



# **PERFORMANCE AUDIT REPORT**

## **Kansas Tax Revenues, Part III: Reviewing Property Tax Exemptions**

**A Report to the Legislative Post Audit Committee  
By the Legislative Division of Post Audit  
State of Kansas  
March 2010**

# ***Legislative Post Audit Committee***

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## ***Legislative Division of Post Audit***

**THE LEGISLATIVE POST** Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about \$13 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of governmental agencies. The audit work performed by Legislative Post Audit helps provide that information.

We conduct our audit work in accordance with applicable government auditing standards set forth by the U.S. Government Accountability Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. The standards also have been endorsed by the American Institute of Certified Public Accountants and adopted by the Legislative Post Audit Committee.

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LEGISLATURE OF KANSAS

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March 11, 2010

To: Members, Legislative Post Audit Committee

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Representative John Grange, Vice- Chair  
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This report contains the findings, conclusions, and recommendations from our completed performance audit, *Kansas Tax Revenues, Part III: Reviewing Property Tax Exemptions*.

The report also contains *Appendix B* showing summary information of tax revenues from major categories of property from 1994 through 2008, as well as the proportions of revenues from these categories over that time period.

The report recommends that the Legislature review several property tax exemptions that have been broadened beyond what the Constitution requires, several exemptions that may result in unequal treatment for similar types of taxpayers, and four costly machinery and equipment exemptions to determine whether changes should be made. In addition, it recommends that the Legislature consider establishing clear public policy goals regarding the types of property it wants to exempt, together with a set of criteria that could be used to measure current and future property tax exemptions against. Lastly, the report recommends that for property tax exemptions that are created with a particular goal in mind (e.g. economic development), the Legislature should consider requiring a mechanism to collect certain information, and establish sunset provisions to trigger a review.

We would be happy to discuss these recommendations or any other items in the report with any legislative committees, individual legislators, or other State officials.

Barbara J. Hinton  
Legislative Post Auditor

# READER'S GUIDE

<b><i>The Big Picture</i></b>		<b><i>The Details</i></b>	
<b>Audit Highlights</b>	The highlights sheet, inserted in each report, provides an overview of the audit's key findings	<b>"At-a-Glance Box"</b>	Used to describe key aspects of the audited agency; generally appears in the first few pages of the main report
<b>Conclusions and Recommendations</b>	Located at the end of the audit questions, or at the end of the report	<b>Side Headings</b>	Point out key issues and findings
<b>Agency Response</b>	Included as the last Appendix in the report	<b>Charts, Tables, and Graphs</b>	Visually help tell the story of what we found
<b>Table of Contents, and lists of figures and appendices</b>	Lets the reader quickly locate key parts of the report	<b>Narrative Text Boxes</b>	Highlight interesting information or provide detailed examples

This audit was conducted by Katrin Osterhaus, Brad Hoff, and Lisa Hoopes. Leo Hafner was the audit manager. If you need any additional information about the audit's findings, please contact Katrin Osterhaus at the Division's offices.

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## **Kansas Tax Revenues, Part III: Reviewing Property Tax Exemptions**

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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 \$8.5 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 to the Kansas Center for Entrepreneurship receives a tax credit of 75% of the amount donated.

Some tax credits are widely available and account for large amounts of forgone tax revenue, while other credits are less frequently used. For example, based on information compiled by the Department of Revenue for the 2007 tax year, 10,400 taxpayers claimed \$36.4 million under the Business Machinery and Equipment Credit. In contrast, 21 taxpayers claimed about \$3,700 from the Agritourism Liability Insurance Credit.

With the proliferation of credits and exemptions over the years, 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. Legislators also want to know whether transferable tax credits represent an effective use of taxpayer dollars.

This performance audit answers the following questions:

- 1. Does Kansas have any tax credits that aren't accomplishing their intended purpose or have outlived their usefulness?**
- 2. What transferable tax credits exist in Kansas, and are they a cost-effective means of generating money to fund certain types of projects or causes?**
- 3. Does Kansas have sales or property tax exemptions that potentially should be considered for elimination?**

For reporting purposes, we separated this audit into three parts. Part I addressed the first two questions related to tax credits. Part II answered the last question related to sales tax exemptions, and Part III answers the last question for property tax exemptions.

To answer these questions, we reviewed Kansas laws and contacted the Department of Revenue, Legislative Research Department, and other agencies that play a role in approving or tracking tax credits to compile a complete list of tax credits and sales and property tax exemptions currently offered under Kansas law. We also determined when these tax benefits were enacted or increased, what their purposes are, how often they are used and, when available, the estimated loss of revenue to the State for tax credits and sales and property tax exemptions.

Because of the large number of tax exemptions we reviewed, we weren't able to perform individual cost-benefit analyses for each one. Instead, we reviewed available reports, guides, or court rulings related to Kansas property tax exemptions, talked to officials from the Division of Property Valuation, as well as a handful of local county appraisers. To the extent possible, we applied the tax policy considerations we compiled as part of our evaluation process for this audit series. In addition, when data were available, we reviewed cost information related to property tax exemptions.

Generally accepted government auditing standards require us to plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We conducted this performance audit in accordance with those standards, except that because of time constraints, we didn't conduct specific work to test the reliability of information the Department compiles for certain machinery and equipment exemptions. To the extent that these data are under- or overstated, the financial impact on local and State government could be under- or overstated as well. However, it's unlikely that the data are so grossly or systematically wrong as to affect our findings in this area.

With the exception noted above, and given the questions posed in the audit, we think the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

A copy of the scope statement for this audit approved by the Legislative Post Audit Committee is included in *Appendix A*. Because of the number of credits and exemptions involved, we added a third question to the approved scope statement to allow us to report on credits and exemptions separately.

Our findings about property tax exemptions begin on page 9, following a brief overview.

## Overview of Kansas Property Taxes and Exemptions

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### ***The Kansas Constitution Establishes Property Taxation As Well as the Mandate for Certain Exemptions***

Property taxes have a long history in the United States, dating back to the British colonial period. Over time, various states created uniformity clauses as part of their constitutions to ensure that the taxes levied on the market value of property would be fair. As described in a recent report by Dr. Glenn Fisher, Regents' Professor Emeritus at Wichita State University, the original Kansas Constitution, adopted in 1859, included similar language with regard to equal taxation, and provided for certain items to be exempt, as follows:

“The Legislature shall provide for a uniform and equal rate of assessment and taxation; but all property used exclusively for State, county, municipal, literary, educational, scientific, religious, benevolent, and charitable purposes, and personal property to the amount of at least two hundred dollars for each family, shall be exempted from taxation.”

**The Kansas Constitution distinguishes several classes and types of property and assesses the value of such property at different rates.** Since its adoption in 1859, Article 11 of the Constitution has been amended eight times concerning matters of property taxation, setting up a tax system that departed from uniform and equal assessment and taxation. Currently, all property is placed into two classes—real property (land and buildings) or tangible personal property (e.g. boats, cars, and household belongings).

For taxing purposes, the Constitution further classifies real property and tangible personal property into various sub-categories, with varying assessment rates. *Figure OV-1* on page 4 shows several examples within each main category. As can be seen in the figure, the differing valuation methods and assessment rates make property taxation more complex.

**The Kansas Constitution requires certain property to be exempt from taxation, and allows the Legislature and local government to exempt additional property.** Several amendments to the Constitution have broadened what's exempt from property taxation since it first was adopted. It still exempts from taxation all property used exclusively for State, county, municipal, literary, educational, scientific, religious, benevolent and charitable purposes, but currently also exempts farm machinery and equipment, merchants' and manufacturers' inventories (except utilities and railroad), livestock, and broadened exemptions for personal property to include all household goods and personal effects not used for the production of income.

OV-1 Examples of Constitutional Differences In Assessment Rates and Valuation Methods			
Type	Assessment Rate	Valuation Method	Additional Information
<b>REAL PROPERTY:</b>			
Residential:	11.5%	Fair Market Value	Typically appraisers use comparable sales of similar properties that have sold recently to establish an appraisal value.
Commercial and Industrial:	25%	Fair Market Value	Typically, appraisers use an income method (using factors such as rental rates, expenses, vacancy levels and capitalization or return on investment rates), or cost method (the cost of replacing the structure, less depreciation)
Vacant lots:	12%	Fair Market Value	Based on comparisons with land that has sold recently
Agricultural land:	30%	Use value	Requires agricultural land to be appraised on its productivity
<b>TANGIBLE PERSONAL PROPERTY:</b>			
Residential use mobile homes:	11.5%	Fair market value	Typically appraisers use the cost method in determining market value.
Commercial and Industrial:	25%	Retail cost when new less depreciation	Valuation is based on retail cost when new <i>less</i> seven-years or <i>less</i> straight line depreciation down to a minimum value of 20% (set out in the Kansas Constitution)
Heavy duty or non-highway motor vehicles:	30%	Fair market value	Regular motor vehicles are to be valued based on specific statutory formulas set out in 79-5101 et seq.
Source: Kansas Constitution Article 11, section 1; Kansas Statutes Annotated; and LPA audit 05-04.			

The Constitution allows the Legislature to enact statutes exempting property beyond what the Constitution exempts, but it also requires the Legislature to provide for a uniform and equal basis of valuation and rate of taxation. In 1985, the Kansas Supreme Court held that, for statutory property tax exemptions to be considered constitutional, they must meet all the following:

- have a public purpose and promote the public welfare
- provide a substantial peculiar benefit (i.e., unique or distinct benefit)
- not allow for large accumulations of tax-exempt property
- not create an improper or preferential classification of property

The Court also stated that the Legislature was the best judge of which exemptions were in the public interest, and pledged it would exercise judicial restraint unless it couldn't find any rational basis for the exemption.

In 1986, a constitutional amendment also allowed local governments to grant real and personal property tax exemptions for economic development activities, limited to 10 years from the time the business started or expanded.

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**Local Governments  
Rely More Heavily on  
Property Taxes Than  
State Government**

Traditionally, property taxes have been a primary revenue source for local governments. According to U.S. Census Bureau data, local governments (e.g. cities, counties, municipalities, and townships) in Kansas derive roughly 76% of their tax revenues from property taxes. In surrounding states, this proportion varies from a low of 52% in Oklahoma, to a high of 81% in Iowa.

**State government primarily has relied on income and sales taxes.** However, since the State's method of financing K-12 education was revised in 1992, property taxes have been collected in the form of a Statewide mill levy for education. That levy has been 20 mills since 1998. As **Figure OV-2** shows, these revenues increased from \$406 million in 2003 to \$560 million in 2009.

<b>OV-2 K-12 School Funding From the 20-mill Property Tax (a)</b>	
<b>Year</b>	<b>Amount (in millions)</b>
2003	\$405.6
2004	\$586.2
2005	\$458.7
2006	\$490.6
2007	\$523.5
2008	\$544.7
2009	\$559.8

(a) Kansas law allows an exemption for the first \$20,000 of appraised residential property value.  
Source: unaudited data from Kansas Department of Education

In addition, the State levies 1.5 mills on taxable property to support two State building funds. These school and building revenues are collected in separate State funds, outside the State General Fund.

**Counties are responsible for appraising most properties, while the Kansas Court of Tax Appeals rules on whether property can be tax exempt.** Under State law, each county is a separate appraisal district under the Statewide program. County appraisers are responsible for discovering, listing, appraising, and maintaining records of taxable and exempt real and personal property at the local level. The Division of Property Valuation has oversight responsibility for county appraisers, and direct responsibility for valuation of agricultural land, public utilities (such as power and telephone companies), and motor carriers.

By law, the initial role in determining whether a property qualifies for exemption lies with the Kansas Court of Tax Appeals (COTA).

A taxpayer applying for an exemption submits a form to the county appraiser. The form, including any comments from the county appraiser, is sent to COTA, which issues an order to either deny or grant the exemption. Only a small percentage of the exemptions COTA rules on are appealed; in those instances, the final decision rests with the Kansas Court of Appeals or the Kansas Supreme Court.

**A rise in the number of property exemptions can shift the tax burden to a smaller group of taxpayers.** Granting property tax exemptions takes certain property **out** of the tax base, which reduces its size. When that happens, applying the same tax rate to the smaller tax base results in reduced tax revenues. [For property tax, the assessed real and tangible personal property values make up the tax base, while the mill levy is the rate.]

When property is exempted from taxation, however, the cost of providing local services (e.g. police, fire, utilities) isn't reduced correspondingly. To maintain property tax revenues at the same level, local governments often increase the local mill levy rate, which in essence shifts the cost of providing those services to other taxable property. When that happens, people or businesses that pay those higher taxes end up subsidizing those who benefitted directly from the exemptions.

Due to the increase in property exemptions which reduces the tax base, and because the State's mill levy rate for school funding has been stable at 20 mills since 1998, the State's revenues from property taxes are also less than what it otherwise would have collected.

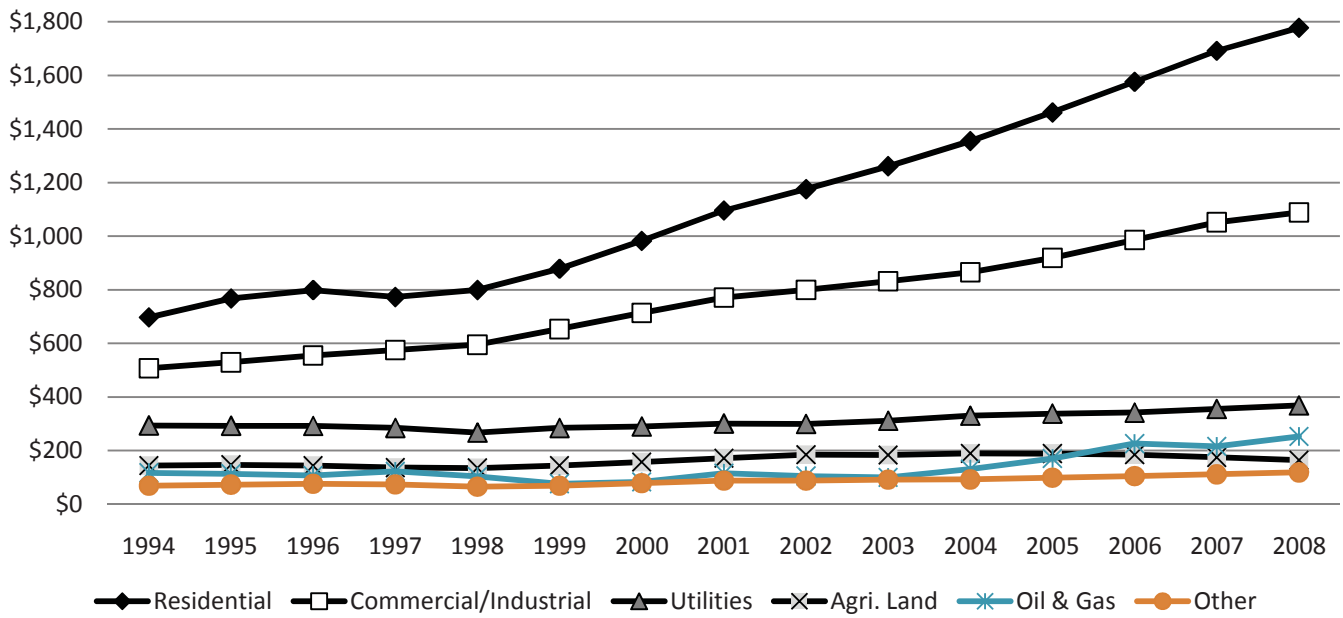
**Figure OV-3** on page 7 shows that tax revenues based on residential real estate have grown faster than any of the other major property categories.

As the figure also shows, the proportion of tax revenues from residential real estate has grown from 38% in 1994 to 47% in 2008 (a 24% increase). **Appendix B** shows tax values and proportions by major property categories across 15 years.

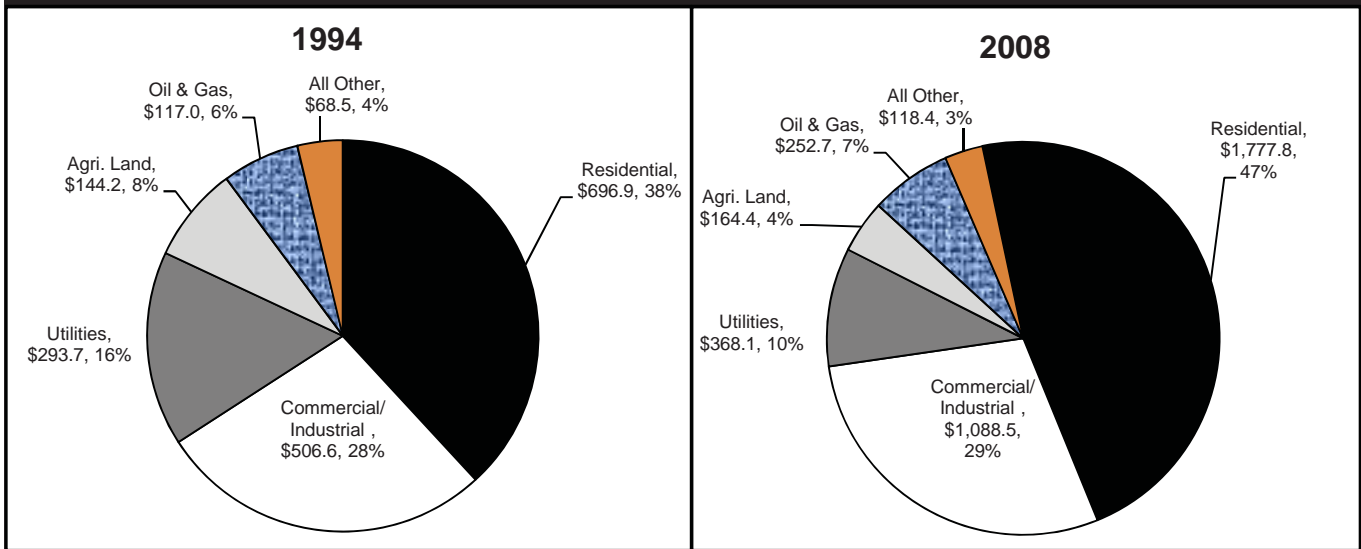
In its December 2006 report, this trend caused Dr. Fisher to conclude that Kansas' property tax is evolving into a real estate tax, which will make financing local government more difficult and will raise the burden on residential property owners.

OV-3

Tax Dollars from Major Categories of Property Over Time (in millions)



Changes in the Proportion of Tax Revenues for Major Property Categories Between 1994 and 2008 (in millions)



Source: Unaudited data from Kansas Department of Revenue



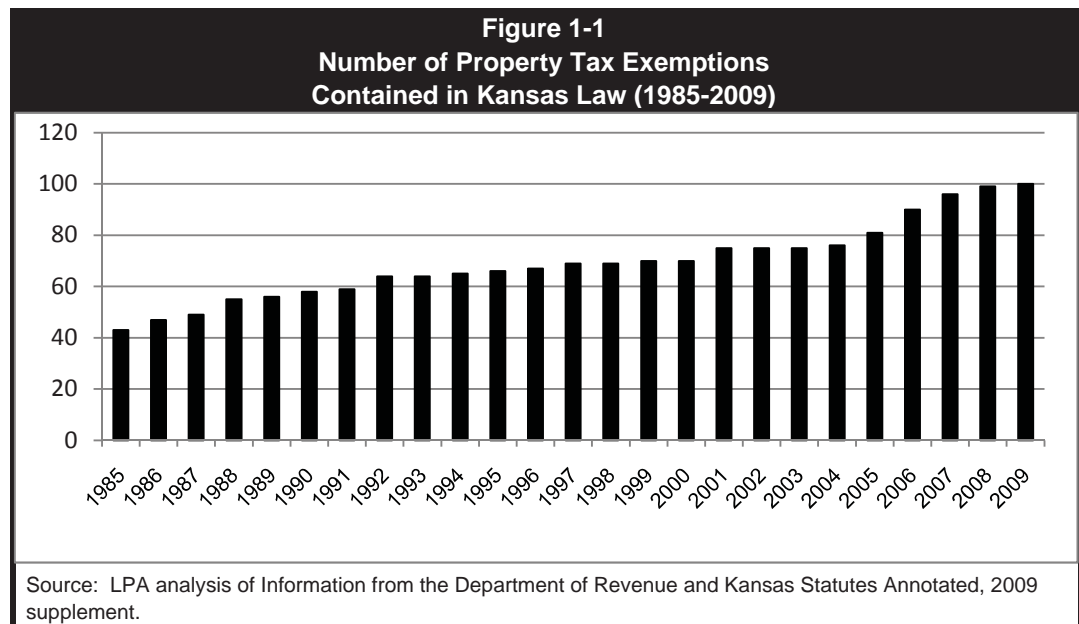
## Question 1: Does Kansas Have Property Tax Exemptions That Potentially Should Be Considered For Elimination?

### *Answer in Brief:*

*Like tax credits and sales tax exemptions, property tax exemptions have increased in recent years. More than half of Kansas' 100 current property tax exemptions relate to exemptions specified in the Kansas Constitution, either directly or for clarification or definitional purposes. Kansas lacks good information about the impact of property tax exemptions on the State, which limits any evaluation of the effectiveness of those exemptions. We identified a number of exemptions the Legislature may want to re-evaluate, including six exemptions that have been broadened beyond what the Constitution requires, and four exemptions that could result in unequal treatment for similar types of taxpayers. Lastly, several property tax exemptions for machinery and equipment, which were enacted in 2006, have significantly eroded the local tax base. Our findings are discussed in more detail in the sections that follow.*

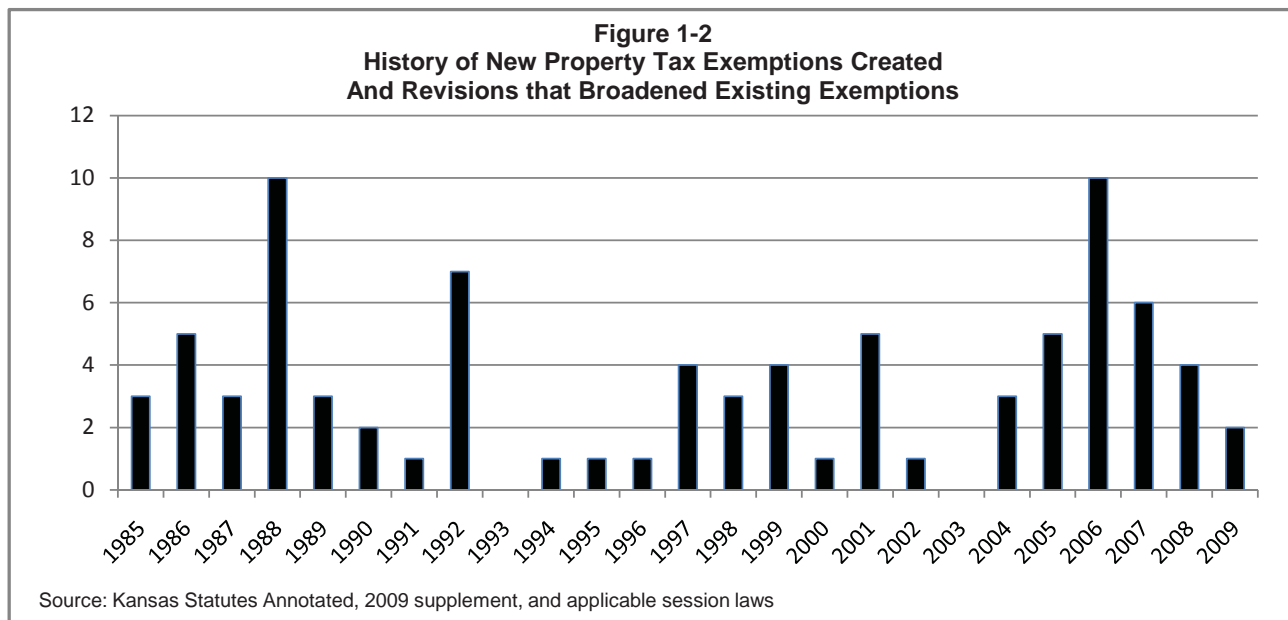
### ***Like Tax Credits and Sales Tax Exemptions, Property Tax Exemptions Have Increased In Recent Years***

As described in the **Overview**, property taxation was established under Article 11 of the Kansas Constitution in 1859. Over time, the Legislature has enacted numerous laws to exempt certain real and personal property. **Figure 1-1** shows the cumulative number of statutes that have been enacted over time.



It's important to remember that the growth in the number of laws related to property tax exemptions hasn't always led to more lost tax revenues. That's because many of the laws the Legislature enacted simply clarified what was to be exempted, based on

Kansas' Constitution. However, over the years the Legislature also has enacted new laws exempting things not mentioned in the Constitution, or has broadened existing ones. **Figure 1-2** shows the years in which statutes were enacted or broadened since 1985.



As the figure shows:

- **Seven exemptions were added or expanded in 1992.** Those included several statutes exempting various airport authorities, and a clarification to the farm machinery and equipment exemption to include aquaculture and Christmas tree-related farming equipment.
- **Five exemptions were added or expanded in 2001.** Three of these exemptions were for electric generation facilities.
- **21 exemptions were added or expanded between 2005 and 2007.** Many of those related to a push to support energy creation, or to exempt certain machinery and equipment.

**More than half of Kansas' 100 current property tax exemptions relate to exemptions specified in the Kansas Constitution, either directly or for clarification or definitional purposes.** These tax exemptions are summarized in **Figure 1-3**, starting on page 11. The figure is organized into several categories, including those that are required based on the Constitution or by federal law, those for governmental entities, and those related to education, businesses, agriculture, and charitable, religious, or benevolent entities.

As the figure shows, more than half the State's 100 exemptions appeared to repeat or clarify the exemptions specified in the Constitution. The other major category was business exemptions, which accounted for 28 exemptions.

**Figure 1-3  
Description of Kansas' Property Tax Exemptions**

#	Exempt Entity	Description of Exemption or Exclusion	Sub-Category	Statutory Citation	Enacted/ Most Recent Expansion	Exemptions that Appear To Repeat or Clarify Constitution
<b>REQUIRED BY KANSAS CONSTITUTION or FEDERAL LAW</b>						
1	State and local governments	Property used <u>exclusively</u> by the State or any municipality or political subdivision.	Government	KS Constitution, Article 11, Section 1; KSA 79-201a ( <i>Second</i> )	1975	yes
2	Educational and charitable orgs.	Real and tangible personal property <u>actually and regularly used exclusively</u> for literary, educational, scientific, religious, benevolent, or charitable purposes.	Misc.	KS Constitution, Article 11, Section 1; KSA 79-201 ( <i>Second</i> )	Prior to 1975/2009	yes
3	Farmers	All farm machinery and equipment, aquaculture machinery and equipment, and Christmas tree machinery and equipment.	Machinery & Equipment	KS Constitution, Article 11, Section 1; KSA 79-201j (a)(b)	1982/2008	yes
4	Businesses	Merchants' and manufacturers' inventories.	Commerce & Industry	KS Constitution, Article 11, Section 1; KSA 79-201m	1988/1989	yes
5	Farmers	Livestock	Agriculture	KS Constitution, Article 11, Section 1	1985	Only stated in Constitution
6	Individuals	Household goods and personal effects not used to produce income. Includes items such as furniture, cooking utensils, refrigerators, dishwashers, vacuum cleaners, etc.	Household/ Personal Items	KS Constitution, Article 11, Section 1; KSA 79-201c ( <i>Second</i> )	1975/2004	no
7	Individuals/ businesses	Personal property moving in interstate commerce through or over Kansas, except public utility inventories subject to tax. Personal property that has been shipped into the State and is stored in a warehouse or storage area; goods, wares, and merchandise that are manufactured, assembled, or packaged in Kansas but that eventually will be shipped in interstate commerce.	Commerce & Industry	KSA 79-201f (a)(b)(c)	1975	Required by federal law
<b>GOVERNMENTAL EXEMPTIONS</b>						
8	State government	State office building and the land it's located on.	Government	KSA 79-201a ( <i>Eleventh</i> )	1975	yes
9	State government	Property acquired by KDOT for the administration, construction, maintenance, or operation of the State highway system.	Government	KSA 79-201a ( <i>Seventeenth</i> )	1992	yes
10	State government	Property acquired and used for state park purposes by the Department of Wildlife and Parks.	Government	KSA 79-201a ( <i>Tenth</i> )	1975/1989	yes
11	Kansas Bioscience Authority	Real and personal property of the Kansas Bioscience Authority, or any property or local obligation acquired or used by the Authority.	Government	KSA 74-99b12	2004	yes
12	Kansas Turnpike Authority	Property acquired and held by the Kansas Turnpike Authority.	Government	KSA 79-201a ( <i>Ninth</i> )	1975	yes
13	Kansas Electric Transmission Authority	Any property of the Kansas Electric Transmission Authority that is exempt for similar private entities.	Government	KSA 74-99d11	2005	yes
14	Wyandotte County Land Bank	Property acquired by the Wyandotte County Land Bank.	Government	KSA 19-26,111	1996	yes
15	City-established land banks	Any property owned by a land bank established by any Kansas city.	Government	KSA 12-5909	2009	yes
16	City governments	Property of a municipality acquired to be used for urban renewal.	Government	KSA 79-201a ( <i>Seventh</i> )	1975	yes
17	City governments	Property acquired and held by a municipality under the municipal housing law.	Government	KSA 79-201a ( <i>Sixth</i> )	1975	yes

Figure 1-3  
Description of Kansas' Property Tax Exemptions

#	Exempt Entity	Description of Exemption or Exclusion	Sub-Category	Statutory Citation	Enacted/ Most Recent Expansion	Exemptions that Appear To Repeat or Clarify Constitution
18	Local governments	Property used to collect, transport, process, recycle, or dispose of solid wastes, or to buy, treat, or distribute water.	Government	KSA 12-5509	1990	yes
19	Local fire departments	All fire engines and other implements used to extinguish fires, and buildings used exclusively by fire departments.	Government	KSA 79-201a (Fourth)	1975	yes
20	Local government airports	Salina Airport Authority and Pratt Airport Authority.	Government	KSA 27-319(b)	1989/1992	yes
21	Local government airports	Property owned and operated as an airport by a political subdivision, including property leased by the political subdivision for purposes related to the operation of an airport.	Government	KSA 79-201q	1991/1992	yes
22	Local government airport	Strother Field airport commission (Winfield/Arkansas City).	Government	KSA 79-201r	1992	yes
23	Local airport authorities	Property owned or leased and operated as an airport by an airport authority, including property leased by the airport authority for aviation related purposes.	Government	KSA 79-201s	1992	yes
24	Local port authorities	Property acquired by a port authority only until the year in which it's rented, leased, subleased, or developed and returns revenue in excess of the amount needed to pay off the authority's obligations and administrative costs.	Government	KSA 12-3418	Prior to 1980	yes
25	Armories	Property acquired and held by a Kansas armory board for armory purposes.	Government	KSA 79-201a (Eighth)	1975	yes
26	Federal government	Property belonging exclusively to the United States, except property Congress has declared subject to state and local taxes.	Government	KSA 79-201a (First)	1975	yes
27	School/Institution	Personal property contained within a dormitory that is exempt from property tax and which is necessary to accommodate students residing there.	Household/ Personal Items	KSA 79-201a (Twentieth)	2001	yes
28	Local water districts	All works, machinery, and fixtures used exclusively by a rural or township water district to convey or produce potable water.	Machinery & Equipment	KSA 79-201a (Third)	1975	yes
29	Local governments	All lands used exclusively as graveyards.	Miscellaneous	KSA 79-201c (Third)	1977	yes
30	Local governments	Real and personal property for an auto race track facility in a redevelopment district; the exemption ends when all special obligation bonds issued to finance the auto race track facility in a major tourism area have been paid off.	Miscellaneous	KSA 12-1771b	2001	yes
31	County fair associations	Real and personal property owned by county fair associations.	Miscellaneous	KSA 79-201a (Fifth)	1975	yes
32	Groundwater mgmt districts	Real and personal property owned by a groundwater management district.	Utilities/Energy	KSA 79-201a (Fifteenth)	1977	yes
33	Local water districts	All real and personal property owned by a joint water district.	Utilities/Energy	KSA 79-201a (Sixteenth)	1987	yes
34	KC Mo water plant	The portion of KCMO's waterworks plant and system located within Kansas (pursuant to a compact and agreement).	Utilities/Energy	KSA 79-201a (Fourteenth)	1975	yes
35	KC Mo water plant	Any portion of the KCMO waterworks plant located in Kansas.	Utilities/Energy	KSA 79-205	1923	yes
<b>EDUCATION-RELATED EXEMPTIONS</b>						
36	Technical schools and community colleges	Buildings owned, leased, or being acquired by a vocational or technical school or community college that are used primarily as industrial training centers for academic or vocational education programs designed for and operated under contract with private industry.	Education	KSA 79-201a (Eighteenth)	1997	yes

**Figure 1-3  
Description of Kansas' Property Tax Exemptions**

#	Exempt Entity	Description of Exemption or Exclusion	Sub-Category	Statutory Citation	Enacted/ Most Recent Expansion	Exemptions that Appear To Repeat or Clarify Constitution
37	Local governments	Buildings constructed on State university property that are owned by a municipality and operated by a non-profit entity comprised of one or more State universities or municipalities for the purpose of strategic technology acquisition and commercialization.	Education	KSA 79-222	2005	yes
38	Technical schools and community colleges	Buildings, and the land it sits on, of a vocational or technical school or community college used as a student union or dormitory.	Education	KSA 79-201a (Nineteenth)	1999	yes
39	State government	Buildings constructed by the Board of Regents for any State educational institution under its control.	Education	KSA 79-201a (Thirteenth)	1975	yes
40	State government	Student union buildings and dormitories at all State institutions under the Board of Regents.	Education	KSA 79-201a (Twelfth)	1975	yes
41	For-profit cos. that conduct research and development	Real and tangible personal property owned by a postsecondary educational institution which is leased by a for-profit company that's <b>actually and regularly used exclusively</b> for research and development purposes.	Education	KSA 79-201a (Twenty-Second)	2008	yes
42	Kansas State University	Property transferred by the City of Olathe to the K-State University Foundation, all buildings and improvements located on such property, and all tangible personal property used for education and research on the K-State Olathe Innovation Campus.	Education	KSA 79-201a (Twenty-First)	2007	yes
43	Private non-profit universities/colleges	Buildings owned by private non-profit universities or colleges and operated as student union buildings, presidents' homes, and student dormitories.	Education	KSA 79-201 (Fifth)	1980/1988	no
44	Alumni associations	Real and tangible personal property <b>actually and regularly used exclusively</b> by an alumni association to provide accommodations and services to a college or university or to alumni, staff, or faculty.	Education	KSA 79-201 (Sixth)	1985	no
<b>AGRICULTURAL EXEMPTIONS</b>						
45	Farmers	All grain (before it has been milled or processed).	Agriculture	KSA 79-201n	1988	yes
46	Farmers	All hay and silage.	Agriculture	KSA 79-201d (First)	1978	yes
47	Farmers	All farm storage structures designed and used to store hay for any 8 of the 10 calendar years following their construction or assembly.	Agriculture	KSA 79-201d (Third)	2005	no
48	Farmers	All farm storage and drying equipment meeting federal eligibility requirements for any of the 8 of the 10 calendar years following the acquisition or construction.	Machinery & Equipment	KSA 79-201d (Second)	1978	yes
<b>BUSINESS EXEMPTIONS</b>						
49	Non-profit commercialization companies	Any building constructed on KU property that is owned and operated by a Kansas non-profit entity for the purpose of strategic technology acquisition and commercialization incubator.	Commerce & Industry	KSA 79-235	2008	no
50	Businesses	Buildings, land, and tangible personal property rented or leased from a majority owner or from a community based non-profit economic development corporation, if the property is used for the same purpose as the exempt property.	Commerce & Industry	KSA 79-221	1990	yes
51	Cellulosic alcohol businesses	Storage structures designed and used in the production of cellulosic alcohol for any 8 of the 10 calendar years following construction or assembly.	Commerce & Industry	KSA 79-201d (Fourth)	2007	no

Figure 1-3  
Description of Kansas' Property Tax Exemptions

#	Exempt Entity	Description of Exemption or Exclusion	Sub-Category	Statutory Citation	Enacted/ Most Recent Expansion	Exemptions that Appear To Repeat or Clarify Constitution
52	Businesses	Machinery, equipment, materials, and supplies used in business with an original retail cost of <\$400 (2005-2006 tax years) or <\$1,500 (2007 tax years-forward).	Machinery & Equipment	KSA 79-201w	1995/2006	no
53	Businesses	Commercial and industrial machinery and equipment acquired after June 2006 as the result of a bona fide transaction and not to avoid taxation.	Machinery & Equipment	KSA 79-223 (First)	2006	no
54	Businesses	Commercial and industrial machinery and equipment transported into Kansas after June 2006 to expand or create a new business.	Machinery & Equipment	KSA 79-223 (Second)	2006	no
55	Telecommunication and railroad companies	Telecommunications and railroad machinery and equipment acquired after June 2006 as the result of a bona fide transaction and not to avoid taxation.	Machinery & Equipment	KSA 79-224 (First)	2006	no
56	Telecommunication and railroad companies	Telecommunications and railroad machinery and equipment transported into Kansas after June 2006 to expand an existing business or create a new one.	Machinery & Equipment	KSA 79-224 (Second)	2006	no
57	Biofuel companies	Biofuel storage and blending equipment. Exemption good for 10 years after completion of installation.	Machinery & Equipment	KSA 79-232	2007	no
58	Power plant owners	Machinery and equipment used to capture carbon dioxide from industrial and other sources, convert it into products, or recover it from sequestration; carbon dioxide injection wells; electric generation units that capture and sequester carbon dioxide and other emissions, for five years after completion.	Machinery & Equipment	KSA 79-233	2007	no
59	Mechanics/ trades people	Hand tools and hand tool boxes <b>actually and regularly used</b> by a mechanic or tradesperson in the construction industry.	Misc.	KSA 79-201o	1988	no
60	Mechanics/ trades people	Hand tools and hand tool boxes <b>actually and regularly used exclusively</b> by a mechanic to construct or repair machinery and equipment, including motor vehicles.	Misc.	KSA 79-219	1986/1988	no
61	Individuals and businesses	Personal property held for sale or display at a fair, exposition, trade show, convention, auction, bazaar, or flea market.	Misc.	KSA 79-215	1986/1987	no
62	Coal power plants	New or expanded (by at least 10%) integrated coal gasification power plant property, and property purchased, constructed, or installed at such plant to comply with required air emission for 12 taxable years following completion of construction/installation.	Utilities/Energy	KSA 79-225	2006	no
63	Oil refineries	New, expanded (by at least 10%), or restored refinery property for 10 taxable years after construction/ installation is complete.	Utilities/Energy	KSA 79-226	2006	no
64	Oil refineries	New pipeline property for 10 years after completion of construction/installation.	Utilities/Energy	KSA 79-227	2006	no
65	Fertilizer plant owners	New or expanded (by at least 20%) integrated coal or coke gasification nitrogen fertilizer plant property for 10 years after completion of construction.	Utilities/Energy	KSA 79-228	2006	no
66	Biomass plant owners	New or expanded (by at least 10%) biomass-to-energy plant property for 10 years after completion of construction.	Utilities/Energy	KSA 79-229	2006	no
67	Nuclear power plant owners	New nuclear generation facility property. Exemption good for 10 years after completion of construction.	Utilities/Energy	KSA 79-230	2007	no
68	Oil lease owners	Oil leases with an average daily production of 3 barrels or less per producing well, or 5 barrels or less per producing well that has a completion depth of 2,000 feet or more.	Utilities/Energy	KSA 79-201t	1992/1998	no

Figure 1-3  
Description of Kansas' Property Tax Exemptions

#	Exempt Entity	Description of Exemption or Exclusion	Sub-Category	Statutory Citation	Enacted/ Most Recent Expansion	Exemptions that Appear To Repeat or Clarify or Constitution
69	Electric facilities	Waste heat utilization system property at electric generation facility for 10 years after completion of construction.	Utilities/Energy	KSA 79-231	2007	no
70	Electric generation facilities	Electric generation facilities and pollution control devices purchased/constructed/installed for the facility. Exemption good for 6 or 12 years after completion of construction.	Utilities/Energy	KSA 79-257	2001	no
71	Electric generation facilities	Electric generation facilities and pollution control devices purchased/constructed/installed for the facility, for 4 or 10 years after completion of construction.	Utilities/Energy	KSA 79-258	2001	no
72	Electric generation facilities	Electric transmission lines and appurtenances and the right-of-way on which the lines are located, for construction begun after 2000 and for 10 years after completion.	Utilities/Energy	KSA 79-259	2001	no
73	Electric generation facilities	Property <b>regularly</b> used to produce and generate electricity using renewable energy resources or technologies (including wind, solar, photovoltaic, biomass, hydropower, geothermal and landfill gas resources or technologies).	Utilities/Energy	KSA 79-201 (Eleventh)	1999	no
74	Landfill owners	Personal property <b>actually and regularly used</b> to collect, refine, or treat landfill gas, or to transport landfill gas to a transmission pipeline.	Utilities/Energy	KSA 79-201 (Twelfth)	2005	no
75	Vehicle dealers	Motor vehicles held as inventory for sale by any motor vehicle dealer.	Vehicles/ Aircraft	KSA 79-201p	1988	yes
76	Businesses	Aircraft used predominantly to earn income for the owner conducting the owner's business or industry.	Vehicles/Aircraft	KSA 79-201k	1982/2004	no
<b>CHARITABLE, RELIGIOUS, BENEVOLENT EXEMPTIONS</b>						
77	Non-profit hospitals	All real and tangible personal property <b>actually and regularly used exclusively</b> for hospital purposes by a non-profit hospital, psychiatric hospital, or public hospital authority.	Healthcare	KSA 79-201b (First)	1975/1998	yes
78	Veterans' organizations	Real property, buildings, and personal property <b>actually and regularly used exclusively</b> by an individually chartered 501c(19) organization of honorably discharged U.S. military veterans for a clubhouse, place of meeting, or memorial hall purposes. Includes up to two acres of real property and buildings located on it that is <b>actually and regularly used exclusively</b> as a memorial park.	Misc.	KSA 79-201 (Eighth)	1986	yes
79	Fraternal groups	Reserve or emergency funds of fraternal benefit societies.	Money & Cash Equivalents	KSA 79-201 (Fourth)	Prior to 1975	yes
80	Academic and charitable organizations	All moneys and credits belonging <b>exclusively</b> to universities, colleges, academies, or other public schools, or to religious, literary, scientific, or benevolent and charitable institutions or associations, appropriated solely to sustain them.	Money & Cash Equivalents	KSA 79-201 (Third)	Prior to 1975	yes
81	Religious organizations and school interlocals and cooperatives	All buildings, furniture, and books used <b>exclusively</b> for the specific purposes of places of public worship or school districts and school district interlocal cooperatives.	Religious Activities and Education	KSA 79-201 (First)	Prior to 1975/1984	yes
82	Religious organizations	All parsonages and land it sits on owned by a church society which is regularly occupied and used <b>predominantly</b> as a residence for a minister or other clergyman. (changed "exclusively" to "predominantly" in 1997)	Religious Activities	KSA 79-201 (Seventh)	1986/1997	no
83	Religious organizations	Any building and land it sits on owned by a church or nonprofit religious society that's federally tax exempt and is actually and regularly occupied and used <b>exclusively</b> for residential and religious purposes.	Religious Activities	KSA 79-201 (Tenth)	1988	yes

**Figure 1-3  
Description of Kansas' Property Tax Exemptions**

#	Exempt Entity	Description of Exemption or Exclusion	Sub-Category	Statutory Citation	Enacted/ Most Recent Expansion	Exemptions that Appear To Repeat or Clarify Constitution
84	Non-profit housing organizations	Real and tangible personal property <b>actually and regularly used exclusively</b> for housing for the elderly by a non-profit organization.	Social Services	KSA 79-201b (Fifth)	1975/1976	yes
85	Non-profit housing organizations	Real and tangible personal property <b>actually and regularly used exclusively</b> to house elderly and handicapped poor people, which is provided by a non-profit organization.	Social Services	KSA 79-201b (Fourth)	1975/1985	yes
86	Non-profit housing organizations	Real and tangible personal property <b>actually and regularly used exclusively</b> for group housing of mentally ill or developmentally disabled people by a non-profit organization.	Social Services	KSA 79-201b (Sixth)	1986	yes
87	Non-profit housing organizations	Real and tangible personal property <b>actually and primarily</b> used to house people who are elderly, disabled, or poor that's owned and operated as a non-profit community housing development organization recognized by the Kansas Housing Resource Corporation.	Social Services	KSA 79-201z	2005	no
88	Non-profit community service organizations	Real and tangible personal property <b>actually and regularly used</b> by a community service organization predominantly for providing humanitarian services owned and operated by a non-profit corporation.	Social Services	KSA 79-201 (Ninth)	1988	no
89	Non-profit children's homes	All real and tangible personal property <b>actually and regularly used exclusively</b> for private children's home purposes by a non-profit private children's home.	Social Services	KSA 79-201b (Third)	1975/1976	yes
90	Non-profit nursing homes	Real and tangible personal property <b>actually and regularly used exclusively</b> for adult care home purposes by a not-profit adult care home.	Social Services	KSA 79-201b (Second)	1975/1976	yes
91	Non-profit groups	Motor vehicles donated to any 501(c)(3) charitable organization to be sold at a charitable auction, the proceeds of which are used to benefit the charitable organization.	Vehicles/Aircraft	KSA 79-201u	1994	yes
<b>CONSUMER EXEMPTIONS</b>						
92	Individuals	Any tangible personal property that would be taxed but the purchase price is \$750 or less.	Household & Personal Items	KSA 79-234	2008	no
93	Individuals	The wearing apparel of every person.	Household/ Personal Items	KSA 79-201c (First)	1975	yes
94	Landowners	Real property upon which surface mining operations were conducted before Jan.1969, which has been reclaimed and returned to productive use (five-year limit).	Miscellaneous	KSA 79-201e	1975	no
95	Individual property owners	Real property contiguous to and a part of the same tract of land upon which a dam or reservoir has been constructed and certified by the Division of Water Resources.	Miscellaneous	KSA 79-201g	1975	no
96	Individuals	Money, notes, and any other evidence of debt.	Money & Cash Equivalents	KSA 79-3109c	1982	no
97	Home owners	Property used for residential purposes to the extent of \$20,000 of its appraised value.	Residences	KSA 79-201x	1997	no
98	Owners of solar energy systems	Any solar energy system.	Utilities/Energy	KSA 79-201h	1980	no
99	Kansas military personnel	Up to two motor vehicles owned by a Kansas resident in the full-time military who is deployed on the vehicle registration application date.	Vehicles/aircraft	KSA 79-5107(e)	1982	no
100	Antique aircraft owners	Any antique aircraft used <b>exclusively</b> for recreational or display purposes.	Vehicles/aircraft	KSA 79-220	1987	no

Source: Kansas Statutes Annotated, 2009 Supplement, applicable session laws, and Department of Revenue officials

Of those 28 business-related property tax exemptions, 15 have been passed since 2006. Four of those were related to business machinery and equipment exemptions enacted to stimulate economic development. Most of the others related to a legislative push in 2006 and 2007 to encourage the creation or expansion of energy production and distribution facilities in the State. Those followed on the heels of a push in 2001 to help build or expand electric generation facilities, pollution control devices, and transmission lines in the State.

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***Kansas Lacks Good Information About the Impact of Property Tax Exemptions on the State***

Unlike for sales tax exemptions, the State doesn't have any complete cost estimates for property tax exemptions. Here's why:

- **Statewide information on statutorily exempt property exists only for real estate, and only in the form of the appraised value that's taken off the tax rolls, not the assessed value or the tax revenue that's forgone.** As described in the Overview, property taxes are paid on both real and personal property. For real property, local county appraisers value the land and improvements annually, which is multiplied by the respective assessment rate. The assessed value is then multiplied by the applicable local mill levy to generate the amount of property tax due from the owner.

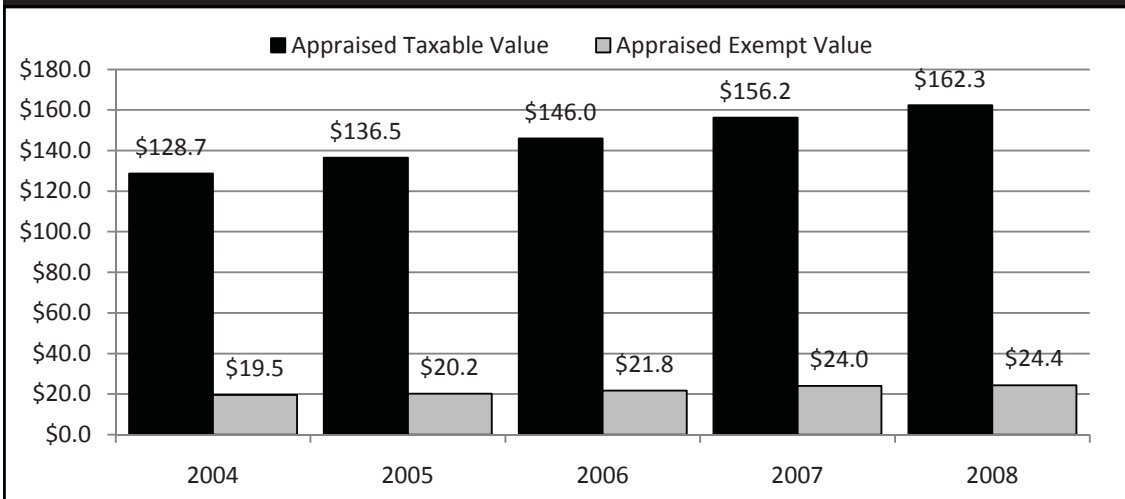
Local appraisal staff do appraise statutorily or constitutionally exempt real estate, but because those parcels are coded as exempt, no assessed or taxable value is calculated for those properties. Based on information local appraisers' offices forward to the Department of Revenue's Division of Property Valuation, real property with an appraised value of more than \$24 billion was exempt from property taxes in 2008. That information is shown in **Figure 1-4** on page 18.

As the top half of the figure shows, between 2004 and 2008, the appraised value of exempt real estate increased from \$19.5 billion to \$24.4 billion (25%). The appraised value of taxable real estate increased from \$128.7 billion to \$162.3 billion (26%) over that same time period.

However, according to State officials and at least one county appraiser we talked to, little time is spent appraising exempt property. As a result, it's not possible to know how accurate the exempted appraisal values are. In addition, because the different assessment rates for different types of property and the varying mill levies currently aren't captured for exempted properties, we weren't able to calculate the assessed value or the tax revenue that's forgone for the real property that's exempt.

- **The new appraisal system isn't set-up to capture the appraised value of exempt real property by type of property.** The bottom half of **Figure 1-4** shows the appraised values of exempt real estate, by broad category, for 2004, the last year for which such data are available Statewide. The figure shows that about \$5 billion in real estate owned by religious and benevolent organizations was exempt from property tax in 2004, and the majority of all exempt real property (74%) was owned by educational or governmental entities.

**Figure 1-4  
Appraised Values for Taxable and Tax Exempt Real Property (in billions)**



**Kansas Exempt Real Property, by Category in 2004**

Subclass	Number of Parcels	Appraised Exempt Value	Percent of total value
Educational	4,367	\$5.668 billion	28.0%
Municipality	21,556	\$3.368 billion	16.6%
Federal	3,271	\$3.023 billion	14.9%
Religious	10,265	\$2.864 billion	14.1%
Benevolent	3,379	\$2.107 billion	10.4%
County	4,449	\$1.494 billion	7.4%
Kansas (a)	2,633	\$1.456 billion	7.2%
Graveyards	2,923	\$87 million	0.4%
Agricultural	460	\$58 million	0.3%
Groundwater Districts	631	\$45 million	0.2%
Other, Sedgwick	41	\$42 million	0.2%
Literary	182	\$35 million	0.2%
Scientific	33	\$14 million	0.1%
Exempt Dam	954	\$4 million	0.0%
Reclaimed Land	4	\$3 million	0.0%
<b>Total (b):</b>	<b>55,148</b>	<b>\$20.268 billion</b>	<b>100.0%</b>

(a) Due to a procedural law, real property owned by the Department Transportation isn't included in this data

(b) Data included in this chart comes from different sources, causing the 2004 exempt values to have slight discrepancies.

Source: Unaudited data provided by Property Valuation Division and Dr. Glenn W. Fisher Wichita State University, *Erosion of the Kansas Property Tax Base*

These data aren't regularly pulled together by the Division of Property Valuation. We tried to assemble more current information, which involved getting parcel-level data from all 105 counties. However, we learned that a new computer system being implemented to inventory and value real estate doesn't allow the same breakdown without counting the value of some properties more than once. That's because of a change in the way the new system handles exemption codes. For

example, a property may be coded both as “religious” and “benevolent,” but the new computer system doesn’t allocate specific appraisal values to each of the categories. Currently, 20 counties use the new appraisal system; the remaining counties are supposed to switch over in the next few years. Division officials weren’t aware of this because they rarely run this report, and there’s no legislative mandate to report the exempted appraisal values by category.

- **For most exempt personal property, such as machinery and equipment, no cost information is available.** Many tangible items exempted from taxation don’t have to be reported to the county appraiser. Such items include farm machinery and equipment, personal property, wearing apparel, household goods and other personal effects, livestock, and grain, as well as commercial/industrial, telecommunications, and railroad machinery and equipment. Without tracking the value of products that otherwise would be taxed, it’s not possible to determine the lost revenue from exempting these items within each county or at a Statewide basis.
- **Initial cost estimates for property tax exemptions in the form of fiscal notes often are nonexistent.** In general, Division of Property Valuation officials told us that fiscal notes typically focus only on the impact for the State, and often can’t provide good estimates because of the lack of data. We looked for fiscal notes related to 28 exemptions for new or expanded property tax exemptions between 1999 and 2009, and found only eight exemptions with fiscal notes that estimated specific lost revenues for the State, and six that cited no or negligible costs to the State. For the 14 remaining exemptions, the fiscal notes didn’t address the effect of the exemption at all, or stated the impact couldn’t be estimated.

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***We Identified a  
Number of Exemptions  
The Legislature May  
Want To Re-Evaluate***

As discussed in Parts I and II of this audit series, given the large number of tax credits and exemptions Kansas currently has (about 250 in all), we couldn’t do an in-depth cost-benefit analysis of each one. In addition, largely non-existent cost information on property tax exemptions limited our review further. Instead, we reviewed available reports, guides, or court rulings related to Kansas property tax exemptions, and talked to officials from the Division of Property Valuation and a handful of local county appraisers. To the extent possible, we applied the tax policy considerations shown in **Figure I-5** on page 20, which we compiled as part of our evaluation process for this audit series.

**We identified six exemptions that provide a broader tax exemption than the Constitution would require.** As discussed in the Overview, the Constitution currently exempts from taxation any property used exclusively for State, county, municipal, literary, educational, scientific, religious, benevolent and charitable purposes,

**Figure 1-5  
Tax Policy Considerations Used To Evaluate Tax Preferences**

**A. Tax Preferences That Are Required by the State Constitution (*Article 11(b)(2)*):**

All property used exclusively for State, county, municipal, literary, educational, scientific, religious, benevolent and charitable purposes, farm machinery and equipment, merchant's and manufacturer's inventories and livestock and all household goods and personal effects not used for the production of income.

**B. Tax Preferences That Are Required by Federal Law:**

1. Sales tax exemption on food stamps based on Federal Food Stamp Act of 1977 (*7 U.S.C. Paragraph 2013(a)*)
2. Sales tax exemption on products related to the Child Nutrition Act of 1966 (*42 U.S.C. Paragraph 1786 (c)(4)*)
3. Tax exemptions related to property involved with Interstate Commerce

**C. Tax Preferences That Tax Policies Suggest Need To Be Exempt from Taxation:**

1. Goods and services purchased by government entities (*taxing government entities would increase the cost of providing government services*)
2. Goods and services subject to another equivalent or "in lieu of" tax (*avoids double taxation of products such as motor fuel, which has an excise tax instead of a sales tax*)
3. Items sold that aren't a final sale to the consumer (*maintains the sales tax as the final tax on consumption*)
4. Isolated or occasional sales (*relieves the seller of the administrative burden of collecting/filing taxes for things like garage sales, flea markets or bazaars.*)

**D. Tax Preferences That Are Made as a Matter of Public Policy:**

**I. Examples of Tax Policy Considerations That Can Favor Having a Tax Preference:**

1. Promoting broad-based equity (*e.g., exempting the sale of mobile homes from sales tax because other residential home sales aren't subject to sales tax*)
2. Promoting a broad-based tax structure that benefits the public at large (*e.g., a tax structure that's balanced and diversified and provides adequate revenues to finance public services over time*)
3. Minimizing regressivity in the State's tax system to reduce the tax burden on the poor (*e.g., providing refunds to low-income taxpayers for food sales because they pay proportionally more of their income on food than other taxpayers*)
4. Reducing market barriers to accomplishing a goal that would benefit the broader public (*e.g., providing a tax credit for companies to offer health insurance benefits that they otherwise wouldn't offer because of high costs*)
5. Encouraging economic growth and development (*e.g., creating incentives for companies to create or retain jobs that otherwise wouldn't occur*)
6. Staying competitive with other states (or countries for global enterprises) that have a tax preference, to guard against significant loss of sales or business (*e.g., offering economic development credits or property tax exemptions for businesses looking to expand or relocate*)
7. Subsidizing certain activities that reduce the services or costs that government otherwise would have to provide (*e.g., offering a tax credit to help fund deferred maintenance costs for universities*)

**II. Examples of Tax Policy Considerations That Can Favor Not Having a Tax Preference:**

1. The purpose or goal of the tax preference can't be clearly articulated or measured
2. The tax preference isn't likely to achieve the public policy goal, or evidence shows it isn't achieving that goal (*e.g., tax preference isn't being used, or likely is too small to cause the entity or individual to take the action*)
3. The cost of the tax preference to the State can't be measured, or evidence shows the cost is greater than expected, or more than policymakers are willing to fund
4. The cost of the tax preference is greater than the benefits the State receives in return
5. The tax preference is too narrow, favoring selected industries, entities, or activities over others without a clear reason for doing so
6. The tax preference creates unfair competition between similar entities
7. The tax preference significantly erodes the State's tax base
8. The tax preference has a significant negative effect on local tax revenues
9. The tax preference is an inefficient or ineffective way of accomplishing the public policy goal (*e.g., 100% tax credit for select entities, instead of funding the activity through a direct appropriation*)
10. The industry is regulated by the State and can recover the necessary costs of doing business from customers and is provided a certain profit through regulated rate of return set by the State
11. The tax preference creates difficulties in administering it because of how it's designed or because it leads to confusion of who can benefit from it.

Source: LPA review of tax policy literature, Kansas Constitution, and federal laws.

farm machinery and equipment, merchants' and manufacturer's inventories, livestock, and household goods and personal effects not used to produce income.

As mentioned previously, many of the exemptions currently in statute simply repeat or clarify what is covered by these constitutional exemptions (this is especially the case for exemptions in the government and charitable, religious, and benevolent categories). However, we identified the following statutes that have been worded or revised to provide a broader exemption than the Constitution would require:

- **Exemption for household goods and personal effects that aren't used to produce income (#6)** KSA 79-201c (*Second*) describes a number of household goods and personal effects that are exempted from taxation. In recent years, however, this statute has been revised several times to exempt household goods and personal effects used in homes for licensed or registered day care or bed-and-breakfast purposes. This may exempt items that are purchased as part of the "business operation," which would go beyond those the constitutional exemption applies to.
- **Exemptions for property that isn't used exclusively for religious, charitable, benevolent, or educational purposes**
  - **Parsonages (#82)**. Under KSA 79-201 (*Seventh*), church parsonages and the land they sit on are exempt if used predominantly as a residence for clergymen or ministers. This exemption has gone back and forth in the past: In 1872, Kansas' Supreme Court ruled that parsonage property wasn't included under the constitutional exemption for religious purposes. In 1909, the Legislature provided specific statutory exemptions for certain property owned by churches, including parsonages. In 1929, the Legislature expanded the parsonage exemption to include residences of church officials. In 1969, the parsonage exemption was repealed as a result of an interim study on property taxes. In 1986, the current statutory provision regarding parsonages was enacted.
  - **Non-profit community housing development organizations (#87)**. KSA 79-201z allows an exemption for real and personal property when used primarily for the housing for the elderly, persons with disabilities, or persons with limited or low income.
  - **Non-profit community service organizations (#88)**. KSA 79-201 (*Ninth*) allows real and personal property tax exemptions when such groups regularly use exempted items predominantly for humanitarian services.
  - **Certain buildings owned by private non-profit universities or colleges (#43)**. KSA 79-201 (*Fifth*) allows student union buildings, presidents' homes, and student dormitories owned by private, non-

profit entities to be exempt from property taxation. Because such property isn't used exclusively for educational purposes, it appears to fall outside the Constitution's mandate. On the other hand, the statute gives private non-profit universities or colleges a similar exemption to the one provided to universities or colleges owned by the State (#40), and may help keep educational costs lower.

- **Property used by alumni associations (#44).** KSA 79-201 (*Sixth*) provides exemptions on real and tangible personal property regularly used exclusively by an alumni association to provide accommodations and services to a college or university or to alumni, staff, or faculty. Such property may not be used exclusively for educational purposes.

According to Department officials, these broader statutes often resulted from taxpayers who lost their tax appeals, and subsequently sought a change in statute to exempt their type of property.

**In its rulings, the Court of Tax Appeals generally has ruled very narrowly on the application of property tax exemptions.** For example:

- A humanitarian organization applied for a property tax exemption on the permanent residences of its full-time volunteers. The Court of Tax Appeals denied the exemption and stated that the residences were a benefit to the volunteers and weren't covered under the humanitarian service that would have made the exemption allowable.
- An applicant sought a property tax exemption on a residential apartment complex that was used predominantly as low income housing, housing for the disabled, and housing for handicapped persons. The Court of Tax Appeals denied the exemption because over 50% of the residential units weren't rented to low income, elderly, or handicapped people and weren't used exclusively for cooperative housing. The Kansas Appeals Court affirmed the Court of Tax Appeals decision.
- The Court of Tax Appeals ruled that a religious camp should lose its tax-exempt status after allowing non-religious groups to use the camp facilities at a nominal fee. A county appraiser told us she has a similar challenge regarding the use of a Boy Scout camp as hunting grounds during certain times of the year.

**We identified four exemptions that could result in unequal treatment for similar types of taxpayers.** Property tax exemptions for which the Kansas Constitution is silent are enacted as a matter of public policy. Tax policy literature states exemptions should be applied equitably to broad groups of classes, services, entities, or individuals, and shouldn't create an unfair competitive advantage. We identified the following exemptions that potentially could result in unequal treatment for taxpayers:

- **Farm structures used to store hay (#47)**. KSA 79-201d (*Third*) allows an eight-year property tax exemption for these structures, but structures other taxpayers use to store their inventory, products, or goods in aren't exempt.
- **Aircraft**
  - **Aircraft used to create income (#76)**. KSA 79-201k provides a property tax exemption for businesses' use of aircraft when used as a primary means of creating income. However, businesses that use other forms of transportation as their principal form of income aren't exempt, such as taxi cabs or delivery trucks.
  - **Antique aircraft for recreational/display purposes (#100)**. KSA 79-220 exempts such aircraft, while owners of antique cars or other antique items don't get a similar subsidy.
- **Low oil production exemption (#68)**. KSA 79-201t allows property tax exemptions on certain low-production oil leases. According to Department officials, the exemption was created to subsidize business owners when oil production became unprofitable because of high overhead and record-low crude oil prices (in 1992, the price of a barrel of domestic crude oil dropped to less than \$30 - after adjusting for inflation). However, other businesses don't get similar subsidies from the State when faced with diminishing profits. In addition, domestic oil prices have fluctuated between a low of \$16 to a high of \$91 since the exemption was created in 1992, which makes it more difficult to justify the exemption. The Kansas Advisory Council on Intergovernmental Relations (created by the Legislature in 2002 to continuously study the State and local tax structure) identified this exemption as one that could be repealed.

As described in the Overview, the Supreme Court laid out several criteria for a statutory property tax exemption to be considered constitutional, including that the exemption can't create an improper or preferential classification of property. Because the exemptions listed above may result in unequal treatment for similar types of taxpayers, they serve to illustrate the difficulties in determining whether existing exemptions meet the Court's test.

**Property tax exemptions for machinery and equipment have significantly eroded the local tax base.** According to the tax policy literature we reviewed, one of the factors policymakers must consider in deciding whether to grant an exemption is the impact it may have on State or local tax revenues, and whether the benefit derived outweighs the cost.

As mentioned earlier, cost information isn't available for most property tax exemptions. However, the Division of Property Valuation has tracked the value of the machinery and equipment on county tax rolls since 2005. Here's why: When the exemptions for commercial/industrial, telecommunications, railroad machinery and

equipment purchases after 2006 went into effect, the Legislature agreed to make annual payments for five years to reimburse each county for part of the tax revenues they would lose. (These are exemptions #53-56 from *Figure 1-3*.)

The State’s payments—called slider payments—were to be based on the property taxes counties received from machinery and equipment in the base year (2005) compared to what they received in fiscal years 2008 through 2012. *Figure 1-6* shows the estimated losses to the counties from the machinery and equipment property tax exemptions.

<b>Figure 1-6</b>							
<b>Estimated Costs of the Machinery and Equipment Exemptions (in millions)</b>							
Fiscal Year	Estimated County Loss	Planned Slider Payments to Counties			Actual/Estimated Slider Payments to Counties		
		Est. State Payment	Slider Payment Rate	Net County Loss (after State Payment)	State Slider payments	Actual Slider Payment Rate	Loss to Counties
2008 (a)	\$28.7	\$25.9	90%	\$2.9	\$25.9	90%	\$2.9
2009 (a)	\$76.4	\$53.5	70%	\$22.9	\$25.0	33%	\$51.4
2010 (a)	\$106.1	\$53.0	50%	\$53.0	\$0.0	0%	\$106.1
2011	\$106.6	\$32.0	30%	\$74.6	\$0.0 (b)	0%	\$106.6 (b)
2012	\$115.0	\$11.5	10%	\$103.5	\$11.5 (b)	10%	\$103.5 (b)
<b>TOTAL</b>	<b>\$432.8</b>	<b>\$175.9</b>	<b>41%</b>	<b>\$256.9</b>	<b>\$62.4</b>	<b>14%</b>	<b>\$370.5</b>

(a) Based on actual data.  
(b) 2011 based on Governor’s Budget Recommendation. 2012 reverts back to initial estimate that may or may not happen.  
Source: Unaudited data from Property Valuation Division, Department of Revenue

As the figure shows, counties were estimated to directly lose more than \$400 million in property taxes over five years, and the State was going to reimburse counties for a total of \$176 million, based on a decreasing percentage of the amount counties lost each year. Because of the recession, however, the State has reimbursed counties for much less than originally planned. Two county appraisers we talked to expressed concerns about the business and machinery equipment exemptions. They told us that the lack of property revenues from such equipment means that mill levies on remaining taxable properties increase, which puts a strain on homeowners, especially in rural areas.

Besides the State’s slider payments to the counties—which have totaled \$51 million to date—we estimated these exemptions cost the State about \$5 million in lost property tax revenues from the Statewide 21.5 mill levy in fiscal year 2008. Those losses are estimated to reach almost \$19 million by 2012.

For several reasons, it’s difficult to know what the true cost of the machinery and equipment property tax exemptions actually will be to both the counties and the State:

- First, that data that are available capture only the value of machinery and equipment removed from the tax rolls, not the value of machinery and equipment purchased since then. Because businesses no longer have to report the value of machinery and equipment they buy to the county appraiser, there's no way to know how much they've actually bought that would have been taxed. And without knowing which businesses bought new machinery or equipment and why, there's no way to directly tie such purchases to the tax exemptions or to any increase in jobs or other economic benefits to the local communities.
- Second, while some counties have had large drops in property tax revenues for machinery and equipment, others have had large increases, suggesting other things may be affecting property taxes. For example, some drops could be the result of a business finishing a large construction project in one county and moving its equipment to another county to work on new projects.

Officials in surrounding states told us that Colorado and Missouri don't offer similar exemptions on machinery and equipment. Oklahoma provides a five-year exemption on new machinery and equipment (which includes items businesses bring into Oklahoma for expansion purposes). Nebraska officials told us their machinery and equipment has a taxable life of seven years. Beginning the eighth year, machinery and equipment isn't taxable in that State.

Lastly, as pointed out in Part I of this audit series, these four machinery and equipment exemptions create a potential for unequal treatment among businesses. That's because businesses that upgraded their equipment after 2006 (or that come from out of State into Kansas with older equipment) get a 100% tax break on property taxes for such equipment, while businesses that own older equipment (and that have been here all along) can claim only a partial property tax break through the related tax credits.

***Conclusion:***

A significant amount of real and personal property currently is exempted from taxation—including all property used for governmental and educational purposes, and certain business machinery and equipment—but there's almost no data on how much the State is losing in tax revenues from these exemptions. A lack of data also makes it almost impossible to gauge what the impact of any property tax exemptions has been, or will be in the future.

The Kansas Constitution exempts much of this property from taxation, and over time the Legislature has broadened those exemptions or created new ones. In recent years, most of the new exemptions have been for businesses—primarily for machinery and equipment and energy development. The information that is

available suggests local governments are losing a significant amount of revenue from the machinery and equipment exemptions, and given the recession, the State hasn't been able to uphold its agreement to compensate them for part of their loss.

Because of tax policy principles that consider, among other things, the impact of tax exemptions on State and local tax revenues, we think the Legislature should review the business and other exemptions that go beyond constitutional mandates or that could result in unequal treatment for similar types of taxpayers to ensure that they continue to provide the proper balance between the Legislature's public policy goals and the State's financial needs. And as we noted in Part II of this audit series dealing with sales tax exemptions, establishing clear public policies regarding which types and classes of property will be exempt will give the Legislature a consistent basis for deciding which exemptions have merit and should be continued, even if in a modified form.

***Recommendations for  
Legislative Action:***

1. The Legislature should review the following property tax exemptions to determine what changes, if any, should be made:
  - a. **exemptions that provide a broader tax exemption than the Constitution would require** (listed on pages 21-22). Among other things, the Constitution exempts property used exclusively for State, county municipal, literary, educational, scientific, religious, benevolent and charitable purposes. The six exemptions identified listed on pages 21-22 allow property that is predominantly or regularly used for these purposes, or allow property that isn't strictly used for educational purposes to be exempt.
  - b. **exemptions that could result in unequal treatment for similar taxpayers** (listed on page 23). In the absence of an established policy regarding which types of property the Legislature wants to exempt, these exemptions treat similar kinds of entities unequally.
  - c. **exemptions that significantly erode the local tax base and are a matter of public policy** (as discussed on pages 23-25). There are pros and cons to having these exemptions. The Legislature should consider whether they continue to provide the proper balance between the Legislature's public policy goals and the State's financial needs.

2. To help ensure that similar types of taxpayers are treated equally, the Legislature should consider establishing a broad tax policy that outlines the types of property it wants to exempt and the general rationale for doing so, and developing a set of criteria that fit within that broad policy. That would allow the Legislature and others to measure current and future tax exemptions against those criteria.
3. To help ensure that property tax exemptions for which the Legislature has a particular goal in mind (e.g. economic development or energy production) can be evaluated for their effectiveness, the Legislature should consider the following:
  - a. requiring a mechanism for taxpayers to report the information needed to know whether that purpose is being met, and the State agency that will be responsible for collecting and reporting on that information
  - b. establishing a sunset provision to ensure that the purpose, effectiveness, and usefulness of these property tax exemptions is reviewed periodically



## 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 benefitting 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**

### **Tax Revenues From Major Categories of Property Over Time**

This appendix contains a summary of tax revenues from major categories of property including residential, commercial and industrial, utilities, agricultural land, and oil and gas, from 1994 to 2008, as well as the proportions of revenues from these categories over that time period.

**Appendix B**  
**Tax Dollars from Major Categories of Property Over Time (in millions)**

Year	Residential		Commercial / Industrial		Utilities		Agricultural Land		Oil & Gas		All Other		Total Tax Revenues from Property Taxes
	Amount	Percent of Total Amount	Amount	Percent of Total Amount	Amount	Percent of Total Amount	Amount	Percent of Total Amount	Amount	Percent of Total Amount	Amount	Percent of Total Amount	
1994	\$696.9	38.1%	\$506.6	27.7%	\$293.7	16.1%	\$144.2	7.9%	\$117.0	6.4%	\$68.5	3.7%	\$1,826.8
1995	\$767.1	39.9%	\$529.2	27.5%	\$292.5	15.2%	\$146.8	7.6%	\$113.3	5.9%	\$72.9	3.8%	\$1,921.7
1996	\$798.9	40.5%	\$554.6	28.1%	\$291.7	14.8%	\$143.5	7.3%	\$106.4	5.4%	\$75.8	3.8%	\$1,971.0
1997	\$772.8	39.3%	\$575.0	29.3%	\$284.4	14.5%	\$136.2	6.9%	\$122.4	6.2%	\$73.9	3.8%	\$1,964.7
1998	\$799.0	40.7%	\$594.9	30.3%	\$267.2	13.6%	\$134.8	6.9%	\$103.6	5.3%	\$65.1	3.3%	\$1,964.5
1999	\$878.3	41.7%	\$653.4	31.0%	\$284.3	13.5%	\$144.2	6.8%	\$76.3	3.6%	\$69.1	3.3%	\$2,105.6
2000	\$982.1	42.6%	\$713.5	31.0%	\$289.8	12.6%	\$156.9	6.8%	\$83.0	3.6%	\$78.5	3.4%	\$2,303.8
2001	\$1,095.6	43.1%	\$770.9	30.3%	\$300.9	11.8%	\$171.7	6.8%	\$115.4	4.5%	\$87.9	3.5%	\$2,542.4
2002	\$1,175.2	44.3%	\$799.2	30.1%	\$299.4	11.3%	\$184.3	7.0%	\$105.0	4.0%	\$88.2	3.3%	\$2,651.4
2003	\$1,261.1	45.4%	\$831.9	29.9%	\$311.1	11.2%	\$183.4	6.6%	\$99.6	3.6%	\$91.2	3.3%	\$2,778.2
2004	\$1,355.3	45.7%	\$865.6	29.2%	\$330.0	11.1%	\$189.6	6.4%	\$131.0	4.4%	\$92.1	3.1%	\$2,963.5
2005	\$1,461.7	46.0%	\$918.8	28.9%	\$337.9	10.6%	\$188.6	5.9%	\$169.9	5.4%	\$98.2	3.1%	\$3,175.1
2006	\$1,576.3	46.1%	\$985.9	28.8%	\$341.7	10.0%	\$184.3	5.4%	\$225.8	6.6%	\$104.4	3.1%	\$3,418.4
2007	\$1,691.9	47.0%	\$1,052.0	29.2%	\$354.8	9.9%	\$174.6	4.8%	\$215.5	6.0%	\$111.2	3.1%	\$3,600.0
2008	\$1,777.8	47.2%	\$1,088.5	28.9%	\$368.1	9.8%	\$164.4	4.4%	\$252.7	6.7%	\$118.4	3.1%	\$3,769.9
<b>Change in proportion 1994-2008:</b>		<b>23.6%</b>		<b>4.1%</b>		<b>-39.3%</b>		<b>-44.8%</b>		<b>4.7%</b>		<b>-16.2%</b>	

Source: Unaudited data from Kansas Department of Revenue

## **APPENDIX C**

### **Agency Response**

On Wednesday, March 3, 2010 we provided copies of the draft audit report to the Department of Revenue. Department officials chose not to provide a written response, but told us the Department had no issues with the report.

**Legislative Division of Post Audit  
Performance Audit Reports on  
Taxation/Revenue  
Issued In Recent Years**

00PA07	Reviewing Various Issues Related to the Department of Revenue's Handling and Processing of Tax Returns	December 1999
01PA04	Employee Credits Against Premium Taxes: Reviewing Issues Related to Those Credits	February 2001
01PA12	Retailer Sales Taxes: Assessing Whether the Amounts Distributed to Localities Have Been Computed Correctly	March 2001
02PA05	Bingo Tax Laws: Reviewing the Department of Revenue's Implementation and Enforcement of Those Laws	November 2001
02PA17	Corporate Income Taxes: Reviewing Factors Affecting the Recent Steep Drop in Those Tax Receipts	August 2002
03PA01	Valuing Commercial Buildings for Property Tax Purposes: Determining Whether Procedures Ensure Accurate Appraisals	November 2002
03PA09	Taxes on Motor Vehicle Sales: Reviewing the Dept. of Revenue's Procedures	April 2003
03PA10	Federal Funds: Determining Whether Opportunities May Exist To Draw Down More Federal Funds	April 2003
03PA18	Motor Fuel Tax Refunds: Determining Whether Adjustments to Refund Claims Were Handled Correctly	June 2003
04PA20	Determining Whether KS System of Taxes & Fees for Contractor Equipment Is Similar to Other States	April 2004
04PA24	Tax Enforcement: A K-GOAL Audit of Department of Revenue Collection of Delinquent Trust Taxes	October 2004
05PA04	Property Valuation in Kansas: Reviewing the Valuation of Agricultural and Commercial Properties	March 2005
10PA03.1	Kansas Tax Revenues, Part I: Reviewing Tax Credits	February 2010
10PA03.2	Kansas Tax Revenues, Part II: Reviewing Sales Tax Exemptions	February 2010