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Update to Analysis of Kansas Corporate Income Tax Dated October 14, 2004 To Reflect Tax Year 2004 Data

The Analysis dated October 14, 2004 focused on the Kansas corporate income tax during tax years 2000, 2001 and 2002 and the impact of the 4 largest business income tax credit incentive programs on corporate income tax receipts, in an effort to determine how the corporate income tax burden falls within various industry sectors. Attached are updates to Tables 2 and 3 of the Analysis, to reflect the addition of tax year 2004 data. The discussion of the Top 20 claimants of the Business and Job Development (B&J) income tax credit is updated for tax year 2004 data. For comparison purposes, also attached are Analysis Tables 2 and 3, updated to include tax year 2003 data. Data on the Top 12 claimants of the High Performance Incentive Program (HPIP) tax credits for tax year 2004 is also discussed.

Recent History of Corporate Income Tax Receipts

Annual Kansas corporate income tax receipts (by fiscal year) since 1995 are shown below:

Fiscal Year	Amount Collected	Percent Change
1995	\$229,421,376	
1996	\$218,586,552	-4.7%
1997	\$263,573,332	20.6%
1998	\$281,651,300	6.9%
1999	\$227,369,923	-19.3%
2000	\$250,122,826	10.0%
2001	\$211,906,919	-15.3%
2002	\$93,958,484	-55.7%
2003	\$105,222,316	12.0%
2004	\$141,173,000	34.2%
2005	\$226,071,634	60.1%
2006	\$350,201,000	55.0%

Although the bottom fell out of corporate income tax receipts in FY 2002, the recent trend is very encouraging. Fiscal Year 2006 receipts set a new record. Thus far in FY 2007, corporate income tax receipts of \$135 million through the end of October are 55% above the April 2006 Consensus Revenue Estimate of \$306 million for FY 2007 and 50% above actual corporate income tax receipts for this same time period last year.

Corporate Income Tax Burden

In updating the Analysis dated October 14, 2004, tax returns from a sample of the largest 414 corporate taxpayers for tax year 2004 were reviewed in order to determine how much impact the business tax credit programs (Business & Job Development, High Performance Incentive Program, Research & Development, Business Machinery & Equipment) have on the corporate income tax burden. These corporations accounted for approximately 60% of the corporate income tax base for tax year 2004. The North American Industry Classification System (NAICS) code, Kansas taxable income, Kansas corporate income tax liability before credits, credits claimed, and the net tax receipts after credits for tax year 2004 for each of these corporations were captured in the database.

The update to Table 2 (attached) summarizes the results by NAICS code categories (using the first 2 digits of the NAICS code) for tax year 2004. The number of corporations included in each NAICS code category is shown in parenthesis in the first column.

Consistent with the Table 2 in the prior Analysis, the Update to Table 2 for tax year 2004 continues to show disparity between the various industry sectors in the proportion of tax liability that is reduced or eliminated by tax credits from participation in business incentive tax credit programs. The "payment percentage" column shown on the attached Update to Table 2 reflects the percent of tax liability (measured before credits are taken) actually paid after credits were applied to reduce tax liability. Manufacturers continue to experience a low tax payment percentage rate, 59.9% for tax year 2004, although higher than the 54.35% payment percentage rate for tax year 2003, and 45.60% tax payment percentage rate for tax years 2000 through 2002. The retail trade sector, now by far the largest in generating total tax liability before credits, as well as in the amount of net taxes paid (tax paid after credits are taken), had a higher tax payment percentage rate of 88.01% for tax year 2004, compared to 87.21% for tax year 2003, and the wholesale trade sector an even higher tax payment percentage rate than retail, 91.29%, although slightly lower than for tax year 2003, which was 94.61%.

While the Analysis dated October 14, 2004 (see Charts 2 and 3 of that document) indicated that manufacturers represented the largest portion of Kansas tax liability before credits (and Kansas taxable income) in the sample during tax years 2000 through 2002, the tax year 2003 data (see Update to Table 2 for tax year 2003) shows that retail trade represents the largest portion of Kansas taxable income, Kansas income tax liability generated before credits are taken, and net taxes paid after credits are taken. The 2004 tax year data continues that trend. As Update to Table 2 for tax year 2004 indicates, the retail sector's total corporate income tax liability before credits was \$35.6 million and tax payments after credits (see "net receipts" column) were \$31.3 million, while the manufacturing sector's total corporate income tax liability before credits was \$31.2 million and tax payments after credits were \$18.7 million.

B&J Credit Data

Within the sample of 414 corporations, the group of top 20 corporations that claimed the most B&J credits during tax year 2004 were identified. Corporations in this group were divided into 2 broad categories by NAICS code: manufacturing/transportation/warehousing and retail/wholesale/other. The effective tax rate for each corporation was computed, as well as the average effective tax rate for each of the two categories. The results are shown below.

Top 20 B & J Credit Claimants Tax Year 2004

Tax Year 2004

5 in Manufacturing/Transportation/Warehousing	15 in Retail/Wholesale/Other
Total Taxable Income: \$99.9 million	Total Taxable Income: \$323.14 million
Total Net Tax: \$6.32 million	Total Net Tax: \$19.45 million
Ave. Effective Tax Rate: 6.33%	Ave. Effective Tax Rate: 6.02%
Range: .69% to 6.78%	Range: -2.23% to 6.47%

This compares to the data for tax year 2003, shown below.

Top 20 B & J Credit Claimants Tax Year 2003

Tax Year 2003

6 in Manufacturing/Transportation/Warehousing	14 in Retail/Wholesale/Other
Total Taxable Income: \$40.96 million	Total Taxable Income: \$247.77 million
Total Net Tax: \$1.742 million	Total Net Tax: \$15.69 million
Ave. Effective Tax Rate: 4.2%	Ave. Effective Tax Rate: 6.3%
Range: -.58% to 7.78%	Range: 3.51% to 6.59%

The tax year 2004 results show rough parity between the manufacturing/transportation/warehousing category and the retail/wholesale/other category in terms of effective tax rates. In fact, the manufacturing/transportation/warehousing category averaged a higher effective tax rate (6.33%) than the retail/wholesale/other category (6.02%), and the range of effective tax rates within the manufacturing/transportation/warehousing category is narrower than for the retail/wholesale/other sector. This contrasts with the tax year 2003 results, which continued to show a significant disparity between the average effective tax rate paid by the manufacturing/transportation/warehousing category vs. the retail/wholesale/other category and wide disparity in effective tax rates paid by individual corporations within the manufacturing/transportation/warehousing category. For example, in tax year 2003, the 6 corporations in the manufacturing/transportation/warehousing category had an average effective tax rate of 4.2% (compared to a lower effective tax rate of 2.1% for tax years 2000 through 2002), although within that category, the effective tax rate ranged from -.58% to 7.78%. Of the corporations in the retail/wholesale/other category in tax year 2003, the average effective tax rate was 6.3%, although within that category, the effective tax rate ranged from 3.51% to 6.59%, a much smaller variance.

The Update to Table 3 for tax years 2000 through 2004 (attached) compares the manufacturing firms and retail firms within the group of corporations included in the "top 20" in B & J credit claimants during tax years 2000 through 2004 (a sample size of 114 corporations). The amount of tax liability (measured before credits are taken), credits and net receipts (tax paid after credits were taken) for all four tax years for manufacturing and retail firms in the group are listed. Of the 114 corporations in the group, 34 were manufacturing corporations and 30 were retail trade corporations. The "total" row at the bottom sums the information not only for these 34 manufacturers and 30 retailers, but also the rest of the 114 corporations in the group.

The Update to Table 3 for tax years 2000 through 2004 shows that manufacturing firms that are large B & J credit claimants continue to succeed in offsetting significant tax liability with tax credits, owing only 32.75% of the amount of their tax liability measured before credits were applied, while retailers offset a much smaller portion of their tax liability, owing 81.52% of the

amount their tax liability measured before credits. The average payment percentage for all 114 corporations in this group of largest B&J credit claimants is 61.23%. Comparing this table to Update to Table 3 for tax years 2000 through 2003, manufacturers owed only 24.14% of their tax liability measured before credits were applied, while retailers owed 81.38% of their tax liability measured before credits. The average payment percentage for all 78 corporations in this group of largest B&J credit claimants for tax years 2000 through 2003 was 56.95%.

HPIP Data

Within the sample of 414 corporations, the top 12 corporations claiming the most HPIP credits during tax year 2004 were identified. Corporations in this group were divided into 2 broad categories by NAICS code: manufacturing and other. The effective tax rate for each corporation was computed, as well as the average effective tax rate for each of the two categories. The results are shown below.

Top 12 HPIP Credit Claimants Tax Year 2004

Tax Year 2004

7 in Manufacturing

Total Taxable Income: \$146.4 million

Total Net Tax: \$2.548 million

Ave. Effective Tax Rate: 1.74%

Range: -1.35% to 4.07%

5 in Other

Total Taxable Income: \$50.6 million

Total Net Tax: \$2.423 million

Ave. Effective Tax Rate: 4.79%

Range: -2.23% to 6.6%

The tax year 2004 data indicates that manufacturers benefited the most from the HPIP program, with over half (7) of the "top 12" claimants being manufacturers, paying a low average effective tax rate of 1.74%. Some participants had negative effective tax rates, eliminating their corporate income tax liability entirely with credit offsets. The 5 non-manufacturer HPIP claimants in the "top 12" group succeeded in offsetting significant tax liability with tax credits, maintaining a low effective tax rate of 4.79% (although not as low as for manufacturers in HPIP), with some of these participants also eliminating their tax liability entirely. This data shows that large-scale participants in HPIP are able to offset most, if not all, of their corporate income tax liability with tax credits, the majority of large claimants being manufacturers.

Updated Conclusions

Many of the conclusions in the Analysis dated October 14, 2004 remain valid for the tax year 2004 corporate income tax data sample: manufacturers continue to utilize the business tax credit incentive programs heavily and have claimed the largest amounts of the credits. Because tax credits are used to lower tax burden, the effective tax rates continue to vary within industry groups of all types, although that disparity narrowed in tax year 2004, a year for strong corporate income tax receipts, and manufacturers were able to offset a lower percentage of their tax liability with credits than in prior years. Generally, the manufacturing sector bears a smaller share of the corporate income tax burden than other sectors of the economy, compared to the taxable income generated by those sectors. However, the tax year 2004 data indicates that the average tax payment percentage for manufacturers increased from 54.35% for tax year 2003 to 59.9% for tax year 2004, while the average tax payment percentage for all corporations in the sample decreased from 85.15% for tax year 2003 to 78.44% for tax year 2004. Also, among the top 20 B&J credit claimants for tax year 2004, the manufacturing/transportation/warehousing category average effective tax rate (6.33%) actually exceeded the average effective tax rate for

the retail/wholesale/other category (6.02%). During years when the economy and tax receipts are strong (such as 2004), even manufacturers have a higher average tax payment percentage.

The tax year 2004 data, as did the 2003 data, continues to show that the retail sector is the most dominant portion of the corporate income tax base, generating the largest amount of Kansas taxable income and contributing the largest portion of the corporate income tax receipts. In tax years 2000, 2001 and 2002, the manufacturing sector generated the largest amount of Kansas taxable income (but not corporate income tax receipts). The retail sector has benefited somewhat less than the manufacturing sector from the tax credit programs. The retail sector typically bears a higher share of the corporate income tax burden, and pays higher effective tax rates, although that disparity did narrow in tax year 2004.

Update to Table 2: Tax and Credits Statistics by Industry from a sample of 414 corporations for Tax Year 2004

Industry (# of corporations)	Total Tax Liability	Total NR Credits	B&J	R&D	HPIP	CIME Credit	Total Ref. Credits	Net Receipts	Payment Percentage
Mining (10)	\$10,164,775	\$5,337,022	\$0	\$0	\$0	\$84,965	\$0	\$4,742,788	46.66%
Utilities (8)	\$2,617,772	\$0	\$0	\$0	\$0	\$4,814	\$8,362	\$2,604,596	99.50%
Construction (10)	\$1,062,113	\$436,967	\$0	\$0	\$436,967	\$25,456	\$0	\$599,690	56.46%
Manufacturing (75)	\$31,200,763	\$8,711,141	\$764,439	\$112,185	\$7,380,319	\$3,771,681	\$30,000	\$18,687,941	59.90%
Wholesale Trade (84)	\$20,218,220	\$597,101	\$18,000	\$216,734	\$416,225	\$1,133,930	\$30,324	\$18,456,864	91.29%
Retail Trade (59)	\$35,563,751	\$3,325,521	\$3,326,251	\$3,718	\$2,599,171	\$940,131	\$0	\$31,298,099	88.01%
Transportation and Warehousing (10)	\$10,628,394	\$519,233	\$210,113	\$0	\$0	\$313,500	\$0	\$9,795,661	92.17%
Information (25)	\$8,717,709	\$1,055,292	\$23,800	\$7,693,024	\$1,028,986	\$2,234,716	\$2,502,520	\$2,925,181	33.55%
Finance and Insurance (41)	\$11,617,309	\$1,123,859	\$473,727	\$0	\$27,715	\$79,849	\$0	\$10,413,601	89.64%
Real Estate and Rental and Leasing (8)	\$842,259	\$0	\$0	\$0	\$0	\$87,435	\$0	\$754,824	89.62%
Professional, Scientific, and Technical Se (21)	\$5,509,049	\$208,037	\$15,760	\$0	\$0	\$63,188	\$0	\$5,237,824	95.08%
Management of Companies and Enterprises (16)	\$9,850,735	\$179,062	\$179,062	\$0	\$0	\$206,854	\$0	\$9,464,819	96.08%
Admin / Support and Waste Manag (11)	\$862,623	\$24,000	\$24,000	\$0	\$0	\$47,204	\$0	\$791,419	91.75%
Health Care and Social Assistance (14)	\$1,670,376	\$0	\$0	\$0	\$0	\$1,102	\$0	\$1,669,274	99.93%
Accommodation and Food Services (10)	\$2,140,856	\$370,973	\$365,477	\$0	\$0	\$65,054	\$0	\$1,704,829	79.63%
Other Industries (12)	4826240.77	175608	175608	0	0	266212	0	\$4,384,421	90.85%
Total All Industries (414)	\$157,492,944	\$22,063,816	\$5,576,237	\$8,025,661	\$11,889,383	\$9,326,091	\$2,571,206	\$123,531,830	78.44%

Other industries includes: Agriculture, Forestry, Fishing and Hunting, Educational Services, Arts, Entertainment and Recreation, and other service sectors not specified by the current codes

Update to Table 3. Summary information for the corporations that claimed most B&J Credits from TY 2000 to 2004

Sector (# of sample)	Total Tax Liability	Total NR Credits	B&J	R&D	HPIP	BM&E	Total Ref. Credits	Net Receipts	Payment Percentage
Manufacturing (34)	\$52,737,690	\$30,965,768	\$16,272,236	\$6,140,317	\$8,400,818	\$4,199,955	\$298,675	\$17,273,292	32.75%
Retail Trade (30)	\$61,975,221	\$10,382,521	\$10,643,159	\$0	\$2,599,171	\$1,091,391	\$0	\$50,321,310	81.52%
Total (114)	\$160,070,038	\$52,296,474	\$36,265,460	\$6,694,224	\$12,430,647	\$7,148,085	\$2,013,593	\$98,004,077	61.23%