

January 2, 2008

**Update to Analysis of Kansas Corporate Income Tax Dated October 14, 2004
To Reflect Tax Year 2005 Sample 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. This Analysis has been annually updated to reflect sample corporate income tax data from the new tax year. Attached are updates to Tables 2 and 3 of the Analysis, to reflect tax year 2005 sample data. The discussion of the Top 20 claimants of the Business and Job Development (B&J) income tax credit is updated for tax year 2005 data. Data on the Top 20 claimants of the High Performance Incentive Program (HPIP) tax credits for tax year 2005 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	\$350,200,874	55.0%
2007	\$442,448,739	26.3%

Although the bottom appeared to fall out of corporate income tax receipts in FY 2002, the recent revenue trend is very encouraging. Fiscal Year 2007 receipts set a new record, surpassing FY 2006 receipts, which had also been a record. Corporate income tax revenues are expected to decrease in FY 2008, as reflected in the November 2007 Consensus Revenue Estimate of \$415 million for FY 2008. Thus far in FY 2008, corporate income tax receipts of \$191.2 million through the end of December 2007 are

running -8.3% below the current Consensus Revenue Estimate and -9.1% below actual corporate income tax receipts for this same time period last fiscal year.

Corporate Income Tax Burden

In updating the Analysis dated October 14, 2004, tax returns from a sample of the largest 418 corporate income taxpayers for tax year 2005 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 75% of the corporate income tax base for tax year 2005. 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 2005 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 2005. 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 2005 shows some disparity between the various industry sectors in the proportion of tax liability that is reduced or eliminated by tax credits through participation in business incentive tax credit programs. However, as the strong growth in corporate income tax receipts has continued in recent years, that disparity appears to be narrowing and the tax payment percentage rate generally appears to be increasing across the board. The "payment percentage" column shown on the 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 experienced a moderately low tax payment percentage rate, 72.8% for tax year 2005, although significantly higher than the 45.6% tax payment percentage rate for tax years 2000 through 2002 and 59.9% for tax year 2004. The manufacturing sector generated the largest portion of taxable income as well as corporate income tax receipts, compared to any other sector in the sample of 418 corporations for tax year 2005. The retail sector generated the next largest share of taxable income and tax receipts for tax year 2005, experiencing a tax payment percentage of 80.43%, somewhat higher than the manufacturing sector tax payment percentage, but lower than in prior tax years. The wholesale trade sector had a higher tax payment percentage than the retail sector in tax year 2005, 90.21%.

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 2005 tax year sample data is consistent with that. As Update to Table 2 for tax year 2005 indicates, the manufacturing sector's total corporate income tax liability taken from the sample before credits was \$61.6 million and tax payments after credits (see "net receipts" column) were \$44.9 million, while the next largest sector, the retail sector, had

total corporate income tax liability before credits of \$42.1 million and tax payments after credits of \$33.9 million.

B&J Credit Data

Within the sample of 418 corporations, the group of top 20 corporations that claimed the most B&J credits during tax year 2005 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 2005

Tax Year 2005

7 in Manufacturing/Transportation/Warehousing
Total Taxable Income: \$152.6 million
million

Total Net Tax: \$9.8 million
Ave. Effective Tax Rate: 6.4%
Range: -.36% to 6.99%

13 in Retail/Wholesale/Other
Total Taxable Income: \$310.8

Total Net Tax: \$17.7 million
Ave. Effective Tax Rate: 5.7%
Range: -2.04% to 6.15%

The tax year 2005 results show a higher effective tax rate for the manufacturing/transportation/warehousing category among the 20 largest B&J tax credit claimants (6.4%) than the retail/wholesale/other category (5.7%) within that same group. The range of effective tax rates for each corporation is narrower for the manufacturing/transportation/warehousing category (-.36% to 6.99%) than the retail/wholesale/other category (-2.04% to 6.15%).

The Update to Table 3 for tax years 2000 through 2005 (attached) compares the manufacturing firms and retail firms within the group of corporations included in the "top 20" in B & J credit claimants during each of tax years 2000 through 2005 (a sample size of 164 corporations). The amount of tax liability (measured before credits are taken), credits and net receipts (tax paid after credits were taken) for all five tax years for manufacturing and retail firms in the group are listed. Of the 164 corporations in the group, 44 were manufacturing corporations and 40 were retail trade corporations. The "total" row at the bottom sums the information not only for these 44 manufacturers and 40 retailers, but also the rest of the 164 corporations in the group.

The Update to Table 3 for tax years 2000 through 2005 shows that manufacturing firms that are large B & J credit claimants continue to succeed in offsetting significant tax liability with tax credits, owing only 33.61% of the amount of their tax liability measured before credits were applied, while retailers that are large B & J credit claimants offset a much smaller portion of their tax liability, owing 82.04% of the amount their tax liability measured before credits. The average payment percentage for all 164 corporations in this group of largest B&J credit claimants is 65.01%.

HPIP Data

Within the sample of 418 corporations, the 20 corporations claiming the largest HPIP credits during tax year 2005 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 20 HPIP Credit Claimants Tax Year 2005

Tax Year 2005

7 in Manufacturing

Total Taxable Income: \$134.4 million million

Total Net Tax: \$2.832 million

Ave. Effective Tax Rate: 2.1%

Range: -.62% to 6.65%

13 in Other

Total Taxable Income: \$208.4 million

Total Net Tax: \$9.121 million

Ave. Effective Tax Rate: 4.4%

Range: -6.7% to 6.99%

The tax year 2005 data indicates that manufacturers benefited significantly from the HPIP program, with 7 of the "top 20" HPIP claimants being manufacturers, paying a low average effective tax rate of 2.1%. Some participants had negative effective tax rates, eliminating their corporate income tax liability entirely with credit offsets and refunds. The 13 non-manufacturer HPIP claimants in the "top 20" group also succeeded in offsetting significant tax liability with tax credits, maintaining a low effective tax rate of 4.4% (although not as low as for manufacturers), with some of these participants eliminating their tax liability entirely and getting refunds. 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.

Updated Conclusions

Many of the conclusions in the Analysis dated October 14, 2004 remain valid for the tax year 2005 corporate income tax data sample: manufacturers continue to utilize the business tax credit incentive programs heavily and have claimed the largest share of the HPIP credits. Retailers claimed the largest share of B & J 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 continued to narrow in tax year 2005, a year for strong corporate income tax receipts. During years when the economy and tax receipts are strong (such as 2005), tax credits are a smaller proportion of taxable income. Therefore, corporations generally will have a higher tax payment percentage. This was certainly true for manufacturers, who were able to offset a lower percentage of their tax liability with credits than in prior years. The tax year 2005 data indicates that the average tax payment percentage for manufacturers increased from 59.9% for tax year 2004 to 72.87% for tax year 2005, while the average tax payment percentage for all corporations

in the sample increased from 78.44% for tax year 2004 to 83.36% for tax year 2005. Also, among the top 20 B&J credit claimants for tax year 2005, the manufacturing/transportation/warehousing category average effective tax rate (6.4%) exceeded the average effective tax rate for the retail/wholesale/other category (5.7%).

For tax year 2005, the manufacturing sector also generated largest share of the taxable income and corporate income tax receipts, compared to the taxable income and income tax receipts generated by other sectors of the economy. See Update to Table 2 for tax year 2005. The tax year 2005 data contrasts with the tax year 2004 and 2003 data (see the annual updates for those tax years), which showed the retail sector as 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).

Update to Table 2: Tax and Credits Statistics by Industry from a sample of 418 Corporations for Tax year 2005.

Industry	Total Tax Liability	Total NR Credits	B&J	R&D	HPIP	BM&E Credit	Total Ref. Credits	Net Receipts	Payment Percentage
Agriculture, Forestry, Fishing and Hunting (5)	\$740,046	\$29,500	\$29,500	\$0	\$0	\$122,350	\$91,217	\$496,979	67.16%
Mining (9)	\$19,582,887	\$9,312	\$0	\$0	\$3,812	\$214,497	\$0	\$19,359,078	98.86%
Utilities (7)	\$22,321,584	\$0	\$0	\$0	\$0	\$134,046	\$4,514	\$22,183,024	99.38%
Construction (9)	\$596,395	\$338,495	\$0	\$0	\$338,495	\$25,976	\$0	\$231,924	38.89%
Manufacturing (79)	\$61,636,721	\$10,359,083	\$744,533	\$780,983	\$6,199,912	\$6,331,866	\$30,000	\$44,915,772	72.87%
Wholesale Trade (85)	\$28,282,928	\$1,179,035	\$131,200	\$215,797	\$311,703	\$1,559,949	\$30,000	\$25,513,944	90.21%
Retail Trade (66)	\$42,112,193	\$6,613,757	\$2,681,593	\$10,695	\$863,827	\$1,618,056	\$10,421	\$33,869,958	80.43%
Transportation and Warehousing (13)	\$21,757,491	\$466,326	\$278,239	\$0	\$188,087	\$1,259,689	\$98,141	\$19,933,335	91.62%
Information (24)	\$16,255,657	\$263,228	\$215,755	\$39,181	\$0	\$3,186,491	\$2,710,068	\$10,095,870	62.11%
Finance and Insurance (35)	\$12,298,177	\$2,155,145	\$652,761	\$0	\$1,225,380	\$120,449	\$25,000	\$9,997,583	81.29%
Real Estate and Rental and Leasing (8)	\$2,026,899	\$0	\$0	\$0	\$0	\$18,039	\$0	\$2,008,860	99.11%
Professional, Scientific, and Technical (18)	\$4,519,710	\$1,908,258	\$63,348	\$2,117,844	\$4,570,668	\$19,690	\$0	\$2,591,762	57.34%
Managt of Companies and Enterprises (20)	\$15,429,257	\$617,423	\$521,623	\$0	\$95,800	\$409,681	\$36,243	\$14,365,910	93.11%
Admin/Support and Waste Mangmt (11)	\$1,112,134	\$88,659	\$33,565	\$0	\$43,594	\$38,947	\$8,500	\$976,028	87.76%
Health Care and Social Assistance (11)	\$1,401,747	\$0	\$0	\$0	\$0	\$6,783	\$1,400	\$1,393,564	99.42%
Accommodation and Food Services (9)	\$3,698,057	\$264,541	\$104,100	\$0	\$0	\$91,559	\$0	\$3,341,957	90.37%
Other Industries (9)	\$6,766,551	\$783,819	\$201,819	\$0	\$0	\$60,506	\$0	\$5,922,226	87.52%
Total All Industries (418)	\$260,538,435	\$25,076,581	\$5,658,036	\$3,164,500	\$13,841,278	\$15,218,574	\$3,045,504	\$217,197,775	83.36%

Other industries includes: Educational Services, Arts, Entertainment and Recreation, and other service and industry 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 2005

Sector (# of sample)	Total Tax Liability	Total NR Credits	B&J	R&D	HPIP	BM&E	Total Ref. Credits	Net Receipts	Payment Percentage
Manufacturing (44)	\$55,181,763	\$31,953,249	\$17,016,769	\$6,140,317	\$9,303,549	\$4,381,914	\$298,675	\$18,547,925	33.61%
Retail Trade (40)	\$81,245,308	\$13,044,114	\$13,324,752	\$0	\$2,599,171	\$1,545,922	\$0	\$66,655,272	82.04%
Total (164)	\$211,050,407	\$59,795,286	\$41,923,496	\$6,717,313	\$13,693,360	\$9,257,056	\$4,185,773	\$137,204,493	65.01%