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  - a. options for restructuring how it provides funding to historic preservation projects so that all the money the State provides through tax credits or other means is available to fund the projects. Such options could include converting the Historic Preservation Tax Credit to a grant program.
  - b. imposing annual limits on the amount of projects for which the Historical Society can approve tax credits. For example the 2009 Legislature imposed a cap of \$3.75 million on the amount of credits allowed for 2010 and 2011.

***Recommendations for Executive Action:***

1. To improve the accuracy of the information the Department of Revenue provides to the Legislature about the number and dollar value of tax credits that are claimed each year, the Department should do the following:
  - a. determine what types of computer edits could be cost-effectively installed in its current computer systems to flag some of the types of errors we found during this audit, and install those edits.
  - b. ensure that the staff responsible for entering tax credit information into the databases understand the importance of the completeness and accuracy of the information.
  - c. periodically spot check some of the data-entry on the tax credits to help ensure that the data from tax returns are being accurately recorded.
2. To ensure that the Legislature has complete information about the number of people or businesses claiming tax credits and the cost of those credits to the State, the Department of Revenue should arrange to gather annual tax credit information from the Insurance Department, and incorporate that information into any analyses it performs or any summary information it develops.

## APPENDIX A

### Scope Statement

This appendix contains the scope statement approved by the Legislative Post Audit Committee for this audit on July 1, 2009. The audit was requested by the Legislative Post Audit Committee.

#### **Kansas Tax Revenues: Reviewing Tax Credits and Exemptions**

Kansas has enacted a number of taxes to fund government operations. A few examples are individual and corporate income tax, privilege tax (on financial institutions), sales and use tax, motor fuel taxes, mineral taxes, and the like. According to the Department of Revenue's fiscal year 2008 annual report, the amount the State collected from various taxes that year, before refunds, was nearly \$8.3 billion.

Over the years, the Legislature has enacted a variety of tax credits and exemptions designed to stimulate certain types of economic activity or to achieve other public purposes. For example, a taxpayer who makes a cash donation of \$250 or more in the Kansas Community Entrepreneurship Fund receives a tax credit of 75% of the amount donated.

Some credits are commonly claimed and account for large amounts of foregone tax revenue, while other credits are less frequently used. For example, based on information compiled by the Department of Revenue for the 2006 tax year, nearly 15,000 taxpayers claimed slightly more than \$28 million under the Business Machinery and Equipment Credit. In contrast, only nine taxpayers claimed about \$17,000 from a credit that allows taxpayers to claim up to 50% of the cost of plugging an abandoned oil well.

With the proliferation of credits and exemptions over the years, Kansas legislators have expressed an interest in knowing whether some of those credits and exemptions still are needed or whether they have outlived their original purposes. They also want to know whether transferrable tax credits represent an effective use of taxpayer dollars.

A performance audit of this topic would answer the following question(s).

- 1. Does Kansas have any tax credits or exemptions that aren't accomplishing their intended purpose or have outlived their usefulness?** To answer this question, we would review the statutes and consult with officials in the Department of Revenue, Legislative Research, and others to come up with a complete list of the tax credits and exemptions that currently are offered under the Kansas law, as well as information about when they were enacted, their original purpose, and how much they've been used (number of taxpayers claiming them and total dollar amount) in recent years. If information is available, we would compare the amount of revenue that currently is being foregone to the projected cost of each credit or exemption at the time it was passed. In addition, we would look across the credits and exemptions to identify any that are infrequently used or show a

significantly declining level of use. We would also talk to officials from taxpayer advocacy groups, and business groups to get their opinions about the usefulness of some of the tax credits and exemptions. We would also talk to officials from the Department of Revenue to identify any problematic issues related to credits or exemptions such as difficulty in tracking transferrable credits. For a sample of the more costly tax credits or exemptions, we would determine whether any mechanisms were put in place to determine whether the credit or exemption actually achieved its intended purpose. If there are requirements the taxpayer must fulfill to take the tax credit, such as creating a certain number of jobs, we would look to see what evidence exists to show that the requirements were fulfilled. For the sample of these credits and exemptions, we would contact nearby states to determine whether they offer those same types of tax breaks. In addition, we would find out what types of information other states can and do report to their legislatures about the use of tax credits and exemptions. We would conduct other work in this area as needed.

2. **What transferrable tax credits exist in Kansas, and are they a cost-effective means of generating money to fund certain types of projects or causes?** To answer this question, we would review the statutes and talk to officials at the Department of Revenue to identify the types of transferrable tax credits allowed in Kansas. We would review testimony that was provided to the Legislature about the anticipated effects of the credits at the time they were proposed. In cases where entities are awarded tax credits that they can sell to third parties to fund projects or activities, we would determine the amount of money generated for projects in relation to the foregone revenue cost to the State. We would review the records at the Department of Revenue to identify the amount of each type of transferrable tax credit that was claimed in recent years and the types of taxpayers who are benefiting from the use of the credits. We would contact officials from a sample of other states or tax policy groups to determine the extent to which these types of credits are used elsewhere, and gather their opinions about whether they think the credits are cost-effective.

**Estimated time to complete:** 12-15 weeks



## APPENDIX B

### Types of Tax Credits and Refund Programs and Who Can Claim Them

This appendix includes information as to the tax credit/refund type as well as information on who can claim each of the 47 tax credits and two refund programs Kansas currently has available.

Tax Credit or Refund Program	Tax Credit/Refund Type	Who Can Claim The Credit or Refund
1. Food Sales Tax Refund (K.S.A. 79-3635)	Refundable	Individuals
2. Earned Income (K.S.A. 79-32,205)	Refundable	Individuals
3. Homestead Property Tax Refund (K.S.A. 79-4501 et seq)	Refundable	Individuals
4. Angel Investor (K.S.A. 74-8131 et seq)	Carryforward and Transferable	Individuals, Corporations, Insurance Companies
5. Agritourism Liability Insurance (K.S.A. 74-50,173)	Carryforward (3 years)	Individuals, Corporations
6. Business & Job Development (K.S.A. 79-32,153; K.S.A. 79-32,160a)	Carryforward	Individuals, Corporations, Banks, Insurance Companies
7. Business Machinery & Equipment (K.S.A. 79-32,206)	Refundable	Individuals, Corporations, Banks, Insurance Companies
8. Center for Entrepreneurship (K.S.A. 74-99c01 et seq)	Carryforward	Individuals, Corporations, Insurance Companies
9. Declared Disaster Capital Investment (K.S.A. 79-32,262)	Carryforward or Refundable	Individuals, Corporations, Banks, Insurance Companies
10. Film Production (K.S.A. 79-32,257 et seq)	Carryforward (3 years)	Individuals, Corporations
11. High Performance Incentive Program (K.S.A. 74-50,132; K.S.A. 79-32,160a(e))	Non-refundable (training); Carryforward (investment - 10 years)	Individuals, Corporations, Banks, Insurance Companies
12. National Guard Employer Insurance (K.S.A. 79-32,213)	Non-refundable	Individuals, Corporations
13. Regional Foundation (K.S.A. 74-50,154)	Refundable	Individuals, Corporations, Banks, Insurance Companies
14. Research & Development (K.S.A. 79-32,182 & 182b)	Carryforward	Individuals, Corporations
15. Single City Port Authority (K.S.A. 79-32,212)	Non-refundable	Individuals, Corporations
16. Small Employer Health Benefit Plan (K.S.A. 40-2246)	Refundable	Individuals, Corporations
17. Telecommunications & Railroad (K.S.A. 79-32,206 & 210)	Refundable	Individuals, Corporations
18. Biofuel Storage & Blending Equipment (K.S.A. 79-32,251 et seq)	Carryforward (14 years)	Individuals, Corporations
19. Biomass-to-Energy (K.S.A. 79-32,233 et seq)	Carryforward (14 years)	Individuals, Corporations
20. Integrated Coal Gasification Power Plant (K.S.A. 79-32,238 et seq)	Carryforward (14 years)	Individuals, Corporations

<b>Tax Credit or Refund Program</b>	<b>Tax Credit/Refund Type</b>	<b>Who Can Claim The Credit or Refund</b>
21. Nitrogen Fertilizer Plant (K.S.A. 79-32,228 et seq)	Carryforward (14 years)	Individuals, Corporations
22. Petroleum Refinery (K.S.A. 79-32,217 et seq)	Carryforward (14 years)	Individuals, Corporations
23. Qualifying Pipeline (K.S.A. 79-32,223)	Carryforward (14 years)	Individuals, Corporations
24. Renewable Electric Cogeneration Facility (K.S.A. 79-32,245 et seq)	Carryforward (14 years)	Individuals, Corporations
25. Abandoned Well Plugging (K.S.A. 79-32,207)	Carryforward (unlimited)	Individuals, Corporations
26. Alternative Fuel Tax (K.S.A. 79-32,201)	Carryforward (3 or 4 years)	Individuals, Corporations
27. Environmental Compliance (K.S.A. 79-32,222)	Carryforward (4 years)	Individuals, Corporations
28. Swine Facility Improvement (K.S.A. 79-32,204)	Carryforward (4 years)	Individuals, Corporations
29. Adoption (K.S.A. 79-32,202)	Carryforward	Individuals
30. Assistive Technology Contribution (K.S.A. 65-7101 et seq)	Non-refundable	Individuals, Corporations
31. Child Dependent Care (K.S.A. 79-32,111a)	Non-refundable	Individuals
32. Child Day Care Assistance (K.S.A. 79-32,190)	Refundable	Individuals, Corporations, Banks
33. Disabled Access (K.S.A. 79-32,176, K.S.A. 79-1117. K.S.A. 40-2813)	Carryforward (4 years)	Individuals, Corporations, Banks, Insurance Companies
34. Individual Development Account (K.S.A. 74-50,201 et seq)	Refundable	Individuals, Corporations
35. Temporary Assistance to Families Contribution (K.S.A. 79-32,200; K.S.A. 39-7,132)	Non-refundable	Individuals
36. Community Service Contribution (K.S.A. 79-32,195 et seq)	Refundable; Carryforward (5 years); or Transferable	Individuals, Corporations, Banks, Insurance Companies
37. Credit for Taxes Paid to Other States (K.S.A. 79-32,111)	Non-refundable	Individuals
38. Deferred Maintenance (K.S.A. 79-32,261)	Refundable or Transferable (Community or Technical college); Carryforward or Transferable (University - 3 years)	Individuals, Corporations, Banks, Insurance Companies
39. Historic Preservation (K.S.A. 79-32,211)	Carryforward (10 years); or Transferable	Individuals, Corporations, Banks, Insurance Companies
40. Historic Site Contribution (K.S.A. 79-32,211a)	Refundable	Individuals, Corporations, Banks, Insurance Companies
41. Law Enforcement Training Center (K.S.A. 79-32,242)	Carryforward	Individuals, Corporations
42. Credit for Salaries Paid to Kansas Employees (K.S.A. 40-252d)	Non-refundable	Insurance Companies
43. Firefighter's Relief Fund (K.S.A. 40-252)	Non-refundable	Insurance Companies

Tax Credit or Refund Program	Tax Credit/Refund Type	Who Can Claim The Credit or Refund
44. Fire Marshal Credit (K.S.A. 40-252)	Non-refundable	Insurance Companies
45. Health Insurance Association Assessment (K.S.A. 40-2121)	Non-refundable	Insurance Companies
46. Insurance Department Service Regulation Fund (K.S.A. 40-112)	Non-refundable	Insurance Companies
47. Life & Health Insurance Guaranty Association (K.S.A. 40-3016)	Non-refundable	Insurance Companies
48. Property & Casualty Insurance Guaranty Association (K.S.A. 40-2906a)	Non-refundable	Insurance Companies
49. Small Insurance Business Credit (K.S.A. 40-252e)	Non-refundable	Insurance Companies
Source: LPA review of Kansas tax credits.		

## **APPENDIX C**

### **Agency Responses**

On Wednesday, February 3, 2010 we provided a draft copy of the audit report to the Department of Revenue and the Insurance Department. We also provided a draft copy of Question 2 to the Kansas State Historical Society. The responses from the Department of Revenue and the State Historical Society are included in this Appendix. Insurance Department officials chose not to provide a written response, but told us they had no issues with the report.

The Department of Revenue generally concurred with the report's findings, conclusions, and recommendations. The State Historical Society pointed out that our draft implied all Historic Preservation Tax Credits are transferred, when in fact not all credits are transferred. We addressed this issue by changing Figure 2-6 on page 49 to include the number of Historic Preservation Tax Credits issued and transferred each year. Those changes had no effect on our findings or conclusions.

# KANSAS

Kansas Historical Society  
Jennie Chinn, *Executive Director*

MARK PARKINSON, GOVERNOR

February 8, 2010

Ms. Barbara J. Hinton  
Legislative Division of Post Audit  
800 Southwest Jackson Street, Suite 1200  
Topeka, Kansas 66612



Dear Ms. Hinton:

As the administrators of the historic preservation tax credits, we appreciate the opportunity to respond to the draft copy of *Part I: Reviewing Tax Credits*. Overall, we do not have any major issues with the facts presented in this audit. However, we think the following points are relevant in any discussion of the audit.

- The audit report implies that all historic preservation tax credits are transferred and therefore “the amount of money a historic preservation project receives is dependent upon the amount of money it’s sold for (pg. 42).” Due to the short time we had to respond to the audit, we were only able to look at data from one year. We randomly choose tax year 2007. Ninety-six projects were completed. Forty-two of those projects transferred or sold their credits. The other 54 projects did not transfer the credits. The 42 projects that transferred credits had a total of \$7,778,426 in credits and the 54 projects that did not transfer credits received \$807,540. Therefore, in 2007 only 44 percent of the projects transferred credits but those projects accounted for 91 percent of the dollars issued.
- The audit report makes note that the historic preservation tax credit “is promised to the project developer upon completion of the project (pg 47).” This appears to be cited as a contributing factor in making the historic preservation tax credits less cost-effective for the state than programs that provide tax credits upon donation. We would like it to be noted that there is an advantage to the state in granting the tax credits upon completion of the project. It is common for developers working with a historic structure to make changes in their rehabilitation plans during the course of a project. Some of these changes will not be eligible expenses under the state statute. Therefore, the only way to ensure that projects meet the statutory standards is to grant the tax credits on the completed project rather than the proposed project.
- The audit report compares the estimated cost of the historic preservation tax credit program at the time of its inception to the actual cost of the program stating correctly that the original estimates “have proven to be extremely low (pg. 50).” This data can also be used to show the tremendous economic need for such a program in the state.
- The report addresses the cap that was placed on the historic preservation tax credits for FY 2010 and 2011. The report cites the guidelines that limit “new credits issued by the Historical Society each year to \$6.25 million” even though the statutory cap is \$3.75 million (pg. 51). We agree with the

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statement, “it’s possible the cost for this credit will exceed the statutory cap in fiscal years 2010 and 2011 (pg. 51).” To date actual issued credits in FY 2010 are not exceeding the statutory cap. However, there are still many open projects in various stages of completion. The Historical Society needs timely guidance from the Legislature on this matter. We agreed to the guidelines as a solution to the difficult administrative challenge created by the cap. By statute the program was previously unrestricted and many open rehabilitation projects take multiple years to complete. The Historical Society does not have access to the data on when tax credits are claimed, which allowed for the creation of the formula in the guidelines. Should we limit tax credits to \$3.75 million or to \$6.25 million for FY 2010 and 2011?

- The audit report makes the statement that the investigation was not “focused on the general benefits to the economy” rather it looked at the transferability of the credits (pg. 55). The Historical Society has worked with the Kansas Preservation Alliance to commission an economic impact report on the historic preservation tax credits. That report, completed by Rutgers University, will be available shortly. The Historical Society would like the Rutgers study to be included in any discussions about the future of the historic preservation tax credits.
- The audit report recommends that the Legislature consider restructuring the historic preservation tax credit program (pgs. 55-56). One of the suggestions made is that consideration be given to the idea of a grant program. Although we are open to any program that provides money to rehabilitate the historic heritage of our state, the concept of a tax credit has offered a different type of incentive that has proven to be a strong economic stimulus tool. Grants generally do not have the same sort of impact. Also grants cannot address emergency repairs the way tax credits can, which is a critical issue for owners of historic properties.

The Historical Society appreciates the issues that are presented in the audit report and we would like to work with the Legislature in restructuring the program if that is deemed necessary. Some of the issues that are important to us include the following.

- We would like to see a program that is user friendly and fairly easy to administer. Capping the program, while open projects exist, has proven to be administratively challenging.
- Based on the previous statutory requirements of the program, the Historical Society currently has 287 open projects with potential state tax credits of \$28.3 million. We would like to see any program adjustments take these projects into consideration.
- If the tax credits were no longer transferable then community non-profits and local governments would be excluded from the program. We would like to see any adjustments to the program consider their needs as well as commercial and individual developers.
- We feel strongly that the rehabilitation of our historic treasures, which can be found in every community in the state, is a cause worthy of state support. Historic preservation has a significant role to play in the economic development of our communities. The success of the historic preservation tax credit program is evidence of the need.

Thank you for the opportunity to provide comments.

Sincerely,



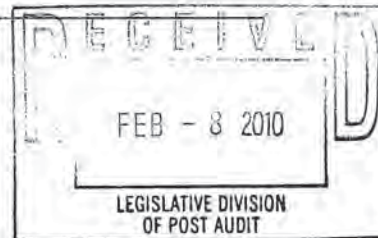
Jennie Chinn

Executive Director and State Historic Preservation Officer

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February 8, 2010

Barbara J. Hinton  
Legislative Post Auditor  
800 Southwest Jackson Street, Suite 1200  
Topeka, KS 66612-2212



Re: Department Response to Performance Audit Entitled: *Kansas Tax Revenues: Reviewing Tax Credits and Exemptions*

Dear Ms. Hinton:

You have requested we indicate what actions we have taken or will take to implement the recommendations made to the Department in the above-referenced draft performance audit. I have copied those recommendations below, along with our responses to them.

LPA Recommendation

1. to improve the accuracy of the information the Department of Revenue provides to the Legislature about the number and dollar value of tax credits that are claimed each year, the Department should do the following:
  - a. determine what types of computer edits could be cost-effectively installed in its current computer systems to flag some of the types of errors we found during this audit, and install those edits.

Department Response

The Department's tax return processing system cannot capture all of the data on a paper return—only that data necessary to complete the processing of the return is captured. This does not include information on a tax credit schedule. For paper income tax returns, all data concerning tax credits shown on schedules must be manually captured by people who review those returns and then record that data into a separate database. The Department is currently reviewing each tax credit database to determine additional cost-effective computer edits that will improve data accuracy. Recommendations for adding feasible computer edits will be proposed to our Information Technology staff and will be implemented as soon as is practical, given the available resources.

The Department is actively campaigning for the electronic filing of tax returns. Electronically filed returns allow the Department to capture the tax credit data electronically and build in computer edits thereby improving the data reliability. The Department has requested introduction of House Bill 2521 and Senate Bill 428 in order to obtain legislative authority to require electronic filing of returns. As more returns are filed electronically, the tax credit data capture errors should resolve themselves. As we

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take steps to move taxpayers to an electronic return filing environment, this will be the most effective strategy for eliminating the tax credit data reliability issues.

LPA Recommendation

- b. ensure that the staff responsible for entering tax credit information into the databases understand the importance of the completeness and accuracy of the information.

Department Response

The Department has taken this recommendation to heart. The Department had begun conducting on-going training of staff in accurately recording tax credit data in the tax credit databases in order to determine the source of errors noted in this audit. In addition, as a result of this audit, all staff responsible for capturing and recording tax credit information have been thoroughly briefed on the importance of accuracy in such work, and will be trained periodically to ensure the accuracy of their work.

LPA Recommendation

- c. periodically spot check some of the data-entry on the tax credits to help ensure that the data from tax returns are being accurately recorded.

Department Response

Since this audit, the Department has implemented procedures with the staff responsible for capturing and recording tax credit information to regularly check the accuracy of recorded tax credit data. In addition, the Department will conduct periodic reviews of the credit database information.

On pages 52-53, the audit notes errors found in the Department’s database for the angel investor credit. The Kansas Department of Revenue has completed a thorough review of the angel investor tax credit data. This review included an analysis of each credit that has been issued by the Kansas Technology Enterprise Corporation (KTEC) and the data accumulated in our automated tax processing system. Upon our review and corrections, KDOR has compiled the following information:

Tax Year	Number of Filers	Amount of Credit Available	Amount of Credit Allowed
2005	90	\$1,772,862	\$1,032,124
2006	123	\$1,701,332	\$1,145,537
2007	163	\$2,677,758	\$2,022,462
2008	237	\$6,243,579	\$4,262,166
TOTAL	613	\$12,395,531	\$8,462,289

KTEC has issued \$13.4M in credits, KDOR has established \$12.4M of these credits in our automated tax processing system. The difference between the amount of credits issued by KTEC (\$13.4) and the amount of credits available or established in KDOR’s ATP system (\$12.4M) can be attributed to taxpayers that haven’t established the credit by submitting the Schedule K-30 with the filing of a tax return.

LPA Recommendation

- 2. To ensure that the Legislature has complete information about the number of people or businesses claiming tax credits and the cost of those credits to the State, the Department of Revenue should arrange to gather annual tax credit information



from the Insurance Department, and incorporate that information into any analyses it performs or any summary information it develops.

Department Response

The Department of Revenue will annually obtain tax credit data from the Department of Insurance and incorporate it into any future annual reports on tax credit usage.

We also offer the following comments concerning the contents of the audit:

On page 29 and recommendation No. 2 on page 55, we strongly agree with the list of tax credits identified for repeal, with the possible exception of the single city port authority credit, which was enacted to help with the financing of the expansion of a short-line railroad headquartered at Pittsburg, Kansas.

We also agree with the list of seven tax credits on pages 30 and 31 identified as being overly generous and would further suggest that any tax credit providing more than a 25% credit for the investment or contribution made is too generous and should be curtailed. In particular, the center for entrepreneurship credit allows for "double dipping" by a credit claimant taking the federal charitable contribution credit, as well as the state tax credit, without the requirement of "adding back" the federal deduction to Kansas taxable income.

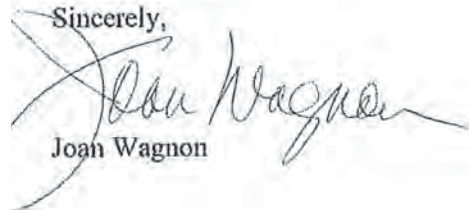
We agree with the LPA observations about the business and job development credit on page 32 and would recommend it be repealed and replaced with a more effective business incentive program.

On pages 37-38 and the LPA recommendations Nos. 1 and 3 on page 55, we strongly agree that any statute providing a tax credit should state the purpose, provide a means for measuring the outcomes of the credit, the authority to collect the appropriate information, make an entity responsible for collecting and evaluating such information (the Department is willing to assume that responsibility), contain a sunset, and be transparent as to who is claiming the credit and how much.

Concerning the discussion of the transferability of the historic preservation tax credit on pages 42-55 the LPA recommendation No. 4 on page 56, we strongly concur and agree that the transferability feature be removed and instead, the credit should be made either refundable with a yearly cap, or a grant should be appropriated each year as funding, with the State Historical Society being given the responsibility to administer this as a grant program.

In conclusion, we believe this audit will provide very valuable information to the Legislature and provide necessary guidance concerning the curtailment or elimination of various credits.

Sincerely,



Joan Wagnon