WSU Accounting & Auditing Convention – State Tax Update
May 17, 2018
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I. Sales/Use

A. General

1. Electronic Cigarettes

a) L. 2017, H2230 changed the effective date on the sales tax on consumable material for electronic cigarettes from January 1, 2017, to July 1, 2017, and amended the tax rate from $0.20 per milliliter to $0.05 per milliliter. K.S.A. 79-3399.

b) The Kansas Department of Revenue (the "KDR") responded to L. 2017, H2230 by issuing Notice 17-12. Notice 17-12 advises that sales taxes on consumable material for electronic cigarettes remitted prior to July 1, 2017, can be credited against tax reports filed after July 1, 2017, until the credit is fully used. A taxpayer may also contact the KDR if the taxpayer prefers to receive a refund. KSA 79-3399.

2. Pet Cremation

a) In response to an inquiry, the KDR has issued a letter to a taxpayer dated July 7, 2017, declaring that the service of pet cremation is not subject to Kansas sales tax, although sales of tangible assets in connection with the cremation would likely be subject to sales tax.

B. Court cases:

1. *Heartland Apartment Association v. City of Mission*, 306 Kan. 2 (2017).

The City of Mission imposed a transportation utility fee on improved real estate. Although titled as a fee, the Court of Appeals found it to be an excise tax. Because state law (K.S.A. 12-194) prohibits cities or counties from imposing excise taxes (other than sales or use taxes), the Court found the transportation user fee to be banned by law and therefore void. Affirmed by Kansas Supreme Court.[1]

2. *In the Matter of the Appeal of Lowe's Home Centers, LLC*, No. 115,254 2017 WL 1369944 (Kan. Ct. App. April 14, 2017).

At issue was whether home appliances that were installed at customers' homes were subject to sales tax. Although tangible personal property is subject to K.S.A. 79-3603(a), K.S.A. 79-3603(p) excludes from sales taxation tangible personal property installed or applied in the remodeling, renovation, etc. of a structure or residence. The taxpayer provided

[1] The case summaries presented here are incorporated from the 2018 Kansas Bar Association ("KBA") Annual Survey of state tax cases with permission from the authors of the Survey. The authors of these materials would like to extend their sincere gratitude to the authors of the Survey, James Scott MacBeth of the Hinkle Law Firm LLC and S. Lucky DeFries of Coffman, DeFries & Nothern, P.A., for their invaluable assistance. Any mistakes in these materials are fully the responsibility of the authors thereof.

installation manuals for each appliance. The Board of Tax Appeals (BOTA) found that the taxpayer met its burden and abated the remaining sales tax at issue.

The Court of Appeals' decision is lengthy and includes a review of the evidence, some discussion of the Streamlined Sales Tax Act, interpretation of the terms "installation" and "contractor" as used in K.S.A. 79-3603(p) and (l), respectively, and the Department's Information Guides EDU-26 and -28. The Court of Appeals ultimately affirmed the BOTA's decision.

For administrative law purposes, three issues arose. First, the Department originally appealed the BOTA summary decision to the Court of Appeals, but that appeal was dismissed as interlocutory. The Department needed to first obtain a full and complete decision from the BOTA under K.S.A. 74-2426(a). Second, the Department questioned whether the taxpayer properly preserved its legal arguments in its notice of appeal. The BOTA found that prehearing order is the time in which specific claims must be identified, and the Court found that such a finding was within the BOTA's discretion. Third, the Department of Revenue contended the BOTA's order did not sufficiently set forth separately stated findings of fact. K.S.A. 77-526(c). The Court of Appeals noted that while order used the heading "evidence" instead of findings of fact, there were 21 separate and concise paragraphs setting forth the facts, so the BOTA's order was sufficient.

3. *In the Matter of the Appeal of BHCMC, L.L.C.*, *d/b/a Boot Hill Casino & Resort*, 307 Kan. 154 (2017).

This is the Supreme Court's review of the Court of Appeals decision, wherein the lower court found that purchases of casino gaming equipment for the Kansas Lottery by an operator of a state-owned casino (under the Kansas Expanded Lottery Act) were not subject to compensating use tax because the State was the ultimate consumer and owner of the machines. The Supreme Court found that BHCMC did not exercise "a right or power incident to … ownership within the state," as required by K.S.A. 2016 Supp. 79-3702(c) and affirmed the prior decisions.

C. STAR Bonds

1. Introduction

a) Sales Tax Revenue (STAR) Bonds provide Kansas municipalities the opportunity to issue bonds to finance the development of major commercial, entertainment, and tourism areas and use the sales tax revenue generated by the development to pay off the bonds.

b) Kansas Department of Commerce Guidelines

(1) In order to be considered a major commercial entertainment and tourism area, a proposed project must be capable of being characterized as a statewide and regional destination, and include a high-quality, innovative, entertainment and tourism attraction, containing unique features which will increase tourism, generate significant positive

and diverse economic and fiscal impacts, and be capable of sustainable development over time.

(2) Public benefit must exceed public cost.

(3) As a general rule, STAR Bond financing should constitute less than 50 percent of total project costs.

(4) Retail tenants of projects financed by STAR Bonds must comply with all Kansas laws, including the Kansas “affiliate nexus” law, and collect sales tax on remote sales to Kansas residents.

c) Approval Process (Steps)

(1) City identifies potential STAR bond district boundaries;

(2) Local council sets public hearings to discuss creation of STAR bond district;

(3) Secretary of Commerce approves the potential district;

(4) Local counsel holds public hearings and adopts ordinances to create district;

(5) Feasibility studies completed and delivered to the city;

(6) Project planning prepared and delivered to the city;

(7) Local planning commission reviews the project;

(8) Local counsel sets and holds public hearings to adopt the project plan;

(9) Local council adopts the project plan;

(10) Secretary of Commerce approves the project plan;

(11) Bond documents developed;

(12) STAR bonds issued for project;

(13) Project begins; and

(14) 20-year Repayment Period.

2. Examples

a) Salina - Salina Field House (67,000 square foot multi-sport athletic facility); automotive museum; Alley Entertainment Complex (47,000 square foot family entertainment complex); 114-room hotel.

(1) Project Update – Groundbreaking ceremony was held April 9, 2018, for the hotel and entertainment complex project. The $160M private-public partnership for downtown revitalization is the largest in the city's history.

b) Derby - Field Station: Dinosaurs (animatronic dinosaur exhibition & park); 100-room hotel; "big-box" retail development; restaurants.

(1) Project Update – Largest animatronic dinosaur park in North America is set to open Memorial Day weekend in Derby, Kansas. Job Fair was held March 1, 2018, in Derby to staff the park.

c) Wichita (Arkansas River Developments) - Delano Catalyst (apartments, commercial space, and hotel rooms); $40M - $60M baseball stadium (to replace Lawrence Dumont and lure AA-level baseball team).

(1) Project Update – Mayor Jeff Longwell announced in March that Wichita is still in the process of negotiating for the return of affiliated baseball to Wichita. Despite legislative machinations in Topeka the city is still confident that STAR Bonds (approved for use by the City Counsel in July of 2017) will be used to build a new ball park (to be used to lure an affiliated baseball team to the city). No date has been set on construction, though the current tenant at Lawrence Dumont (the Wichita Wingnuts) were told in May that they would need to find a new home for 2019.

d) Others - Kansas City Speedway (Kansas City); The Kansas Underground Salt Museum (Hutchinson).

3. Policy Considerations

a) Supporters

(1) STAR bonds are a proven tool for spurring economic development in the state (increasing jobs & economic productivity in the districts they fund).

(2) It is estimated that completed STAR bond projects bring in tens of millions of dollars in increased state tax revenue every year.

b) Criticisms

(1) State does not perform an independent 3rd party feasibility study of the projects (feasibility studies often performed by developers and approved at the local level). Some legislators believe that state should

perform additional diligence given that state tax revenues are being forgone in STAR bond districts.

4. Update

a) Legislative Reform Efforts (2016-17 Session) – Senate Bill 30 extended the sunset date for the STAR Bond Financing Act from July 1, 2017, to July 1, 2020. KSA 12-17,179. However, Senate Bill 30 provides that the no new STAR Bond project district may be established until July 1, 2018, provided, however, that cities and counties with existing districts may continue to develop the projects. KSA 12-17,165.

b) Legislative Reform Efforts (2017-18 Session) –Kansas lawmakers on both sides of the aisle continue to argue that the STAR Bond program needs an overhaul to ensure transparency and the financial viability of proposed projects.

(1) SB 432 – Sought to introduce transparency, financial viability requirements, and other reforms to the STAR Bond Financing Act. Died in House Committee.

(2) Sub HB 2572 – Would have required the Department of Commerce to create a database of economic development incentive program information; would have required state officials to compile and publish information about tax incentives and whether each incentive program was producing a positive return on investment. Died in Senate Committee.

II. Property

A. General

1. Redevelopment Authorities – A property tax exemption is created for land, buildings, and tangible personal property owned by redevelopment authorities within a formal federal enclave in Johnson or Labette counties if such property is leased to a business for manufacturing, research and development, or warehousing. The board of county commissioners of Johnson or Labette counties must approve the same by resolution. KSA 79-264.

2. Automatically Exempt – The legislature expanded the list of tax exempt property that are not required to seek approval of the exemption by the BOTA, including recreational vehicles owned by full-time members of the military, property acquired from a land bank exempt from property tax, and property owned exclusively by the United States (unless Congress declared the same taxable). KSA 79-213.

3. Pipeline Exemption – The legislature has added subsection (o) to KSA 79-213 to provide that exemptions under KSA 79-227 – *i.e.* the exemption for "[a]ny new qualifying pipeline property" – must be filed within two years of the date construction of the qualifying pipeline began. KSA 79-227.

B. Court cases:

1. *In the Matter of the Appeal of Reeve Cattle Co., Inc. For the Years 2013 and 2014 in Finney County, Kansas*, 53 Kan.App.2d 781 (2017).

The Court of Appeals affirmed the Board of Tax Appeals decision whereby it held that mixer-feeder trucks used on feedlots are regularly and actually used in farming and ranching, so are exempt under K.S.A. 79-201j, and are not taxable as "trucks". The mixer-feeder trucks were modified so as to mix and dispense the feed, had limited speed potential, were rarely used on public roads and were not required to be registered for highway/street use because they were defined as implements of husbandry.

2. *In the Matter of the Protest Application of the City of Council Grove for tax years 2012 and 2013*, 401 P.3d 180 (Kan. Ct. App. 2017).

The Kansas Court of Appeals considered the valuation appeal of residential/recreational lots subject to a ground lease between the city and members of a lake association. The Court found that the County's appraiser did not comply with USPAP and the appraiser's methods were not consistent with K.S.A. 79-503(a). Although the Court affirmed the BOTA's value for the 2012 tax year, the Court found that it lacked jurisdiction for the 2013 tax year because the city that owned the lots did not authorize that appeal.

3. *Miller v. Board of County Commissioner*, 305 Kan. 1056 (2017).

The Wabaunsee County Board of County Commissioners had concerns about Miller's service as the County Appraiser, advising him to either resign or be fired. When Miller refused to resign the Board voted to terminate him. Miller appealed contending the Board did not have the authority to terminate him and terminate his salary and benefits. The Courts interpreted K.S.A. 2014 Supp. 19-431 such that the Board did not have the right to immediately end Miller's employment. Instead, his termination needed to be further ordered by the property valuation division of the Department of Revenue. Since PVD did not order Miller's removal until after his contract term expired, Miller was entitled to back pay and benefits through the end of his contract.

4. *In the Matter of the Protest of Barker*, 54 Kan.App.2d 364 (2017).

The Kansas Court of Appeals has determined that equipment used to produce oil is not exempt under K.S.A. 79-201t(a), because the equipment is not included in the definition of an "oil lease" for purposes of the exemption.

5. *In the Matter of the Equalization Appeal of Kansas Star Casino, L.L.C., for the Year 2014 in Sumner County, Kansas*, 406 P.3d 921 (Kan. Ct. App. 2017).

The Court of Appeals considered whether the Board of Tax Appeals summary order constituted an appealable final order pursuant to K.S.A. 77-607(1). The District Court had denied it had jurisdiction over the non-final matter, and the Court of Appeals agreed. Another issue was raised, relating to the 2016 change to K.S.A. 74-2426(c)(4), which change allowed only the taxpayer to appeal to District Court. There would need to be some interpretation of that change, had the matter been remanded the District Court, but because the District Court's decision (denying that it had jurisdiction over the matter) was affirmed, the issue was not addressed.

6. *In the Matter of the Equalization Appeal of Target Corporation*, 55 Kan.App.2d 234 (2017).

This case concerned the valuation of four retail store locations. The Board of Tax Appeals (BOTA) found the taxpayers' appraisal information more compelling, and the County appealed. The Court noted the County did not base its valuations on an actual view and inspection, but rather on settled values from a prior year. Although K.S.A. 79-1460 allowed for carry-forward values, that part of the statute was found to be unconstitutional before the BOTA hearing took place, so the Court found them impermissible as a matter of law. By using the impermissible values, the County failed to meet its burden. The Court then looked at the taxpayer's evidence. The County contended that the BOTA decision did not properly value the property "as-vacant". The Court ultimately concluded the BOTA's valuation process was reasonable based on the taxpayer's evidence affirming the BOTA decision.

III. Income

A. Senate Bill 30 – July 6, 2017

1. Repeal of Non-Wage Business Income Exclusion

Effective January 1, 2017, Senate Bill 30 repeals the exclusion that existed under Kansas law for years beginning after December 31, 2012, and ending December 31, 2016, for non-wage business income reported by individuals from pass-through entities and sole proprietorships on federal Schedules C, E and F and lines 12, 17 and 18 of federal Form 1040 ("Non-Wage Business Income").

2. Income Tax Rates

DATES	HIGHEST MARGINAL RATE FOR MARRIED AND SINGLE
Prior law	4.6%
2017	5.2%
2018 and later	5.7%

3. Level at which Individuals are Exempt from Kansas Income Tax

Beginning in tax year 2018, the low income exclusion is reduced from $12,500 to $5,000 for married individuals filing a joint return and from $5,000 to $2,500 for all other taxpayers.

4. Itemized Deductions of Individuals

For the 2017 tax year, K.S.A. 79-32,120 allows the following as itemized deductions: "(A) 100% of charitable contributions that qualify as charitable contributions allowable as deductions in section 170 of the federal internal revenue code; (B) 50% of the amount of qualified residence interest as provided in section 163(h) of the federal internal revenue code; and (C) 50% of the amount of taxes on real and personal property as provided in section 164(a) of the federal internal revenue code."

For the 2018 tax year, "50% of expenses for medical care allowable as deductions in section 213 of the federal internal revenue code" are allowed.

For the 2019 tax year, the percentage of section 163 qualified residence interest, section 164 real and personal property taxes, and section 213 medical expenses that may be deducted goes from 50% to 75%.

Finally, **for the 2020 tax year and thereafter**, the percentage of section 163 qualified residence interest, section 164 real and personal property taxes, and section 213 medical expenses that may be deducted rises from 75% to 100%.

5. Credit for Child and Dependent Care (Non-Refundable)

For the 2018 tax year, the Kansas credit is 12.5% of the amount of the federal credit. This amount increases to 18.75% of the federal credit for the 2019 tax year and 25% of the federal credit for the 2020 tax year and thereafter.

B. Notice 17-05 – July 1, 2017

For tax years beginning after December 31, 2016, there is no requirement for an individual to add-back a federal net operating loss (NOL) as an addition for KS with the effect of allowing a federal NOL to flow through.

C. Kansas Residency Status

The question of whether or not one has ceased to be a resident of Kansas is fact-driven, and there is no absolute assurance of how Kansas will treat a move. The longer one can show a lack of strong association with Kansas, the more likely that Kansas will fail in any attempt to claim resident. Factors indicative of being a non-Kansas resident follow, but they do not provide a conclusive result as to residency. This is because of K.A.R. 92-19-4a(b)(7)(S) which states that the KDOR may consider “any other fact relevant to the determination of that person’s domicile”, which is broad and ambiguous.

1. Be outside of Kansas for more than 183 days/year to avoid residency presumption. Keep a calendar and try and attach one receipt per day showing that you were outside the state for that day as evidence of being outside of Kansas.
2. Buy (preferably) or rent a non-Kansas residence and furnish it.
3. Move the “near and dear” items outside Kansas.
4. Declare a homestead exemption in another state.
5. If possible, sell or transfer any real estate in Kansas to family or other entities.
6. Have no salary or other earned income in Kansas.
7. Change driver’s license to a new state and surrender your Kansas license.

8. Change all bank accounts to another state and try not to retain any bank accounts in Kansas.
9. Move your only safe deposit box to another state.
10. Change vehicle registration(s) and insurance to another state.
11. Identify the other state's residence as your principal residence for insurance purposes.
12. Obtain a library card in another state.
13. Change social and service clubs to another state and serve local charities.
14. Change voter registration to another state and terminate your Kansas voter registration. Do not vote in Kansas.
15. Do wills, medical directives and powers of attorney under another state's law.
16. Engage a local doctor, dentist and/or chiropractor; have some or all of your medical records moved to your local doctor.
17. Move your religious affiliation and membership to a local group in another state; make local contributions.
18. Have all of your income tax returns sent to a non-Kansas address; never have them go to your former Kansas address.
19. Have credit cards, brokerage statements and other financial-related mail go to an address outside Kansas.
20. Obtain a resident fishing and/or hunting license from the new state.
21. Focus your social, economic and other activities in the new state of residency.
22. Avoid spending significant amounts of time in Kansas.
23. Take vacations and other trips that begin and end in another state.
24. Change your passport address to another state.
25. Order personalized stationery with a non-Kansas address.
26. File a nonresident Kansas income tax return, if required.
27. If feasible, have family gatherings centered outside Kansas.
28. Send a change of address notification to the Kansas Department of Revenue.
29. Send letters using stationery with a non-Kansas address.

D. Proposals

On April 9, 2018, the Senate passed its tax bill, which would have reduced state revenue, and sent it to the House. With an attitude of fiscal responsibility, especially in light of any pending school finance legislation, the House killed the Senate's bill on May 4, 2018.

E. Credits

1. Senate Bill 19 – June 15, 2017

   It amends the tax credit available under K.S.A.72-99a02 for contributions to a scholarship granting organization which provides eligible students with scholarships to pay tuition to a qualified school in Kansas. In addition to amending certain definitions, the legislation expands eligibility for the tax credit to individuals and places an annual cap of $500,000 on contributions.

2. Angel Investor Tax Credit

This tax credit has been extended to tax year 2021. The Angel Investor tax credit is available to qualified individuals who provide seed-capital financing for emerging Kansas businesses engaged in development, implementation, and commercialization of innovative technologies, products and services. There is a $50,000 limit for a single Kansas business or $250,000 in tax credits for a single year per investor with carryforward allowed.

Tax Year	Number of Filers	Amount of Credit Allowed
2011	292	$4,368,492
2012	300	$5,427,683
2013	260	$3,359,989
2014	280	$4,110,725
2015	311	$3,975,840
2016	241	$3,406,503

2. Rural Opportunity Zone (ROZ) Credit

The ROZ credit provides an income tax exemption for certain nonresident individuals who establish residency in ROZ counties and is available through tax year 2021. To claim this tax credit, the income tax return must be filed electronically.

Tax Year	Number of Filers	Amount of Credit Allowed
2012	98	$236,660
2013	253	$575,331
2014	335	$968,896
2015	419	$1,289,433
2016	495	$1,349,511

3. High Performance Incentive Program (HPIP) Credit

The HPIP credit provides tax incentives to employers that pay above-average wages, have a strong commitment to training and education for their workers, and invest capital in facilities and technology.

HPIP (includes both T&E and Investment credit)

Tax Year	Number of Filers	Amount of Credit Allowed
2011	318	$51,979,448
2012	313	$55,793,769
2013	299	$64,527,276
2014	303	$59,656,757
2015	290	$52,585,609
2016	233	$35,940,773

a) Company qualifications for HPIP:

1) be a for-profit company subject to state taxes;
2) pay above-average wages (as compared to other similar firms in the same geographical area with matching North American Industry Classification System (NAICS) codes);
3) make a significant investment in eligible employee training; and
    a. spend more than 2% of payroll for training and education expenditures (see employee training tax credit below) OR
    b. participate during the tax year in the Kansas industrial training (KIT), Kansas industrial retraining (KIR) or the State of Kansas investments in lifelong learning (SKILL) program.
        i. The KIT program provides training assistance to manufacturing, distribution, or regional or national firms and other businesses primarily engaged in the development or production of goods or the provision of services for out-of-state sale. The business must create at least five new jobs. The KIT program will pay a negotiated amount of the costs of training including instructor salaries, training aids and supplies, and materials.
        ii. KIR provides retraining assistance to employees of restructuring industries that are likely to be displaced because of obsolete skills. At least five existing employees must be trained to qualify.
        iii. SKILL provides funds for training assistance to businesses that are creating a large number of new jobs or creating new jobs paying higher-than-average wages.
4) be either a manufacturer or able to document that most of its sales are to Kansas manufacturers and/or out-of-state businesses or government agencies. A business in any NAICS code can qualify if it is a headquarters or back-office operation of a national or multi-national corporation.

b) HPIP benefits:

1) Kansas Investment Tax Credit, which equals 10 percent of all eligible capital investment that exceeds $50,000. In the five metro counties of

Johnson, Douglas, Shawnee, Wyandotte and Sedgwick, the threshold is $1 million. The credit is limited to the taxpayer's tax liability and can be carried forward for 16 years and has no cap.

2) Employee Training Tax Credit, which provides a dollar-for-dollar state tax credit up to $50,000, for training and education expenditures that exceed 2% of total payroll at the worksite. This tax credit has no carry-forward provision.
3) Sales Tax Project Exemptions (STPE) on purchases of materials and services related to capital investment at the worksite.

c) Steps to be HPIP-certified:

1) Complete the Project Description form, which demonstrates the applicant's foreknowledge of the program. This form must be received by the Department of Commerce <u>prior</u> to any formal commitment to make an investment.
2) Request the STPE from the Department of Revenue.
3) Complete the HPIP application at the end of the four-quarter measurement period, which directly precedes the certification period during which one intends to capture tax credits for new capital investment.

d) Claim HPIP benefits:

1) All HPIP tax credits are claimed on Kansas Department of Revenue Form K-59 when the business files its state income tax return.
2) The sales tax exemption is claimed by first requesting an exemption certificate from the Department of Revenue (after submittal of the Project Description) on Form PR-70b. This certificate will be issued upon HPIP certification.

IV. Miscellaneous

A. Promoting Employment Across Kansas (PEAK) Program

The creation of the PEAK Act, K.S.A. 2015 Supp. 74-50,210 through 74-50,219, was passed by the Kansas legislature in 2009. PEAK is intended to encourage economic development in Kansas by incenting companies to relocate, locate or expand business operations and jobs in Kansas. The Secretary of Commerce has discretion to approve applications of qualified companies and determine the PEAK benefit. During the benefit term, participating PEAK companies may receive 95 percent of the Kansas withholding tax of PEAK-eligible employees/jobs that are paid at or above the county median wage where the PEAK business facility is located. Depending on the number of PEAK jobs/employees to be hired over a five-year period and their wage levels, the Secretary can approve a PEAK benefit for up to 10 years.

PEAK Benefits Received by PEAK Companies	
Fiscal Year	TOTAL
2012	$8,880,930
2013	$14,167,697
2014	$24,140,271
2015	$28,549,096
2016	$30,532,347
2017	$33,455,960
2018 (to date)	$11,728,205

PEAK requires that the company:

1. commit to creating five new jobs in non-metropolitan counties or 10 new jobs in the metropolitan counties of Shawnee, Douglas, Wyandotte, Johnson, Leavenworth and Sedgwick within a two-year period.

2. pay wages to the PEAK jobs/employees that, when aggregated, meet or exceed the county median wage or NAICS average wage for their industry.

3. be for-profit in eligible NAICS codes or not-for-profit headquarters facilities.

4. make available to its full-time employees "adequate" health insurance coverage and pay at least 50% of the premium.

5. work with a Department of Commerce regional project manager to apply to the PEAK program. Applications are accepted throughout the year and must be received **prior** to hiring PEAK jobs/employees and within 180 days of acknowledgment that the project will be located in Kansas.