

Kansas, Inc.

Charles R. Ranson, President

Sales Tax Exemption and Income Tax Credit Report:

Calendar Year 2000

KANSAS, INC.

Created by the 1986 Legislature, Kansas, Inc. is an independent, objective, and non-partisan 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. The other members, as mandated by the enacting legislation, include four members of the Legislature, a representative from the Board of Regents, the Secretary of Commerce & Housing, a representative from labor, and nine members from the private sector representing key Kansas industrial sectors. Private sector members are appointed by the Governor and confirmed by the Kansas Senate.

Kansas, Inc.'s mission is to build a strong, diversified economy that promotes new and existing industries. To attain that goal, we undertake three primary activities: 1) planning and policy research to formulate and update a statewide economic development strategy; 2) recommending program and public policy initiatives; and 3) conducting oversight and evaluation of strategy implementation.

Since 1987, Kansas, Inc. research reports have covered such diverse topics as: aviation, value-added agriculture, business taxation, 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.

Sales Tax Exemption and Income Tax Credits for Economic Development: *Modified Report for Calendar Year 2000*

Background: K.S.A. 74-8017 requires Kansas, Inc. to prepare an annual report evaluating the cost effectiveness of state and local tax incentives granted for a.) sales tax exemptions and b.) income tax credits. The submission of this abbreviated¹ report to the standing committees of the House and Senate, which are responsible for tax and economic development policy, satisfies the obligation for the calendar year 2000 report.

The ability to evaluate the effectiveness of these two incentives is, unfortunately, limited because there is no mechanism in place for an accurate cost benefit analysis. This would require indicating if the present value of all future economic benefits created (new jobs and/or wages) exceeds the present value of all taxes foregone. Foregone tax revenue data is available through the Department of Revenue. However, current law does not require taxpayers to report the information needed to complete a cost benefit analysis of the incentives.

In addition, Kansas, Inc.'s ability to evaluate the utilization of income tax credits is, unfortunately, severely limited by inaccessibility to claimants' identities through the Kansas Department of Revenue. Pages 13-15 of the January 2000 Sales Tax Exemption and Economic Development Income Tax Credits Report explain the system's deficiencies in greater detail.

To date, no action has been taken that will produce a report that would be an accurate cost benefit analysis of incentives. However, a series of actions were undertaken during calendar year 2001, which attempt to improve the reporting of income tax credit utilization. Specifically, the Governor approved House Bill 2219 on April 19, 2001. It repealed K.S.A. 74-8017 and removed the requirement that Kansas, Inc. produce an annual report on sales tax exemptions and income tax credits. On May 9, 2001, however, the Governor signed House Bill 2591. It repealed House Bill 2219, and requires the following:

- Kansas, Inc. to "provide an annual report evaluating the cost effectiveness of various income tax credits and sales tax exemptions" on and after January 1, 2003.
- The Secretary of Revenue shall develop a questionnaire on the utilization of state income tax credits and sales tax exemptions that shall be completed by all

¹ The abbreviated report is the result of Kansas, Inc.'s ongoing effort to create meaningful analysis of income tax credits and sales tax exemptions. In calendar year 2003, Kansas, Inc. intends to continue production of this report with a full blown and more accurate analysis. In the mean time, this report has been produced to satisfy the old requirements under K.S.A. 74-8017. However, this report should not be used to accurately evaluate the effectiveness of income tax credits and sales tax exemptions.

corporate taxpayers subject to state income tax that shall be submitted to the Department of Revenue concurrently with the filing of an annual corporate income tax return. The questionnaire will request information needed to complete a cost benefit analysis.

- Kansas, Inc. and the Kansas Department of Revenue shall agree upon procedures and submit an appropriate proposed bill for the purpose of disclosure of corporate and individual taxpayer information to fulfill the requirements of HB 2591, and to protect sensitive taxpayer information.

In accordance with the requirements under K.S.A. 74-8017, Kansas, Inc. has produced this report on income tax credits and sales tax exemptions. At this time, however, we are unable to make an accurate evaluation on the utilization, or an accurate cost benefit analysis of the incentives. In addition, there have been no attempts to evaluate incentives as an investment (as opposed to a cost) and/or evaluate the overall return on investment over a two, five, or ten year period. Such a study would be time consuming and costly, and is not the purpose of this document, but could be if appropriate funding and staff were provided. As a result, for the year 2000, we have produced this abbreviated memo that merely provides estimates on the cost of the incentives to the State of Kansas. This memo does not capture the benefit of these incentives.

Calendar Year 2000 Sales Tax Exemptions

The Kansas Enterprise Zone Act offers qualified businesses state and local sales tax exemption for certain purchases made in connection with the creation of jobs. To qualify for this exemption, the business must submit a *Request for Project Exemption Certificate* to the Kansas Department of Revenue. The firm must provide the Department with an estimate of the total amount of investment the firm plans to make in the project, including what portion will be spent for machinery and equipment. It is that estimated investment which is reported in this document and referred to as “*planned investment*.”

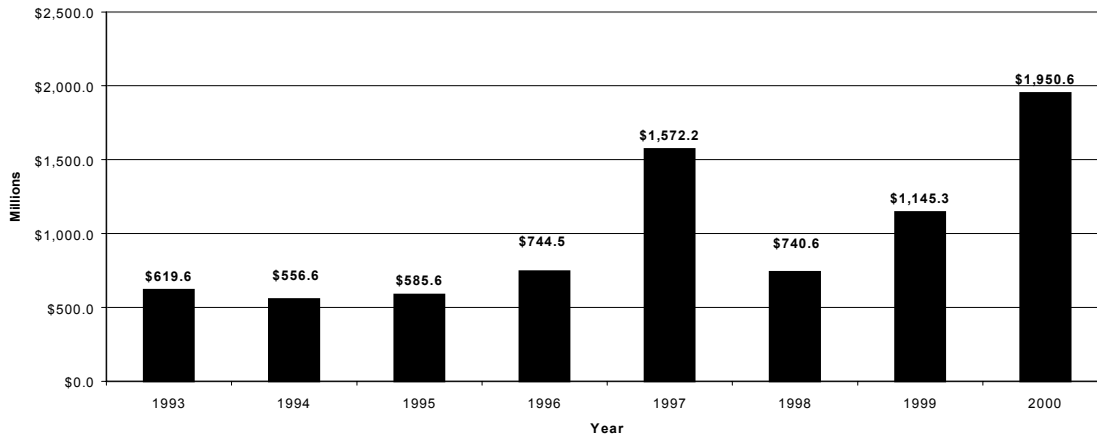
References made to planned investment are tabulations of estimated investment reported on exemption certificates and cannot be viewed as a precise measure of the total amount of investment that actually occurred for the following reasons:

- 1.) Not all investments are eligible for sales tax exemption and would therefore not be reported on a request for project exemption certificate.
- 2.) Some investment is exempted through the Industrial Revenue Bond process and, therefore, not captured in this report.
- 3.) The amount of total planned investment reported is just that, “planned investment”. It had not taken place at the time the request for exemption. In addition, current law does not require taxpayers to report the information needed to complete a cost benefit analysis of each planned investment to determine the final validity of the ultimately claimed exemption and level of job creation. Kansas, Inc. cannot determine which of these projects may have been canceled or postponed, or which projects may have run over or under estimated costs.

The Department of Revenue estimates that the investment associated with sales tax exemptions resulted in foregone revenue in the amount of \$68.0 million for calendar year 2000. In theory, the cost of the foregone sales tax revenue could be offset by the benefit of new job creation. However, current law does not require taxpayers to report the information needed to complete a cost benefit analysis of the incentives.

Aggregation of total planned investment reported by firms can, however, lend important insight into investment and growth trends in the state. Chart One reports the historical total planned investment between calendar year 1993 to 2000. In calendar year 2000, \$1,950.6 million in investment was associated with sales tax exemptions. The investment was an increase of 70.3% above the calendar year 1999 total of \$1,145.3 million. The Department of Revenue estimates that the investment associated with sales tax exemptions resulted in foregone sales tax revenue in the amount of \$68.0

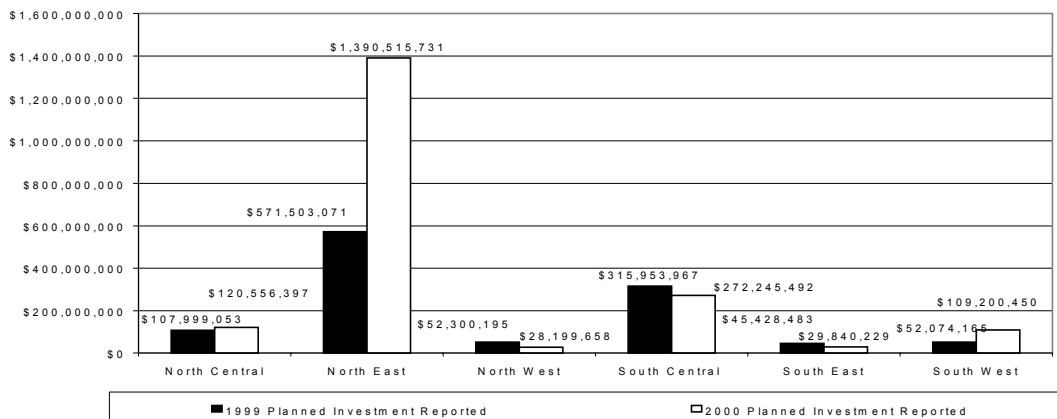
Chart One: Planned Investment Reported



million. In theory, the cost of the foregone revenue could be offset by the benefit of new job creation. However, current law does not require taxpayers to report the information needed to complete a cost benefit analysis of the incentives.

Chart Two reflects the total planned investment reported by region for calendar year 1999, and 2000. For calendar year 2000, the North East region recorded \$1,390.5 million in planned investment, an increase of 143.3% over calendar year 1999. Sales tax exemptions in the amount of \$48.5 million were associated with this region's total planned investment. The South Central region recorded \$272.2 million in planned investment, and \$9.8 million in sales tax exemptions were granted. The remaining four

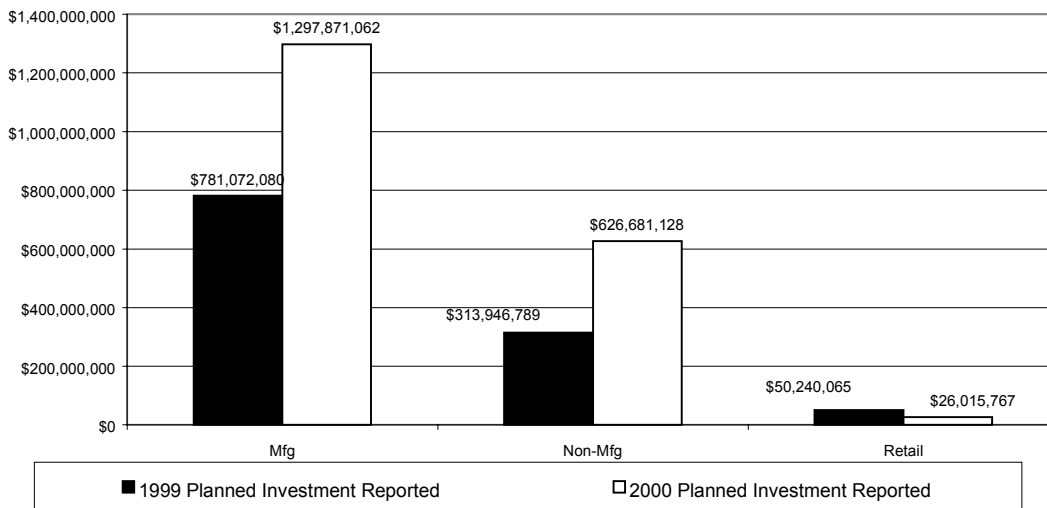
Chart Two: Planned Investment by Region



other regions recorded a \$287.8 million in total planned investment, and \$9.8 million in sales tax exemptions were granted. As previously stated, however, it is unclear on the actual level of wage and/or job creation associated with these credits.

Chart Three depicts the total planned investment reported by industry type for calendar year 1999, and 2000. For calendar year 2000, Non-Manufacturing Investment recorded \$626.6 million in planned investment, an increase of 99.6% over calendar year 1999. Funding increased by 66.2% in the Manufacturing Sector, but declined by 48.2% in the Retail Sector, between calendar year 1999 and 2000. In terms of foregone sales tax revenue, the manufacturing sector recorded \$45.2 million, the non-manufacturing sector recorded \$21.9 million, and the retail sector recorded approximately \$1.0 million. Again, however, what is unclear is the level of job creation associated with these credits.

Chart Three: Total Planned Investment Reported by Industry



Calendar Year 2000 Income Tax Credits

By statute, Kansas, Inc. is required to report on five (5) tax credit programs designed to encourage economic development. However, there are more than five income tax programs available in Kansas, indicating that the data available in this and past reports has been, at best, incomplete.

From January 1, 2000 to September 30, 2000, the Department of Revenue reports that 268 filers made 397 claims. The total value of the credits claimed was \$13.4 million. However, based on limitations of liability for the credit, only \$8.4 million in claims were allowed. The credits are available to individuals and corporations. In addition, privilege tax (banks, and savings and loans) filers are eligible to make claims for some of the credits.

The Department of Revenue estimates that the investment associated with five income tax credits totaled \$8.4 million in foregone revenue from January 1, 2000 to September 30, 2000. In theory, the cost of the foregone revenue could be offset by the benefit of new job creation. However, current law does not require taxpayers to report the information needed to complete a cost benefit analysis of the incentives.

January 1, 2000 to September 30, 2000 Tax Credits

Filers	Claims	Credit Claimed	Credit Allowed
268	397	\$13,408,031	\$8,388,427

Kansas law requires Kansas, Inc. to report on five types of income tax credits. They include:

1. Business and Job Development Credit (2000), including two subset programs a.) Kansas Enterprise Zone, and b.) Job Expansion and Investment Credit Act.

Filers	Claims	Credit Claimed	Credit Allowed
216	344	\$5,611,365	\$4,569,724

The various programs under this category include an investment tax credit, and a job creation credit. Kansas law allows a taxpayer to claim the credits for investment in a "qualified business facility" that creates a required number of new jobs. This credit had 344 claims, allowing \$4.6 million in incentives.

2. High Performance Incentives Program Credit (2000)

Filers	Claims	Credit Claimed	Credit Allowed
23	24	\$7,517,646	\$3,640,605

The various programs within this category include training and education tax credit, and an investment tax credit. Kansas law allows a taxpayer to claim the credits for training and education of an employee. Credits can also be claimed through investment in a “qualified business facility”, although the specific level of new job creation is not required. This credit had 24 claims, allowing \$3.6 million in incentives.

3. Local Seed Capital Pool Credit (2000)

Filers	Claims	Credit Claimed	Credit Allowed
0	0	\$0	\$0

No credits were claimed for the 2000 calendar year. The program allows a credit for those taxpayers who invest in a certified local seed capital pool.

4. Research and Development Tax Credit (2000)

Filers	Claims	Credit Claimed	Credit Allowed
29	29	\$279,020	\$178,098

This program allows a tax credit for “qualified expenditures in research and development activities”. No measurable benefit from the investment is required.

5. Kansas Venture Capital Investment Tax Credit (2000) ** Less than five filers*

Filers	Claims	Credit Claimed	Credit Allowed
* CONFIDENTIAL			

This program allows a tax credit for those taxpayers who invest in stock issued by a certified Kansas Venture Capital, Ink.

Kansas, Inc. Board of Directors

CO-CHAIRS

Governor
Bill Graves
Topeka

Kathleen Clark
Kathleen Clark CPA Chartered
Overland Park

MEMBERS

Stan R. Ahlerich
Ahlerich Farms
Winfield

Patti Bossert
Key Staffing
Topeka

Frank Clifford
Raytheon Aircraft Company
Wichita

Kent Glasscock
Speaker of House
Topeka

Anthony Hensley
State Senator
Senate Minority Leader
Topeka

Alan R. Hoffman
Kansas Natural Gas, Inc.
Hays

Dave Kerr
Senate President
Topeka

Annie Kuether
State Representative
Topeka

Wayne Maichel
Kansas AFL-CIO
Topeka

Larry L. McCants
First National Bank
Goodland

Tamera J. Nelson
Caterpillar
Emporia

John C. Prather
Groendyke Transport, Inc.
El Dorado

Deryl K. Schuster
Business Loan Center, Inc.
Mid-America Division
Wichita

Gary L. Sherrer
Lt. Governor / Secretary of
Commerce & Housing
Topeka

Kim A. Wilcox
Kansas Board of Regents
Topeka

KANSAS, INC. STAFF

Charles R. Ranson
President

Debby Fitzhugh
Director of Operations

Ann Marshall
Office Assistant

Kent Qandil
Senior Research Analyst

Kansas, Inc.
632 SW Van Buren, Suite 100
Topeka, Kansas 66603
785-296-1460
<http://www.ink.org/public/ks-inc/>
ksinc02@ink.org

