $12,749.22 in tax revenue in 2002 from the *Lietz* decision, saying that the lost revenue must be shifted to other sources, such as the property tax. He commented that those construction firms which are granted exemptions are given a competitive advantage over those who do not have exemptions (Attachment 7). Randl Rivers, Superintendent for Mill Creek Valley USD 329, spoke in support of Mr. Miller's comments, noting that special exemptions create inequities and inefficiencies in government (Attachment 8).

Joleen Rankin, County Appraiser for Dickinson County, testified that granting exemptions for construction equipment continues the migration of the general tax burden to a narrower base (Attachment 9). She said the construction exemption will require Dickinson County to refund $23,000 plus interest. Answering questions, Ms. Rankin said the statutory definition of farming is too wide if it allows construction equipment to be exempt.

Delton Gilliland, Osage County Attorney, reviewed the legal history for exempting farm machinery and equipment, saying that the *Lietz* decision is contrary to the interest of counties, noting that there is no constitutional definition for farm machinery and equipment in the constitution, thus making the constitutional objection to the "exclusive" and "for hire" terms questionable. Mr. Gilliland exceeded his time limit before he was able to make any recommendations.

Steve Rein, Rush County Personal Property Manager, opposed including earth-moving machinery in the exemption of farm machinery and equipment from personal property taxes (Attachment 10). He acknowledged that earth-moving equipment is often used for agricultural purposes, but that such work is usually done for hire, and because owners depreciate the equipment for tax purposes, such action causes it to meet the definition of taxable personal property in Kansas.

Vic Miller, the Topeka attorney who argued the *Lietz* case, appeared as representative for land contractors; he sought to clarify and rebut statements from previous conferees. He said the granting of exemptions for farm-use construction equipment by county appraisers has been erratic and inconsistent, and that since 1989 BOTA has consistently granted exemptions for earth-moving equipment, using "actually and regularly used for farm operations" as the basis for its decisions.

Sharon Pittman, Morris County Appraiser, requested the Committee revise the statute to minimize the erosion of the tax base. She provided examples of construction equipment assessments and the negative impact on tax revenues (Attachment 11).

Leslie Kaufman, State Director, Kansas Farm Bureau Public Policy Division, cautioned the Committee against any change in the present law that would have a negative impact on true farm or ranch operations (Attachment 12). She urged the Committee to guard against unintended consequences that would harm Kansas farmers and ranchers if the Committee recommends a change in the law.

The Chair closed the public hearing on farm machinery exemptions, saying he intended to draft memoranda regarding the custom computer software sales tax issue and the farm machinery property tax exemption, inviting other members to sign on to each memo or to include separate recommendations.

Mr. Courtwright reviewed the Sunsetting Sale Tax Exemptions Committee Report (Attachment 13). Members voiced a desire to examine larger tax policy issues and not become distracted by individual exemptions, suggesting that if the sales tax base were broadened, the rates might be reduced; such a task could be assigned to the House and Senate tax committees. *A motion was made to ask KDOR to continue updating the fiscal notes associated with sales tax exemptions to assure the best possible information is available; further, to ask KDOR to update the fiscal notes associated with extending the tax to previously untaxed services. The Committee requests House and Senate leadership to* *study tax policy in Kansas with special attention to the sales tax base and exemptions. The motion passed. (Motion, Senator Lee; second, Representative Sharp.)*

April Holman presented the Committee Report on Sales Tax Parity on the Sale of Firearms, Weapons, and Ammunition (Attachment 14). Noting that the issue appears to be an isolated problem relating more to enforcement than to statutory issues, *Senator Corbin made a motion that no action be taken. Representative Larkin seconded the motion, which passed.*

Mr. Courtwright reviewed the following Committee Reports, saying that the Committee had already adopted each of them in concept and that no further action was required:

- Legal Issues Regarding Expansion of Tax Credits to Railroads and Other State-Assessed Property (Attachment 15);
- Motor Fuels Tax; (Attachment 16) Mr. Courtwright said the new administration might review this issue further;
- Family Development Account Program (Attachment 17); and
- Re-Evaluation of KSA 79-201B Fifth, Relating to the Property Tax Treatment of Certain Independent Living Centers (Attachment 18).

The minutes for the October 24-25 meeting were approved. (Motion, Senator Donovan, second, Representative Horst.)

The Chair expressed appreciation for the work of the members and staff. The meeting was adjourned at 12:17 p.m.

Prepared by Gary Deeter
Edited by April Holman and
Chris Courtwright

Approved by Committee on:

January 17, 2003