Kansas, Inc.

Charles R. Ranson, President

Sales Tax Exemption and Economic Development income Tax Credits Report

as required by K.S.A. 74-8017

prepared by

Mikel Miller
Director of Research

January 2000

KANSAS, INC.

January 14, 2000

K. S. A. 74-8017 requires Kansas, Inc. to prepare an annual report evaluating the cost effectiveness of state and local tax exemptions granted under the Kansas Enterprise Zone Act and various other state economic development income tax credits. Our submission of this report to the standing committees of the House and Senate responsible for tax and economic development policy satisfies that obligation.

Our analysis of the effectiveness of state and local sales tax exemption is the product of a statewide survey of businesses having recently received exemption status for a project in the state. An impressive survey response rate of 51% and the quality of the survey instrument used gives me confidence in reporting that analysis of business responses strongly suggests that the continued presence of this exemption is an important inducement to Kansas-based businesses and those considering making Kansas their home.

Kansas, Inc.'s ability to similarly evaluate the effectiveness of economic development tax credits is, unfortunately, severely limited by inaccessibility to claimants' identities through the Kansas Department of Revenue. The current questionnaire system, established by K.S.A. 74-8017 as a means to identify claimants, fails to capture sufficient information and represents an indefensibly costly burden on the corporate taxpayers of Kansas. Pages 13-15 explain the system's deficiencies in greater detail.

Utilization of economic development tax credits continues to grow, with claims reaching $26.7 million in the most recent calendar year. If the state wishes to evaluate accurately the effectiveness of these tax credit dollars, Kansas, Inc. recommends enactment of the provisions set forth in S.B. 69, currently filed for consideration by this Legislature. S.B. 69 would amend K.S.A. 74-8017 to repeal language requiring continued use of the ineffective questionnaire. In its place, the Department of Revenue would be directed to provide Kansas, Inc. with the name, address, and telephone number if available, of any taxpayer claiming an economic development tax credit. Access to this information would enable a true evaluation of the effectiveness of these economic development tools. Kansas, Inc. asks for your support of S.B. 69.

Sincerely,

Charles R. Ranson
President

KANSAS, INC.

Created by the 1986 Legislature, Kansas, Inc. is an independent, objective, and nonpartisan organization that seeks to build consensus and act collectively to achieve state economic development goals.
Kansas, Inc. is governed by a 17-member, predominately private sector, Board of Directors that is co-chaired by the Governor and a senior private sector executive. Private members are appointed by the Governor and confirmed by the Kansas Senate.

It is a quasi-public instrumentality of state government that operates as a partnership between government and the private sector as the means to achieve a Kansas economy that is internationally competitive. The activities and products of Kansas, Inc. strive to meet the highest standards of objectivity, independence, and credibility. It is a nonpartisan entity that serves the public interest through cooperative efforts and consensus building among the leadership of the executive and legislative branches of state government, the business community, and the general public.

By conducting strategic analysis of and planning for the economic development of the State of Kansas, evaluating state economic development policies and programs, and overseeing the formulation and implementation of economic development policy for the State, Kansas, Inc. strives to enable all Kansans to achieve a higher quality of life and standard of living by fostering economic vitality statewide, and by competing in the global economy.

Since 1987, Kansas, Inc. research reports have covered such diverse topics as: aviation, global market penetration, value-added agriculture, business taxation, seed and venture capital formation, interstate banking, oil and gas, business financing, workforce training, rural development, and education. Through analysis and open dialogue, Kansas, Inc. identifies policy options and builds the consensus essential for concerted action on vital economic issues.

The executive and legislative branches of state government and the private sector in Kansas all share the responsibility for Kansas, Inc.'s agenda. This joint commitment is illustrated by our financing: the operating expenses of Kansas, Inc. are funded by state government and the research and educational program is financed by the business community.

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INTRODUCTION

Legislative Mandate. In 1994, the Kansas Legislature passed H.B. 2556 (K.S.A. 74-8017) which gave Kansas, Inc. the responsibility to prepare an annual report to evaluate the cost effectiveness of state **sales tax exemptions** granted under the Kansas Enterprise Zone Act and various **state economic development income tax credits**. The bill required that the results of this annual analysis be submitted to the standing committees on Taxation and Economic Development of the House, and Assessment & Taxation and Commerce of the Senate.

SECTION 1: SALES TAX EXEMPTION ANALYSIS

Prior Reports. In years past, this annual report presented an in-depth analysis of business investment reported in connection with sales tax exemption by region, county-size, and economic sector. This analysis provided unique insights into investment and growth trends in Kansas by region, and industrial sector, and county size.

In addition, past reports presented a rigorous estimate of how much state sales tax revenue is forgone in connection with sales tax exemption.

Inaccessibility to Data. The data necessary to provide the extensive analysis discussed above is collected from applications for sales tax exemption certificates processed the previous fiscal year by the Department of Revenue. Due to a review of the statutory language contained in K.S.A. 74-8017, a decision was made by the Department to discontinue providing Kansas, Inc. with the applications for sales tax exemption certificates. In doing so, the Department conferred with Kansas, Inc. to discuss possible amendments to K.S.A. 74-8017 which they believed would again allow them to supply the applications for sales tax exemption certificates. The Department also offered to provide Kansas, Inc. with an aggregation of data from the applications for Kansas, Inc.'s subsequent analysis. Kansas, Inc. staff declined this offer believing the proposed alternative would not allow for the in-depth and comprehensive analysis required.

Proposed Solution - S.B. 69. S.B. 69 was introduced in Senate Commerce during the 1999 Legislative Session. The bill passed the and awaits hearing in House Taxation. The bill would amend K.S.A. 74-8017 to allow the Department of Revenue to provide Kansas, Inc. the necessary documents to resume the historical analysis.

Kansas, Inc. respectfully requests your support for S.B. 69 during the 2000 Legislative Session.

Analysis Provided. In the meantime, this year's report will present the results of a survey conducted by Kansas, Inc. of Kansas firms whose request for sales tax exemption was processed in FY 1998 (the last year information was provided). The findings provide insight into the behavior altering effects of incentives and in particular sales tax exemption.

1999 SURVEY OF SALES TAX EXEMPTION RECIPIENTS

Background

In April 1999, Kansas, Inc. conducted a survey of companies that were issued sales tax exemption certificates during fiscal year 1998. A total of 284 surveys were mailed and 145 completed surveys were returned for a response rate of 51%. A copy of the survey is attached as Appendix A.

Respondent Characteristics

Company Size. The majority of respondents (65%) were small companies employing 100 or fewer workers. Firms employing between 100 and 500 made up 21% of respondents and firms employing over 500 made up 14% of respondents. Figure 1 graphically illustrates the makeup of those that responded to the survey.

Respondents by Sector. The large majority (70%) of respondents were manufacturers. The second largest group of firms were retailers (14%), with the other sectors each representing less than 6% of the survey population. (Figure 2 and Table 1)

Respondents by Region. The largest percentage of firms (29%) responding to the survey were from the South Central region of the state. The second largest group was from the Northeast region (23%). (Figure 3 and Table 1)

The largest group of respondents were manufacturers from the South Central region of the state (22%). The second largest group were manufacturers from the Northeast region (16%), followed by manufacturers from the North Central region (12%). The remaining respondents were spread among the regions without large concentrations being present. (Table 1)

Respondents by County Size. Three categories are used to describe county size: metropolitan, mid-sized and rural. Metropolitan counties are those nine counties in the state's metropolitan statistical areas (MSAs) as defined by the U.S. Census. Mid-sized counties are non-metropolitan counties with populations over 10,000. Rural counties are those with populations of less than 10,000.

The percentage of firms responding to our survey was about equally divided between firms located in metropolitan counties, mid-sized counties, and rural counties. (Figure 4)

Respondent Population Characteristics

Figure 1

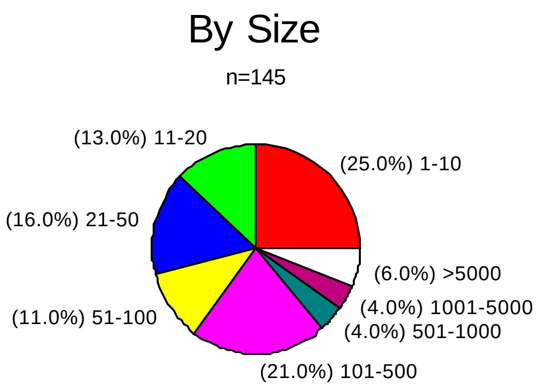
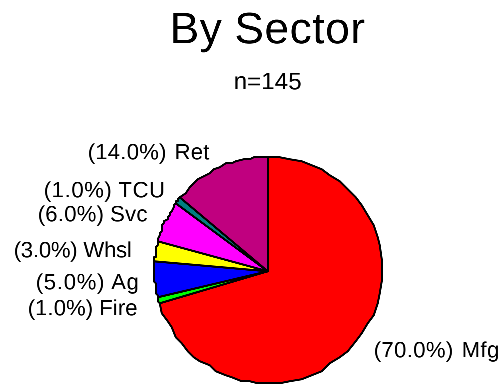


Figure 2



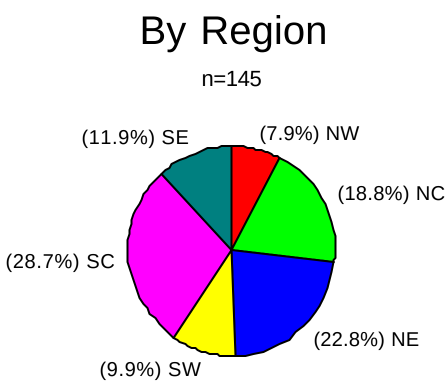


Figure 3

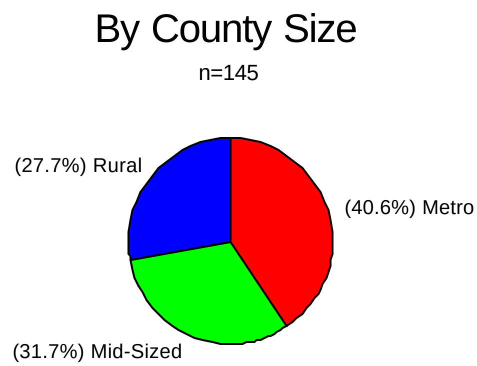


Figure 4

Table 1
Respondent Population Distribution by Region and Sector n=145

		NC	NE	NW	SC	SE	SW
		19 %	23 %	8%	29 %	12 %	10%
AG	**5%**	3		2			2
FIRE	**1%**	1				1	
Manufacturing	**70%**	17	23	7	32	14	7
Retail	**14%**	5	3	3	4	1	4
Service	**6%**		3		5	1	
TCU	**1%**		1				1
Wholesale	**3%**	1	3		1		

Type of Project

The majority of respondents (76% or 109 firms) were existing Kansas firms undergoing an expansion of their present facility. Another 19% (28 firms) were start-up firms and 5% (7 firms) were out-of-state firms that were either expanding into Kansas or relocating to Kansas. (Table 2)

Table 2
Which best describes the project for which the sales tax exemption was granted? n-144

Type of Project	Percent	Firms	Percent	Firms
Start-Up	19%	28		
Existing Kansas Firms	76%	109		
Expansion of an existing Kansas firm			96%	105
Relocation within Kansas			4%	4
New to Kansas Firms	5%	7		
Expansion into KS by an out of state firm			71%	5
Relocation to KS from an out of state location			29%	2
	100%	144		

Survey Analysis - Did Incentives Make a Difference for this Population?

The "But For" Test. Whenever an analysis of business incentives is undertaken, the researcher must determine, as best he or she can, whether the desired outcome (new business creation, retention, expansion, or successful recruitment) would have taken place with or without the incentive. This question is sometimes called the "but for" test.

Culling out the Mobile Firms. To answer the "but for" question, we must first determine whether the company's owners or managers had seriously considered conducting the project in another state. To do this, the survey asked all existing Kansas firms and start-ups whether they had seriously considered conducting their project in another state. Of the 138 start-up and existing Kansas firms surveyed, 15% (20 firms) said they had seriously considered undertaking their project in a different state. We call these firms **"mobile firms."**

> 15% of existing Kansas firms and start-ups said they had seriously considered undertaking their project in a different state. We call these firms **"mobile firms."**

By the remaining firms' (85%) own admission, the decision to remain in Kansas had been primarily "pre-determined" by other factors and was not influenced by incentives. It is, however,

> For 85% of existing Kansas firms, the decision to remain in Kansas is primarily "pre-determined" by other factors and is not influenced by incentives.

important to note that incentives may well have had an influence on these **"location-bound" firms'** decision to expand their businesses or the extent of their investment. This concept is discussed on page 11 of this analysis.

Effect of incentives on Mobile Firms. We asked the firms that had seriously considered moving to tell us the three most important reasons for their ultimate decision to remain in Kansas to undertake their project.

Sixty-five percent (65% or 13) of the 20 mobile firms, said that state and/or local incentives played an important role in their decision to remain in Kansas (Table 3). Five of the 13 firms (38%) were very large firms, indicating that incentives in general may be more important to the decision-making process of larger companies that would have the ability to command substantial incentives packages in other states.

Q. Do state and local incentives effect existing Kansas firms' decisions to remain in Kansas?

A. 65% of mobile firms, said that state and/or local incentives played an important role in their decision to remain in Kansas.

Table 3
Of Mobile Firms (Existing Kansas Firms and Start-ups that *Seriously Considered Moving*) n=20

What were the three most important reasons for your firm's ultimate decision to remain in or move to Kansas?	
State and/or local tax incentives	**65% (13)**
Proximity to markets	**50% (10)**
Well-trained skilled labor force	**35% (7)**
Owner's place of residence	**35% (7)**
Cost of labor less expensive	25% (5)
Quality of life in Kansas (i.e. education, housing, cost of living)	25% (5)
Transportation infrastructure	20% (4)
State and/or local financial incentives (i.e. grants, HPIP program, training dollars, etc.)	15% (3)
Competitive tax structure	10% (2)
Aggressive recruitment/retention efforts	5% (1)
Availability of educational/training facilities	5% (1)
Other	0% (0)

Significance of Sales Tax Exemption Specifically.

To find out how significant sales tax exemption was among the incentives that had an important role in retaining those 13 mobile firms, we asked them to what extent this particular incentive affected that decision. Fifty-four percent (7 firms) of firms greatly influenced by incentives said sales tax exemption contributed significantly to their decision to remain in Kansas and 38% (5 firms) said it contributed somewhat. This indicates that when incentives are important to a firm's decision, sales tax exemption is among the most significant for a majority of firms. Broadening the analysis, we can therefore say that sales tax exemption had a significant impact on the decision to remain in Kansas for 35% of all mobile firms. (Table 4)

> **Q. Does sales tax exemption effect mobile firms' decisions to remain in Kansas?**
>
> A. When incentives are important to a firm's decision, sales tax exemption is among the most significant.
>
> A. Sales tax exemption had a significant impact on the decision to remain in Kansas for 35% of all mobile firms.

Table 4

To what extent was sales tax exemption for this project a factor in your company's decision to go ahead with this project in Kansas?

	Of those that said incentives were an important reason they remained in KS n=13	Percent of all 20 mobile firms
it contributed significantly	54% (7)	35%
it contributed somewhat	38% (5)	25%
it contributed only slightly	8% (1)	5%
it did not contribute	0% (0)	0%

Answering the "but for" question

To test the validity of the reported significance of the sales tax exemption, and find out what the effect of its absence would have been, we asked the 20 mobile firms (and subsets of those 20) what their actions would likely have been if sales tax exemption had not been available. The results are reported in Table 5.

Of the 20 mobile firms, 3 firms said they would have canceled their projects. Of the subset that said state and/or local incentives played a major role in their decision not to leave Kansas, 2 said they would have canceled their project had sales tax exemption not been available. Of the even smaller subset that said state and/or local incentives played a significant role in their decision to remain in Kansas and that of the incentives available, sales tax exemption contributed significantly to their decision to remain in Kansas, 2 firms said they would have canceled the project had sales tax exemption not been available.

Q. What would be the effect on mobile firms' decision to stay in Kansas if sales tax exemption was not available?

A. Based on this series of responses, we can conclude that if sales tax exemption was not available to mobile Kansas firms expanding their operations, approximately 10% could be expected to leave the state to conduct their project.

One of the 2 firms that repeatedly said they would have canceled their project had sales tax exemption not been available was a very large firm which employs between 1000 and 5000.

Based on this series of responses, we can conclude that if sales tax exemption was not available to mobile Kansas firms expanding their operations, approximately 10% could be expected to leave the state to conduct their project.

Table 5

Of Mobile Firms

If sales tax exemption had not been available for your company, what would have been the effect on this project? We would have....

	1st Level Test A. Those that considered moving n=20	**2nd Level Test** B. Subset of A. that said state and/or local incentives played a major role n=13	**3rd Level Test (Most valid)** Subset of B. that said ST exemption contributed significantly n=7
proceeded with the project as planned	25% (5)	23% (3)	14% (1)
proceeded on a smaller scale	60% (12)	61% (8)	57% (4)
canceled the project	15% (3)	15% (2)	29%(2)

Effect of Incentives on Out-of-State Firms

Of the 145 respondents, seven (7) were either expansions into Kansas by an out-of-state firm or relocations to Kansas from an out-of-state location. These firms were asked to identify the three most important reasons for their firm's decision to move to or expand into Kansas. Seventy-one percent (71%) told us that state and/or local tax incentives played an important role in their decision making process. More specifically, those five (5) firms were asked to what extent sales tax exemption influenced their decision. Eighty percent (80%) said sales tax exemption contributed significantly to their ultimate decision. Broadening the analysis, we can say that 57% of the new-to-Kansas firms reported that sales tax exemption contributed significantly to their ultimate decision to locate in Kansas.

Q. Do state and local Incentives effect out-of-state firms' decisions to locate in or expand into Kansas?

A. 71 % of new to Kansas firms said incentives played an important role in their decision to move to Kansas.

A. 57% of the new-to-Kansas firms said that sales tax exemption (specifically) contributed significantly to their ultimate decision to locate in Kansas.

To further test the validity of responses, the four (4) firms that told us sales tax exemption had contributed significantly to their decision were asked what their actions would likely have been if sales tax exemption had not been available. The results are reported in Table 6.

Three (3) of the four (4) firms said they most likely would have canceled the project. These three (3) firms that said they would have canceled their move to Kansas were all manufacturers, two employ 100 to 500 Kansans now and 1 employs 500 to 1000 Kansans now. Two are located in mid-sized counties and one of the smaller two is located in a metropolitan county.

Based on this series of responses, it is safe to conclude that if sales tax exemption was not available to firms considering locating in Kansas, 40 to 45% could be expected to locate in a state other than Kansas.

Q. What would be the effect on out of state firms' decision to move to Kansas if ST exemption was not available?

A. If sales tax exemption was not available to firms considering locating in Kansas, 40 to 45% could be expected to locate in a state other than Kansas.

As one would expect, incentives in general, and sales tax exemption more specifically, are a far more important factor in the decision making process of a firm considering moving to Kansas than they are to an existing Kansas firm's decision to remain in Kansas.

Table 6 **Of Out of State Firms that Moved to or Expanded into Kansas n=7**		
If sales tax exemption had not been available for your company, what would have been the effect on this project? We would have....		
	Subset of those that said incentives contributed significantly (n=5)	Subset of n=5 that said ST exemption contributed significantly (n =4)
proceeded with the project as planned	0% (0)	0% (0)
proceeded on a smaller scale	40% (2)	25% (1)
canceled the project	60% (3)	75% (3)

<u>Other Factors considered in decision making process.</u>

While the survey was only conducted on firms that received sales tax exemption, the results can be considered reliable for the majority of Kansas firms considering an expansion or those considering a move to Kansas from another state.[1] Analysis of the two relevant classifications of firms (20 mobile firms and the 7 firms that moved to or expanded into Kansas) provides insight into the strengths and weaknesses of the Kansas' business climate.

Sixty-eight percent (68%) of existing Kansas firms and 71% of new-to-Kansas firms cited <u>state and/or local incentives</u> as an important factor in their decision-making process. No other variable was named more often.

The second most often named variable was <u>proximity to markets</u> with 50% of existing Kansas firms and 57% of new-to-Kansas firms reporting the Kansas location as an key factor in their location decision.

Kansas' <u>well-trained skilled labor force</u> ranked third among the factors named by both classifications of firms. Thirty-five percent (35%) of the existing Kansas firms and 43% of new-to-Kansas firms consider Kansas' workforce among the three most important reasons they chose to remain in or move to Kansas.

For new-to-Kansas companies <u>state and/or local financial incentives</u> also played a big role in their decision with 43% citing this as one of the three most important factors that contributed to their decision to move or expand into Kansas. The majority of these firms

[1] Generally speaking, nearly all firms (with the exception of retail and personal services) are eligible for sales tax exemption on projects provided a minimum number of net new jobs are created (depending on the industry).

specified state training dollars as the financial incentive that influenced them. The transportation infrastructure was also cited by 43% of the new-to-Kansas firms.

Surprisingly, low cost of labor was not named among the three most important factors by new-to-Kansas firms. Nor was quality of life named. Not surprisingly based on recent Kansas, Inc. research into the competitiveness of the Kansas tax structure, none of the firms cited competitive tax structure as an important reason they chose to move to or expand into Kansas.

Effect of Sales Tax Exemption on Location-Bound Firms

Of the 145 firms that responded, 118 were start-up or existing Kansas firms that had not seriously considered undertaking their project in another state. In other words, these 118 firms were not influenced by sales tax exemption or any other incentive they may have received[2] except to say that the incentive reduced the overall cost of their project.

To gauge the significance of the cost reducing effect of sales tax exemption on the projects undertaken by these firms, firms were asked to describe the likely outcome had sales tax exemption not been available. Forty-three percent (43%) said they would have proceeded with the project as planned, while 56% said they would have proceeded on a smaller scale. Only two (1.7%) firms said they would have canceled their projects. Both were very small firms in rural counties. (Table 7)

Q. What impact does sales tax exemption have on location-bound Kansas firms?

A. 56% of firms said the cost reducing effect provided by sales tax exemption has an impact on the overall size of the investment made with regard to their project.

Based on these responses, we can say that for the majority of firms, the cost reducing effect provided by sales tax exemption has an impact on the size of the investment made with regard to their project. Further analysis showed the cost savings impacted firms of different sizes and in different industries about equally.

[2] Other state incentives might include but are not limited to **1) Job Creation Tax Credit** (allows $1,500 to $2,500 credit for each new employee), **2) Investment Tax Credit** (allows 1% credit for investment in a qualified business facility), **3) High Performance Firms Incentives Program (HPIP)** (allows a 10% tax credit for on qualified investment and for training expenditures above 2% of payroll). Local incentives vary widely between locations but could include property tax exemption, cash, real estate, infrastructure development, etc..

Table 7 Of Location-Bound Kansas Firms n=118 missing=1	
If sales tax exemption had not been available for your company, what would have been the effect on this project? We would most likely have....	
proceeded with the project as planned	43% (50)
proceeded on a smaller scale	56% (65)
canceled the project	1.7% (2)

SECTION 2: ECONOMIC DEVELOPMENT INCOME TAX CREDITS

The second section of this report concentrates on economic development income tax credits resulting from the operation of:

- Job Creation and Investment Tax Credits (K.S.A. 79-32,153 and 79-32,160a);
- tax credits for investment in Kansas Venture Capital, Inc.(K.S.A. 74-8304A and 74-8305);
- tax credits for investment in a Certified Venture and Seed Capital Funds (74-8401);
- Research and Development Tax Credits (K.S.A. 79-32,182); and
- Workforce Training and Investment Tax Credits for High Performance Firms (K.S.A. 74-50,132).

Source of Data Used. The information provided on usage of economic development income tax credits is gleaned from an annual report compiled by the Department of Revenue. This report provides an accounting of the number of firms and individuals claiming each credit and the total amount of credits claimed. Due to confidentiality provisions now existing in statute, the limited information available through in the Department's report is the only source of information available on the usage of economic development income tax credits.

Inaccessibility to additional data limits Kansas, Inc.'s ability to provide the mandated evaluation of the cost effectiveness of the various economic development tax credits as prescribed by K.S.A. 74-8017. The following paragraphs outline the result of the data collection system now in place for gathering data on taxpayers using economic development tax credits and its failure to produce the desired results.

Failed Alternative Data Collection System

Background. As described in the introduction to this report, the 1994 Legislature passed H.B. 2556 (K.S.A. 74-8017) and charged Kansas, Inc. with evaluating the cost effectiveness of the various income tax credits available to Kansas businesses. Kansas, Inc. determined, and the Kansas Legislature agreed, that an evaluation such as this would require identifying taxpayers who claimed income tax credits and contacting or surveying those identified. To that end, the original version of H.B. 2556 gave Kansas, Inc. access to corporate tax records to identify filers. The bill passed both tax committees, but the Senate Committee of the Whole did not support Kansas, Inc.'s access to the necessary corporate tax records.

In response, H.B. 2556 was amended on the Senate floor to provide what was envisioned to be an effective alternative method to identify corporations claiming state income tax credits without revealing information from the corporate tax records. The amendment required all corporations subject to state income tax to file a questionnaire along with their corporate income tax returns stating whether the corporation had claimed any of the economic development tax credits listed. The Department of Revenue was then required to harvest the completed questionnaires from the corporate tax return and provide them to

Kansas, Inc. Kansas, Inc. would use the information from the questionnaires to contact those firms regarding the effect of incentives on their company.

As directed, the Secretary of Revenue, with the cooperation of Kansas, Inc., developed a questionnaire which became a part of the Corporate Tax Booklet beginning in 1994. Kansas, Inc. has revised the questionnaire annually to improve its utility.

Effectiveness of Questionnaire System. From the time the first completed questionnaires began to be received at Kansas, Inc., the adequacy of the questionnaire method of collecting information became suspect. Table 8 compares the number of completed questionnaires received by Kansas, Inc. as of September 30, 1999 with the actual number of corporate claims filed for tax credits during that same period. As reported in Table 8, less than 20% are being captured through the questionnaire process now in place.

Table 8

Results of Questionnaire Collection Process

	Questionnaires Received* (1994 to 9/30/99)	Actual Corp. Claims Reported by Revenue** (1994 to 9/30/99)	Percent of Actual Claims (1994 to 9/30/99)
Venture & Seed Capital	0	4	0%
Research and Development	29*	306	9%
HPIP	18	30	60%
Job Creation or Investment Tax Credit	353*	2532	14%
Totals	400	2872	14%

*1999 Questionnaire requested taxpayers include "new claims" for credits only while the actual corporate claims reported by Revenue includes claims for carry-overs of credits.

Source: Kansas Department of Revenue Credit Summary Report as of September 30, 1999

<u>Other Limitations/Considerations</u>

1) The questionnaire only captures corporate taxpayers and does nothing to identify individual taxpayers who claim a tax credit on their personal returns (i.e. sole proprietor, partnerships, LLC's, or a pass-through from a corporation.) According to the Department of Revenue, nearly 40% of filers are individual taxpayers.

2) The questionnaire is an expensive proposition for both the corporate taxpayer and the Department of Revenue which must harvest the questionnaires from the thousands of corporate returns processed. Many of the Kansas corporations, whether they are

claiming credits or not, incur additional accounting fees associated with completing and filing the questionnaire. Nine out of ten questionnaires received by this office are completed by taxpayers that have not claimed a credit.

3) Despite the best efforts of the Department of Revenue, results from the questionnaire system are disappointing and cannot be used as intended because too few filers are identified in each category of tax credits to allow for reliable survey results. Kansas, Inc. is therefore unable to produce with confidence analysis of the effectiveness of the economic development tax credits as required by the statute.

Proposed Solution - S.B. 69

After numerous discussions between Kansas, Inc. and the Corporate Tax Section of the Department of Revenue, Kansas, Inc. requested introduction of a bill to amend K.S.A. 74-8017 during the 1999 Legislative Session. S.B. 69 passed the Senate and awaits hearing in House Taxation.[3] The bill would amend K.S.A. 74-8017 by repealing that portion of the law requiring the questionnaire. In its place, S.B. 69 would add language requiring the Department of Revenue to provide Kansas, Inc. with the name, address and telephone number (if available) of any taxpayer claiming an economic development credit. This information would be used to conduct an annual survey of taxpayers claiming credits to help determine the effectiveness of the economic development tax credits.

Again, Kansas, Inc. requests your support for S.B. 69 during the upcoming legislative session.

[3] A similar bill was introduced in 1998 but died in Senate Commerce without being heard due to heavy schedule.

ECONOMIC DEVELOPMENT INCOME TAX CREDITS

This section describes a number of tax credits designed to encourage economic development in the state and presents the most recent fiscal impact calculations. Numerical tabulations were gleaned from the recent report of the Research and Revenue Analysis Office, Kansas Department of Revenue.

Historical Fiscal Impact 1986 to 9/30/99. Figures 5 & 6 illustrate the fiscal impact and composition of economic development tax credits actually claimed since 1986. Figure 5 shows the significant increase beginning in 1993 in total economic development credits claimed. Much of the increase can be traced to changes made to the original Enterprise Zone Act made by the 1992 Legislature. Those changes eliminated the original Enterprise Zone program, which limited eligibility for incentives to only designated county-wide zones, and established the current program which extends Enterprise Zone eligibility statewide. Appendix B to this report contains a full history of the Kansas Enterprise Zone Act along with an outline of incentives provided.

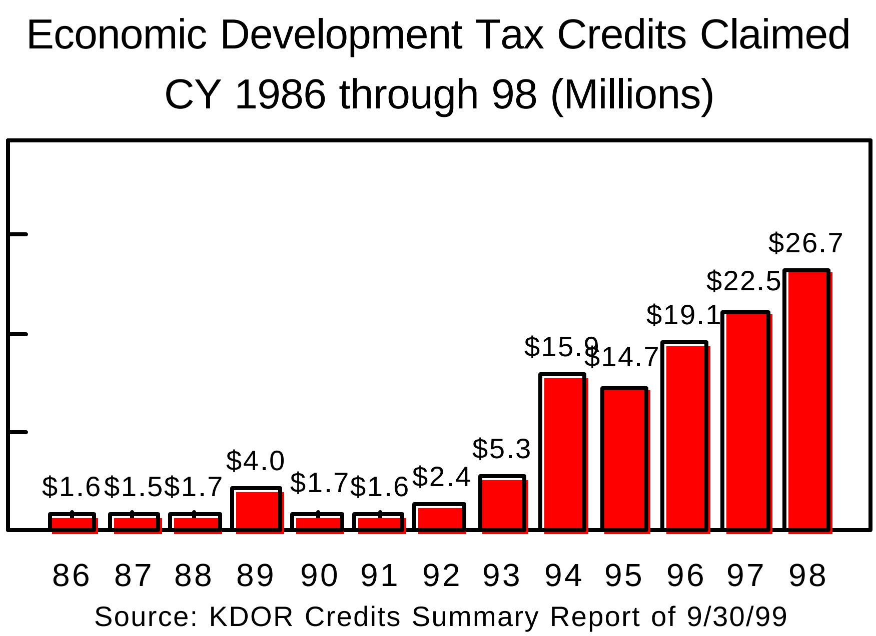


Figure 5

As Figure 6 illustrates, the vast majority of credits (81%) granted between 1986 and September of 1999 were Job Creation and Investment Tax Credits authorized under the Kansas Enterprise Zone Act and K.S.A. 79-32,153 et seq.. The second largest amount was for Research and Development Tax Credits.

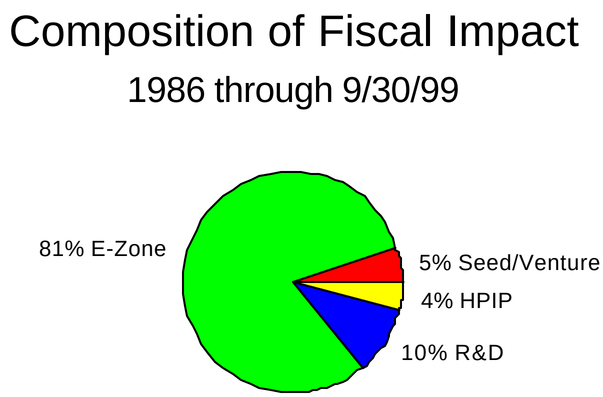


Figure 6

Fiscal Impact during Calendar Year 1998. According to the Department of Revenue, taxpayers claimed economic development income or privilege tax credits totaling $26.7 million during Calendar Year 1998. Figure 7 reflects data compiled by the Department of Revenue and provides a comparison of the fiscal impacts of each economic development tax credit. The figures represented include credits and carry-overs actually claimed during Calendar Year 1998. Eighty-four percent (84%) of the total economic development credits claimed during Calendar Year 1998 were Job Creation and Investment Credits available through the Kansas Enterprise Zone and K.S.A.79-32,153 et seq.. Claims for High Performance Firms Incentives Program credits doubled between 1997 and 1998 and are expected to continue to grow.

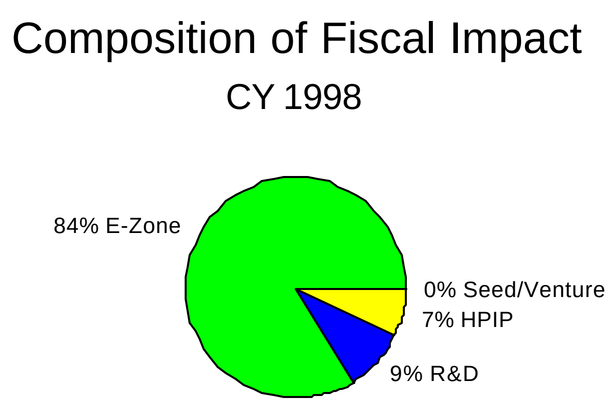


Figure 7

Historical Fiscal Impact for Individual Credits

Kansas Enterprise Zone Act - K.S.A. 79-32,153 and 79-32.160a *et seq.*

The basic *Job Creation Tax Credit* is $1,500 per net new job. If a county has been designated as a nonmetropolitan business region, the credit is $2,500 per net new job. The *Investment Tax Credit* is $1000 per $100,000 of qualified investment. This credit is the same for manufacturing or non-manufacturing businesses throughout the state, regardless of location. The 1996 Legislature revised the *Kansas Enterprise Zone Act* to provide eligibility for insurance companies and financial institutions by allowing the credits to be used against the privilege tax on net income. Both the Job Creation and the Investment Tax Credits are claimed by submitting a Schedule K-34 with the business' Kansas income tax filing. Both credits may be used to offset up to 100% of the business' annual tax liability. Unused credits may be carried forward indefinitely. Table 9 reports Job Creation and Investment Tax Credits claimed between 1994 and 9/30/99.

Table 9

Job Creation and Investment Tax Credit (E-Zone)

Current with Carry-over, Post 1994 Revamping*

	Total Filers	**Total Claimed**
1994	54	$ 799,216
1995	133	2,431,843
1996	206	6,531,454
1997	239	10,909,568
1998	252	15,511,908
As of 9/20/99	100**	2,995,277**
Total	**984**	**39,179,266**

Source: KDOR Credit Summary Report of September 30, 1999

*See "Recent History of Sales Tax Exemption as it Applies to the Kansas Enterprise Zone Act" in the Appendix.

**Privilege tax filers and individual filers for 1999 were suppressed by KDOR and are not included in this figure or in the total figure.

Job Creation and Investment Tax Credit Act of 1976 - K.S.A. 79-32,153 *et seq.* The *Job Creation and Investment Tax Credit Act of 1976* provides incentives to those businesses that may not qualify for the Enterprise Zone incentives, such as retail businesses, or non-manufacturing businesses that do not create at least 5 net new jobs. Eligibility for these credits requires the creation of at least two net new jobs. This Act provides a job creation credit of $100 per net new employee per year for a period of 10 years and an investment tax credit of $100 per $100,000 of qualified investment. Credits may be used to offset up to 50% of the business' Kansas income tax liability. Unused credits may not be carried forward. Table 10 reports Job Creation and Investment Tax Credits awarded between 1977 and 9/30/99.

Table 10
Job Creation and Investment Tax Credit (Non E-Zone)
Current (No Carry-over Allowed)

	Total Filers	**Total Claimed**
1977	11	32,182
1978	38	111,304
1979	74	288,289
1980	160	619,134
1981	214	1,218,860
1982	208	711,487
1983	191	1,215,628
1984	195	758,912
1985	237	1,028,489
1986	220	1,618,901
1987	237	1,459,585
1988	228	1,073,801
1989	266	679,312
1990	262	878,137
1991	232	822,445
1992	775	1,575,909
1993	897	3,033,541
1994	968	11,350,693
1995	1,029	10,690,617
1996	1,137	10,748,033
1997	550	9,416,906
1998	525	6,842,601
As of 9/30/99	82	1,266,047
Total	**8,736**	**67,440,813**

Source: KDOR Credit Summary Report of September 30, 1999

Research and Development Tax Credit - K.S.A. 79-32,182 et seq. Created in 1986, this tax credit is designed to increase research and development activity by Kansas businesses. The income tax credit is equal to 6.5% of a company's investment in research and development above the average expenditure of the previous three-year period. Only 25% of the allowable annual credit may be claimed in any one year. Any remaining credit may be carried forward in 25% increments until exhausted. Table 11 reports Research and Development Tax Credits awarded since the programs inception and 9/30/99.

Table 11
Research and Development Tax Credit
Current and Carry-over

	Total Filers	Total Claimed
1988	12	$ 133,890
1989	24	407,807
1990	39	249,737
1991	50	449,221
1992	63	764,043
1993	76	1,757,598
1994	85	3,171,884
1995	90	720,139
1996	83	875,454
1997	55*	*1,340,675
1998	57	2,382,291
As of 9/20/99	15	61,539
	649	**$12,314,278**

Source: KDOR Credit Summary Report of September 30, 1999
*Individual filers for 1999 were suppressed by KDOR and are not included in this figure or in the total figure.

Kansas Venture Capital, Inc. - K.S.A. 74-8304A, 74-8305 et seq. and Certified Venture and Seed Capital Credit - K.S.A. 74-8401. These credits are designed to encourage cash investment in venture capital and seed capital pools in Kansas. To that end, a credit equal to 25% of the taxpayer's cash investment in stock issued by Kansas Venture Capital, Inc., a certified Kansas venture capital company, or a certified local seed pool may be deducted from a taxpayer's income or privilege tax liability. The entire amount of the credit may be claimed in one year, or if the amount of the credit claimed exceeds the taxpayer's liability in any year, the amount may be carried forward until the credit is exhausted. Table 12 reports tax credits awarded since the inception of the program and 9/30/99.

Table 12

Certified Venture Capital Investment Credit (KVCI)

Current and Carry-over

	Total Filers	**Total Claimed**
1986	7	$ 6,846
1987	12	26,523
1988	168	452,510
1989	170	2,936,313
1990	74	533,483
1991	54	341,465
1992	12	42,299
1993	7	527,857
1994	4	417,600
1995	11	689,499
1996	6	406,774
1997	0*	0*
1998	0*	0*
As of 9/30/99	0*	0*
Total	**525**	**$6,381,169**

Certified Seed Capital Investment Tax Credit

Current and Carry-over

	Total Filers	**Total Claimed**
1989	2	$ 7,527
1990	2	10,179
1991	0	0
1992	1	4,689
1993	1	8,621
1994	0	0
1995	0	0
1996	0	0
1997	0*	0*
1998	0*	0*
As of 9/30/99	0*	0*
Total	**6**	**$31,016**

Source: KDOR Credit Summary Report of September 30, 1998
*KDOR Credit Summary Report of September 30, 1999

High Performance Firms Incentives Program (HPIP) Credit - K.S.A. 74-50,132. This incentives program was enacted in 1993 to retain Kansas' existing high-performance businesses, encourage investment in worker training and education, and spur the attraction of new, high quality firms to the state. The first firm was certified in late 1994. The incentives offered under the program are limited to manufacturers, export oriented service sector firms, and corporate headquarters and back-office operations of national or multi-national corporations. To qualify, a firm must pay above average wages for their industry in the county in which it is located, and either invest an amount equal to 2% of its total payroll on employee training or participate in either the Kansas Industrial Training (KIT) Program, the Kansas Industrial Retraining (KIR) Program, or the State of Kansas Investment in Lifelong Learning (SKILL) Program. Firms wishing to use this credit must be certified by the Kansas Department of Commerce & Housing (KDOC&H.)

Income Tax credits available through this program are:

- 10% Investment Tax Credit against corporate income tax on any investment exceeding $50,000. The credit may be taken over a 10-year period subject to annual requalification by KDOC&H.
- Workforce Training Tax Credit on training expenditures above an amount equal to 2% of total payroll. The credit is limited to $50,000 with no carry-over provision provided.

Table 13 reports tax credits awarded since the inception of the program and 9/30/99.

Table 13
High Performance Firms Incentives Program (HPIP)
Investment Tax Credit and Workforce Training Tax Credit
Current with Carry-over for Investment Credit Only

	Total Filers	Total Claimed
1994	3*	$166,549*
1995	10*	189,585*
1996	22	492,049
1997	22	808,207
1998	26	1,924,750
As of 9/30/99	5	1,414,524
Total	**88**	**$4,995,664**

Source: KDOR Credit Summary Report of September 30, 1999
*KDOR Credit Summary Report of September 30, 1998

HPIP Evaluation Results

Kansas, Inc. performed a statutorily required evaluation of the HPIP program in FY 1998. The report was published in May of 1998 and found the HPIP program to be effectively meeting its statutory goals. A number of recommendations were made by Kansas, Inc. which included the continuation of the program and amending the HPIP statute to allow the warehousing, wholesale trade and distribution sectors to qualify for HPIP certification. The

1999 Legislature agreed with the recommendation and included these sectors for eligibility.

As part of that evaluation, Kansas, Inc. contracted with Central Research & Consulting of Topeka (CRC) to conduct a confidential survey of 64 firms having taken advantage of HPIP incentives. In all, 59 of the 64 firms certified for HPIP incentives between FY 1994 and FY 1997 were successfully contacted and surveyed for a response rate of 92%.

The majority of projects reported on were in the manufacturing sector (78%). Sixty-eight percent (68%) of the projects were for headquarters or back office operations of a national or international firm. Most of the projects or firms earned both Investment Tax Credits and Workforce Training Tax Credits and 78% of respondents' projects involved the purchase of machinery and equipment. The great majority of projects (93%) were relocations or expansions of existing Kansas firms or facilities.

Survey Goals. Specifically, the goal of the survey was to answer the following questions.

1) Did the HPIP program influence certified firms' decision to:
    a) make the capital investment?
    b) locate the project in Kansas?
2) Did the HPIP program influence certified firms to:
    a) raise wages?
    b) increase investment in worker training?
    c) increase sales outside the state?
    d) engage a consultant to improve operations?

Major Findings.

< Overall, HPIP incentives had a greater impact on recruitment efforts than on the retention of existing Kansas firms.

< 41% of existing Kansas firms said the HPIP program had a "significant impact" on their decision to invest in new machinery and equipment or facility.

< 47% of existing Kansas firms that had seriously considered leaving the state to undertake their projects, said the HPIP incentives "contributed significantly" to their ultimate decision to remain and invest in Kansas.

< 41% of existing Kansas firms that had seriously considered leaving the state to undertake their projects, said that had it not been for the HPIP incentives, they would have taken the project to another state.

< HPIP incentives had less impact on existing Kansas firms that had not seriously considered moving from the state. In a confidential survey, 38% of those firms said they would have proceeded with the project as planned with or without the HPIP

incentives. Fifty-three percent (53%) said they would have proceeded on a smaller scale.

< 40% of out-of-state firms said that HPIP incentives “contributed significantly” to their firm’s decision to locate their facility in Kansas.

< 40% of out-of-state firms said that had it not been for the HPIP program, they would have located in another state.

< 23% of HPIP firms said they had increased worker training to meet HPIP requirements. There is no way of knowing how many firms are currently in the process of increasing investment in worker training to meet HPIP requirements.

< None of the HPIP firms said they had increased wages to meet HPIP requirements. However, there is no way of knowing how many firms are currently in the process of increasing wages to meet HPIP requirements.

< 13% of service sector firms said they had increased sales outside the state to meet HPIP requirements. There is no way of knowing how many firms are currently in the process of increasing sales outside the state to meet HPIP requirements.

Appendix A

Background Information and Instructions

Records indicate that during FY 1998 (7/1/97 to 6/30/98), FIELD(2) was granted Sales Tax Exemption Certificate(s) FIELD(1). The certificate(s) was granted in connection with a project(s) FIELD(3) which involved FIELD(7).

Remember... your answers will be kept in the strictest of confidence and will only be reported in the aggregate to protect the identity of your company and responses! If you have any questions at all, please call Mikel Miller at 785 296 1460.

Your name and title/position with the company:______________________________________
Phone where you can be reached: ___________________________

Q1. Which best describes the project for which the sales tax exemption certificate was used?
(Check only one)

a. _____ start-up of a new business **(please go on to Q2)**
b. _____ expansion of an existing Kansas firm **(please go on to Q2)**
c. _____ relocation to another city from an existing Kansas location **(please go on to Q2)**
d. _____ expansion into Kansas by an out-of-state firm **(please skip to Q3)**
e. _____ relocation to Kansas from an out-of-state location **(please skip to Q3)**

Q2. Did your company seriously consider undertaking this project in another state?
____Yes **(please complete the remaining questions)**
____ No **(please skip to Q5)**

Q3. What were the three(3) most important reasons for your firm's ultimate decision to undertake the project in Kansas?

a. _____ aggressive recruitment efforts
b. _____ state and/or local tax incentives
c. _____ state and/or local financial incentives (i.e. grants, HPIP program, training dollars, etc.)
(Please specify: ____)
d. _____ well-trained skilled labor force
e. _____ cost of labor less expensive
f. _____ proximity to markets
g. _____ transportation infrastructure
h. _____ availability of educational/training facilities
i. _____ competitive tax structure
j. _____ quality of life in Kansas (i.e. education, housing, cost of living)
k. _____ owner's place of residence

l. _____ Other____

FIELD(1)

Q4. To what extent was sales tax exemption for this project a factor in your company's decision to go ahead with this project in Kansas?

a. _____ it contributed significantly
b. _____ it contributed somewhat
c. _____ it contributed only slightly
d. _____ it did not contribute

Q5. If sales tax exemption had not been available for your company, what would have been the effect on this project?

More than likely, our company would have:

a. _____ proceeded with the project as planned
b. _____ proceeded on a smaller scale
c. _____ canceled the project

Q6. How many full-time employees does your company employ?

Total ____________ In Kansas ___________

Q7. Has your company claimed or used any of the following incentives over the last two years?

_____ **Job Creation Tax Credit** (allows $1,500 to $2,500 credit for each new employee)
_____ **Investment Tax Credit** (allows 1% credit for investment in a qualified business facility)
_____ **Research and Development Tax Credit** (allows a credit of 6.5% of firm's investment in R&D above the previous year's investment)
_____ **High Performance Firms Incentives Program (HPIP)** (allows a 10% tax credit for on qualified investment and for training expenditures above 2% of payroll)

Thank you so much for your time!

Please return your completed survey in the postage paid envelope provided.

Appendix B

Recent History of Sales Tax Exemption as it Applies to the Kansas Enterprise Zone Act

1982: The Kansas Legislature established the Kansas Enterprise Zone Act, providing a city the ability to designate a portion of its area as an enterprise zone. Businesses which located within the zone would receive a sales tax refund on property and services associated with the construction, expansion, or rehabilitation of a business facility. In addition, job creation and investment tax credits were provided if a project created at least two net new jobs.

1986: Counties were given the authority to establish county enterprise zones.

1988: Sales tax on machinery and equipment used in manufacturing was made exempt. Prior to this, manufacturers had to be located in a designated enterprise zone to receive this exemption. Kansas had been the only state in the region with this tax.

1992: The Legislature enacted a new Kansas Enterprise Zone Act, which reconfigured the original program established pursuant to K.S.A. 12-17,107 et seq. Enterprise zones established in the earlier program were eliminated and enterprises zone incentives were extended statewide with enhanced levels of benefits in certain rural areas. In contrast to the earlier program, the revamped enterprise zone laws linked eligibility for sales tax exemption, investment tax credits, and job creation tax credits to the type of business and their ability to meet certain job creation qualifications.

1994: The Enterprise Zone Act was amended again to add a definition of “corporate headquarters” and to clarify the existing definitions of “non-manufacturing business” and retail business.” This amendment was proposed by Kansas, Inc. to correct misinterpretations of the law which had resulted in the denial of enterprise zone benefits to many companies. The amendment also permitted owners of leased property to receive sales tax exemptions when constructing, reconstructing, remodeling, or enlarging a facility which will be leased for a period of five years or more to a business which would be eligible for the exemption if it had constructed, reconstructed, remodeled, or enlarged the facility itself.

1995: The Legislature repealed the 2.5% sales tax imposed in 1992 on labor used in original construction. This law became effective April 15, 1995.

1996: The Legislature amended the law to allow businesses to offset 100 percent of their Kansas income tax liability with E-Zone tax credits. It also included a definition for ancillary support facilities (back office operations), and headquarters which looks at the function the facility plays rather than the type of business the facility belongs to. The bill also amended the Act to allow insurance companies and financial institutions, which pay privilege tax, to be eligible for job expansion and investment tax credits.

Summary of Kansas Enterprise Zone Incentives

Eligibility for the various incentives and the value of the incentive depend on 1) the type of business, 2) the location of the business within the state, and 3) the number of net new jobs created. The *Kansas Enterprise Zone Act* defines the six counties of Douglas, Johnson, Leavenworth, Sedgwick, Shawnee, and Wyandotte as metropolitan counties. As such, they are ineligible to apply for the enhanced job credits available to designated non-metropolitan counties.

Jobs Criteria/Definitions

<u>Manufacturing</u>
A manufacturing business is defined as any commercial enterprise identified under Standard Industrial Classification (SIC) codes, major groups 20-39 and must create a minimum of two (2) net new jobs.

<u>Non-Manufacturing</u>
A non-manufacturing business means any commercial enterprise other than a manufacturing or retail business that creates a minimum of five (5) net new jobs or the business headquarters of an enterprise or the ancillary support facility of an enterprise if the facility creates at least 20 new full-time positions.

<u>Retail</u>
A retail business is defined as any business providing goods or services taxable under the Kansas Retailers' Sales Tax Act; any professional service provider set forth in K.S.A. 17-2707, and amendments thereto; any bank, S&L, or other lending institution; any commercial enterprise whose primary business activity includes the sale of insurance; any commercial enterprise deriving its revenues directly from noncommercial customers in exchange for personal services such as, but not limited to barber shops, photographic studios, and funeral services. Retail businesses must create a minimum of two (2) net new jobs.

Basic Incentives

<u>Manufacturing</u>
Sales Tax Exemption
Job Creation Tax Credit - $1,500 per net new job.
Investment Tax Credit - $1,000 per $100,000 of qualified business facility investment.

<u>Non-Manufacturing</u>
Sales Tax Exemption
Job Creation Tax Credit - $1,500 per net new job.
Investment Tax Credit - $1,000 per $100,000 of qualified business facility investment.

<u>Retail</u>
Sales Tax Exemption - Available for businesses in communities of less than 2,500 population
Job Creation Tax Credit - $100/year for 10 years for each net new job created (K.S.A. 1995 Supp. 79-32,153.
Investment Tax Credit - $100/year for 10 years for each $100,000 in qualified business investment (K.S.A. 1995 Supp. 79-32,153.

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Desig. Non-metro Regions

<u>Manufacturing</u>
Sales Tax Exemption
Job Creation Tax Credit - $2,500 per net new job.
Investment Tax Credit - $1,000 per $100,000 of qualified business facility investment.

<u>Non-Manufacturing</u>
Sales Tax Exemption
Job Creation Tax Credit - $2,500 per net new job.
Investment Tax Credit - $1,000 per $100,000 of qualified business facility investment.

<u>Retail</u>
Sales Tax Exemption - Available for businesses in communities of less than 2,500 population
Job Creation Tax Credit - $100/year for 10 years for each net new job created (K.S.A. 1995 Supp. 79-32,153.
Investment Tax Credit - $100/year for 10 years for each $100,000 in qualified business investment (K.S.A. 1995 Supp. 79-32,153.