

Survey of Kansas Law: Taxation

*Sandra Craig McKenzie**

In July 1988, when this survey period began,¹ Kansas counties were struggling to complete statewide reappraisal of real property while Kansas taxpayers anxiously awaited the results. The first set of property tax bills based on the reappraised values arrived in November 1989, and the clamor for property tax relief began immediately, prompting a special session of the legislature in December 1989. The "property tax crisis" remained on the legislative agenda for the next four years, and undoubtedly played a role in the defeat of Governor Mike Hayden in the 1990 election. Newly elected Governor Joan Finney began her administration in 1991 with a highly controversial proposal to extend the retail sales tax to services. And in 1992, Shawnee County District Judge Terry Bullock placed school finance on the legislative agenda and ultimately provided the vehicle for property tax relief—a uniform statewide mill levy for schools may reduce property tax bills in 285 of the state's 304 school districts.

The survey period ends in December 1992 with a feeling of *deja vu*. A new classification amendment approved by Kansas voters in November 1992 took effect January 1, 1993 and Attorney General Robert Stephan threatened to send county appraisers back to square one with a lawsuit alleging that the 1985-1989 reappraisal efforts fell short of the constitutional mandate of "uniform and equal."²

I. AD VALOREM PROPERTY TAX

Statewide reappraisal dominated the property tax landscape during the survey period, beginning in the spring of 1989 when counties

* Professor of Law, University of Kansas. B.A. 1971, J.D. 1974, University of New Mexico. Research assistance was provided by David B. Spizman, University of Kansas Law School Class of 1993 and by William Cleaver, University of Kansas Law School Class of 1994.

1. This Survey covers developments in Kansas tax law from July 1988 through December 1992. This includes the 1989 through 1992 legislative sessions, and judicial opinions found in: 243 Kan. 776 through 251 Kan. 612; 13 Kan. App. 2d 1 through 17 Kan. App. 2d 409.

2. *State ex rel. Stephan v. Department of Revenue*, 92-CV-796 (Shawnee County D. Ct. filed June 15, 1992). Shawnee County District Court Judge Terry Bullock was once again the hero of the story, as he persuaded the parties to avoid litigation. A settlement order was entered on July 1, 1992, outlining a twelve point plan. Roger Myers, *Judge Defuses Crisis*, TOPEKA CAPITAL J., July 2, 1992, at 1-A.

mailed change-of-value notices to taxpayers showing reappraised values for real property.³ Led by the *Wichita Eagle Beacon*, newspapers across the state published the new values as they became available. A large number of taxpayers pursued the valuation appeal process, which involves a meeting with the county appraiser, and subsequent review by hearing officers, the county commission, and finally the Board of Tax Appeals.⁴

Given the conditions that prompted the 1985 legislature to order reappraisal, it is not surprising that many, if not most, taxpayers saw the appraised value of taxable property increase.⁵ Legislative efforts to ensure that valuation increases did not necessarily translate into tax increases included the classification amendment and a special tax lid. The classification system approved by constitutional amendment in conjunction with reappraisal was designed to prevent massive shifts in tax burden among groups of taxpayers. The reappraisal tax lid sought to prevent a windfall to local governments if pre-reappraisal tax rates were applied to the increased post-reappraisal valuations.⁶ In spite of these efforts, many taxpayers did face property tax increases when tax bills were mailed in November 1989. Among those taxpayers hardest hit were (1) homeowners (especially those with older residences), (2) owners of small businesses (especially service-oriented businesses that did not benefit from the 1989 exemption for merchants' and manufacturers' inventories), and (3) fraternal benefit societies. The Board of Tax Appeals, already facing a backlog of valuation appeals, feared a further avalanche of protests.

A. *Payment of Taxes Under Protest*

Public furor over property taxes caused Governor Mike Hayden to convene a special session of the Kansas Legislature in December 1989 to consider temporary relief measures. Taxpayers were granted a grace period for payment of 1989 property taxes, delaying their

3. KAN. STAT. ANN. § 79-1412a (1989).

4. KAN. STAT. ANN. §§ 79-1448, -1609 (Supp. 1992). See text *infra* part I.A for 1992 changes in the process.

5. See prior Survey, Sandra Craig McKenzie & Eric B. Milstead, *Survey of Kansas Law: Taxation*, 37 KAN. L. REV. 961 (1989), for a history of reappraisal.

6. KAN. STAT. ANN. §§ 79-5020 to 79-5037 (1989 & Supp. 1992). By limiting local governments to essentially the same amount of property tax revenue raised in 1988, tax rates (mill levies) generally declined across the state in 1989. Governor Joan Finney announced that continuing the tax lid on local governments would be her primary legislative agenda for 1993. John Hanna, *Governor to Focus on Tax Lid*, TOPEKA CAPITAL J., Nov. 6, 1992, at 1-A.

first half payment from December 20, 1989 to January 16, 1990.⁷ Taxpayers choosing to pay under protest were allowed to pay one-quarter of the tax due by January 16, 1990, with a second quarter due March 20, 1990, and the final half due as usual on June 20, 1990.⁸

Prior to 1990, the protest procedure began with an informal meeting between taxpayer and county appraiser, after which the taxpayer had thirty days in which to pursue the protest by filing an application for refund directly with the Board of Tax Appeals. The 1989 special session amended the protest procedures by adding steps at the local level. The protest now begins with a formal meeting between taxpayer and appraiser.⁹ Changes in valuation recommended by the county appraiser (or subsequently by a hearing officer or county commission) are subject to review by the state Board of Tax Appeals.¹⁰ Changes not reviewed within forty-five days become final.¹¹ This review was added by the 1989 special session to serve as a check on the discretion of local officials.¹²

After the formal meeting, the taxpayer who wants to pursue a protest has two options: to seek review at the county level, with a subsequent appeal to the Board of Tax Appeals, or to bypass the county commission and proceed directly to the Board of Tax Appeals.¹³ The 1989 special session added the optional review at the county level in an effort to "reopen" the valuation appeal

7. Act of Dec. 12, 1989, ch. 2, § 1, 1989 (Special Session) Kan. Sess. Laws 2. The grace period was even shorter for taxpayers who intended to claim property tax payments as a federal income tax deduction in 1989; such payments could be made no later than December 31, 1989. The grace period also applied to personal property tax. *Id.* § 2, 1989 (Special Session) Kan. Sess. Laws 2, 4.

8. *Id.*

9. Act of Dec. 12, 1989, ch. 2, § 3, 1989 (Special Session) Kan. Sess. Laws 2, 5 (codified at KAN. STAT. ANN. § 79-2005(a) (Supp. 1992)).

10. *Id.*

11. *Id.*

12. If the county commission orders a change in value, the Board of Tax Appeals has 45 days from receipt of notification of change in value in which to review the change. *Id.*, 1989 (Special Session) Kan. Sess. Laws 2, 6 (codified at KAN. STAT. ANN. § 79-2005(f) (Supp. 1992)). Alterations in the protest process made by the special session left unanswered questions. The taxpayer has 30 days from the notification of the results of the formal meeting in which to decide whether to present the protest to the county commission (or hearing officer) or the Board of Tax Appeals. *Id.* (codified at § 79-2005(e)). The decision whether to pursue the protest must be made prior to expiration of the 45 day period for review by the Board of Tax Appeals of any change in value recommended at the formal meeting. *See id.* (codified at § 79-2005(a)).

13. Upon receipt of the written notification of the results of the formal meeting with the county appraiser, the taxpayer has 30 days to pursue the protest. KAN. STAT. ANN. § 79-2005(e) (Supp. 1992).

process for 1989 taxes, and to resolve disputes without adding to the logjam at the Board of Tax Appeals.¹⁴ Although this made sense as a temporary measure with regard to 1989 taxes, the trend in subsequent reforms has been toward less, not more, county commission participation in the valuation process.¹⁵

B. *Property Tax Calendar*

Statewide reappraisal brought a change to a computerized system. The computer-assisted mass appraisal (C.A.M.A.) software was designed to allow annual updating of real property valuations, similar to what had previously been done for personal property. Acknowledging the large volume of valuation appeals and tax protests filed for 1989,¹⁶ the legislature approved a moratorium on new valuations for real property in 1990.¹⁷ The second wave of C.A.M.A.-generated valuation notices was sent in 1991.¹⁸

Although the annual updating cycle continued in 1992, some experts have suggested switching to a two year cycle, similar to that produced by the 1990 moratorium.¹⁹ Updating values every other year would give counties adequate time to complete the inspections, data collection, and other administrative tasks associated with property appraisal. Physical inspection of all real property is currently required every four years.²⁰ Beginning in 1992, valuations cannot be increased unless there has been an actual physical inspection of the property.²¹

14. KAN. STAT. ANN. § 79-2005(e) specifically refers to review by hearing officers under § 79-1602 as part of the county level review step in the protest procedure. Although KAN. STAT. ANN. § 79-1602 was repealed in 1992, and replaced by a new system of hearing officers and panels, *see infra* notes 25-33 and accompanying text, § 79-2005(e) does not reflect this change.

15. See text describing 1992 reforms to remove county commission from the valuation process *infra* notes 25-33 and accompanying text.

16. As of late 1990, there were still 18,000 appeals from 1989 waiting to be heard by the Board of Tax Appeals. Kevin Bumgarner, *Home Owners Feeling Effects of Reappraisal*, WICHITA BUS. J., Mar. 22, 1991, at 1.

17. Act of Mar. 26, 1990, ch. 90, § 5, 1990 Kan. Sess. Laws 639, 644.

18. Beginning in 1991, valuation notices must be sent each year, even if there is no change. Act of May 9, 1991, ch. 279, § 1, 1991 Kan. Sess. Laws 1558 (codified at KAN. STAT. ANN. § 79-1460 (Supp. 1992)). Prior law required notice only in the event of a change in valuation or classification. All taxpayers received change of value notices in 1989.

19. Roger Myers, *Appraisal Reforms Now Law*, TOPEKA CAPITAL J., May 25, 1992, at 1A-2A.

20. KAN. STAT. ANN. §§ 79-1455, -1476 (1989 & Supp. 1992).

21. Act of May 23, 1991, ch. 279, § 1, 1991 Kan. Sess. Laws 1558 (codified at KAN. STAT. ANN. § 79-1460 (Supp. 1992)); *see also* Op. Kan. Att'y Gen. 90-531 (drive-by inspection with review of previous years records does not constitute physical inspection of property).

C. Valuation Appeals

Changes in the property tax calendar for 1992 have effectively expanded the time frame for valuation appeals. Change-of-value notices must be mailed by March 1 (formerly April 1) of each year.²² A taxpayer now has until April 15 to file an informal appeal.²³ Formerly, appeals had to be filed within twenty-one days after mailing notice of valuation. Through 1992, a valuation appeal began with a meeting between taxpayer and county appraiser, with subsequent review by hearing officers (if appointed), and then review by the county commission sitting as the County Board of Equalization.²⁴

Beginning in 1993, the county commission will no longer hear valuation appeals. After an informal meeting with the county appraiser, the next step will be a hearing before a hearing officer or panel (H.O.P.).²⁵ Informal hearings with the county appraiser will be complete by May 15 (formerly May 1).²⁶ The H.O.P.s will complete their tasks by July 1 (formerly June 15).²⁷

The new H.O.P.s will differ from the hearing officers utilized in some counties to handle valuation appeals during 1989 and 1990. Counties with more than 10,000 parcels are required to appoint an H.O.P.; appointment of H.O.P.s is optional in counties with fewer than 10,000 parcels.²⁸ Counties can also form joint district H.O.P.s with the approval of the Director of Property Valuation.²⁹ Appeals from decisions of the H.O.P. will be heard by the state Board of Tax Appeals.³⁰ Appeals from decisions of the county appraiser will go directly to the Board of Tax Appeals in counties where no H.O.P. is appointed.³¹

22. Act of May 20, 1992, ch. 282, § 4, 1992 Kan. Sess. Laws 1758, 1761 (codified at KAN. STAT. ANN. § 79-1460 (Supp. 1992)). Valuation notice for personal property must be mailed by May 1 (*i.e.* no change). *Id.*

23. Act of May 20, 1992, ch. 282, § 3, 1992 Kan. Sess. Laws 1758, 1760 (codified at KAN. STAT. ANN. § 79-1448 (Supp. 1992)). Initial appeal deadline for personal property is May 15 (formerly within 21 days of county mailing notice). *Id.*

24. KAN. STAT. ANN. § 79-1448 (Supp. 1992).

25. *Id.*

26. *Id.*

27. Act of May 20, 1992, ch. 282, § 10, 1992 Kan. Sess. Laws 1758, 1765 (codified at KAN. STAT. ANN. § 79-1606 (Supp. 1992)).

28. *Id.* § 7, 1992 Kan. Sess. Laws 1758, 1763 (codified at KAN. STAT. ANN. § 79-1611 (Supp. 1992)). Counties cannot use a home rule charter resolution to avoid appointing hearing officers or panels. *Id.* § 15, 1992 Kan. Sess. Laws 1758, 1769 (codified at KAN. STAT. ANN. § 19-101g(a)(25) (Supp. 1992)).

29. KAN. STAT. ANN. § 79-1611 (Supp. 1992).

30. Act of May 20, 1992, ch. 282, § 12, 1992 Kan. Sess. Laws 1758, 1767 (codified at KAN. STAT. ANN. § 79-1609 (Supp. 1992)).

31. KAN. STAT. ANN. § 79-1611 (Supp. 1992).

The goal of these reforms is to make the valuation process less political, by substituting trained H.O.P.s for elected officials.³² Persons serving as hearing officers or on hearing panels must be "qualified by virtue of experience and training in the field of property appraisal and property tax administration" and must complete a training course conducted by the Director of Property Valuation.³³

Two companion measures will improve credentials for county appraisers and other appraisal employees. County appraisers must now be certified or licensed under Section 58-4101.³⁴ County employees who perform "appraisal analysis functions" will also be required to attend training approved by the Director of Property Valuation.³⁵

Concerns about the quality of appraisals also prompted legislation requiring the Director of Property Valuation to establish standards for property tax appraisals, including a minimum requirement that appraisals be in writing.³⁶ Appraisals generated under the C.A.M.A. system will be sufficient to meet the written requirement.³⁷ Pending action by the Director of Property Valuation, appraisals must conform with generally accepted appraisal standards in effect on March 1, 1992.³⁸

Another 1992 change addresses the frustration of taxpayers who have successfully pursued appeals and obtained reductions in appraised value, only to see the valuation of the property increased the following year. Many taxpayers are unfamiliar with the concept of annual updating, which was not done for real property prior to 1989. Many counties also experienced technical difficulties with the C.A.M.A. software in incorporating the changes made during the appeals process into the C.A.M.A. data base. And, in some

32. Compare the 1989 legislature's attempts to make the county commission more involved in the protest procedure. See KAN. STAT. ANN. § 79-2005(e) (Supp. 1992). Although that option still exists, it seems likely that most taxpayers will skip the county commission and take their protest directly to the Board of Tax Appeals.

33. KAN. STAT. ANN. § 79-1611 (Supp. 1992). Note that a county commissioner could choose to serve as a hearing officer if he or she meets the qualifications. See *id.*

34. A grandfather clause will allow reappointment of current appraisers who do not meet the licensure standard. Act of May 20, 1992, ch. 282, § 1, 1992 Kan. Sess. Laws 1758, 1758-59 (codified at KAN. STAT. ANN. § 19-430 (Supp. 1992)).

35. Act of Apr. 23, 1992, ch. 178, § 1, 1992 Kan. Sess. Laws 710 (codified at KAN. STAT. ANN. § 79-1411b (Supp. 1992)).

36. Act of May 13, 1992, ch. 249, § 1, 1992 Kan. Sess. Laws 1485 (codified at KAN. STAT. ANN. § 79-505 (Supp. 1992)).

37. *Id.* § 3, 1992 Kan. Sess. Laws 1485, 1486 (codified at KAN. STAT. ANN. § 79-504 (Supp. 1992)).

38. KAN. STAT. ANN. § 79-505(a)(1) (Supp. 1992).

instances, the reductions may simply not reflect fair market value. Legislation approved in 1992 will prohibit an increase in the year following a successful valuation appeal unless the county appraiser can document compelling and substantial reasons to increase the value.³⁹

In a move that could be even more effective to produce quick resolution of valuation disputes and prevent logjams at the Board of Tax Appeals, the 1992 legislature also explored the possibility of binding arbitration. A pilot program in Lyon, Ellis, Saline, and Shawnee Counties will offer binding arbitration as an alternative to the H.O.P. following an informal hearing with the county appraiser.⁴⁰ The trial program will be in operation from 1993-1995.⁴¹ Arbitrators will be chosen from a list of persons with experience and training maintained by the Director of Property Valuation.⁴² If the county and property owner do not agree, an arbitrator will be selected by the administrative judge for the district in which the property is located.⁴³

Hearings will be complete by the end of June, and arbitrators will render decisions by July 5.⁴⁴ The decision of the arbitrators will be final and will not be subject to appeal.⁴⁵ Taxpayers will also be precluded from protesting⁴⁶ a valuation that has been the subject of arbitration.⁴⁷ Under current law, a taxpayer can appeal the valuation of property for a single year in up to three separate proceedings.⁴⁸

D. Real Estate Ratio Study Act

An important tool for monitoring the quality of appraisals across the state is the Assessment-Sales Ratio Study. Several changes were made by the legislature during the 1989 special session and the

39. KAN. STAT. ANN. § 79-1460(c) (Supp. 1992).

40. Act of May 20, 1992, ch. 282, § 14, 1992 Kan. Sess. Laws 1758, 1767 (codified at KAN. STAT. ANN. § 79-1494 (Supp. 1992)).

41. *Id.* Counties cannot use a home rule charter resolution to avoid participation. KAN. STAT. ANN. § 19-101g(a)(26) (Supp. 1992).

42. KAN. STAT. ANN. § 79-1494.

43. *Id.*

44. *Id.*

45. *Id.*

46. Taxpayers may generally protest the payment of taxes under KAN. STAT. ANN. § 79-2005 (Supp. 1992).

47. KAN. STAT. ANN. § 79-1494.

48. The three proceedings are: filing a valuation appeal (KAN. STAT. ANN. § 79-1448 (Supp. 1992)), paying the first half of property taxes under protest (KAN. STAT. ANN. § 79-2005), and filing an additional protest along with the second half tax payment (KAN. STAT. ANN. § 79-2005).

1991 regular sessions, as Kansas continued to struggle with what appeared to be major problems in the quality of appraisals in some counties. After a 1992 recodification, the study will be known as the Kansas Real Estate Ratio Study Act.⁴⁹

The Real Estate Ratio Study will be conducted for each county on a calendar year basis, with the first study covering the period from September 1, 1991 to December 31, 1992.⁵⁰ Mid-year ratios will be determined, and a final study will be published by April 1 of each year.⁵¹

Information for the study comes from the Real Estate Sales Validation Questionnaire (formerly known as the Certificate of Value).⁵² As of July 1991, questionnaires were required to be filed, with several exceptions, whenever there was a transfer of title.⁵³ The 1992 legislation allows the Director of Property Valuation to use sales data from previous years and to conduct appraisals to supplement sales data to determine reliable ratios.⁵⁴

Access to Real Estate Sales Validation Questionnaires is granted to the following: various public officials including the county appraiser, Director of Property Valuation, and county commissioners; appraisers; and financial institutions for the purpose of conducting appraisals as required by federal and state regulators.⁵⁵ Property owners may also have access to the Questionnaires (but only as to property within the same subclass) for purposes of prosecuting an appeal, or deciding whether to appeal.⁵⁶

49. Act of Apr. 16, 1992, ch. 131, § 1, 1992 Kan. Sess. Laws 518 (codified at KAN. STAT. ANN. § 79-1485 (Supp. 1992)).

50. *Id.* § 8, 1992 Kan. Sess. Laws 518, 520 (codified at KAN. STAT. ANN. § 79-1492 (Supp. 1992)).

51. *Id.* §§ 5-6, 1992 Kan. Sess. Laws 518, 520 (codified at KAN. STAT. ANN. §§ 79-1489, -1490 (Supp. 1992)).

52. Act of May 23, 1991, ch. 162, § 8, 1991 Kan. Sess. Laws 1068, 1075 (codified at KAN. STAT. ANN. § 79-1437c (Supp. 1992)).

53. KAN. STAT. ANN. §§ 79-1437c, -1437e (Supp. 1992). Exceptions include: transfers to secure or release security for a debt; transfers to confirm or correct a deed previously recorded, without additional consideration; gifts or donations stated in a deed or other instrument; cemetery lot; and lease or transfer of severed mineral interests. § 79-1437e.

Additional exceptions added in 1992 include: transfers to a trust, without consideration; transfers resulting from a divorce settlement; transfers made solely for the purpose of creating joint tenancy or tenancy in common; transfers by sheriff's deed; transfers by deed that has been in escrow for more than five years; transfers by quitclaim deed filed for the purpose of clearing a title encumbrance; transfers to convey a right-of-way; and transfers pursuant to eminent domain. Act of Apr. 23, 1992, ch. 159, § 2, 1992 Kan. Sess. Laws 645 (codified at KAN. STAT. ANN. § 79-1437e (Supp. 1992)).

54. Act of Apr. 16, 1992, ch. 131, § 4, 1992 Kan. Sess. Laws 518, 519 (codified at KAN. STAT. ANN. § 79-1488 (Supp. 1992)).

55. KAN. STAT. ANN. § 79-1437f (Supp. 1992).

56. Act of May 20, 1992, ch. 282, § 19, 1992 Kan. Sess. Laws 1758, 1772 (codified at KAN. STAT. ANN. § 79-1437f(b) (Supp. 1992)).

E. Classification

In 1985, as a prelude to statewide reappraisal, Kansas voters approved the "classification amendment" to article XI, section 1 of the Kansas Constitution. The new classification scheme took effect in January 1989; prior to that date all taxable property was assessed (listed on the tax rolls) at thirty percent of its appraised value.⁵⁷ The classification amendment established four classes of real property and six classes of personal property with assessment percentages ranging from twelve percent to thirty percent.⁵⁸ A few questions have arisen over assignment of property to a particular class; for example, day care homes. County appraisers classified day care homes as commercial property, which is assessed at thirty percent. Owners, on the other hand, asserted that the homes retained their residential character and should be assessed at twelve percent. This dispute was resolved in favor of the day care homes by the 1992 legislature. The statute now provides that property used partly for a registered or licensed day care home⁵⁹ will be considered to be used for residential purposes.⁶⁰

Although the purpose of the classification system was to prevent large shifts in tax burdens when property was reappraised, shifting did occur. Numerous proposals for changes in the classification system have been introduced at each legislative session since 1989. It was not until 1992 that the legislature finally agreed on a proposal that was submitted to Kansas voters at the general election on November 3, 1992. The amendment was approved, and will make the following changes, effective January 1, 1993.⁶¹

The number of subclasses of real property will increase from four to seven:

(1) Residential: Assessment of real property used for residential purposes (including both single and multi-family) will be reduced from 12 percent to 11.5 percent.⁶² Attempts to create a separate subclass for multi-family dwellings have not been successful.

(2) Agricultural Land: No change will be made in the current system of placing land devoted to agricultural use on the tax rolls at thirty percent of its use value.⁶³

57. KAN. STAT. ANN. § 79-1439 (1988).

58. Act of May 17, 1988, ch. 375, § 7, 1988 Kan. Sess. Laws 2333, 2338 (codified at KAN. STAT. ANN. § 79-1439 (1989 & Supp. 1992)).

59. KAN. STAT. ANN. § 65-501 (1989).

60. Act of Apr. 16, 1992, ch. 107, § 1, 1992 Kan. Sess. Laws 417 (codified at KAN. STAT. ANN. § 79-1439(b)(1)(A) (Supp. 1992)).

61. Act of May 5, 1992, ch. 342, § 1, 1992 Kan. Sess. Laws 2402.

62. *Id.* at 2403.

63. *Id.*

(3) Vacant Lots: Vacant lots will continue to be assessed at twelve percent. The classification of vacant lots located in areas zoned for commercial development has been the subject of disputes, because commercial property is assessed at thirty percent, while vacant lots are assessed at twelve percent.⁶⁴ Legislative attempts to include in the proposed amendment a higher rate on vacant lots zoned commercially were not successful.

(4) Not-for-Profit Organizations: The amendment creates a new subclass of property owned and operated by organizations recognized as tax exempt under Section 501(c) of the Internal Revenue Code and included in the subclass by law. Such property will be assessed at twelve percent (currently thirty percent).⁶⁵ Although the main impetus for this change came from lodge groups such as the Elks and Masons, fraternal benefit societies are only one of the twenty-five categories of organizations that are tax exempt under Section 501(c).⁶⁶ Legislative action to define the scope of the property tax exemption will be necessary.⁶⁷

(5) Commercial and Industrial: Commercial and industrial real estate, including commercial buildings on land devoted to agricultural use, will constitute a new, separate subclass. Assessment of this property will be reduced from thirty percent to twenty-five percent.⁶⁸

(6) Public Utility: Public utility property (except railroad property) will become a new subclass with an assessment rate of thirty-three percent (formerly thirty percent).⁶⁹ Railroad real property will be assessed at "the average rate for all other commercial and industrial property."⁷⁰ The explanatory ballot statement described the railroad assessment as federally mandated.⁷¹

64. *Id.*

65. *Id.* at 2404.

66. Fraternal benefit societies are tax exempt under I.R.C. § 501(c)(8) (1988). The best known category of tax exempt organizations is for "religious, charitable, scientific, . . . literary, or educational purposes." I.R.C. § 501(c)(3) (1988). Most organizations that qualify under § 501(c)(3) are also exempt from property tax under one of the existing constitutional or statutory exemptions.

67. Bill Blankenship, *Don't Count Your Tax Break Dollars Yet*, TOPEKA CAPITAL J., Dec. 10, 1992, at 1-A. Although the 1993 legislature did include sections to identify those nonprofit groups eligible for the new classification in the "super trifecta" bill passed during the final hours of the wrap-up session, the measure was vetoed by Governor Finney. Martin Hawver, "Trifecta" Bill Repackaged, *Session Ends*, TOPEKA CAPITAL J., May 3, 1993; Finney Vetoes "Super Trifecta" Tax Relief Bill, LAWRENCE J. WORLD, May 20, 1993. The issue will be presented to the legislature again in 1994. Roger Myers, *Panel OKs Four Tax Relief Bills*, TOPEKA CAPITAL J., June 15, 1993.

68. Act of May 5, 1992, ch. 342, § 1, 1992 Kan. Sess. Laws 2404.

69. *Id.*

70. *Id.*

71. *Id.* at 2406.

(7) Other: All other real property not specifically subclassified will remain at thirty percent.⁷² Note that commercial, industrial, and utility property, which currently fall into this class, will be moved to separate subclasses.

The number of subclasses of personal property will be unchanged, although the amendment authorizes the legislature to create a seventh subclass for recreational vehicles:

(1) Mobile Homes: Assessment of mobile homes used for residential purposes will be reduced from 12 percent to 11.5 percent to match the assessment of residential real estate.⁷³

(2) Mineral Leasehold: The amendment will reduce from thirty percent to twenty-five percent the assessment of low production oil and gas leaseholds—defined as an oil leasehold with average daily production of five barrels or less or a natural gas leasehold with average daily production of 100 mcf or less.⁷⁴ All other mineral leaseholds will remain at thirty percent.⁷⁵

(3) Public Utility: Assessment of nonrailroad public utility personal property, including public utility inventories, will be increased from thirty percent to thirty-three percent.⁷⁶ Railroad personal property will be assessed at the average rate for all other commercial and industrial property. The inclusion of public utility inventories is significant; they are currently exempt from taxation under the Kansas Supreme Court ruling in *Colorado Interstate Gas Co. v. Board of County Commissioners of Morton County*.⁷⁷

(4) Motor Vehicles: The amendment made no change in taxation of motor vehicles, but authorizes the legislature to create a separate subclass of recreational vehicles for property tax purposes.⁷⁸ Implementation of this will require legislative action to define the subclass and establish a system of taxation.⁷⁹

72. *Id.* at 2404.

73. *Id.*

74. *Id.*

75. Beginning in 1992 a more narrowly defined category of low producing oil leases, other than royalty interests, will be exempt from property tax. The new statutory exemption will apply to leases with average daily production of no more than two (2) barrels, or completion depth of 2000 feet or more and an average daily production of no more than three (3) barrels. Act of May 20, 1992, ch. 282, § 20, 1992 Kan. Sess. Laws 1758, 1773-74.

76. Act of May 5, 1992, ch. 342, § 1, 1992 Kan. Sess. Laws 2404.

77. 247 Kan. 654, 802 P.2d 584 (1990) (constitutional exemption for merchants' and manufacturers' inventories applies to natural gas owned by public utility held for resale).

78. Act of May 5, 1992, ch. 342, § 1, 1992 Kan. Sess. Laws 2403.

79. Implementing a tax break for owners of recreational vehicles was part of two tax relief bills passed during the 1993 legislative session. These measures, dubbed the "trifecta" and "super trifecta" in honor of the ongoing gambling controversy, were both vetoed by

(5) Commercial and Industrial Machinery and Equipment: In contrast to the decreased assessment for commercial real estate, the assessment of commercial and industrial machinery and equipment will increase from twenty percent to twenty-five percent.⁸⁰ The valuation method for equipment remains unchanged.

(6) Other: All other personal property not specifically classified will continue to be assessed at thirty percent.⁸¹

F. Exemptions and Abatements

The prior Survey noted that the 1985 legislative mandate for reappraisal prompted a veritable flood of new statutory exemptions in anticipation of the 1989 completion of reappraisal.⁸² Although a few minor exemptions were added during the current survey period, legislative efforts have concentrated on the controversial economic development tax abatements under article XI, section 13 of the Kansas Constitution.

A new exemption was created for low producing oil leases, other than royalty interests, beginning in 1992. A low producing lease is defined as one with an average daily production of no more than two barrels, or a completion depth of 2000 feet or more and an average daily production of no more than three barrels.⁸³

Another exemption, created for merchants' and manufacturers' inventory,⁸⁴ was the focus of some attention. Enacted in 1988 to implement the constitutional exemption, Section 79-201m was amended in 1989, clarifying the definitions of "merchant" and "inventory."⁸⁵ Subsection (b), added during the December 1989 special session, purportedly limits the exemption by making it inapplicable to tangible personal property of a public utility.⁸⁶ In spite of the legislature's action, the Kansas Supreme Court ruled

Governor Finney. Roger Myers, *Finney Wins Big Veto Battles*, TOPEKA CAPITAL J., Apr. 29, 1993; *Finney Vetoes "Super Trifecta" Tax Relief Bill*, LAWRENCE J. WORLD, May 20, 1993. The issue will be presented to the legislature again in 1994. Roger Myers, *Panel OKs Four Tax Relief Bills*, TOPEKA CAPITAL J., June 15, 1993.

80. Act of May 5, 1992, ch. 342, § 1, 1992 Kan. Sess. Laws 2405.

81. *Id.*

82. McKenzie & Milstead, *supra* note 5, at 967-76.

83. Act of May 20, 1992, ch. 282, § 20, 1992 Kan. Sess. Laws 1758, 1773-74. Note that the constitutional amendment, discussed *supra* at note 74, would reduce the assessment rate for a broader category of "low production" leases.

84. KAN. STAT. ANN. § 79-201m (Supp. 1992).

85. Act of Apr. 10, 1989, ch. 289, § 1, 1989 Kan. Sess. Laws 1720 (codified at KAN. STAT. ANN. § 79-201m (Supp. 1992)).

86. Act of Dec. 12, 1989, ch. 1, § 1, 1989 (Special Session) Kan. Sess. Laws 1 (codified at KAN. STAT. ANN. § 79-201m(b) (Supp. 1992)).

a year later that the merchants' and manufacturers' inventory exemption applies to natural gas owned and held for resale by a public utility.⁸⁷ Although it does not specifically invalidate Section 79-201m(b), the opinion holds that the legislature has no authority to narrow the scope of a constitutionally authorized exemption.⁸⁸

The constitutional provision authorizing tax abatements for economic development has been the source of considerable controversy during the survey period. Pursuant to article XI, section 13 of the Kansas Constitution, a county or city may grant a full or partial abatement of property taxes, for a period of no more than ten years, for the purpose of attracting new business or encouraging improvements to existing businesses.⁸⁹ Concern over the standards being used in various communities resulted in legislation requiring counties and cities to promulgate policies and procedures for the granting of tax abatements.⁹⁰ After a 1990 amendment, abatements may only be granted after a public hearing, following appropriate publication of notice, and notice to other cities, counties, and school districts affected by the abatement.⁹¹ Abatements for personal property require a factual determination that the abatement is necessary to retain jobs in the State of Kansas.⁹² Beginning July 1, 1990, economic development abatements require initial approval by the Board of Tax Appeals⁹³ and must be renewed annually.⁹⁴

Economic development tax abatements reduce the assessed valuation in a taxing district, which has the effect of increasing the

87. *Colorado Interstate Gas Co. v. Board of County Comm'rs of Morton County*, 247 Kan. 654, 663, 802 P.2d 584, 590 (1990).

88. *Id.* at 660, 802 P.2d at 588. The court specifically refused to consider the validity of § 79-201m(b), noting that "[f]or some inscrutable reason, the parties herein make no reference to this amendment to K.S.A. 79-201m." *Id.* at 659, 802 P.2d at 588.

89. Abatements are available for real property used exclusively in the businesses of "(A) Manufacturing articles of commerce; (B) conducting research and development; or (C) storing goods or commodities which are sold or traded in interstate commerce." KAN. CONST. art. XI, § 13.

90. Act of May 9, 1990, ch. 345, § 1, 1990 Kan. Sess. Laws 1877 (codified at KAN. STAT. ANN. § 79-251(a) (Supp. 1992)).

91. *Id.* (codified at KAN. STAT. ANN. § 79-251(b) (Supp. 1992)).

92. Act of May 9, 1990, ch. 345, § 2, 1990 Kan. Sess. Laws 1877, 1878 (codified at KAN. STAT. ANN. § 79-252 (Supp. 1992)).

93. Act of May 9, 1990, ch. 345, § 4, 1990 Kan. Sess. Laws 1877, 1880 (codified at KAN. STAT. ANN. § 79-213(m) (Supp. 1992)). Procedures for the granting of tax exemptions were amended in 1989. Act of May 10, 1989, ch. 288, § 3, 1989 Kan. Sess. Laws 1711, 1717 (codified at KAN. STAT. ANN. § 79-213 (Supp. 1992)). The amendments suspend the taxpayer's liability for property taxes during the pendency of an application for exemption. If the exemption is denied, the taxes are due 30 days after the Board of Tax Appeals issues its order. KAN. STAT. ANN. § 79-213(i) (Supp. 1992).

94. Act of May 9, 1990, ch. 345, § 3, 1990 Kan. Sess. Laws 1877, 1878 (codified at KAN. STAT. ANN. § 79-210 (Supp. 1992)).

tax burden on other taxable property in the district.⁹⁵ The effect of abatements has traditionally been felt only locally, within the city, county, and school district in which the property is located. With the adoption of a significant new statewide mill levy for school finance, the issue of abatements becomes a matter of statewide concern. Abatements granted by one community shift the tax burden to taxable property in other parts of the state. The perception that some cities have granted abatements for large amounts of taxable property undoubtedly fueled the secession movement in several western Kansas counties.

From a judicial standpoint, the most interesting exemption issue during the survey period concerns tax-exempt status for property that is subject to a lease. Leases are generally ignored for purposes of computing property tax bills, which are sent to the owner of the property.⁹⁶ Tax-exempt status, on the other hand, typically requires consideration of the use of the property, and not simply ownership. Thus, the existence of a lease complicates the issue.

The issue first came up during the survey period in two similar cases involving property owned by an airport authority and leased to private businesses unrelated to the airport—*Tri-County Public Airport Authority v. Morris County Commission*⁹⁷ and *Salina Airport Authority v. Board of Tax Appeals*.⁹⁸ The airport authorities claimed that the properties were used exclusively for municipal purposes and were therefore exempt under Section 79-201a *Second*.⁹⁹ Both exemptions were denied on the grounds that leasing property for the production of income did not constitute exclusive use for municipal purposes (even though the income was used to support the airport).¹⁰⁰

95. The mill levy for a taxing district is determined by dividing the necessary revenue by the total assessed valuation for the taxing district.

96. The concept is known as unitary assessment. Kansas, like many other states, follows the rule of unitary assessment except for mineral interests. See, e.g., KAN. STAT. ANN. § 79-420 (Supp. 1992) (providing for separate assessment and taxation of mineral interests).

97. *Tri-County Pub. Airport Auth. v. Morris County Comm'n*, 245 Kan. 301, 777 P.2d 843 (1989).

98. *Salina Airport Auth. v. Board of Tax Appeals*, 13 Kan. App. 2d 80, 761 P.2d 1261 (1988).

99. *Tri-County Airport*, 245 Kan. at 302, 777 P.2d at 845; *Salina Airport*, 13 Kan. App. 2d at 82, 761 P.2d at 1263-64. Section 79-201(a) *Second* specifically exempts "[a]ll property used exclusively by the state or any municipality or political subdivision of the state." KAN. STAT. ANN. § 79-201(a) *Second* (Supp. 1992). The use requirement was added to the statute in 1963; prior to that time the statute exempted property based on mere ownership by a municipality. See *City of Liberal v. Seward County*, 247 Kan. 609, 613, 802 P.2d 568, 570 (1990).

100. *Tri-County Airport*, 245 Kan. at 310-11, 777 P.2d at 850; *Salina Airport*, 13 Kan.

The statute, Section 79-201a *Second*, is typical of exemption statutes in that it requires that property be “used exclusively by the state or any municipality or political subdivision of the state,” but does not specify whether the exclusive use requirement applies to the owner, the tenant, or both.¹⁰¹ The opinions in the airport cases focus on the owner’s use, in holding that leasing property for the production of income does not satisfy the exclusive use test.¹⁰² Both opinions suggest, however, that the exemptions would have been granted if the tenant’s use of the property had been for a governmental purpose, such as an airport related business.¹⁰³

A 1990 Kansas Court of Appeals opinion—*In re Application of Park Commissioners for Ad Valorem Tax Exemption*¹⁰⁴—applied the exclusive use requirement of Section 79-201a *Second* to the tenant’s use of the property in question.¹⁰⁵ This case involved a stable and adjoining residence, owned by the Wichita Airport, leased to the City of Wichita, and subleased to a private individual. The city’s application for tax-exempt status for the residence ended up at the Court of Appeals. Focusing on the tenant’s use of the two properties, the court concluded that the stable was operated as a public facility and thus met the exclusive use test under Section 79-201a *Second*.¹⁰⁶ The residence, on the other hand, was not open to the public and its use therefore did not qualify as a governmental purpose, so that tax-exempt status was properly denied.¹⁰⁷

In *Board of Wyandotte County Commissioners v. Kansas Avenue Properties*,¹⁰⁸ an opinion that seems contradictory to *In re Application of Park Commissioners*, the Kansas Supreme Court

App. 2d at 84, 761 P.2d at 1264-65. In 1991 the legislature effectively overruled *Salina Airport* and *Tri-County Airport* by enacting KAN. STAT. ANN. § 79-201q (Supp. 1992), which exempts property owned and primarily operated as an airport by a political subdivision, including property leased by the political subdivision for purposes not essential to the operation of an airport. Act effective July 1, 1991, ch. 7, § 2, 1991 Kan. Sess. Laws 31, 31-32 (codified at KAN. STAT. ANN. § 79-201q (Supp. 1992)).

101. § 79-201a *Second* (Supp. 1992).

102. *Tri-County Airport*, 245 Kan. at 307-08, 777 P.2d at 848; *Salina Airport*, 13 Kan. App. 2d at 84, 761 P.2d at 1265; see also *City of Liberal v. Seward County*, 247 Kan. 609, 802 P.2d 568 (1990) (city’s royalty interest held not tax exempt under § 79-201a *Second*).

103. *Tri-County Airport*, 245 Kan. at 310, 777 P.2d at 849; *Salina Airport*, 13 Kan. App. 2d at 84, 761 P.2d at 1265.

104. 14 Kan. App. 2d 777, 799 P.2d 505 (1990).

105. *Id.* at 783, 799 P.2d at 509.

106. See *id.* at 787, 799 P.2d at 512.

107. See *id.*

108. 246 Kan. 161, 786 P.2d 1141 (1990).

considered the exclusive use requirement of article XI, section 13 of the Kansas Constitution (economic development tax abatements) as it applies to leased property.¹⁰⁹ Even though the property was being used by the tenant-lessee "solely for one or more of the economic development purposes contained in the amendment,"¹¹⁰ the court held that the landlord's use (renting for profit) precluded the abatement.¹¹¹ "We hold that property owned by a non-tax-exempt entity and leased for profit to a qualifying tax-exempt entity is not being used exclusively for tax-exempt purposes and is subject to ad valorem and property taxes."¹¹²

One possible explanation for the different results in *Kansas Avenue Properties* and the Section 79-201a *Second* cases is that the landlords (owners) in *Salina Airport*, *Tri-County Airport*, and *In re Application of Park Commissioners* were all governmental entities, not private, for-profit corporations. The court in *Kansas Avenue Properties* seems to state that the abatement is available only to an owner that is itself a tax-exempt organization, contrary to traditional rhetoric that exemptions do not depend on ownership. The requirement of exclusive use would then be applied only after the ownership test is satisfied. This two-step approach is supported by language in *City of Liberal v. Seward County* in which the Kansas Supreme Court interpreted Section 79-201a *Second* as requiring "that the property belong to and be used exclusively by the state or municipality," even though the statute makes no reference to ownership.¹¹³

Subsequent legislative action has followed this approach and imposed both ownership and use requirements as prerequisites to tax exemptions. Amendments to Section 79-201a *Second* during 1989 (not discussed in the opinions above) limited the concept of exclusive use where property is leased to government by a private entity to property acquired under a lease-purchase agreement.¹¹⁴

109. *Id.* at 164, 786 P.2d at 1144.

110. *Id.* at 176-77, 786 P.2d at 1152.

111. *Id.* at 177, 786 P.2d at 1152.

112. *Id.* at 168, 786 P.2d at 1146 (quoting Appeal of Wirt, 225 Kan. 517, 523, 592 P.2d 875, 880 (1979)).

113. *City of Liberal v. Seward County*, 247 Kan. 609, 613, 802 P.2d 568, 572 (1990). Section 79-201a *Second* exempts "[a]ll property used exclusively by the state or any municipality or political subdivision of the state." The use requirement was added to the statute in 1963; prior to that time the statute exempted property owned by a municipality. See *City of Liberal*, 247 Kan. at 613, 802 P.2d at 572.

114. Act of Apr. 27, 1989, ch. 288, § 2, 1989 Kan. Sess. Laws 1711, 1714 (codified at KAN. STAT. ANN. § 79-201a *Second* (1989)).

Leases in existence on the effective date (1989) are protected by a grandfather clause.¹¹⁵

Legislative relief for airport authorities, enacted in response to *Salina Airport* and *Tri-County Airport*, also imposed both an ownership and a use requirement. New Section 79-201q establishes an exemption for property owned and primarily operated as an airport by a political subdivision, including property leased by the political subdivision for purposes not essential to the operation of an airport.¹¹⁶ *Kansas Avenue Properties* generated legislative response in the form of a new Section 79-221, authorizing abatements for leased property if the owner is a community-based not-for-profit economic development corporation.¹¹⁷

G. Homestead Property Tax Refund

The 1992 legislature made two significant changes in the homestead property tax refund.¹¹⁸ First, the maximum refund to eligible taxpayers will be increased from \$500 to \$600.¹¹⁹ The refund is limited to low-income tax payers;¹²⁰ the increased refund amount will increase the maximum eligible household income from \$15,000 to \$17,200.¹²¹ The increased amount will benefit both homeowners and renters who are eligible for the refund.¹²²

The second major change made in 1992 will allow homeowners to apply the expected refund to reduce property tax liability at the time of payment.¹²³ The taxpayer will assign the anticipated refund

115. *Id.* § 2, 1989 Kan. Sess. Laws 1711, 1715 (codified at KAN. STAT. ANN. § 79-201a *Second* (1989)).

116. Act effective July 1, 1991, ch. 7, § 2, 1991 Kan. Sess. Laws 31 (codified at KAN. STAT. ANN. § 79-201q (Supp. 1992)). This effectively overrules *Salina Airport* and *Tri-County Airport*, although the reversal was limited by further legislative action in 1992. Beginning in 1993, the airport exemption (Section 79-201q) covers property owned and primarily operated as an airport by a political subdivision, including property leased by a subdivision for purposes essential to operation of an airport. Leases for purposes not essential to an airport in existence on April 15, 1991 are protected by a grandfather clause. Act of Apr. 23, 1992, ch. 171, § 1, 1992 Kan. Sess. Laws 680.

117. Act of May 9, 1990, ch. 345, § 5, 1990 Kan. Sess. Laws 1877, 1880-81 (codified at KAN. STAT. ANN. § 79-221 (Supp. 1992)).

118. KAN. STAT. ANN. §§ 79-4501 to -4521 (1989 & Supp. 1992).

119. Act of Apr. 16, 1992, ch. 98, § 4, 1992 Kan. Sess. Laws 331 (codified at KAN. STAT. ANN. § 79-4509 (Supp. 1992)).

120. See KAN. STAT. ANN. § 79-4501 (1989).

121. The phased-in reduction for low-income brackets is found at KAN. STAT. ANN. § 79-4508 (1989).

122. Renters can claim 15% of rent paid (up to \$600) as "rent constituting property taxes." KAN. STAT. ANN. § 79-4502(i) (1989).

123. KAN. STAT. ANN. § 79-4521(a) (Supp. 1992).

to the county by obtaining a certificate of eligibility from the county clerk and presenting it to the county treasurer at the time of payment. The taxpayer will then owe only the excess of the first half of the property tax payment over the prior year's refund. Homestead property tax refunds claimed by taxpayers who follow this procedure will be paid directly to the county treasurer. Any excess of the property taxes levied for the year over the amounts paid by the taxpayer and the actual refund received will be due with the second half payment on June 20 of the next year.¹²⁴

In addition to the homestead property tax refund, the 1989 legislature authorized a special circuit breaker refund to provide relief in the first two years after reappraisal.¹²⁵ Section 79-4520 authorized a special refund, called a circuit breaker, of up to \$500 in 1989, and \$250 in 1990 for taxpayers whose 1989 real property taxes exceeded 1988 taxes by at least fifty percent.¹²⁶ Eligibility for the refund was limited to claimants having a household income not in excess of \$35,000.¹²⁷

H. Collection Issues

The interest rate on unpaid property taxes will be reduced from eighteen percent to twelve percent, beginning with taxes levied in 1992.¹²⁸ Other property tax statutes, including the motor vehicle tax, will reference this rate instead of the general interest rate for unpaid and delinquent taxes.¹²⁹

Taxation of personal property presents special problems, especially with respect to collection of the tax. Taxpayers are required to file an annual rendition form listing taxable personal property.¹³⁰ Beginning in 1993 rendition forms will be due by March 15 for both corporate and noncorporate filers.¹³¹ Rendition forms must be signed and will be required to be certified as true if prepared by a paid preparer.¹³² The minimum penalty for filing a false or

124. KAN. STAT. ANN. § 79-2004c(a) (Supp. 1992).

125. See Act of Mar. 1, 1989, ch. 303, § 5, 1989 Kan. Sess. Laws 1774, 1777 (codified at KAN. STAT. ANN. § 79-4520 (1989)).

126. KAN. STAT. ANN. § 79-4520 (1989).

127. *Id.*

128. See Act of May 22, 1992, ch. 319, § 1, 1992 Kan. Sess. Laws 2208 (to be codified as amended at KAN. STAT. ANN. §§ 79-2004, -2004a).

129. The general interest rate is found in KAN. STAT. ANN. § 79-2968 (1989).

130. KAN. STAT. ANN. § 79-306 (Supp. 1992).

131. Act of Apr. 23, 1992, ch. 165, § 2, 1992 Kan. Sess. Laws 659 (codified at KAN. STAT. ANN. § 79-306 (Supp. 1992)). Oil and gas statements of assessment will also be due March 15. Act of May 20, 1992, ch. 282, § 2, 1992 Kan. Sess. Laws 1759 (codified at KAN. STAT. ANN. § 79-332a(a) (Supp. 1992)).

132. KAN. STAT. ANN. § 79-306 (Supp. 1992).

fraudulent rendition form has been increased from \$50 to \$1000, with a \$5000 maximum.¹³³ The penalty also applies to willful failure to disclose taxable property, understating the value of taxable property, or refusal to deliver a rendition upon request by certified letter.¹³⁴

The moveability of personal property (in contrast to real property) presents special challenges in making sure that taxable items are listed. Upon discovery of property that has not been listed, or has been listed but undervalued, it is added to the tax rolls as having escaped taxation.¹³⁵ The county treasurer will issue a bill for the additional or escaped taxes due. Beginning July 1, 1990 such taxes are payable within forty-five days.¹³⁶ The Attorney General had previously ruled that escaped or additional taxes were not due until November 1 of the year in which the property was added to the tax rolls.¹³⁷

Kansas lawyers, like those in many other parts of the United States, have seen bankruptcy play an increasingly important role in law practice over the previous decade. The growing number of bankruptcies has resulted in new laws; for example, the Kansas Legislature in 1985 created a new lien for unpaid personal property taxes aimed specifically at transfers in bankruptcy.¹³⁸ Another aspect of the "bankruptcy boom" is the increased influence of federal bankruptcy courts in interpreting state laws. An example of this is the Kansas law regarding personal property tax liens. There are only four judicial opinions on the subject, with the two recent (constituting fifty percent of the available case law) having been written by bankruptcy judges.¹³⁹ This means that the federal

133. Act of Apr. 23, 1992, ch. 165, § 3, 1992 Kan. Sess. Laws 659, 660 (codified at KAN. STAT. ANN. § 79-1420 (Supp. 1992)).

134. *Id.*

135. KAN. STAT. ANN. § 79-1427a(a) (Supp. 1992). This principle applies to real property as well. See KAN. STAT. ANN. § 79-417 (1989); *Crawford v. Board of County Comm'rs of Johnson County*, 13 Kan. App. 2d 592, 776 P.2d 832 (1989) (holding that improvements to real property have "escaped taxation" under the statute only when the property owners are aware of their favored status and remain silent).

136. See KAN. STAT. ANN. §§ 79-1427a, -1475 (Supp. 1992).

137. Op. Kan. Att'y Gen. 86-75 (May 27, 1986).

138. Act of Apr. 19, 1985, ch. 184, § 1, 1985 Kan. Sess. Laws 891 (codified at KAN. STAT. ANN. § 79-2020 (1989)). This Act was enacted in response to *Robbins-Leavenworth Floor Covering, Inc. v. Leavenworth Nat'l Bank*, 229 Kan. 511, 625 P.2d 494 (1981). The case is discussed in Sandra Craig McKenzie & Virginia Ratzlaff, *Survey of Kansas Law: Taxation*, 33 KAN. L. REV. 71, 76 (1984) and McKenzie & Milstead, *supra* note 5, at 983.

139. *In re Knights Athletic Goods, Inc.*, 98 B.R. 553 (Bkrtcy. D. Kan. 1989); *In re White Hat Feed, Inc.*, 67 B.R. 851 (Bkrtcy. D. Kan. 1986). The other two leading opinions interpreting Sections 79-2109, 79-2110, and 79-2111 are *Robbins-Leavenworth Floor Covering, Inc. v. Leavenworth Nat'l Bank & Trust Co.*, 229 Kan. 511, 625 P.2d 494 (1981) and *Palmer v. First Nat'l Bank of Kingman*, 10 Kan. App. 2d 84, 692 P.2d 386 (1984).

bankruptcy judges are the leading interpreters of Kansas law on this point.

I. Motor Vehicle Tax

In a 1990 opinion, Attorney General Robert Stephan stated that the "alphabet inequity" caused by the staggered payment of motor vehicle taxes violated the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution.¹⁴⁰ The problem is best explained by means of example: Taxpayers B and T purchased identical 1989 model cars in June of 1989. T would renew the car's registration and pay a full year's tax in November of 1989, while B's first renewal would occur in February of 1990. At the time Stephan issued his opinion, taxpayer B's taxes would have been calculated after depreciating the value of the car by sixteen percent. Taxpayer T did not get the benefit of the depreciation until his second full year of registration in 1990. (Depreciation was not taken on an automobile for which the model year was the same as the registration year.)

The "alphabet inequity" was corrected prospectively by an administrative regulation that applies the sixteen percent annual depreciation to any portion of a registration year that extends into a subsequent calendar year.¹⁴¹ Regulation 92-55-2a became effective January 1, 1991. The 1992 legislature took no further action on this problem, apparently considering the regulation to be adequate. A group of taxpayers affected by the alphabet inequity prior to January 1, 1991 brought a class action seeking a refund of motor vehicle taxes. The Kansas Supreme Court dismissed the action due to the taxpayers' failure to exhaust administrative remedies.¹⁴²

Calculation of the motor vehicle tax has required reference to the "county average tax rate for the next preceding tax year."¹⁴³ Historically, application of this formula involved a two year lag. For example, motor vehicle taxes assessed in 1981 were based on the county average tax rates for 1979, and the practice continued thereafter. The meaning of the statutory term "next preceding tax year" was challenged by taxpayers hoping to take advantage of lower tax rates in 1989 after reappraisal.¹⁴⁴ In a suit filed in January 1991, taxpayers in Johnson County sought a refund of motor vehicle taxes collected in 1990, arguing that 1989 (and not

140. Op. Kan. Att'y Gen. 90-100 (Aug. 23, 1990).

141. KAN. ADMIN. REGS. 92-55-2a (1991).

142. *Zarda v. State*, 250 Kan. 364, 826 P.2d 1365 (1992).

143. KAN. STAT. ANN. § 79-5105(c) (1989).

144. See *Dean v. State*, 250 Kan. 417, 826 P.2d 1372 (1992).

1988) was the "next preceding tax year" for purposes of calculating 1990 motor vehicle taxes.¹⁴⁵ Although the district court agreed with the taxpayers on the merits, the suit was dismissed for failure to exhaust administrative remedies.¹⁴⁶ The dismissal was affirmed by the Kansas Supreme Court.¹⁴⁷

The 1992 legislature clarified the statutory language by removing the phrase "next preceding tax year" and substituting "the second calendar year before the calendar year in which the owner's full registration year begins."¹⁴⁸ This codifies the current practice, effective January 1, 1993.

J. School Finance and Property Tax Reform

Many of the property tax relief measures that were introduced into the legislature in the wake of statewide reappraisal were addressed only to a specific group of taxpayers, such as homeowners. Property tax rates, usually expressed as a mill levy, are calculated each year by dividing the total revenue needed from property taxes by the total assessed valuation for the taxing district. Tax relief measures that reduce the tax burden for a particular group of taxpayers (by reducing assessed valuations or granting exemptions, for example) do so only at the expense of the remaining taxpayers, so long as the revenue to be raised remains unchanged.

Providing property tax relief for all taxpayers requires a shift in focus to how local governments spend property tax revenues. The ad valorem property tax is an important revenue source for cities, counties, townships, and school districts. Reducing property tax bills for all taxpayers can take one of two approaches: Local governments can reduce spending, which in most cases will require reductions in governmental services, or property tax revenues can be replaced by funding from alternate sources.

In many, if not most, communities across Kansas, the school district mill levy has historically represented the largest portion of the total property tax bill. It was the school finance crisis that finally allowed the legislature to address the property tax relief issue from the spending side. Shawnee County District Judge Terry Bullock was the judicial hero of the saga. His October 14, 1991 Opinion of the Court on Questions of Law Presented in Advance

145. *Id.* at 418, 826 P.2d at 1374.

146. *Id.*

147. *Id.* at 428, 826 P.2d at 1380.

148. Act of May 22, 1992, ch. 308, § 1, 1992 Kan. Sess. Laws 2029.

of Trial in *Mock v. State of Kansas*¹⁴⁹ set the stage for action during the 1992 legislative session. Faced with the very real threat that the school finance scheme found in the School District Equalization Act would be held unconstitutional, the legislature emerged from a long wrap-up session with a new plan.¹⁵⁰

The new school finance measure represents a significant shift in philosophy regarding public school funding in Kansas. Although the plaintiffs in *Mock* presented several challenges to the School District Equalization Act (SDEA), one major issue was reliance on local property taxes for school funding. Districts with a large tax base (high total assessed valuation) could raise adequate funds with a much lower mill levy than a district with a lower tax base. Although the SDEA incorporated a measure of state funding, the basic discrepancy between "rich" and "poor" districts remained a fundamental problem. The 1992 school finance plan addressed this problem by replacing local levies with a uniform state-mandated property tax levy for schools of thirty-two mills in 1992, increasing to thirty-three mills in 1993, and thirty-five mills in 1994 and thereafter.¹⁵¹ Certain districts will have local option budget authority to levy property tax in addition to the uniform levy in an amount to allow a local district to increase its state authorized budget by up to twenty-five percent (or ten percent of prior year).¹⁵² The thirty-two mill levy will generate \$293,000,000 less in revenue than the current property tax levy for schools, with the shortfall coming from sales and income taxes.

Public reaction to the new school finance package was generally positive; in 285 of the state's 304 school districts, school property tax levies in 1991 were higher than 32 mills. These taxpayers anticipated smaller property tax bills for 1992, under the thirty-two mill uniform levy. In the counties described as "winners," the school finance formula will also translate into reduced motor vehicle taxes beginning in 1994, when the 1992 ad valorem property tax levies become the base year for calculating vehicle taxes.¹⁵³ The

149. *Mock v. State of Kansas*, No. 91-CV-1009 (Shawnee County Dist. Ct. Oct. 14, 1991), reprinted in 31 WASHBURN L.J. 489 (1992); see Philip C. Kissam, *Constitutional Thought and Public Schools: An Essay on Mock v. State of Kansas*, 31 WASHBURN L.J. 474 (1992).

150. Act of May 20, 1992, ch. 280, 1992 Kan. Sess. Laws 1691-1755.

151. *Id.* § 27, 1992 Kan. Sess. Laws 1706.

152. *Id.* § 29, 1992 Kan. Sess. Laws 1707. Changes were being considered for the 1993 session. Roger Myers, *Circuit Breaker for Tax Hikes May Be Diluted*, TOPEKA CAPITAL J., Dec. 2, 1992, at 1-A.

153. Although several proposals for motor vehicle tax relief were introduced during the 1992 legislative session, legislators were able to accomplish vehicle tax relief as a by-product of school finance reform, without changing the motor vehicle tax.

drop in motor vehicle tax revenue will be felt by all of the local government units that share in motor vehicle taxes. This overall reduction will be offset to some degree by shifts in the distribution formula to reflect the school district's smaller share of the total.

For taxpayers in nineteen of the state's school districts, the thirty-two mill uniform levy results in increased ad valorem property tax bills in 1992, and increased motor vehicle taxes beginning in 1994. These districts tend to have high assessed valuations due to oil and gas, nuclear power plants, or other wealth (Johnson County).

Nine western Kansas counties expressed their outrage at the new school finance formula by holding local referenda in April 1992 on the question of secession from Kansas.¹⁵⁴ This culminated in a constitutional convention held in Ulysses on September 11, 1992, when six counties voted to become "West Kansas," the fifty-first state.¹⁵⁵ Other less drastic responses included threatened economic boycotts of the "winning" counties and, of course, litigation.

Nine southwest Kansas school districts filed suit in Shawnee County District Court on September 15, 1992, joining suits filed earlier by the Blue Valley and Burlington districts.¹⁵⁶ Plaintiffs in the lawsuits claim that the new school finance measure is unconstitutional because it destroys local control. Further, the suits allege that the lack of a uniform system of property appraisal across the state results in unequal taxation. This claim was also raised by Attorney General Robert Stephan in the lawsuit challenging reappraisal.¹⁵⁷

II. RETAIL SALES AND COMPENSATING TAX

A. *Taxation of Services*

Newly elected Governor Joan Finney sailed into her first legislative session in January 1991 with a determination to broaden the

154. Jan Landon, *Secessionists Make It Official*, TOPEKA CAPITAL J., Sept. 12, 1992, at 1-A. The nine counties were Grant, Haskell, Hodgeman, Kearney, Kiowa, Meade, Morton, Stanton, and Stevens. *Id.*

155. Only Haskell, Kiowa, Meade, Morton, Stanton, and Stevens counties voted to petition the 1993 legislature for approval as the state of West Kansas. The convention also selected the yucca as the state flower and the pheasant as the state bird, prompting speculation over whether statehood would mean the end of pheasant hunting. Jan Landon, *West Kansas Chosen*, TOPEKA CAPITAL J., Sept. 12, 1992, at 1-A.

156. *Nine Districts Sue Kansas Over '92 School Finance Law*, KANSAS CITY STAR, Sept. 16, 1992, at C-2. Earlier in the summer Judge Bullock had released jurisdiction over the litigation in *Mock*. The next round of litigation has been assigned to Judge Marla Luckert.

157. *State ex rel Stephan v. Kansas Dep't of Revenue*, No. 92-CV-796 (Shawnee County D. Ct. filed June 15, 1992) (settlement order dated July 1, 1992).

sales tax base by taxing a wide range of services, from barbers and accountants through doctors and lawyers. The public debate focused on "repealing the exemptions for services." While politically attractive, this rhetoric reflects a misconception about the structure of the Kansas Retailers Sales Tax. The tax applies broadly to all retail sales of tangible personal property, unless the legislature had specifically acted to create an exemption. For sales of services, on the other hand, the general rule is one of nontaxability; services are only taxed if the legislature has made specific provision in the statutes.

B. School Finance Reform

Kansas took the first steps towards taxing sales of services in a comprehensive way as a part of the 1992 school finance reform package. The legislature chose to restructure the school finance system by reducing reliance on ad valorem property taxes. The attractive thirty-two mill statewide levy was projected to result in a \$293,000,000 shortfall. Legislators looked to both the sales and income taxes to raise the additional funds.

As other states have found, increasing revenue from sales taxes requires increasing the tax rates, broadening the tax base, or a combination thereof. A state-wide sales/compensating tax increase from 4.25 percent to 4.9 percent went into effect June 1, 1992.¹⁵⁸ This was projected to generate over \$150,000,000 revenue in 1992-93. The new 4.9 percent rate will apply to a tax base that has been expanded to include four new categories of retail sales: interstate telephone and telegraph services;¹⁵⁹ residential intrastate telephone and telegraph services;¹⁶⁰ trade fixtures and equipment, including second-hand fixtures installed in business;¹⁶¹ and hotel and motel rooms rented for more than twenty-eight consecutive days.¹⁶²

C. Construction Services

The most controversial part of the efforts to finance school reform through sales taxes involved the imposition of a new 2.5

158. Act of May 20, 1992, ch. 280, § 59, 1992 Kan. Sess. Laws 1738 (codified at KAN. STAT. ANN. § 79-3603 (Supp. 1992)).

159. Exemption for WATS services and certain private services is retained. *Id.* § 59, 1992 Kan. Sess. Laws 1738-39 (codified at KAN. STAT. ANN. § 79-3603(b)(2) (Supp. 1992)).

160. *Id.* § 60, 1992 Kan. Sess. Laws 1748 (repeals KAN. STAT. ANN. § 79-3606(z) (1989)).

161. *Id.*, 1992 Kan. Sess. Laws 1747 (repeals KAN. STAT. ANN. § 79-3606(p) (1989)).

162. *Id.* § 59, 1992 Kan. Sess. Laws 1739 (amends KAN. STAT. ANN. § 79-3603(g) (1989)).

percent sales tax on construction services. The new tax, which is expected to generate over \$50,000,000 in revenue, applies to original construction services under contracts dated after May 15, 1992.¹⁶³ Electricity, gas, and water consumed in the production or manufacture of tangible personal property will also be subject to the 2.5 percent tax.¹⁶⁴

The 2.5 percent tax on construction services was greeted with little enthusiasm, especially by homebuilders who expressed concerns that the new tax would be confusing to calculate and administer.¹⁶⁵ Although there is a degree of uncertainty with any new tax, construction services on remodeling projects have been subject to the Kansas Retailers Sales Tax for several years.¹⁶⁶ Application of this tax will often require severing a contract into its taxable and nontaxable components.¹⁶⁷

One unique aspect of the sales tax on construction services is that the home or other building that is the end product is considered real property, which is not subject to the sales tax. Thus, as some contractors discovered, the tax on construction services does not apply to buildings constructed speculatively.¹⁶⁸ This avoidance technique is practically limited to wealthy builders who can afford to take the risk of building speculatively. Homes purchased under contract will be more expensive than speculative homes, possibly eliminating "marginal buyers" from the market.

The tax was especially unpopular in the Johnson County area, where officials from Prairie Village and Overland Park (joined by Manhattan legislators) requested an opinion from the Attorney General on using home rule powers to avoid adding the local (city

163. *Id.*, 1992 Kan. Sess. Laws 1740-41 (codified at KAN. STAT. ANN. § 79-3603(p) (Supp. 1992)). There are exceptions for oil and gas wells, nonprofit community housing projects, and contracts entered into prior to May 15, 1992. *Id.*

164. *Id.*, 1992 Kan. Sess. Laws 1742 (codified at KAN. STAT. ANN. § 79-3603(u) (Supp. 1992)).

165. *See, e.g.*, Gene Meyer, *Construction Tax Creates Anxiety on Kansas Side*, KANSAS CITY STAR, June 3, 1992, at C-1; Roger Myers, *Construction Tax Confuses Homebuilders*, TOPEKA CAPITAL J., June 24, 1992, at 2-D. Repeal of the 2.5 percent sales tax on construction services and utilities used in construction was part of both the "trifecta" and "super trifecta" tax relief bills passed during the 1993 legislative session. Both measures were vetoed by Governor Finney. Roger Myers, *Finney Wins Big Veto Battles*, TOPEKA CAPITAL J., Apr. 29, 1992; *Finney Vetoes "Super Trifecta" Tax Relief Bill*, LAWRENCE J. WORLD, May 20, 1993.

166. KAN. STAT. ANN. § 79-3603(p) (1989).

167. *See, e.g.*, *In re Appeal of Bernie's Excavating Co.*, 13 Kan. App. 2d 476, 772 P.2d 822 (1989) (installation of sewer and water pipe was taxable under Section 79-3603(p); excavation services in connection with installation were not taxable).

168. Martin Hawver, *Some Contractors Skirt Home Tax*, TOPEKA CAPITAL J., Sept. 16, 1992.

and county) levies to the 2.5 percent statewide rate. Attorney General Stephan concluded that the county and city-wide portion of the sales tax is not uniform, thus allowing a local government to use its home rule powers to "charter out" of the local sales tax as it applies to construction services.¹⁶⁹

The opinion based its conclusion as to uniformity on a 1992 amendment to Section 12-187,¹⁷⁰ which allows certain cities to impose a sales tax in quarter percent increments (to a total of one percent) for the purpose of financing health care services.¹⁷¹ This was held to render the entire local sales tax nonuniform because the health care tax can only be levied by cities located in counties that have no county wide sales tax.¹⁷²

Although it seems unlikely that local governments will be anxious to do so, the opinion would allow a local government to use home rule powers to remove the local sales tax on items other than construction services.¹⁷³ While it is true that the local sales tax results in tax rates that vary across the state, the tax base has been the same statewide. This opinion creates an additional level of complexity, with the possibility of a nonuniform tax base; that is, transactions that are taxable in some jurisdictions, are not in others. The inherent administrative complexity in this decision is much greater than any problems caused by varying rates.

D. Mail Order Sales

One other major sales tax development during the survey period that will affect Kansans occurred in Washington rather than Topeka. In *Quill Corp. v. North Dakota*,¹⁷⁴ the United States Supreme Court changed its position of more than twenty years on state taxation of mail order sales. In 1967, the Court held that the State of Illinois could not require National Bellas Hess, Inc., which did only mail-order business in Illinois, to collect a compensating tax¹⁷⁵

169. Op. Kan. Att'y Gen. 92-96 (July 13, 1992).

170. Act of May 13, 1992, ch. 251, § 1, 1992 Kan. Sess. Laws 1490 (to be codified at KAN. STAT. ANN. § 12-187(a)(2)).

171. Op. Kan. Att'y Gen. 92-96 (July 13, 1992).

172. *Id.* Cities in counties that have a county-wide levy cannot impose the special health care tax. Act of May 13, 1992, ch. 251, § 1, 1992 Kan. Sess. Laws 1491 (to be codified at KAN. STAT. ANN. § 12-187(a)(2)).

173. Op. Kan. Att'y Gen. 92-96 (July 13, 1992).

174. 112 S. Ct. 1904 (1992).

175. The compensating tax is levied on the buyer for the privilege of using or consuming the property within the taxing state. Its purpose is to offset the competitive advantage otherwise enjoyed by retailers located out of state, who are not subject to the territorial limits of the sales tax.

on sales to Illinois residents.¹⁷⁶ This decision gave mail-order businesses a significant tax advantage over retailers located within the state, who are required to collect sales taxes. The *National Bellas Hess* decision was grounded in both the Commerce Clause (undue burden on interstate commerce) and the Due Process Clause (insufficient contacts with the taxing state to justify imposition of the tax).¹⁷⁷

With the explosion in mail-order sales since 1967, the issue has been one of increasing importance for states in the search for revenue sources. The Supreme Court opened the door for states to tap into this significant market in *Quill*.¹⁷⁸ The *Quill* Court held that the Due Process Clause did not prevent North Dakota from requiring an out-of-state retailer to collect a use tax on sales to North Dakota residents.¹⁷⁹ In holding that only the Commerce Clause barred North Dakota's attempts to require Quill to collect use tax, the Court paved the way for federal legislation authorizing states to require collection of use taxes by out-of-state mail order companies.¹⁸⁰

III. INCOME TAX

A. School Finance Reform

Part of the additional funds needed to reduce reliance on the property tax in educational finance will come from increases in the income tax rates. New rates for individuals are expected to produce \$120,000,000 in new revenue. New rates for a married couple filing a joint return will be:

- 3.50% on taxable income up to \$30,000;
- 6.25% on taxable income of \$30,000 to \$60,000; and

176. *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967).

177. *Id.* at 758-60.

178. 112 S. Ct. 1904 (1992).

179. *Id.* at 1916. The Court stated that:

In this case, there is no question that Quill has purposefully directed its activities at North Dakota residents, that the magnitude of those contacts are more than sufficient for due process purposes, and that the use tax is related to the benefits Quill receives from access to the State. We therefore agree with the North Dakota Supreme Court's conclusion that the Due Process Clause does not bar enforcement of that State's use tax against Quill.

Id. at 1911.

180. *See id.* at 1916 ("Accordingly, Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes.").

6.45% on taxable income over \$60,000.¹⁸¹

Increases for other individuals are steeper:

4.40% on taxable income up to \$20,000;
7.50% on taxable income of \$20,000 to \$30,000; and
7.75% on taxable income over \$30,000.¹⁸²

The new corporate rate is a base rate of 4.00 percent plus a surtax of 3.35 percent on taxable income over \$50,000.¹⁸³

B. *Military Pensions*

In a decision that may eventually cost Kansas taxpayers \$100,000,000, the United States Supreme Court, in *Barker v. Kansas*,¹⁸⁴ held the Kansas Income Tax Act unconstitutional as applied to military retirement pay.¹⁸⁵ The taxpayers, approximately 14,000 military retirees, filed suit to prevent Kansas from assessing or collecting Kansas income tax on federal military retirement benefits. These taxpayers alleged that Kansas discriminated against the military retirees by taxing military retirement pay, but not taxing retirement benefits paid to state and local government retirees.¹⁸⁶

Taxpayers in *Barker* relied on a 1989 Supreme Court decision striking down a similar scheme in which Michigan taxed retirement benefits of retired federal employees, but did not tax benefits of retired state and local government employees.¹⁸⁷ Michigan was clearly in violation of 4 U.S.C. § 111, which authorizes states to tax federal employees' compensation if the taxation does not discriminate against the federal employees because of the source of the compensation.¹⁸⁸

181. Act of May 20, 1992, ch. 280, § 55, 1992 Kan. Sess. Laws 1732 (codified at KAN. STAT. ANN. § 79-32,110(a)(1) (Supp. 1992)).

182. *Id.* (codified at KAN. STAT. ANN. § 79-32,110(a)(2) (Supp. 1992)).

183. *Id.*, 1992 Kan. Sess. Laws 1733 (codified at KAN. STAT. ANN. § 79-32,110(c) (Supp. 1992)).

184. 112 S. Ct. 1619 (1992).

185. *See id.* at 1626.

186. *Id.* at 1622. Both military and state and local government retirement benefits are included in adjusted gross income for federal income tax purposes. *Barker v. State*, 249 Kan. 186, 190, 815 P.2d 46, 49 (1991) (citing I.R.C. § 61(a) (1988)), *rev'd sub nom.* *Barker v. Kansas*, 112 S. Ct. 1619 (1992). Kansas income tax uses federal adjusted gross income as a starting point, but then allows a deduction for state and local retirement pay. *Id.* There was no deduction for military retirement pay. *Id.* at 191, 815 P.2d at 50.

187. *Barker*, 112 S. Ct. at 1622 (citing *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989)). *Davis* has spawned similar litigation in other states. See cases discussed in *Barker*, 249 Kan. at 206, 815 P.2d at 59.

188. *Davis*, 489 U.S. at 808-10.

The Kansas Supreme Court upheld the Kansas taxing scheme because of what it considered to be significant differences between military retirement pay and retirement pay of state and local government employees.¹⁸⁹ Military retirement pay has been characterized as reduced pay for current services, unlike other retirement pay which is simply deferred compensation for past services.¹⁹⁰ This difference, per the Kansas Supreme Court, justified the differential treatment for Kansas income tax purposes.¹⁹¹

The United States Supreme Court rejected this distinction, holding that military retirement pay constitutes deferred compensation for past services for purposes of 4 U.S.C. § 111.¹⁹² Kansas cannot impose income tax on military retirement pay while exempting retirement pay of state and local government employees.¹⁹³

The 1992 legislature amended the Kansas Income Tax Act to reflect the holding in *Barker*.¹⁹⁴ The case was remanded to Shawnee County District Court for further consideration of military retirees' claims for refunds of taxes collected on military retirement pay since 1984.¹⁹⁵ Estimates of the cost of refunds plus interest exceed \$100,000,000.¹⁹⁶

C. Unitary Business

As noted in the previous Survey, the “[p]roblems of taxing multi-state corporations continue to arise.”¹⁹⁷ One such problem area is the ability of a state to tax the multi-state income of a nondomiciliary (foreign) corporation. A state can tax a portion of the multi-state income of a foreign corporation if it is engaged in a “unitary” business with a domiciliary corporation. A state cannot tax multi-state income derived from separate (nonunitary) business activities that are not located in the taxing state. The critical issue then becomes distinguishing unitary business activities from separate activities.

189. *Barker v. State*, 249 Kan. at 204-05, 815 P.2d at 58.

190. *Id.* at 197-202, 815 P.2d at 53-56.

191. *Id.* at 205, 815 P.2d at 58.

192. *Barker v. Kansas*, 112 S. Ct. 1619, 1629 (1992).

193. *Id.*

194. Act of May 13, 1992, ch. 247, § 1, 1992 Kan. Sess. Laws 1475 (codified at KAN. STAT. ANN. § 79-32,117(c)(vii) (Supp. 1992)).

195. *Pension Question Sent to Lower Court*, TOPEKA CAPITAL J., June 9, 1992. The issue of retroactivity was decided in the retirees' favor by the United States Supreme Court in a case involving discriminatory taxation of federal retirement benefits by the State of Virginia. *Harper v. Virginia Dep't of Taxation*, 61 U.S.L.W. 4664 (June 18, 1993).

196. Roger Myers, *Veterans Seek Prompt Payback*, TOPEKA CAPITAL J., June 26, 1993.

197. McKenzie & Milstead, *supra* note 5, at 998.

The Kansas Department of Revenue requires unitary businesses to file a combined report to facilitate apportionment of taxable income to Kansas.¹⁹⁸ In *Pioneer Container Corp. v. Beshears*,¹⁹⁹ the Kansas Supreme Court upheld the combined reporting requirement, but generated some confusion over the appropriate test for identifying a unitary business.²⁰⁰ In *In re Tax Appeal of A. M. Castle & Co.*,²⁰¹ the Kansas Supreme Court expressed its clear preference for the dependency/contribution test. The court stated, "The essential test to be applied is whether or not the operation of the portion of the business within the state is dependent upon or contributory to the operation of the business outside the state."²⁰²

A recent United States Supreme Court opinion—*Allied Signal, Inc. v. Director of Taxation*²⁰³—reaffirmed a three part test for identifying a unitary business. The three factors to be considered are functional integration, centralization of management, and economies of scale.²⁰⁴ This test was rejected by the Kansas Supreme Court in *A. M. Castle*.²⁰⁵

IV. CONCLUSION

Tax reform is an ever-popular topic of discussion at all levels of government. There are two major perspectives to every tax reform debate: taxing and spending. The "taxing" perspective focuses on the mechanics of collecting the revenue and on the distribution of the tax burden among taxpayers. The "spending" perspective considers the purposes and programs for which the total revenue to be collected will be spent. As the developments during the survey period indicate, effective tax reform must inte-

198. See *Pioneer Container Corp. v. Beshears*, 235 Kan. 745, 750, 684 P.2d 396, 401 (1984).

199. 235 Kan. 745, 684 P.2d 396.

200. In the recent case of *First Nat'l Bank of Manhattan v. Kansas Dep't of Revenue*, 13 Kan. App. 2d 706, 779 P.2d 457 (1989), the Court of Appeals considered the issue of whether a bank holding company and its subsidiary bank constituted a unitary business. The court stated erroneously that we had adopted the three unities test, citing *Pioneer* for its authority. In doing so, the Court of Appeals confused our quote from the BOTA order in *Pioneer* with our actual holding.

In re Tax Appeal of A.M. Castle & Co., 245 Kan. 739, 743, 783 P.2d 1286, 1289 (1989).

201. 245 Kan. 739, 783 P.2d 1286.

202. *Id.* at 744, 783 P.2d at 1290 (quoting *Pioneer*, 235 Kan. 745 (syl. para. 4), 684 P.2d 396 (1984)).

203. 60 U.S.L.W. 4554 (1992).

204. *Id.* at 4557.

205. 245 Kan. at 742-45, 783 P.2d at 1289-90 (rejecting what it calls the "three unities" test; *i.e.* unity of ownership, unity of operations, and unity of use).

grate both the taxing and the spending perspectives. This is complicated at the state and local level where many of the taxing decisions are made by state government while spending decisions are made by local government.

Efforts by the state legislature to control property taxes, such as creating new exemptions and sending a new classification amendment to the voters, failed to achieve any true reform because they address only the "taxing" perspective. As long as spending decisions are made by local government, these measures serve only to redistribute the property tax burden. The school finance crisis allowed meaningful property tax reduction for many taxpayers because state legislators were able to address both taxing and spending for education. State control of local spending for schools allowed for real property tax reform, primarily through the imposition of a uniform statewide levy.

The complexity of relationships between taxing and spending also exists between the national and state levels of government, as shown by events during the survey period. The Supreme Court's opinion in *Quill* authorizes federal legislation to allow taxation of mail order sales to state residents. This "taxing" decision could significantly increase state revenues. On the other hand, the Supreme Court's decision in *Barker* creates a potential debt of \$100,000,000 for taxpayers of Kansas. While *Quill* represents a welcome windfall, the problem posed by *Barker* is more troublesome. Kansas may be forced to raise taxes to pay the refunds due under *Barker*, which is in effect a spending decision made outside of state government.²⁰⁶ The message from the survey period is a reminder that meaningful tax reform requires a cooperative effort by all levels of government keeping in mind both the taxing and the spending perspectives.

206. This phenomenon has had a growing impact on local governments, which must tax in order to pay for spending decisions made by state and local governments. *Unfunded Mandates: Local and State Leaders Speak Out*, KAN. GOV'T J., Apr. 1993, at 387.

