SURVEY OF KANSAS LAW: TAXATION

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1. INTRODUCTION

The Kansas Law Review published its first Survey of Kansas Law in 1955 (volume 4). The survey was a regular biennial feature of the Law Review into the 1970s when its appearance became more erratic. This survey and its immediate predecessor covered periods of about four years, perhaps introducing a quadrennial mode. In his introduction to the premier survey, Fred Six, Editor in Chief of the Review stated its purpose: "The Survey is not intended to provide merely a digest of Kansas case law, nor is each section to be an exhaustive critique of the law. The true field of the survey should be between these extremes." The survey format offers the author considerable flexibility in choosing what to include and what to exclude and in deciding on the amount of analysis and critique of developments to be supplied.

The primary utility of the survey is as a research tool for the Kansas attorney. The survey should place recent legislative and judicial developments in context. Although earlier surveys were viewed, at least in part, as a substitute for reading advance sheets, this survey will focus more heavily on legislative developments. Summaries of recent cases are available from a variety of sources, and the Kansas attorney has a more difficult time obtaining information on actions of the Kansas legislature. Thus, this survey's primary goal is to provide history and interpretation of important legislative developments during the survey period. Additionally, the survey offers a critique of judicial action during the period.

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II. **Ad Valorem Property Tax**

The major development of the survey period was the reappraisal of all real property in the state. Although the need for reappraisal has been apparent for many years, the legislature has had great difficulty in addressing the issue. The 1985 legislature finally ordered statewide reappraisal, scheduled to be completed by January 1, 1989.²

The taxation process begins with identifying taxable property. Both real and personal property are subject to *ad valorem* taxation in Kansas, unless specifically exempted.³ Next, the property must be valued. Valuation of real property involves two components: appraisal and assessment. Prior to 1985 Kansas statutes required taxable property to be appraised at fair market value. Property was then assessed (listed on the tax rolls) at thirty percent of its appraised value. Thus, a home with a fair market value of 100,000 dollars would be assessed at 30,000 dollars.⁴

The actual tax burden on a particular piece of property depends on the mill levy for the taxable year. The total mill levy for a taxable year is multiplied by the assessed value to determine the taxes due.⁵ The county collects property taxes for distribution to the other taxing authorities. Cities, counties, townships, school districts, and other local government units have the power to impose property taxes.⁶

A fundamental principle of the property tax is that two similar pieces of property should have similar tax burdens. This requires accurate appraisal of property—the task of the county appraiser (formerly county assessor). One long-standing problem with real property appraisal in Kansas has been the lack of geographical uniformity. As a result of “competitive undervaluation”⁷ by county appraisers, real property was appraised at vastly differing rates in different counties. Where taxing districts overlap county lines, a

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⁴ See id. § 79-1439.
⁵ A 20 mill levy would create a tax burden of $600 for the owner of the $100,000 house. Taxes are assessed in dollars but expressed as mills. G. Fisher, The Kansas Property Tax 3 (1987).
lower appraisal rate in one county can shift the tax burden for that district to taxpayers in other counties within the district.

Timing is another barrier to equitable administration of the property tax. Although personal property is reappraised annually, this has not been true of real property. Thus, even if all real property is accurately listed on the tax rolls at thirty percent of its fair market value, older property will be undervalued relative to newer property. Without reappraisal, the increasing value of older real property escapes taxation.

The Kansas legislature has a long history of unsuccessful attempts to deal with the inequities stemming from "competitive undervaluation" between county appraisers and the need to update appraised values. Reappraisal of real property was ordered by the legislature in 1963. Some counties complied quickly, others much more slowly. A 1978 statute, section 79-1451 of Kansas Statutes Annotated, prohibited use of reappraisal values by a county until all 105 counties had completed reappraisal. This virtually guaranteed the failure of statewide reappraisal, offering little incentive for a county to incur the expense of reappraisal to obtain values that might never be used. In fact, in December 1981, almost twenty years after reappraisal was mandated, two counties had not yet complied.10

Beginning in the 1970s legislators considered a series of proposals for reappraisal but were unable to agree on any of them. Lawmakers had to confront the political reality that reappraisal would shift the property tax burden. Many taxpayers whose property had been consistently undervalued, especially rural land owners and residential homeowners, faced increases in appraised or assessed valuation. Instead of the required thirty percent of fair market value assessment ratio, such land was typically assessed at between five percent to fifteen percent of fair market value. Economists predicted that reappraisal would substantially increase the proportionate share of the tax burden borne by residential and agricultural real estate.

The 1985 legislature met the challenge by mandating statewide reappraisal of real property and concurrently proposing an amendment to article eleven, section one of the Kansas Constitution to establish classifications of real and personal property that would

9. Id. § 79-1439 (1984); Note, supra note 7, at 324.
10. See Note, supra note 7, at 324.
prevent massive shifts in the tax burdens.\textsuperscript{12} Reappraisal could not go into effect until the Classification Amendment had been submitted to the voters. Kansans approved the amendment in November 1986, and the effects of reappraisal will be felt beginning January 1, 1989. The combination of reappraisal and classification finally adopted is similar to a proposal of the 1979 Legislative Interim Studies Committee.\textsuperscript{13}

The Classification Amendment modifies the "uniform and equal" requirement of the Kansas Constitution, effectively codifying the pre-existing inequities in appraised valuation. The amendment makes three major changes in property appraisal and assessment. It establishes "use valuation" for agricultural land, creates categories of real and personal property, and adds to the list of constitutionally exempt property.\textsuperscript{14}

Beginning January 1, 1989, agricultural land will be appraised under a method of "use valuation" that requires valuation based on the property's ability to produce income in a specific agricultural use.\textsuperscript{15} All other property will continue to be appraised at fair market value, which accounts for the "highest and best" use of a piece of real estate. "Use valuation" benefits owners of agricultural land located on the fringes of urban development. Property taxes on such land can be burdensome if the land is appraised at a fair market value that contemplates urban uses rather than agricultural ones. Use valuation protects the land owner who prefers to continue agricultural uses, even though the land might be worth much more if devoted to urban (commercial) uses. Use valuation for agricultural land was authorized by an amendment to article eleven, section twelve of the Kansas Constitution in 1976, but was never implemented by the legislature.\textsuperscript{16} Use valuation of agricultural land was part of the 1979 Interim Studies recommendation for reappraisal and classification.\textsuperscript{17}

The second major function of the 1986 Classification Amendment was to divide property into classes for assessment purposes. Four real property classes and six personal property classes were established. The "uniform and equal" requirement will now be


\textsuperscript{13} \textit{Legislative Coordinating Council, Report on Kansas Legislature Interim Studies to the 1980 Legislature} (1979).

\textsuperscript{14} \textit{Kan. Const.} art. 11, § 1.

\textsuperscript{15} \textit{Id.}


\textsuperscript{17} \textit{Interim Studies, supra} note 13, at 28.
applied as follows to each class of property. Classes of personal property and applicable assessment ratios are as follows:\textsuperscript{18}

- mobile homes (for residential use) 12%
- mineral leaseholds 30%
- tangible public utility property 30%
- certain motor vehicles 30%
- commercial and industrial machinery and equipment\textsuperscript{19} 20%
- all other tangible personality 30%

The twelve percent ratio for mobile homes used as residences is consistent with the twelve percent ratio applied to residential real estate.

The assessment ratios for real property classes are as follows:\textsuperscript{20}

- residential real estate (both single and multifamily) 12%
- vacant lots 12%
- agricultural land (appraised at use value) 30%
- all other property 30%

The twelve percent ratio for residential real estate and vacant lots is derived from the actual valuation figures in effect in 1985.\textsuperscript{21} Agricultural land, like residential real estate and vacant lots, was also historically undervalued. Use valuation should protect urban agricultural land from increases in property tax assessments when land is reappraised. Fair market value and use valuation of rural agricultural land are theoretically identical; thus, reappraised values of rural agricultural land may increase.


\textsuperscript{19} Commercial and industrial machinery and equipment is to be valued based on its useful life:

[I]f its economic life is seven years or more, [such machinery and equipment] shall be valued at its retail cost when new less seven-year straight-line depreciation, or . . . if its economic life is less than seven years, [it] shall be valued at its retail cost when new less straight-line depreciation over its economic life, except that, the value so obtained for such property as long as it is being used shall not be less than 20% of the retail cost when new of such property . . . .


The legislature tried a very similar method for valuation of farm machinery in its earlier efforts to relieve the property tax burden on farmers by enacting Kan. Stat. Ann. § 79-343. This section was repealed, however, after the supreme court held that it violated the uniform and equal requirements of the Kansas Constitution. See State ex rel. Stephan v. Martin, 230 Kan. 759, 641 P.2d 1020 (1982).


\textsuperscript{21} Classification essentially preserves the results of the inequitable undervaluation in effect in 1985.
The reappraisal legislation\textsuperscript{22} addressed many of the problems contributing to previous inequities. The state has assumed part of the reappraisal cost and has provided computers for processing the data generated by reappraisal and for ongoing record keeping. The process has been carefully monitored by the 1986, 1987, and 1988 legislative sessions. Counties were expected to submit quarterly progress reports on the process.

The Director of Property Valuation will be required to review valuation in each county annually to determine compliance with statewide appraisal valuation guides.\textsuperscript{23} The Board of Tax Appeals is directed to review the annual assessment-to-sales ratio study to monitor each county’s compliance with the assessment ratios in section 79-1439 of Kansas Statutes Annotated.\textsuperscript{24} Other provisions encourage recalcitrant counties to move ahead with reappraisal. Although approximately fifteen counties were experiencing difficulties with reappraisal in July 1988, all eventually completed the process.

Once reappraisal has been completed, valuations must be reviewed every four years.\textsuperscript{25} One reason property tax reform has been difficult to achieve has been the lack of public awareness of inequities. Section 79-1480 of Kansas Statutes Annotated addresses this by requiring the county clerk to make available to the public an organized listing of the assessed valuations for all real property within the county.\textsuperscript{26}

Taxpayers are uneasy about reappraisal. They fear increased tax burdens in spite of classification and use valuation. The legislature responded to this fear with a lid on tax levies for 1989, when reappraised values become effective.\textsuperscript{27} With few exceptions, a local taxing district’s tax levy in 1989 can produce no more revenue than was produced in 1988. Assuming that reappraisal will increase assessed valuation, the actual mill levy for a taxing district would then decrease in 1989.\textsuperscript{28} The tax levy lid mainly will affect cities and counties; it does not apply to school districts.

\textsuperscript{23} KAN. STAT. ANN. § 79-1479(b) (Supp. 1988).
\textsuperscript{24} Id. § 79-1479(c).
\textsuperscript{25} Id. § 79-1476.
\textsuperscript{26} Id. § 79-1480 (amended by Act approved Apr. 16, 1987, ch. 376, § 1, para. 1, 1987 Kan. Sess. Laws 1895). Newspapers around the state are publishing values as the change of value notices are sent. See Lawrence J. World, Feb. 17, 1989, at 1D, col. 1.
\textsuperscript{27} KAN. STAT. ANN. §§ 79-5022 to -5037 (Supp. 1988); see also Brady, Howes, & Musil, supra note 2, at 22 n.2.
\textsuperscript{28} County A has an assessed valuation in 1988 (before reappraisal) of $1,000,000. A
A final aspect of the Classification Amendment is the addition of certain categories of exempt property.\textsuperscript{29} Prior to 1985 the constitution exempted the following property from \textit{ad valorem} taxation: "All property used exclusively for state, county, municipal, literary, educational, scientific, religious, benevolent and charitable purposes and all household goods and personal effects not used for the production of income, shall be exempted from property taxation."\textsuperscript{30}

The 1985 amendment added "farm machinery and equipment, merchant’s and manufacturer’s inventories and livestock" to this list.\textsuperscript{31} Farm machinery and equipment previously had been exempted by statute.\textsuperscript{32} The exemptions for merchants’ and manufacturers’ inventories and livestock are new.\textsuperscript{33} These constitutional exemptions join a host of new exemptions authorized by the legislature during the survey period.\textsuperscript{34}

Two major factors influenced the expansion of property tax exemptions during the 1985 through 1988 sessions. One factor dates back to a 1968 legislative study of the property tax system. The Hodge Committee (named for its chairman, Senator Frank Hodge) recommended elimination of most statutory exemptions to the property tax in an effort to limit exemptions to those mandated by the constitution in article eleven, section one.\textsuperscript{35} The 1969 legislature adopted the Committee’s proposal and repealed many levy of 20 mills will produce $2000 in revenue. If reappraisal increases the county's assessed valuation to $1,500,000, the tax levy lid limits the county's revenue from the 1989 assessment to $2000. Thus, the mill levy will be only approximately 13.33 mills.

\textsuperscript{29} KAN. CONST. art. 11, § 1 (codified at KAN. STAT. ANN. § 79-1439 (Supp. 1988)).


\textsuperscript{32} See KAN. STAT. ANN. § 79-201 (Supp. 1988).


\textsuperscript{34} In addition to exemptions listed in KAN. CONST. art.11, § 1, the legislature has authorized property tax exemptions that are codified in KAN. STAT. ANN. ch.79, art. 2. Kansas courts have interpreted KAN. CONST. art. 11, § 1 to permit the creation of additional legislative exemptions provided "such exemptions have a public purpose and promote the general welfare." State ex rel. Tomasic v. Kansas City, 230 Kan. 404, 412, 636 P.2d 760, 768 (1981) (citations omitted).

\textsuperscript{35} See JOINT COMMITTEE ON THE STATE TAX STRUCTURE, INTERIM REPORT TO THE KANSAS LEGISLATURE, JOURNAL OF THE SENATE 104, 127 (Jan. 30, 1969) [hereinafter Hodge Committee].
statutory exemptions including those for the following: Church parsonages; some grave sites; public and family libraries; some government-owned property; veterans' clubhouses; organizations such as the YMCA, YWCA, Boy Scouts, Girl Scouts, and Camp Fire Girls; Kansas Blue Cross-Blue Shield; certain married student housing; and farm ponds. 36

This action was followed in 1973 by a judicial decision indicating a similarly restrictive view of tax exemptions. In Lutheran Home, Inc. v. Board of County Commissioners, 37 the Kansas Supreme Court denied a request for tax exemption for a nursing home run by a nonprofit corporation. The court held that the term "charity" implies a gift and that the nursing home was not a charity because patients were charged for their care. Further, the home's income was sufficient to pay its operating expenses and make payments to reduce both principal and interest on its debt. 38 Although many organizations no longer qualified for tax-exempt status as a result of these legislative and judicial actions, county appraisers and commissioners and the Division of Property Valuation did not actively seek to enforce the new standards. The Board of Tax Appeals was relatively generous in granting applications for tax-exempt status until about 1984. 39 Thus, only recently have nonprofit organizations felt the effects of the 1969 legislation and the Lutheran Home decision.

The Board of Tax Appeal's more restrictive approach coincided with reappraisal, which is expected to increase the proportionate share of the property tax paid by owners of commercial property. Commercial property owners have not been sheltered from the effects of reappraisal by the reduced assessments and use valuation afforded to agricultural and residential property owners. 40 Thus, commercial property owners have sought to increase the number of available tax exemptions.

A review of the legislature's actions during the 1985 through 1988 sessions reveals an enormous expansion in exemptions from

38. Id. at 274, 505 P.2d at 1122.
40. See Kan. Const. art. 11, § 1; Kan. Stat. Ann. § 79-1439 (Supp. 1988); see also France, Viewpoint, Classification Could Backfire, Topeka Capital J., Jan. 8, 1989, at 5D, col. 1 (Director of Governmental Affairs for Kansas Association of Realtors urging repeal of classification as it affects commercial real estate). During the 1989 legislative session commercial real estate owners organized under the name "Kansans Reappraising Classification" attempted to impose a moratorium on using reappraised values for imposing property taxes. As of April 1989 all such attempts had been unsuccessful.
property tax. The Hodge Committee's work has been virtually eliminated. Legislative actions and court decisions have effectively overruled the Lutheran Home test.

Property used exclusively for religious purposes has long been exempt under section 79-201 First of Kansas Statutes Annotated. The definition of religious uses was expanded twice during the survey period. Churches now may operate a licensed nonprofit day care center without loss of exempt status. A 1988 amendment also allows a church to devote a portion of its facility to the sale of books, religious tracts, or other items related to religious doctrine.

The legislature also has enacted new exemptions for parsonages and convents. The 1986 legislature created a new parsonage exemption that applies to land and buildings owned by a church society and used as a parsonage. The 1988 legislature added an exemption for land and buildings owned by a nonprofit religious organization and used as a convent or monastery.

The 1969 legislature repealed the previous parsonage exemption. This left parsonages subject to property taxation beginning January 1, 1970. The new parsonage exemption applies to taxable years beginning January 1, 1985. The Attorney General has reminded taxpayers that a church must apply for exempt status for a

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For all taxable years commencing after December 31, 1984, all parsonages owned by a church society and actually and regularly occupied and used exclusively as a residence by a minister or other clergyman of such church society who is actually and regularly engaged in conducting the services and religious ministrations of such society, and the land upon which such parsonage is located to the extent necessary for the accommodation of such parsonage.


- actually and regularly occupied and used exclusively for residential and religious purposes by a community of persons who are bound by vows to a religious life and who conduct or assist in the conduct of religious services and actually and regularly engage in religious, benevolent, charitable or educational ministrations or the performance of health care services.

Id.
parsonage, even if it qualified under the pre-1969 statute.\textsuperscript{45} New educationally-related exemptions include all real and personal property belonging to the alumni association of a public or nonprofit college or university located in Kansas\textsuperscript{46} and the president's home of a private nonprofit university or college.\textsuperscript{47} Other new exemptions apply to veteran's organizations and their auxiliaries\textsuperscript{48} and humanitarian service organizations.\textsuperscript{49} These legislative actions restore and expand exemptions repealed in 1969.

The exemption for property used exclusively for "literary, educational, scientific, religious, benevolent and charitable purposes"\textsuperscript{50} was enlarged significantly to allow such groups to: (a) charge recipients for services rendered based on ability to pay (sliding scale fees); (b) charge for actual expenses in connection with exempt uses of property; (c) allow "minimal and insubstantial" nonexempt uses of property that are incidental to exempt uses; and (d) charge reasonable fees for admission to cultural or education events.\textsuperscript{51} This expansion effectively overrules the Lutheran Home test that charity requires a gift,\textsuperscript{52} and it broadens the traditional requirement that the property be used exclusively for exempt purposes. A similar amendment to section 79-201b First of Kansas Statutes Annotated allows hospitals and other groups to charge for actual expenses associated with use of facilities, allows nonexempt uses that are "minimal and insubstantial," and allows use by more than one exempt organization.\textsuperscript{53}

The Kansas Supreme Court considered the hospital exemption in Board of Johnson County Commissioners v. St. Joseph Hospital\textsuperscript{54} and held that property that was physically located in Kansas but


\textsuperscript{46} Act approved Apr. 29, 1985, ch. 311, § 1 para. 6, 1985 Kan. Sess. Laws 1354, 1355 (codified at KAN. STAT. ANN. § 79-201 para. 6 (Supp. 1988)).

\textsuperscript{47} Act approved Apr. 21, 1988, ch. 373, § 1 para. 5, 1988 Kan. Sess. Laws 2324, 2325 (codified at KAN. STAT. ANN. § 79-201 para. 5 (Supp. 1988)).


\textsuperscript{49} Act approved Apr. 21, 1988, ch. 373, § 1 para. 9, 1988 Kan. Sess. Laws 2324, 2326-27 (codified at KAN. STAT. ANN. § 79-201 para. 9 (Supp. 1988)).

\textsuperscript{50} KAN. CONST. art. 11, § 1(b)(2).


\textsuperscript{52} Lutheran Home, Inc. v. Board of County Comm'rs 211 Kan. 270, 277-78, 505 P.2d 1118, 1124 (1973).


owned by a Missouri hospital corporation, was exempt from ad valorem taxation under section 79-201b even though the hospital operated only in Missouri. The hospital stored medical equipment, supplies, and office furniture at a material management center in Kansas. The Board of Tax Appeals granted exemption, but the District Court of Shawnee County reversed on appeal, finding that the hospital had to operate in Kansas to qualify. The supreme court agreed with the Board of Tax Appeals and restored tax-exempt status.55

The exemption in section 79-201b Fourth for housing for the elderly attracted both legislative and judicial attention. In Board of Johnson County Commissioners v. Ev. Lutheran Good Samaritan Society,56 the Board of Johnson County Commissioners appealed from a decision of the Board of Tax Appeals exempting an elderly housing facility from taxation. The controversy concerned the Good Samaritan Olathe Towers, a 149-unit housing facility, constructed with financing provided through the National Housing Act. The Board of Tax Appeals granted tax-exempt status to the facility, citing sections 79-201b Fourth (housing for low-income elderly) and 79-201b Fifth (nonprofit housing for elderly).57

The county challenged the exemption because four of the units were rented to handicapped individuals who were not elderly and four were rented to elderly individuals with incomes too high to qualify for federal rent subsidy. The county argued that the presence of the handicapped nonelderly made section 79-201b Fourth inapplicable and that the presence of the elderly tenants with higher incomes made section 79-201b Fifth inapplicable.58

As to the handicapped tenants, the court noted that the National Housing Act provides financing for facilities to serve both elderly and handicapped families.59 Thus, the Good Samaritan Towers

55. *Id.* at 619, 738 P.2d at 458.
57. *Id.* at 623, 694 P.2d at 460.
58. *Id.* at 623, 694 P.2d at 460-61.
59. The National Housing Act defines handicapped persons as follows:
The term "elderly or handicapped families" means families which consist of two or more persons and the head of which (or his spouse) is sixty-two years of age or over or is handicapped, and such term also means a single person who is sixty-two years of age or over or is handicapped. A person shall be considered handicapped if such person is determined, pursuant to regulations issued by the Secretary, to have an impairment which (A) is expected to be of long-continued and indefinite duration, (B) substantially impedes his ability to live independently, and (C) is of such a nature that such ability could be improved by more suitable housing conditions. A person shall also be considered handicapped if such person is a developmentally disabled individual as defined in section 102(5) of the
was required by federal law to accept handicapped individuals as tenants. The court felt that this federal requirement effectively broadened the exemption in section 79-201b Fourth. Because a federally financed project could not restrict its tenants to the elderly and exclude the handicapped, the county's interpretation of section 79-201b Fourth effectively would nullify the statute.60

As to the elderly tenants with high incomes, the court did not address the arguments raised about section 79-201b Fifth, but found instead that the four higher income tenants did not bar a tax exemption under section 79-201b Fourth. The court focused on the following language in the statute: "All real property . . . actually and regularly used exclusively for housing for elderly persons having a limited or lower income, assistance for the financing of which was received under the national housing act and acts amendatory thereof and supplemental thereto."61 The court reasoned:

It is common knowledge that when construction of public housing for the elderly (and handicapped) is financed through the National Housing Act, the operation of the facility is subject to ongoing federal control. Resident eligibility, amount of rent to be charged, amount of rent subsidy, operational expenses, etc., are the subjects of a plethora of federal statutes and regulations.62

Thus, the court concluded that the legislature was relying upon the federal regulation incident to the National Housing Act to ensure that the public purpose of the Kansas tax exemption would be met. If federal regulations permitted the four tenants who did not qualify for federal rent subsidy, the Kansas statute was satisfied.63

Reacting to the Good Samaritan decision announced on January 26, 1985, the 1985 legislature amended section 79-201b Fourth to include housing for handicapped individuals as well as the elderly.64 Concern for what was viewed as an "unintended expansion" of the section in the Good Samaritan case prompted the legislature to remove the reference to the National Housing Act.65 This

60. Good Samaritan, 236 Kan. at 622, 694 P.2d at 460.
63. Id. at 625, 694 P.2d at 461.
removal left the section applicable to property used regularly and exclusively "for housing for elderly and handicapped persons having a limited or lower income . . . ." 66 The legislature may have thought that the Good Samaritan Towers could not meet such a standard because of the four units rented to higher income tenants.

A legislative committee studied the problem during the interim between the 1985 and 1986 sessions and recommended restoring the following reference to federal law: "All real property . . . actually and regularly used exclusively for housing for elderly and handicapped persons having a limited or lower income, assistance for the financing of which was received under 12 U.S.C.A. 1701, et seq., or under 42 U.S.C.A. 1437 et seq. . . . ." 67 The committee found that a cite to both the National Housing Act (section 1437 of title 42 of the United States Code) and the Housing and Community Development Act (section 1701 of title 12 of the United States Code) sufficiently clarified the section to solve the Good Samaritan problem. 68 The legislature's quarrel with Good Samaritan Towers arose from the four high income tenants, not the Towers' construction financing. This amendment does little to change the result in Good Samaritan because it does not address operation of the facility.

As a part of its report, the 1985 interim committee also proposed an expansion of the special care housing exemptions found in section 79-201b. This provision was adopted to exempt nonprofit group housing for the mentally ill or retarded charging less than cost. 69

The 1985 Committee was also concerned with the tax status of housing for the low income nonelderly, but made no recommendations on that subject. The 1988 legislature amended section 79-201b Fourth again to include co-operative housing projects for individuals with limited or low incomes. 70 Such projects, like housing for the elderly and handicapped, must be financed under the National Housing Act or the Housing and Community Development Act. The 1988 legislature addressed the operation of co-

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68. Id. at 111.
operative housing facilities by requiring them to meet federal Housing and Urban Development ("HUD") regulations. Apparently satisfied with the holding in Good Samaritan, the legislature did not add such a requirement for housing for the elderly and handicapped, thereby shifting responsibility for monitoring operation of the facility to HUD.

The most recent Survey noted the successful enactment in 1982 of a tax exemption for farm machinery. The supreme court considered this exemption twice during the survey period. In Farmers Co-op. v. Kansas Board of Tax Appeals the court held that farm machinery owned by custom cutters was not exempt, even though the machinery was rented by farmers for farm uses. In T-Bone Feeders, Inc. v. Martin the court denied tax-exempt status to farm machinery used by a commercial feedlot, again distinguishing farming and ranching from feedlot operations.

The legislature responded in 1985 by expanding the definition of farming and ranching in section 79-201j of Kansas Statutes Annotated to include "performing of farm or ranch work for hire," thus bringing custom cutters within the scope of the exemption. The legislature did not exempt commercial feedlots.

In 1982 the legislature also added the exemption for business aircraft. The court of appeals considered this exemption twice, holding in In re Cessna Employees' Flying Club that aircraft owned by a nonprofit flying club qualified for the exemption. The Board of Tax Appeals had held that the club, which was formed for the purpose of promoting private flying and providing economical flying for its members, did not constitute a business.

In Kenneth Godfrey Aviation, Inc. v. Smith, the court addressed the application of section 79-201k of Kansas Statutes Annotated to aircraft owned by an air service business that rents

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72. 236 Kan. 632, 694 P.2d 462 (1985). Custom cutters lease machinery for use on farms, but are not actually engaged in farming or ranching themselves.
76. KAN. STAT. ANN. § 79-201k (Supp. 1988).
and charters airplanes to the general public. Members of the public used the planes for various purposes, including both business and personal use. The court held that the exemption was available only if the planes were used exclusively in business; personal use by some private renters barred the exemption for the flying service. This obviously is inconsistent with *Cessna Employees' Flying Club*, whose members used the planes for pleasure, and fails to recognize rental of planes as a business itself.79

Once again the legislature came to the rescue, amending section 79-201k to exempt "all aircraft actually and regularly used exclusively to earn income for the owner in the conduct of the owner's business or industry."80 Rental of planes by an aviation service would be a use to earn income for the service in the conduct of the owner's business, qualifying the planes for tax-exempt status regardless of the renter's motives. Antique aircraft (those thirty years and older) used for recreation or display are now exempt from property tax.81

As noted above, the farm machinery exemption becomes part of the constitution, along with exemptions for merchants' and manufacturers' inventories, when reappraisal becomes effective on January 1, 1989. Hand tools and hand tool boxes are exempt under section 79-219 of Kansas Statutes Annotated. The Attorney General, however, has questioned the constitutionality of the exemption for hand tools.82

Finally, grain,83 property used for display or sale at conventions and household goods of home day care providers all have been exempted from tax.

The sheer number of new property tax exemptions enacted during the four-year survey period is staggering. One obvious consequence is the loss of tax revenue.84 This concerned the Hodge Committee,

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79. The court relies on its opinion in *Farmer's Co-op*, which was correct in distinguishing rental business from farming business, but not for the reasons given in the opinion. *Id.* at 438, 746 P.2d at 1071.
86. The exemption for the Topeka YMCA has been estimated to be worth $90,000. *Topeka Capital-J.*, Jan. 12, 1989, at 2A, col. 2.
which noted in its report to the 1969 legislature that "the exemption of any parcel of property raises the burden on nonexempt property."\textsuperscript{87} The extent to which the tax burden was shifted from exempt to nonexempt property could not be identified, because the amount of exempt property in Kansas was unknown at the time.

The Hodge Committee recommended legislation requiring listing and appraisal of all exempt property in the state. Sections 79-1466 and 79-1467 of Kansas Statutes Annotated, adopted in 1982, direct each county appraiser to prepare a listing of exempt real property and personal property respectively, within the county. In spite of this requirement, complete information on the extent of exempt property is not known.\textsuperscript{88} Completing reappraisal should produce an up-to-date list of exempt real property.

Inadequate information makes it difficult for the legislature to assess the revenue impact of new exemptions as additional property is removed from the tax rolls. This uncertainty creates obvious difficulties for governmental units that rely on property tax for revenue, particularly in light of the tax levy lids imposed by reappraisal.

One fundamental characteristic of the Kansas property tax is that it is a tax on property itself, not on the owners of property. Kansas traditionally has favored exemptions from property tax based on the \textit{use} of property for certain purposes (in rem), rather than on the identity or status of the owner (in personam).\textsuperscript{89} The in rem exemption is consistent with the theory that the \textit{ad valorem} property tax is a nondiscriminatory tax based solely on the value of the property, without regard to the owner’s ability to pay.

Although the new exemptions added during the survey period continue to exempt property based on its use for specified purposes, they have moved away from the restrictive view of the Hodge Committee and \textit{Lutheran Home}. The new sections have added in personam qualifications, relaxed the requirement of exclusive use, and broadened the notions of "public purpose."

In addition to use of the property for exempt purposes, several sections also require that the property owner or user be tax exempt—a status requirement. The exemption for veterans’ organizations requires that the property be used by a group that is tax

\textsuperscript{87} Hodge Committee, \textit{supra} note 35, at 132.
\textsuperscript{88} See Buchele, \textit{supra} note 39, at 279-80.
\textsuperscript{89} In personam exemptions create classifications that must meet fourteenth amendment standards of equal protection. See Buchele, \textit{supra} note 39, at 256-57.
exempt under section 501(c)(19) of the Internal Revenue Code. The exemption for convents and monasteries goes farther and actually specifies tax-exempt status for the property owner.

Requiring tax-exempt status of the owner or user of property might be viewed as a means of restricting the number of exemptions granted. Another possible justification is that the requirement is an additional safeguard to ensure continuing use of the property for property tax-exempt purposes. To qualify for exemption from federal income tax, an organization must be organized and operated exclusively for certain purposes enumerated in section 501(c) of the Internal Revenue Code ("IRC"). Thus, tax-exempt status under section 501(c) could be viewed as a means of policing the organization’s continuing nonprofit status, similar to the Kansas Supreme Court’s use of HUD requirements in Good Samaritan to police the operation of the elderly housing facility.

Either justification ignores property use as the basis of property tax exemptions. Mere ownership by an organization that is exempt from federal income tax liability does not automatically ensure that property will be exempt from Kansas property tax. The status of the owner theoretically is irrelevant to an exemption based on

90. The veterans’ organization exemption reads as follows:

All real property, all buildings located on such property and all personal property contained therein, actually and regularly used exclusively by any individually chartered organization of honorably discharged military veterans of the United States armed forces or auxiliary of any such organization, which is exempt from federal income taxation pursuant to section 501(c)(19) of the Internal Revenue Code of 1986, for clubhouse, place of meeting or memorial hall purposes, and real property to the extent of not more than two acres, and all buildings located on such property, actually and regularly used exclusively by any such veterans’ organization or its auxiliary as a memorial park.


91. The convents and monasteries exemption reads as follows:

Any building, and the land upon which such building is located to the extent necessary for the accommodation of such building, owned by a church or nonprofit religious society or order which is exempt from federal income taxation pursuant to section 501(c)(3) of the federal Internal Revenue Code of 1986, and actually and regularly occupied and used exclusively for residential and religious purposes by a community of persons who are bound by vows to a religious life and who conduct or assist in the conduct of religious services and actually and regularly engage in religious, benevolent, charitable or educational ministrations or the performance of health care services.


92. As a practical matter, property used exclusively by a veterans’ organization is likely to be owned by the organization as well. Thus, users will frequently be owners.

93. Buchele discusses the administrative convenience argument and notes that reliance on IRS policing may not be a good idea, citing the PTL club as an example. Buchele, supra note 39, at 285.
use. Tax-exempt status under federal law is based on how the organization is organized, the sources of its income, and how it spends its funds. The broadest form of status requirement is the Kansas property tax exemptions that specify use or ownership of property by organizations "contributions to which are deductible under the Kansas income tax act." This is virtually identical to a requirement that the corporation be exempt from federal income tax. One problem with this type of requirement is the availability of federal tax-exempt status for a variety of purposes that are not covered in the Kansas property tax exemptions.

This difference is illustrated in National Collegiate Realty Corp. v. Board of Johnson County Commissioners, which found that the NCAA national headquarters is entitled to a property tax exemption under section 79-201 Second of Kansas Statutes Annotated. The court relied in part on the NCAA's federal income tax-exempt status under IRC section 501(c)(3), and found that the property was used exclusively for education purposes. The court failed to recognize that the NCAA might also be exempt under section 501(c)(3) because of its purpose to promote amateur sports competition, a use that is not exempt under section 79-201 Second.

94. The Kansas Supreme Court noted this distinction between exemptions from federal income taxation and exemptions from property taxation:

The contention that since the plaintiff corporation has been granted a federal income tax exemption as a nonprofit corporation, the exemption shall also extend to corporate real estate is rejected. Under the Federal Internal Revenue Code, income tax exemption does not depend so much upon how the applicant makes its money or how it uses its property as upon how it is currently spending the money it makes.


95. For example, certain group housing for the mentally retarded and handicapped are exempt, if the group home is operated by a nonprofit corporation licensed under Kansas statutes, and "contributions to which are deductible under the Kansas income tax act." Kan. Stat. Ann. § 79-2016 para. 6 (Supp. 1988).

96. Tax-exempt status under I.R.C. § 501(c) carries two major benefits: organizations are exempt from federal income tax, and donors may deduct contributions to the organization from their income tax under I.R.C. § 170. Exemptions from Kansas income tax under Kan. Stat. Ann. § 79-32, 113 extend to federally exempt organizations. Contributions that are deductible under federal law (I.R.C. § 170) are also deductible under state law. Thus, a requirement that an organization be eligible for contributions deductible under Kansas income tax, is essentially a requirement that the organization be exempt from federal income tax.

97. For example, the purposes contained in the most common subsection, I.R.C. § 501(c)(3), are broader than the purposes allowed in Kansas.


99. See Buchele, supra note 39, at 284-85, for discussion of National Collegiate Realty.
Addition of tax-exempt status as a requirement for property tax exemption is a move toward in personam exemptions based only on ownership. Although there may be sound administrative reasons to identify the property owner, this shift in emphasis from the use of the property to the identity of the property owner marks a fundamental change in taxation philosophy. This shift makes the exemption in personam rather than in rem.

A second trend in recent exemptions has been the dramatic liberalization of the traditional standard of “exclusive use” of exempt property for exempt purposes. Kansas historically had a strict view of exclusive use. The survey period in particular marks a considerable deviation from that standard. Church use has been broadened to allow church day-care center and bookstore use.\textsuperscript{100} Residential use of a facility has been considered common to all individuals\textsuperscript{101} and thus inconsistent with exclusive use for exempt purposes. The legislature nevertheless restored the parsonage exemption and added a new exemption for college presidents’ residences.

Church day-care use illustrates an additional consideration raised by these exemptions: unfair competition. Church day care in a building that is not subject to property taxes may be cheaper than day care in a taxable building.

The most dramatic departure from the exclusive-use standard occurs in the amendments to sections 79-201 Second,\textsuperscript{102} which allow use for nonexempt purposes that are “minimal in scope and insubstantial in nature” if the nonexempt use is incidental to an exempt use. These amendments also allow charitable, religious, scientific, and other groups to charge sliding scale fees and recover other costs associated with use of the exempt property. These amendments are a marked departure from the strict test in Lutheran Home, which held that “charitable” required a gift.

The best, or perhaps worst, example of the liberalization of property tax exemptions is the new humanitarian service organization exemption added in 1988.\textsuperscript{103} This exemption, codified in section 79-201 Ninth, reads as follows:

\textsuperscript{101} Parsonage exemptions have been denied on exclusive use theory. See Buchele, supra note 39, at 259.
\textsuperscript{102} Exemption for literary, educational, scientific, religious, benevolent, or charitable purposes.
\textsuperscript{103} Buchele notes the trend toward reversal of the Hodge Committee recommendations. The humanitarian services exemption was aimed specifically at the Topeka YMCA, which was successful in its claim of tax-exempt status as a humanitarian service organization. See Topeka Capital J., Jan. 12, 1989, at 1a, col. 4. The YMCA was required to discontinue
All real property and tangible personal property actually and regularly used by a community service organization for the predominant purpose of providing humanitarian services, which is operated by a corporation organized not for profit under the laws of the state of Kansas or by a corporation organized not for profit under the laws of another state and duly admitted to engage in business in this state as a foreign not-for-profit corporation if: (a) the directors of such corporation serve without pay for such services; (b) the corporation is operated in a manner which does not result in the accrual of distributable profits, realization of private gain resulting from the payment of compensation in excess of a reasonable allowance for salary or other compensation for services rendered or the realization of any other form of private gain; (c) no officer, director or member of such corporation has any pecuniary interest in the property for which exemption is claimed; (d) the corporation is organized for the purpose of providing humanitarian services; (e) the actual use of property for which an exemption is claimed must be substantially and predominantly related to the purpose of providing humanitarian services, except that, the use of such property for a nonexempt purpose which is minimal in scope and insubstantial in nature shall not result in the loss of exemption of such use is incidental to the purpose of providing humanitarian services by the corporation; (f) the corporation is exempt from federal income taxation pursuant to section 501(c)(3) of the internal revenue code of 1986 and; (g) contributions to the corporation are deductible under the Kansas income tax act. As used in this clause, "humanitarian services" means the conduct of activities which substantially and predominantly meet a demonstrated community need and which improve the physical, mental, social, cultural or spiritual welfare of others or the relief, comfort or assistance of persons in distress or any combination thereof including but not limited to health and recreation services, childcare, individual and family counseling, employment and training programs for handicapped persons and meals or feeding programs. Notwithstanding any other provision of this clause, motor vehicles shall not be exempt hereunder unless such vehicles are exclusively used for the purposes described therein.

The provisions of this paragraph shall apply to all taxable years commencing after December 31, 1986,104

Subsections (f) and (g) are obviously status requirements because they are based on federal income tax exemptions.105 Subsection (e) allows for nonexempt uses and applies a very broad new definition of humanitarian services. The new section moves even farther from the exclusive-use standard with a new test of "substantially and predominantly" used for exempt purposes.

its exclusive health club. The YWCA was also granted exemption as a humanitarian service group. Topeka Capital J., Sept. 2, 1988, at 1a, col. 1. Legislative desire to help the YMCA reached backward because it also relieved the YMCA of back taxes. See Smith, 1988 Legislative Summary Part II, J. Kan. B.A., Aug. & Sept. 1988 at 11, 14.


105. Subsections (a), (b), and (c) are taken from language of I.R.C. § 501. These subsections, which essentially duplicate each other, add little to subsections (f) and (g). The limits on compensation probably are aimed at the "PTL" problem.
The Kansas Supreme Court stated the standard for evaluating statutory exemptions in *State ex rel. Tomasic v. City of Kansas City.*\(^{106}\) Under this standard, these exemptions must (1) have a public purpose and promote the general welfare, (2) provide a substantial, peculiar benefit, (3) not allow for large accumulations of tax-exempt property, and (4) not be improper (preferential) classifications of property.\(^{107}\) It is not clear whether section 79-201 Ninth meets this test.\(^{108}\)

In addition to reappraisal and exemptions, another area of concern during the survey period has been the mechanical aspects of property tax collection. Taxpayers are required to list taxable personal property with the county treasurer.\(^{109}\) Property is to be appraised annually as of January 1 ("Tax Day"). As noted in *Litho Stepping, Inc. v. Wyandotte County,*\(^{110}\) Kansas does not tax property acquired after January 1 until the next year. *Litho Stepping* concerned section 79-316 of Kansas Statutes Annotated which, the court explained, was enacted to deal with livestock that was brought into the state after Tax Day, but taken out before it could be listed the next year. The court labeled section 79-316 an anachronism.\(^{111}\) The legislature took heed and repealed sections 79-315 and 79-316.\(^{112}\)

Other amendments to rules on listing property for taxation conform to changes in exemptions.\(^{113}\) Motor vehicles generally are listed and taxed separately from other personal property as part of the vehicle registration system.\(^{114}\) *State v. Raulston*\(^{115}\) found that section 8-713 of Kansas Statutes Annotated, which requires payment of all personal property taxes prior to registration, is constitutional.

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107. Id. at 578-79, 701 P.2d at 1323-24. A "substantial, peculiar benefit" means a benefit not available from taxable property or a taxable business. In *Tomasic*, these criteria were applied to a ten-year property tax abatement for IRB-financed construction.
111. Id. at 316, 698 P.2d at 848.
Section 79-306 of Kansas Statutes Annotated sets the date for filing statements of tangible personal property and section 79-1422 of Kansas Statutes Annotated imposes penalties on taxpayers who file late. The previous survey\textsuperscript{116} discussed amendments in 1981 to section 79-1422 in response to \textit{National Co-operative Refinery Association v. Board of County Commissioners}.\textsuperscript{117} The legislature intended these amendments to correct legislative oversight by adding a fifty percent penalty for filing more than sixty days late or failure to file.\textsuperscript{118} That action still left loopholes in the statute because section 79-1422 did not address taxpayers who filed statements, but underreported taxable property.

The 1985 legislature again amended section 79-1422 and enacted section 79-1427a of Kansas Statutes Annotated to address underreporting.\textsuperscript{119} Section 79-1427a applies to taxpayers who never file (as opposed to filing late), or file and underreport. Unreported property is considered to have "escaped taxation" and underreported property is considered to have "escaped appraisal." Under section 79-1427a, the county appraiser can go back four years from discovery, retroactive to 1982,\textsuperscript{119} and impose a 100 percent penalty for failure to file, for underreporting, or both. Sections 79-1422 and 79-1427a both were amended in 1987 to abate the penalties if property that escaped taxation is repossessed by a secured creditor who pays the taxes and interest due.\textsuperscript{120} The 1987 amendments are a logical result in light of increasing bankruptcies.

In addition to taxpayer "errors" in reporting, it is also possible for the taxing district to make errors that result in taxes not being paid. \textit{In Re Midland Industries}\textsuperscript{121} considered the application of section 79-1701 of Kansas Statutes Annotated to such situations. The dispute in \textit{Midland Industries} arose from errors by the Sedgwick County Appraisers Office, which had recorded appraised values too low. When the error was discovered, the county at-

\textsuperscript{116} McKenzie & Ratzlaff, \textit{supra} note 71.
\textsuperscript{117} 228 Kan. 595, 618 P.2d 1176 (1980).
\textsuperscript{119} Act approved Apr. 25, 1985, ch. 309, §§ 1-3, 1985 Kan. Sess. Laws 1351 (codified at Kan. Stat. Ann. §§ 79-1422, -1427a (Supp. 1988)). The 50\% penalty for filing more than 60 days late also applies to underreporting (failure to file a full and complete statement) if not corrected within one year of the date for filing. Section 79-1427a imposes a 100\% penalty for underreporting (or failure to file) beginning one year from the date the statement was due.
tended to collect the taxes. The Kansas Supreme Court held that section 79-417 did not apply because the property had not “escaped taxation,” which, as used in the statute, means failure to report or underreporting by the taxpayer. Section 79-1701 did not include this situation as one of the clerical errors that could be corrected, nor did section 79-1702 apply to a taxing district that erred in a taxpayer’s favor.

In 1985 the legislature responded by amending section 79-1701, adding new subsection (h), which encompasses errors by taxing districts.122 Sections 79-1701a and 79-1702 were also amended to cover such situations, giving county commissioners and the Board of Tax Appeals power to order additional assessments.123

The Kansas Supreme Court considered the correction of clerical errors again in In re U.S.D. No. 437.124 Assignment of personal property to the wrong school district resulted in an overpayment of taxes by the Frito Lay Company for several years. The district court affirmed the Board of Tax Appeals, ruling that this error was a clerical error within the meaning of section 79-1701(g). The county had a duty to correct the error upon discovery.125


The issue in Palmer was very similar to the issue in Robbins-Leavenworth Floor Covering, Inc. v. Leavenworth National Bank & Trust Co.,127—who should pay the taxes? In such a situation

125. The court stated that Midland Industries was “overruled to the extent it conflicts with a county’s statutory duty to collect taxes on property which has escaped taxation as defined by K.S.A. 1987 Supp. 79-1427a and to correct those errors listed in K.S.A. 1987 Supp. 79-1701.” Id. at 560, 757 P.2d at 317-18.
the logical result is that the taxes should be paid out of the sale proceeds. The Kansas Court of Appeals followed the Robbins analysis and held that there was no tax lien created under either sections 79-2109 or 79-2110 of Kansas Statutes Annotated because the seller of the inventory—the bank—was not the owner at the time of assessment. KFI owned the inventory on January 1, 1980, for the 1980 taxes, and the bankruptcy estate was the owner for purposes of the 1981 assessment.

The court further held that section 79-2111 of Kansas Statutes Annotated applied, requiring payment of taxes out of the sale proceeds. The bank had acquired the inventory through legal process, and although section 79-2111 did not require Palmer to pay the taxes, he was entitled to recover them from the bank. The bank argued that Palmer was barred from recovery, having paid as a volunteer, but the court of appeals found that the tax warrant served on him rendered his payment involuntary. He therefore had an equitable right to recover from the bank.

III. RETAIL SALES TAX AND COMPENSATING USE TAX

The survey period saw an increase in the state retail sales tax from three percent to four percent. The increase, however, was offset by the creation of several new exemptions. Sales of both new and used mobile homes are exempt, although the exemption for new mobile homes is limited to forty percent of gross receipts from the sale. Also exempt are tangible personal property purchased with food stamps and vouchers issued by the federal supplemental food program for women, infants, and children. The 1987 legislature also added exemptions for certain purchases made by nonprofit nursing homes, nonprofit youth development programs, and community mental health centers.

Authorization of the Kansas lottery was accompanied by a sales tax exemption for lottery tickets. Agricultural interests will ben-

128. This was the key issue in Robbins-Leavenworth, in which the court found that a voluntary repossession was not a "legal process." Here, the voluntary bankruptcy procedure did constitute a legal process.
132. Id. § 79-3606(ii).
133. Id. § 79-3606(jj).
134. Id. § 79-3606(kk).
135. Id. § 79-3606(ll).
136. Id. § 79-3606(gg).
efit from an exemption for the sale of farm machinery to feed lots.\footnote{137} In 1987 the legislature also enacted new exemptions related to enterprise zones, including purchases of machinery and equipment to be installed in an enterprise zone\footnote{138} and sales of tangible personal property in connection with construction or remodeling of a qualified business within an enterprise zone.\footnote{139}

The 1988 legislature added a long list of new exemptions to section 79-3606 of Kansas Statutes Annotated. These new exemptions and related subsections are summarized as follows: (w) sales of food products for use in preparing meals for indigent or homeless individuals; (mm) manufacturing equipment; (nn) educational materials for free distribution to public by nonprofit corporation organized to promote public health; (oo) seeds, tree seedlings, fertilizers, services to prevent soil erosion on land devoted to agricultural use; (pp) advertising agency and licensed broadcast station services; (qq) tangible personal property purchased by community action group to repair or weatherize housing occupied by low income individuals; (rr) drill bits and explosives used in drilling; and (ss) purchases of tangible personal property and services by a nonprofit museum or historical society tax exempt under section 501(c)(3).\footnote{140}

Case law during the survey period addressed problems with collecting the sales and compensating use taxes. \textit{J. G. Masonry, Inc. v. Department of Revenue}\footnote{141} presented two issues related to applying the compensating use tax\footnote{142} to transactions that had not been subject to retail sales tax. J. G. Masonry, a Kansas corporation, purchased antifreeze from a Standard Oil retail outlet in Kansas City. Standard Oil did not collect retail sales tax on the purchase. The Department of Revenue argued that section 79-3703


\footnote{141. 235 Kan. 497, 680 P.2d 291 (1984).}

of Kansas Statutes Annotated\textsuperscript{143} authorized collection of the compensating tax from J. G. Masonry. The supreme court agreed with the taxpayer that section 79-3703 did not apply to transactions that occur exclusively within Kansas.\textsuperscript{144} The state should have collected the sales tax from the retailer; section 79-3703 did not authorize collection from the consumer.\textsuperscript{145}

J. G. Masonry also had purchased office supplies from a supplier in Chicago. The Department of Revenue sought to collect compensating tax on the purchase under section 79-3705a of Kansas Statutes Annotated.\textsuperscript{146} The taxpayer argued that it was not liable for compensating tax because the Chicago seller could have collected it.\textsuperscript{147} The taxpayer argued that section 79-3705a should apply only when sales tax is neither collected nor collectible. The court, however, sided with the state. When the seller was not authorized to collect the Kansas retail sales tax, imposition of the compensating tax on the consumer was correct.\textsuperscript{148} The legislature clarified the issue by removing the phrase "collectible" from section 79-3705a.\textsuperscript{149} The amended version of section 79-3705a requires the consumer to file a return and pay compensating tax if the retailer does not collect sales tax.\textsuperscript{150}

The legislature further ensured the collection of the Kansas Retailers' Sales Tax and the Compensating Tax by imposing personal liability for the taxes on individuals responsible for collection.\textsuperscript{151} New section 79-3643 of Kansas Statutes Annotated applies

\begin{footnotesize}
\begin{enumerate}
\item Section 79-3703 reads in pertinent part:
\[\begin{align*}
\text{There is hereby levied and there shall be collected from every person in this state a tax or excise for the privilege of using, storing, or consuming within this state any article of tangible personal property. \ldots All property purchased or leased within or without this state and subsequently used, stored, or consumed in this state shall be subject to the compensating tax if the same property or transaction would have been subject to the Kansas retailers' sales tax had the transaction been wholly within this state.}
\end{align*}\]

\item J. G. Masonry, 235 Kan. at 509-10, 680 P.2d at 300-01.

\item Id. at 509, 680 P.2d at 300.

\item "If the tax levied under KSA 79-3703 is not collected or collectible by the retailer, then the person using, consuming or storing tangible personal property in this state shall file a return and pay the tax, as required by KSA 79-3706." Kan. Stat. Ann. § 79-3705a (1985).

\item Id. at 508, 680 P.2d at 300.

\item Id. at 509, 680 P.2d at 301.


\item Id.

\end{enumerate}
\end{footnotesize}
regardless of whether the retailer does business as a proprietorship, partnership, or corporation.

The mechanics of collecting the Retail Sales Tax came before the Kansas Court of Appeals in *In re News Publishing*.\(^{152}\) News Publishing, a newspaper publisher, contracted with newspaper carriers to deliver its newspapers. The carriers, typically young people under age sixteen, purchased the papers at wholesale from News Publishing for retail sale to the public.\(^{153}\) News Publishing also informed the carriers that they should collect sales tax on sales to customers and remit the tax to News Publishing. News Publishing forwarded the sales tax collected by carriers to the Department of Revenue.\(^{154}\)

After a field audit established a large number of sales by carriers on which tax had not been collected, the Department of Revenue sought to recover the uncollected sales tax from News Publishing. The Board of Tax Appeals ruled that News Publishing was a wholesaler and that retailers, in this case the carriers, were primarily responsible for collecting the sales tax.\(^{155}\) Section 79-3608 of Kansas Statute Annotated requires retailers selling tangible personal property to obtain a registration certificate from the director of taxation. Section 79-3604 of Kansas Statute Annotated, however, shifts the responsibility for collecting sales tax to the wholesaler in certain instances.\(^{156}\) On appeal, the Department of Revenue argued that section 79-3604 made News Publishing liable


\(^{153}\) Id. at 329, 743 P.2d at 560.

\(^{154}\) Id.

\(^{155}\) See id. at 330, 743 P.2d at 561.

\(^{156}\) Section 79-3604 reads as follows:

Whenever the director of taxation shall determine that in the retail sale of any tangible personal property or services because of the nature of the operation of the business including the turnover of independent contractors, the lack of a place of business in which to display a registration certificate or keep records, the lack of adequate records or because such retailers are minors or transients there is a likelihood that the state will lose tax funds due to the difficulty of policing such business operations, the director shall refuse to issue a registration certificate to such person and it shall be the duty of the vendor to such person to collect the full amount of the tax imposed by this act and to make a return and payment of said tax to the director of taxation in like manner as that provided for the making of returns and the payment of taxes by retailers under the provisions of this act. Whenever the director shall determine that it is necessary to refuse to issue a registration certificate to any retailer under the provisions of this section, he or she shall immediately notify the vendor or vendors to such retailer of such refusal and the resulting duty to collect and make a return and payment of said tax.

for collection of sales tax because the carriers never applied for registration certificates. The court of appeals affirmed the Board of Tax Appeals ruling, however, holding that section 79-3604 did not impose a duty on a wholesaler to collect sales tax unless the retailer’s registration certificate application had been denied and the wholesaler had been so informed. The facts did not indicate that News Publishing had been informed of its duty to collect the tax. In 1970 the Legislature had foreseen the situation that occurred in News Publishing, and it amended section 79-3604. Its efforts to solve the problem, however, were insufficient.

The question of situs of an activity for purposes of the sales tax arose during the survey period. The 1985 legislature amended section 12-191 of Kansas Statutes Annotated, which governs situs of transactions for purposes of the county and city retailers’ sales tax. Under section 12-191, leasing of telecommunications or data processing equipment used in connection with telephone services is considered to take place at the lessee’s location. Section 12-191 reverses the usual rule that sales are considered to occur at the retailer’s place of business.

The constitutionality of the compensating use tax was challenged in J. G. Masonry, Inc. v. Department of Revenue. In J. G. Masonry, the taxpayer argued that the tax imposed an unfair burden on interstate commerce because it applied to freight charges for shipment from an out-of-state seller to a purchaser as well as to the purchase price. The court upheld the validity of the tax, noting that freight charges are part of the purchase price under the sales tax applicable to intrastate sales. The use tax equalizes ultimate costs to the consumer regardless of whether the transaction is interstate or intrastate. All delivery charges are subject to taxation. The sale, use, or consumption of all tangible personal property within the state is burdened by a uniform tax rate, regardless of the locale of the seller.

158. Id. at 333, 743 P.2d at 563.
163. Id. at 503, 680 P.2d at 297.
164. Id. at 508, 680 P.2d at 299.
165. Id. at 508, 680 P.2d at 300.
The sales tax exemption for original construction\(^{166}\) also was addressed by the court in *J. G. Masonry*. The taxpayer claimed that portions of its construction project were improperly taxed and should have been covered by the "original construction" exemption.\(^{167}\) The court ruled that a construction project entirely within an existing building did not qualify for the original construction exemption,\(^{168}\) holding that original construction means an addition in size to an existing structure, not merely interior remodeling.\(^{169}\)

In *In re Newton Country Club Co.*,\(^{170}\) the court of appeals addressed the issue of taxing mandatory gratuities. The Newton Country Club charged its members a mandatory fifteen percent gratuity on all purchases of food and beverages. The gratuities were paid to employees on a monthly basis.\(^{171}\) The club did not include the mandatory gratuity in gross receipts in its sales and liquor excise tax reports. The club argued that it did not benefit from the gratuity and therefore should not be taxed on it. The court agreed with the Department of Revenue's argument that the mandatory gratuity represented a portion of the total cost of food and drinks to the consumer and was taxable under both the retail sales tax and the liquor excise tax.\(^{172}\)

In 1985 the Kansas Supreme Court decided *In re K-Mart Corp ("K-Mart II")*.\(^{173}\) In *K-Mart II* the Department of Revenue appealed from an order of the Board of Tax Appeals holding that the taxpayer's purchase of advertising supplements distributed in local newspapers across the state was not taxable under the compensating tax.\(^{174}\) The court relied on the basic principle that the sales or use tax is to be paid only once on a given item by the final consumer and ruled that the subscriber pays sales tax on the entire newspaper, including the advertising supplements.\(^{175}\) Thus, the court found that the supplements were component parts of the newspaper and were therefore exempt from sales and use tax under

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\(^{167}\) *J. G. Masonry*, 235 Kan. at 498, 680 P.2d at 293.

\(^{168}\) Id. at 300, 680 P.2d at 294.


\(^{171}\) Id. at 639, 753 P.2d at 305.


\(^{174}\) *K-Mart II*, 238 Kan. at 393, 710 P.2d at 1306.

\(^{175}\) Id. at 398, 710 P.2d at 1308.
sections 79-3602(1) and 79-3606(m) of Kansas Statutes Annotated. Justice Herd dissented from the conclusion that the advertising supplements are component parts of newspapers. The supplements are not printed by the newspaper, and there is no extra charge for the supplements. Unlike the regular features of a newspaper, advertising supplements are unindexed and unscheduled. Thus, Herd agreed with Arkansas and South Dakota that the advertising supplements were not component parts of newspapers, and that K-Mart's use of the supplements was taxable.

In 1986 the court moved away from the K-Mart II decision by denying an exemption from the use tax for property used in oil field operations. In re Angle, d/b/a/ Frontier Oil Company concerned a taxpayer's claim that casing, cement, and drill bits used in oil well drilling operations should be exempt from sales tax under the component parts exemption in section 79-3606(n). The court denied the exemption, reasoning that drill bits, casing, and cement are "tools" that are used in more than one drilling operation. Thus, they are not "consumed" by the drilling procedure and do not fall within the meaning of section 79-3606(n).

The casing and cement used in the drilling process may continue to serve a prominent function in the operation of a producing well for as long as fifty years. As is often the case when the courts have denied an exemption, the legislature granted relief to oil companies with a new sales tax exemption for drill bits and explosives used in drilling.

During the survey period the court of appeals frequently attempted to distinguish between transactions subject to the sales or

176. Id. at 400, 710 P.2d at 1310. Herd also found the result to be unfair to Kansas printers, who are required to collect sales tax on similar sales of advertising supplements and thus cannot compete on an equal footing with out-of-state printers. The majority's ruling that supplements are exempt from sales-use tax under the component parts exemption should also apply to supplements printed within Kansas.


179. See also K Mart Corp. v. Idaho State Tax Comm'n, 111 Idaho 719, 727 P.2d 1147 (1986) (use of advertising supplements printed out of state subject to Idaho use tax; component part exemption in Idaho statutes is limited to manufacturing-type businesses).


use tax and nontaxable transactions. In In re R & R Janitor Service,\textsuperscript{184} the taxpayer claimed that her cleaning service did not constitute servicing or maintenance of tangible personal property within the scope of section 79-3603(q) of Kansas Statutes Annotated.\textsuperscript{185} The Department of Revenue consistently had interpreted this section to include janitorial services. The court held that section 79-3603(q) was not unconstitutionally vague, but that its application to cleaning services was erroneous.\textsuperscript{186}

In another case involving section 79-3603(q), In re Black,\textsuperscript{187} the court of appeals determined that welding parts onto an oil drilling rig and fitting pipe onto an existing pipeline constituted “altering” tangible personal property and were taxable under section 79-3603(q). The taxpayer argued that the rigs and pipelines were not “fastened to, connected with or built into real property,” and therefore, the altering (welding) was not subject to tax.\textsuperscript{188} Looking to the legislative history, the court stated that this language was intended to clarify the taxability of fixtures and was not intended to restrict taxation under section 79-3603(q) to fixtures.\textsuperscript{189} The court also rejected the taxpayer’s alternative claim that welding pipe onto pipelines and welding angle iron onto drilling rigs was “original construction” and therefore exempt from sales or use taxes under section 79-3603(p). Rather, the welding was an alteration.\textsuperscript{190}

Taxable services were at issue again in In re AT&T Technologies, Inc.,\textsuperscript{191} in which the court upheld a determination by the Board of Tax Appeals that repair services performed by AT&T on telephones owned by Southwestern Bell are taxable under section

\begin{footnotesize}
\begin{enumerate}
\item[186.] In re R&R Janitor Service, 9 Kan. App. 2d at 506, 683 P.2d at 914.
\item[188.] See id. at 667-68, 684 P.2d at 1038-39. The court examined Kan. Stat. Ann. § 79-3603(q) (Supp. 1983), which read in pertinent part: “[A] tax at the rate of 3% upon the gross receipts received for the service of repairing, servicing, altering or maintaining tangible personal property which when such services are rendered is not being held for sale in the regular course of business.”
\item[189.] In re Black, 9 Kan. App. 2d at 668-69, 684 P.2d at 1038-39. This interpretation was broader than that in In re R&R Janitor Service.
\item[190.] Id. at 669-70, 684 P.2d at 1039-40. “‘Altering’ means changing or modifying in some form, manner or respect, so as to affect some details, characteristics, or elements of the thing changed without destroying its existence or identity, or substituting an entirely new thing in its place.” Id. at 670, 684 P.2d at 1040.
\end{enumerate}
\end{footnotesize}
79-3603(q). The court reasoned that the repairs performed by AT&T on Southwestern Bell's telephone equipment were taxable because Southwestern Bell, not its service customers, was the primary consumer of the equipment. Thus, AT&T was not repairing equipment to be resold that would be exempt from sales tax.\textsuperscript{192}

The court also considered a cross-appeal by the Department of Revenue from the Board of Tax Appeal's determination that computer software was intangible property and thus not subject to the compensating tax. Taxability of computer software has been the subject of numerous decisions and articles in recent years, as courts and legislators have struggled to keep taxing statutes abreast of advances in technology.\textsuperscript{193} The cross-appeal in \textit{AT&T Technologies} involved the relationship between the \textit{ad valorem} property tax and the sales and use taxes. In both contexts, taxability depends in part on whether computer software is considered to be tangible or intangible personal property.

The Kansas courts first considered this issue in \textit{In re Strayer}.\textsuperscript{194} \textit{Strayer} addressed whether computer software is subject to the \textit{ad valorem} property tax, which generally applies to tangible (but not intangible) personal property. The Kansas Supreme Court surveyed the approaches taken in other states and followed the lead of California,\textsuperscript{195} focusing on the distinction between "operational programs" and "application programs."\textsuperscript{196} The \textit{Strayer} court concluded:

> [O]perational programs, without which a computer cannot operate, have a value that is to be considered an essential portion of the computer hardware and are therefore taxable as tangible personal property in conjunction with the hardware. Application programs, those which are particularized instructions adopted for special programs, are intangible property not subject to the personal property tax for tangible property.\textsuperscript{197}

At issue in \textit{AT&T Technologies} was whether software developed by AT&T outside the state of Kansas and used by Southwestern

\textsuperscript{192} \textit{Id.} at 561-62, 749 P.2d at 1038-39.


\textsuperscript{194} 239 Kan. 136, 716 P.2d 588 (1986).

\textsuperscript{195} \textit{Id.} at 141, 716 P.2d at 592 (citing \textit{CAL. REV. & TAX CODE} §§ 995, 995.2 (West Supp. 1986)).

\textsuperscript{196} Hellerstein explains the difference: "Computer software programs are of two broad types—the operating program, which controls the hardware and makes the machine run, and the application program, which performs specific functions, such as preparing a payroll or a loan amortization schedule for use by a bank." Hellerstein, \textit{supra} note 193, at 967.

\textsuperscript{197} \textit{Strayer}, 239 Kan. at 143, 716 P.2d at 593-94.
Bell within the state was subject to the Kansas Compensating Tax. Although complementary to the sales tax, the use tax applies only to tangible personal property, and not to intangible property or services. The specific software used by Southwestern Bell was a type of "application" software, and under Strayer would be considered intangible personal property. Both the Board of Tax Appeals and the Kansas Supreme Court felt that the Strayer results should be extended to the sales-use tax. Thus, the software in AT&T Technologies was intangible and not subject to the use tax.

The decision in AT&T Technologies was handed down in February 1988, as the legislature considered a recommendation from the Interim Studies Committee to amend section 79-3603(s) of Kansas Statutes Annotated (the Retailers' Sales Tax), which taxes "gross receipts received from the sale of computer software. As used in this subsection 'computer software' means information and directions loaded into a computer which dictate different functions to be performed by the computer." The Interim Studies proposal recommended expanding section 79-3603(s) to include alteration of software.

The 1988 legislature adopted the interim studies recommendation, but also responded to the AT&T Technologies decision by

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198. AT&T Technologies, 242 Kan. at 570, 749 P.2d at 1045.
[A] tax at the rate of 4% upon the gross receipts received from the sale of computer software, and the sale of the services modifying, altering, updating or maintaining computer software. As used in this subsection, "computer software" means information and directions loaded into a computer which dictate different functions to be performed by the computer. Computer software includes any canned or prewritten program which is held or existing for general or repeated sale, even if the program was originally developed for a single end user as custom computer software. The sale of computer software or services does not include: (1) The initial sale of any custom computer program which is originally developed for the exclusive use of a single end user; or (2) those services rendered in the modification of computer software when the modification is developed exclusively for a single end user only to the extent of the modification and only to the extent that the actual amount charged for the modification is separately stated on invoices, statements and other billing documents provided to the end user. The services of modification, alteration, updating and maintenance of computer software shall only include the modification, alteration, updating and maintenance
amending the definition of tangible personal property in section 79-3602(f) of Kansas Statutes Annotated. The new section reads as follows: "Tangible personal property' means corporeal personal property. Such term shall include any computer software program which is not a custom computer software program, as described by subsection (s) of K.S.A. 1987 Supp. 79-3603, and amendments thereto." The amendment does not follow the approach taken in Strayer, but effectively classifies software programs as "custom software" and other software (often referred to as canned software). Custom software, such as that leased by Southwestern Bell in AT&T Technologies, is specifically exempted from the sales tax in section 79-3603(s) and is also exempted from the use tax by virtue of section 79-3602(f). The use tax applies only to tangible personal property, and custom software is not included in the definition of tangible personal property.

Canned software programs are subject to both the sales tax and the use tax because of their status as tangible personal property. The court in AT&T Technologies voiced its concern that the status of computer software as tangible or intangible property ought to be the same for the ad valorem property tax and the sales-use tax. The legislature's action in 1988 leaves open whether canned software is now subject to ad valorem tax as tangible personal property on the strength of the definition in section 79-3602(f).

In 1986, and again in 1988, the legislature addressed the inequity of sales-use tax application to out-of-state mail order sales. The 1988 recommendations included amending the definition of retailer to include solicitation of mail order sales, or in the alternative, supporting federal legislation to overturn National Bellas Hess, Inc. v. Department of Revenue.

of computer software taxable under this subsection whether or not the services are actually provided.


204. This may mean that custom software is intangible personal property, as AT&T Technologies held. Other jurisdictions have concluded that custom software should be regarded as a service, not as property.


206. 386 U.S. 753 (1967) (shipping goods into state is insufficient nexus to collect sales tax).
IV. Economic Development Incentives

During the survey period the state legislature expanded its attempts to encourage economic diversity and development within economically distressed areas. In 1986 the legislature authorized counties, as well as cities, to establish enterprise zones. The original 1982 Enterprise Zone Act, examined in the previous survey, provided economic incentives for businesses to locate within economically distressed urban areas. The 1986 amendment expanded the benefits of the Act to include rural areas. In addition, cities or counties now may use population comparisons for any ten-year period beginning after 1970, in contrast to the original requirement of population comparisons strictly between 1970 and 1980. The amendment also liberalized the geographic boundaries of enterprise zones, including industrial parks located outside city limits and noncontiguous areas.

Additional tax benefits associated with enterprise zones include sales tax exemptions for tangible personal property connected with building or remodeling within an enterprise zone and an exemption for equipment to be installed in an enterprise zone. In a similar spirit, the 1986 legislature established a credit against the state income tax for expenditures for research and development conducted within the state.

One specific economic development project, the General Motors plant in Fairway, has been the subject of ongoing litigation. The

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208. McKenzie & Ratzlaff, supra note 71, at 82.
213. In State ex rel. Tomasic v. Kansas City, Kansas Port Authority, 230 Kan. 404,
project involved the use of industrial revenue bonds to finance the purchase of land and construction of facilities that would be leased to General Motors under a lease-purchase agreement. In *State ex rel. Tomasic v. Kansas City, Kansas Port Authority, ("Tomasic II"),* the Kansas Supreme Court considered several constitutional challenges to the project. Relying in part on its opinion in *State ex rel. Tomasic v. Kansas City, Kansas Port Authority ("Tomasic I"),* the court rejected several constitutional challenges to the ten-year property tax exemption in section 79-201a Second for city-owned facilities financed with industrial revenue bonds. The court articulated a four-part test for statutory property tax exemptions. The exemption in section 79-201a Second of Kansas Statutes Annotated is based on ownership by the city. Use by General Motors did not affect the exemption.

V. **Excise Taxes**

The previous survey noted the enactment of a mineral severance tax. The new tax generated litigation over whether basic sediment and water ("BS & W"), a by-product of oil well drilling, was subject to the tax. In *Director of Taxation v. Kansas Krude Oil Reclaiming Co.* the taxpayer argued that the legislature never intended to tax the oil contained in BS & W. The Board of Tax Appeals agreed, finding an implied exemption from taxation and assigning an allowance from taxation under section 79-4217(a) of Kansas Statutes Annotated. The Kansas Supreme Court held that BS & W contains recoverable crude oil and is not exempt from taxation. The 1985 legislature responded to the decision by adding a new subsection (e) to section 79-4221 of Kansas Statutes Annotated to require the reporting of all "gas, . . . coal, salt and oil" regardless of whether the product is taxable or exempt from taxation. In 1986 the legislature further required that a valid operator's license be obtained from the corporation commission.

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217. See *supra* notes 107-08 and accompanying text.
as a prerequisite to granting a severance tax exemption.\textsuperscript{221}

Other excise tax developments included the imposition of a tax on marijuana and controlled substances.\textsuperscript{222} The tax was a response to the growing volume of illicit drug distribution and use in the state. The legislation exempts persons who legally possess marijuana or other controlled substances.\textsuperscript{223}

As noted earlier, the Kansas Court of Appeals has indicated that the liquor excise tax should be imposed on mandatory gratuities.\textsuperscript{224} The liquor excise tax equals a percentage of the gross receipts derived from the sale of alcoholic beverages. Gross receipts is defined as "the amount charged the consumer" for an alcoholic drink.\textsuperscript{225} The court of appeals in \textit{Newton Country Club} determined that mandatory gratuities are included in the amount charged the consumer and are thus subject to the excise tax. Voluntary gratuities, however, are not subject to the excise tax.\textsuperscript{226}

\section*{VI. INHERITANCE AND ESTATE TAX}

Two Kansas Supreme Court decisions during the survey period emphasize the importance of instructions in a will concerning payment of federal estate taxes. In both cases the court affirmed the rule that when the will contains no specific directions on the subject, the federal estate tax is payable out of the residue of the estate, under the principles of equitable apportionment. In \textit{Dittmer v. Schmidt},\textsuperscript{227} although the decedent intended that his two daughters receive approximately equal amounts of property from his estate, his failure to indicate how the federal estate tax should be apportioned meant that the daughters did not share the tax burden equally. Betty Jean Dittmer received a larger share of property from her father’s probate estate, whereas Bryana’s share included some certificates of deposit on which she was the surviving joint tenant. Finding no instructions in the decedent’s will concerning apportionment of the tax burden, the court applied the principle

\begin{enumerate}
\item \textit{Id.} at 1872.
\item \textit{Id.} at 642, 753 P.2d at 307.
\item KAN. ADMIN. REGS. 92-24-11 (1985).
\end{enumerate}
of equitable apportionment.\textsuperscript{228} After the residuary estate had been exhausted, the remaining tax liability was apportioned between Betty Jean and Bryana in proportion to their share of the probate estate.\textsuperscript{229} Betty Jean thus paid about fifty-eight percent while Bryana paid only forty-two percent.

In \textit{In re Estate of Adair},\textsuperscript{230} failure to provide instructions for payment of federal estate taxes meant that a gift to charity was reduced by estate taxes, even though the charitable gift did not contribute to the tax burden. The decedent's will left half of the residue of the estate to a sister and half to the Wichita Art Museum. The museum objected to sharing the estate tax burden on the grounds that the gift to charity was deductible and did not contribute to the federal estate tax burden. The court held that the rule of equitable apportionment requires all beneficiaries of the estate, including charitable organizations, to share in the federal estate tax burden.\textsuperscript{231}

Legislative changes in the estate and inheritance tax area included (1) a 1985 amendment to section 79-1545(f) of Kansas Statutes Annotated concerning recapture of inheritance tax when property ceases to qualify for use valuation,\textsuperscript{232} and (2) an amendment to section 79-1569 of Kansas Statutes Annotated to extend the lien for inheritance taxes or interest due to any proceeds from the sale of a decedent's assets.\textsuperscript{233}

VII. Income Tax

Problems of taxing multistate corporations continue to arise. In \textit{Pioneer Container Corp. v. Beshears},\textsuperscript{234} the Kansas Supreme Court upheld the Director of Taxation's requirement that Pioneer Container, a Missouri corporation, and its Kansas subsidiary, Pioneer Bag Company, file a "combined report" for corporate income tax purposes. Kansas, like many other states, has adopted the Uniform Division of Income for Tax Purposes Act ("UDITPA") to facil-

\textsuperscript{228} Betty Jean argued that the burden should be shared equally, based on a codicil to the will indicating that the daughters should share the estate equally. \textit{Id.} at 698, 701, 683 P. 2d at 1255, 1256.

\textsuperscript{229} \textit{Id.} at 702, 683 P. 2d at 1256-57.


\textsuperscript{231} \textit{Id.} at 781, 703 P. 2d at 800.


itate apportionment of income when businesses operate in more than one state.\textsuperscript{235} Pioneer Container and Pioneer Bag constituted a "unitary business," with Pioneer Bag contributing economically to the benefit of Pioneer Container, its parent corporation.

The supreme court ruled that the Director of Taxation could require unitary businesses to file combined reports to facilitate the Department of Revenue's apportionment of the business income to Kansas. Although the combined report is not mentioned in the UDITPA, the court held that the information return was a useful tool in determining the amount of tax due and rejected Pioneer's constitutional objections.\textsuperscript{236}

The survey period saw legislative changes in the income tax as well. As taxpayers, especially farmers, continued to have trouble making loan payments, the legislature eased the tax burdens of foreclosure. The 1986 legislature removed gains realized on mortgage foreclosures from the calculation of taxable income for Kansas income tax purposes.\textsuperscript{237} In 1988 the legislature amended the Kansas income tax laws to eliminate the taxation of interest from Kansas government obligations.\textsuperscript{238}

Other legislative action included a requirement that taxpayers file mineral production payment reports.\textsuperscript{239} This requirement was made retroactive so that the Director of Taxation could demand production payment reports for periods prior to the effective date of the legislation.\textsuperscript{240} The Kansas television and film industry received a reprieve from withholding requirements for extras used in television and motion pictures. Extras who work less than fourteen days during a calendar year are not considered "employees" under section 79-3295 of Kansas Statutes Annotated and thus not subject to withholding.\textsuperscript{241}

VIII. MISCELLANEOUS TAXES

During the survey period the legislature continued efforts to tax intangible property. In 1982 the Kansas Supreme Court held the

\textsuperscript{236} Pioneer Container Corp., 235 Kan. at 756, 684 P.2d at 406.
\textsuperscript{240} Id.
intangibles tax to be unconstitutional.\textsuperscript{242} As a result, the legislature repealed the intangibles tax and enacted legislation allowing local units of government to impose a gross earnings tax. The new gross earnings tax was virtually identical to the intangibles tax it replaced.\textsuperscript{243}

The new tax survived a series of constitutional challenges in \textit{Cogswell v. Sherman County}.\textsuperscript{244} The Kansas Supreme Court held that the Kansas Constitution did not require that the tax be the same in all cities and counties across the state—uniformity within a taxing district is sufficient.\textsuperscript{245} Further, the court upheld the statutory scheme that allows, but does not require, local governmental units to impose a gross earnings tax.\textsuperscript{246} This statutory scheme did not make the tax a statewide tax, nor did it constitute an unauthorized delegation of legislative responsibility.\textsuperscript{247}

Several Kansas Attorney General opinions issued during the survey period concerned the mortgage registration tax imposed by section 79-3102 of Kansas Statutes Annotated.\textsuperscript{248} The amount of the tax is based on the amount of debt involved in the transaction and not on the value of the property given to secure the debt.\textsuperscript{249}

\begin{itemize}
\item[\textsuperscript{242}] Von Ruden v. Miller, 231 Kan. 1, 642 P.2d 91 (1982). In \textit{Von Ruden}, the court held that the local option allowing voters to repeal the intangibles tax was an unconstitutional delegation of power. \textit{Id.} at 15, 642 P.2d at 102. See McKenzie & Ratzlaff, \textit{supra} note 71, at 84.
\item[\textsuperscript{243}] A dispute concerning the intangibles tax reached the Kansas Supreme Court in 1985, after the tax had been repealed. The dispute in \textit{In re Angle}, 237 Kan. 817, 703 P.2d 825 (1985), involved the intangibles tax. During 1981 the taxpayer was a resident of Eastborough, a city that had not repealed the intangibles tax under the then existing local option. The taxpayer’s principal business office was located in Wichita, which had repealed the intangibles tax for 1981. Eastborough sought to tax earnings from bank accounts, certificates of deposit, treasury bonds, and municipal bonds used in connection with his business activities. \textit{Id.} at 818, 703 P.2d at 826.
\item[\textsuperscript{244}] The Board of Tax Appeals relied on the test in \textit{Humpage v. Robards}, 229 Kan. 461, 625 P.2d 469 (1981), and held that the taxpayer had shown a lack of control over the intangibles. Their integration into his Wichita business activities was sufficient to establish that Wichita and not Eastborough was the tax situs of the intangibles. \textit{Angle}, 237 Kan. at 818, 703 P.2d at 826. See also McKenzie & Ratzlaff, \textit{supra} note 71, at 85-86 for discussion of the \textit{Humpage} test. The Kansas Supreme Court felt that the issue was adequately answered by \textit{Kan. Stat. Ann.} § 79-3109(a) without reference to \textit{Humpage}. \textit{Angle}, 237 Kan. at 819-20, 703 P.2d at 826-27.
\item[\textsuperscript{245}] The gross earnings tax, \textit{Kan. Stat. Ann.} § 12-1,103 (1982), codifies the \textit{Humpage} test. Thus, \textit{Angle} would win under the new statute.
\item[\textsuperscript{246}] 238 Kan. 438, 710 P.2d 1331 (1985).
\item[\textsuperscript{247}] \textit{Id.} at 443, 710 P.2d at 1335-36.
\item[\textsuperscript{249}] \textit{Id.} 85-23 (1985).
\end{itemize}
The tax does not apply to a sale of property when complete performance is rendered in less than ninety days from the execution of the contract and when no debt is created or lien placed on the property being sold. The mortgage registration tax does not apply to a mortgage filed to correct an error in a previously recorded mortgage.

In a move consistent with previous attempts to enhance the climate for interstate commerce, the legislature repealed the taxation of express companies. Express companies are firms that convey packages to or through the state in an express fashion.

The Kansas Supreme Court followed a general regional trend by upholding the constitutionality of the state bingo regulations. The taxpayers, various bingo parlors, contended that sections 79-4706(q), (r), and (s) of Kansas Statutes Annotated abridged the operators' right to contract, violated the taxpayers' rights to due process and equal protection of the law, and were an invasive exercise of the state's police powers. The disputed provisions of the statute restrict bingo games played in a single hall (not subdivided) to three days per week separated by at least forty-four hours. The court upheld the challenged provisions of section 79-4706, finding no constitutional right to run a bingo game on a daily basis. Although the statute did interfere with the operators' right to contract, the court found that the legislature's determination to regulate the bingo industry was paramount.

IX. Procedure

The area of procedure also saw legislative response to judicial decisions. As of 1985 Kansas laws allowed venue for an appeal from agency decisions only in the county where the order was entered. In 1986 the legislature amended section 74-2426 of Kansas Statutes Annotated, which governs jurisdiction for review of orders in tax appeals. The change provides for venue in the county where an order or agency action is effective.

250. Id. 85-108.
251. Id. 85-113.
255. Id. at 353, 699 P.2d at 514.
256. Id. at 353, 699 P.2d at 513-14.
257. Id. at 358, 699 P.2d at 517.
258. Id. at 360, 699 P.2d at 518.
260. Id.
State ex rel. Smith v. Miller\textsuperscript{261} reiterated the general rule that when an adequate remedy is provided by statute, an aggrieved taxpayer must exhaust the administrative avenues available before seeking relief from the court. The taxpayer, Linn Valley Lakes, complained of the ad valorem property tax assessed against company property situated in Linn County. Linn Valley Lakes initially appealed the assessments to the County Board of Equalization ("CBE") and then appealed the CBE's adverse ruling to the Board of Tax Appeals. Before the Board of Tax Appeals could act, Linn Valley Lakes sought relief in district court by way of mandamus and quo warranto, alleging the unconstitutionality of the taxing statutes.\textsuperscript{262} The taxpayer argued that it should not have to proceed with the Board of Tax Appeals appeal because the relief it was seeking, declaration that the statute was unconstitutional, was beyond the scope of either the CBE or the Board of Tax Appeals. The court observed that the taxpayer's claim, in essence, was that the property valuation was too high. Thus, the court held that Linn Valley Lakes could seek relief in the district court after the determination of the Board of Tax Appeals.

Department of Revenue v. Coca-Cola\textsuperscript{263} addressed the authority of the Director of Revenue to issue a subpoena duces tecum and interrogatories pursuant to section 79-3233 of Kansas Statutes Annotated. The case stemmed from an assessment of additional income tax upon the Coca-Cola Company. The Department of Revenue issued interrogatories and a subpoena duces tecum. When Coca-Cola declined to provide the information to the Department, the Director sought judicial enforcement. The court upheld the Director's authority under section 79-3233 to issue the subpoena and interrogatories during the pendency of the administrative hearing. The Director's authority in this regard did not terminate, as Coca-Cola contended, at the beginning of the hearing. Rather, section 79-3233 allows the Director to issue subpoenas and interrogatories "within the bounds of reasonable discretion."\textsuperscript{264}

Both the court and the legislature dealt with the issue of interest on disputed taxes. In 1987 the legislature amended section 74-2438 of Kansas Statutes Annotated, which provides for the accrual of interest on taxes that are the subject of an appeal to the Director of Taxation or the Board of Tax Appeals. Interest begins to accrue on the date an order is entered or 180 days after the matter is

\textsuperscript{261} 239 Kan. 187, 718 P.2d 1298 (1986).
\textsuperscript{262} Id. at 190, 718 P.2d at 1301.
\textsuperscript{264} Id. at 551, 731 P.2d at 276.
fully submitted, whichever is earlier. Interest continues to accrue until the tax is paid.265

The Kansas Supreme Court heard three cases during the survey period that involved interest on various taxes, fees, and refunds. City of Lenexa v. Johnson County266 concerned four corporations that paid mortgage registration fees under written protest. The court held that section 16-204 of Kansas Statutes Annotated authorized payment of postjudgment interest only. There was no statutory authority for payment of interest on wrongfully assessed mortgage registration fees prior to judgment. In re Midland Industries267 followed a similar line of reasoning. A clerical error in favor of taxpayers resulted in taxes not being paid. The court held that the county had no authority to collect the taxes.268 Taxpayers sought interest on the illegally collected taxes. The court ruled that taxpayers were entitled to a refund under section 79-2005 of Kansas Statutes Annotated, but that the county was not liable for interest on its obligations unless statutorily decreed. No statute required payment of interest in this situation.

In yet another decision limiting the duty of local governments to pay interest on taxes, the court in Unified School District No. 490 v. Board of Butler County Commissioners269 ruled that the county could retain for its general fund any interest that had accrued on undistributed taxes. During the pendency of a valuation dispute, the Atchison, Topeka and Santa Fe Railroad paid forty percent of the disputed taxes to the counties involved, and sixty percent to the court. Following a settlement between the railroad and the counties, the county disbursed the disputed taxes, but kept the interest earned during the dispute. The school district brought suit seeking an order to require the county treasurer to pay the school district its share of interest earned on the undistributed tax payments. The court held that the legislative scheme in sections 79-2004 and 79-2004a of Kansas Statutes Annotated clearly authorized the county to keep the interest earned on undistributed taxes.270

270. Id. at 12, 696 P.2d at 69.