

**2008**  
**GUIDE**  
to  
**KANSAS**  
**SMALL BUSINESS**  
**ISSUES**

**Presented by**

**The Kansas Small Business Coalition**

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## **FOREWORD**

This 2008 Guide is an extensive revision of the 2007 Guide.

Chapter 3, Health Insurance, is the biggest revision. Health Insurance is the top small business concern and it is likely to be the biggest issue in the 2008 legislative session. The new chapter is seven pages compared to three last year. It has been completely revised.

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## INTRODUCTION

*“For the U.S. to survive and continue its economic and political leadership in the world, we must see entrepreneurship as our central competitive advantage. Nothing else can give us the necessary leverage to remain an economic superpower. Nothing else will allow us to continue to enjoy our standard of living.” – Carl J. Schramm, President, the Kauffman Foundation*

Small business is the bedrock of the Kansas economy. It constitutes more than half of the private, non-farm workforce<sup>1</sup>, half the business wealth<sup>2</sup>, half the gross domestic product<sup>3</sup>, and far more than half of the taxes paid by businesses to state and local governments<sup>4</sup>.

Small business is the bedrock of Kansas employment. While big business and farm fortunes swing wildly, small business remains comparatively steady. Small business keeps people employed, absorbs those laid off from big business, continues to pay taxes, and keeps most of its profits in Kansas.

Small business is the bedrock of state and local revenues. Compared to big business and farms, Kansas small business pays a disproportionate share of income tax on business income, property tax, sales tax, and almost every other type of tax<sup>5</sup>. And it keeps paying even during economic downturns. Small business tax payments are much more predictable and dependable than any other major source of tax revenues<sup>6</sup>.

At the same time, small business doesn't take much from Kansas governments. Kansas small business enjoys only a small portion of economic development incentives, property tax and sales tax abatements and exemptions, workforce training funds, and other business incentives and tax advantages.

Kansas government is paying increased attention to nurturing small business. In 2004, as part of the Kansas Economic Growth Act, a new Kansas Center for Entrepreneurship (KCFE) was established. It serves as an entry point for small business owners and prospective entrepreneurs for finding assistance, training, information, financial assistance, and more.

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<sup>1</sup> U.S. Small Business Administration (SBA), Office of Advocacy, 2007 Small Business Profile: Kansas, Page 1. Small businesses employed 54.6% of the state's non-farm private workforce in 2004 (latest available).

<sup>2</sup> “Small Business Share of Wealth on the Rise”, NFIB Main Street Message, October 2002.

<sup>3</sup> “Frequently Asked Questions”, SBA Office of Advocacy, January 2008: “Small firms create more than 50 percent of the nonfarm private Gross Domestic Product.

<sup>4</sup> “Wealthy Americans and Business Activity”, The Tax Foundation, August 2004, page 3: “We estimate that business owners will pay 54.3% of all individual income taxes in 2004.”

<sup>5</sup> See Chapter 2.

<sup>6</sup> “The State of Small Business, a Report to the President”, SBA, 2001, Page 3.

“NetWork Kansas” is the name KCFE uses for its access points for small business owners. The toll-free number is 877-521-8600 and the website is [www.NetWorkKansas.com](http://www.NetWorkKansas.com).

Kansas won't grow without a strong small business community, and small business won't grow without the understanding and cooperation of government officials.

The Kansas Small Business Coalition  
January 2008

*The Kansas Small Business Coalition is made up of statewide small business associations with a combined membership of more than 20,000 small businesses.*

### ***More on NetWork Kansas***

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## CHAPTER 1: ENTREPRENEURSHIP AND THE ECONOMY

*“Entrepreneurs rightly command enormous respect, and their contributions to the U.S. economy are followed by academics and policymakers alike. Economic development officials must decide whether to focus their resources on attracting large firms or to devote their energies toward growing the small businesses they already have.” -- Chad Moutray, SBA Chief Economist & Director of Research in “The Small Business Economy – A Report to the President”, December 2006.*

### Sources of Kansas Job Growth

A study<sup>7</sup> on job growth by Dr. Art Hall of the K.U. Center for Applied Economics sheds a very interesting light on whether it is better to focus economic development resources on attracting large firms versus nurturing startups and growth of existing businesses.

For the 15-year period from 1990 through 2004, only 3.2% of new jobs created in Kansas were created by companies moving into Kansas from outside the state.

Expansions of existing Kansas businesses accounted for 39.8% of the new jobs, while new start-up businesses accounted for 57.0%.

Looking at jobs gained versus jobs lost in each of the three categories, an equally interesting picture emerges.

Move-ins minus move-outs accounted for 20,989 or 19.15% of the 109,591 net jobs gained over the 15 years.

Expansions minus contractions of existing firms accounted for a gain of 52,799 or 48.18% of net gains.

Firm births minus firm deaths accounted for 35,803 or 32.67% of net gains.

### “The Entrepreneurial Imperative”

Carl J. Schramm, President of the Kauffman Foundation, published the book “The Entrepreneurial Imperative” in the fall of 2006<sup>8</sup>. It studiously lays out the importance of small business and entrepreneurship to the U.S. Some quotes from the book concerning competing in the world economy:

- “Technology isn’t the answer, since everyone now either has the same technology or can easily obtain it.”
- “Education will not keep us out in front. Many parts of the world surpass the U.S. in teaching skills needed for the future.”

<sup>7</sup> Study by Dr. Art Hall, Center for Applied Economics, division of the Kansas University School of Business. Hall computed this information from federal government databases.

<sup>8</sup> Link to the book's web site: [www.entrepreneurialimperative.com](http://www.entrepreneurialimperative.com).

- “...we have largely given up when it comes to basic manufacturing because we simply can’t compete globally on price...when it comes to manufacturing, we must become entrepreneurial.”
- “It is true we possess a substantial edge in finance, but the fact is that all capital markets are now global...”
- “The message of this book is simple: Entrepreneurship is America’s comparative advantage, and we need to exploit it fully both at home and abroad.”
- “Encouraging, managing, and supporting an entrepreneurial economy is central to our place in the world going forward.”
- “Entrepreneurship is not only an integral part of our genius but also the only uniquely American resource at our disposal and we must exploit it fully.”

Schramm’s definition of an entrepreneur is “one who undertakes personal economic risk to create a new organization that will exploit a new technology or innovative process that generates value to others.”

Others would keep it simpler, describing an entrepreneur as “one who undertakes personal economic risk to create a new business.” To them, the man or woman who buys a garbage truck to serve an area that was previously underserved is a classic entrepreneur. No new technology or innovative processes are needed. Generating value to others is all that is required. The genius is in the recognition that a need exists.

### **Colleges Focusing On Entrepreneurship**

In 1986, only 586 colleges offered courses in small business management or entrepreneurship. By 1992, the number had nearly tripled. Today, the number has increased to approximately 1600 two- and four-year colleges<sup>9</sup>.

### **Rural High Growth Entrepreneurs**

A North Carolina study<sup>10</sup> of 1000 rural entrepreneurs whose firms have doubled either their sales or their employment in three years shows the following:

- They tend to have more education than the general population.
- They tend to be “bootstrappers”, building their businesses themselves.
- They are very optimistic about their businesses.
- They have been in business an average of 15 years.
- They focus strongly on specific business goals and measurements.

<sup>9</sup> “The Small Business Advocate”, U.S. Small Business Administration, September 2006.

<sup>10</sup> [www.ncruralcenter.org/pubs/highgrowthentrep\\_09\\_06.pdf](http://www.ncruralcenter.org/pubs/highgrowthentrep_09_06.pdf)

## CHAPTER 2: KANSAS SMALL BUSINESS, BY THE NUMBERS

*“There are now millions of nimble capitalists—people putting up their own money, people venturing schemes for financing, and people doing the management of it all—and it is to these latter-day ‘ordinary’ capitalists that we owe our astounding prosperity.” -- Mortimer B. Zuckerman, U.S. News and World Report.*

A big problem when contemplating small business is grasping the numbers and variety involved. There are about 17,000 publicly-traded corporations in the U.S. while there are about 27 million small businesses<sup>11</sup>. It is easy to visualize the extent of big business, but very difficult to grasp and understand the extent of small business.

It is fairly easy for government officials to grasp the importance of helping big employers like Waddell & Reed, Goodyear, Boeing, Santa Fe, and Sprint to stay competitive with outsiders, and to keep the Kansas tax structure competitive so they will stay here. It is more difficult to see how important it is to help small business, and even more difficult to figure out how to do it.

In 2003, the average small employer had one location and ten employees. The average large employer had 61 locations and 3,300 employees<sup>12</sup>.

### Small Business Isn't Small

Collectively, small business isn't small. It provides employment to 54.6%<sup>13</sup> of the non-farm private work force in Kansas. It generates more than 50% of the gross domestic product<sup>14</sup>. It possesses half of the business wealth in the U.S.<sup>15</sup> In the past decade, it has annually provided 60% to 80% of net new jobs. In 2004 (latest available, it provided all of the net new jobs<sup>16</sup>. It has been giving 67% of workers their first job<sup>17</sup>. It hires a larger proportion of women, younger workers, older workers, and part-time workers than does big business<sup>18</sup>.

If an average of 6,975 sounds like a lot, it isn't enough. With 7,625 new startups in 2003, Kansas was only 30<sup>th</sup> in the nation in the rate of employer firm formations.

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<sup>11</sup> “Frequently Asked Questions, January 2008, SBA, says there were about 26.8 million small businesses in 2006 and more than 17,000 large businesses in 2004.

<sup>12</sup> “The Small Business Economy – A Report to the President”, SBA, December 2006, page 8.

<sup>13</sup> U.S. Small Business Administration, Office of Advocacy, 2007 Small Business Profile: Kansas, Page 1.

<sup>14</sup> “Frequently Asked Questions”, SBA Office of Advocacy, January 2008: “Small firms create more than 50 percent of the nonfarm private Gross Domestic Product.

<sup>15</sup> “Small Business Share of Wealth on the Rise”, NFIB Main Street Message, October 2002.

<sup>16</sup> “Frequently Asked Questions”, SBA Office of Advocacy, January 2008. In 2004, businesses with under 500 employees provided a net increase of 1.86 million jobs while businesses with more than 500 employees lost a net 181,000 jobs.

<sup>17</sup> SBA, “Small Business Vital Statistics” ([www.sba.gov/aboutsba/](http://www.sba.gov/aboutsba/)).

<sup>18</sup> Ibid.

## Public vs. Private

In July 2002 there were 16,254 public corporations in the U.S.<sup>19</sup>. In 2004 (last year available), there were 17,047 employers in the U.S with more than 500 employees<sup>20</sup>.

Comparing these to other statistics, it is safe to say that the huge preponderance of employers with more than 500 employees are public corporations and more than 99% of all employers with less than 500 employees are closely-held small businesses.

About 1800 public corporations have employees in Kansas<sup>21</sup>, even though some of them have only a small number of employees here. In contrast, there are about 68,700 Kansas small businesses with employees<sup>22</sup> and another 179,000 non-employer firms, many of which employ only the owners<sup>23</sup>. There are 63,000 farms<sup>24</sup> that are not included in those numbers, bringing the total number of small businesses and farms in Kansas to about 305,000.

## New Business Startups

In the twelve years from 1995 through 2006, an average of 6,975 new businesses with employees started up in Kansas each year<sup>25</sup>. Beginning in 1999, the rate of startups is ranked compared to other states.

7,600 in 1995	
6,693 in 1996	
7,243 in 1997	
7,758 in 1998	
5,755 in 1999	49 <sup>th</sup> in the U.S.
7,026 in 2000	38 <sup>th</sup> in the U.S.
6,483 in 2001	46 <sup>th</sup> in the U.S.
6,703 in 2002	41 <sup>st</sup> in the U.S.
7,625 in 2003 <sup>26</sup>	30 <sup>th</sup> in the U.S.
6,742 in 2004 <sup>27</sup>	46 <sup>th</sup> in the U.S.
7,095 in 2005 <sup>28</sup>	42 <sup>nd</sup> in the U.S.
6,973 in 2006 <sup>29</sup>	43 <sup>rd</sup> in the U.S.

<sup>19</sup> U.S. Treasury Secretary Paul O'Neill, National Public Radio, July, 2002.

<sup>20</sup> "Employer Firms, Employment, and Annual Payroll by Firm Size, and State, 2004", SBA Office of Advocacy, based on data provided by the U.S. Census Bureau. See [www.sba.gov/advo/stats/st.pdf](http://www.sba.gov/advo/stats/st.pdf).

<sup>21</sup> Ibid. Kansas had 1,821 employers in 2004 that had 500 or more employees nationwide.

<sup>22</sup> U.S. Small Business Administration, Office of Advocacy, 2007 Small Business Profile: Kansas, Page 1: In 2006, 68,700 or 97.1% of the 70,700 employer businesses were firms with less than 500 employees.

<sup>23</sup> U.S. Small Business Administration, Office of Advocacy, 2007 Small Business Profile: Kansas, Page 1: In 2005, non-employer firms increased by 2.5% to 179,000.

<sup>24</sup> "Fewer Farmers Tilling Less Land", Topeka Capital-Journal, February 26, 2002.

<sup>25</sup> "Small Business Economic Indicators 2000, 2001, 2002, 2003", SBA Office of Advocacy.

<sup>26</sup> "Small Business Economic Indicators 2003", SBA Office of Advocacy, August 2004, Page 18.

<sup>27</sup> "The Small Business Economy, a Report to the President", SBA, 2005, page 214.

<sup>28</sup> "The Small Business Economy, a Report to the President", SBA, 2006, page 222.

<sup>29</sup> "The Small Business Economy, a Report to the President", SBA, 2007, page 300.

Startups are extremely important. Of today's 25 largest U.S. companies, 19 were either small businesses or did not exist in 1960<sup>30</sup>. Kansas' best chance to have a new Fortune 500 company based here is for us to grow our own. Only a tiny fraction of startups have any financial subsidies from the State of Kansas. Unlike Enron and other huge corporations, if these small businesses make money, they pay income taxes.

Read much more about startups in Chapter 14 of this Guide.

### How Small is Small?

Overwhelmingly, the most common definition by the Small Business Administration is "fewer than 500 employees", but the number varies for some businesses.

The Family and Medical Leave Act uses 50 employees as the criteria. Kansas law defines small group health insurance as 50 employees or less. Many state laws across the country use 50 or 100 employees as criteria.

### Size of Kansas Employer Firms, 2004<sup>31</sup>

These statistics are the latest published. They do not include the 179,000 small businesses in Kansas that, in 2005<sup>32</sup>, had only owners as employees and paid income taxes as proprietors.

Firm Size*	Firms	Employment	Payroll
Zero**	6,994	0	\$ .249 billion
1-4	28,606	60,182	\$ 1.363 billion
5-9	10,600	69,589	\$ 1.691 billion
10-19	6,563	87,279	\$ 2.258 billion
20-99	5,774	212,209	\$ 6.052 billion
100-499	1,480	180,544	\$ 5.279 billion
500+	1,821	506,474	\$18.834 billion

\* Caution: In categorizing employers as to firm size, the statistics were not restricted to Kansas employees. For instance, there were not 1,821 employers with 500+ Kansas employees, there were 1,821 employers who have at least one employee in Kansas but 500+ nationwide. The other three columns isolate only Kansas statistics.

\*\*These firms had employees at some time during the year but not on the March "snapshot" date.

<sup>30</sup> "Creators of Our Prosperity", U.S. News and World Report, June 8, 1998, Page 64.

<sup>31</sup> "Employer Firms, Establishments, Employment, and Annual Payroll by Firm Size and State, 2004", SBA Office of Advocacy, based on data provided by the U.S. Census Bureau.

<http://www.sba.gov/advo/research/data.html> [http://www.sba.gov/advo/research/st\\_04.pdf](http://www.sba.gov/advo/research/st_04.pdf)

<sup>32</sup> U.S. Small Business Administration, Office of Advocacy, 2007 Small Business Profile: Kansas, Page 1

## CHAPTER 3: HEALTH INSURANCE AND HEALTH CARE COSTS

*"America needs a health care system that empowers patients to make rational and smart decisions for themselves and their families, a health care system in which the relationship between the patient and the provider is central, not a health care system where decisions are made by the federal government. Health Savings Accounts are good for the uninsured, they're good for small businesses, they're good for larger corporations." -- President George W. Bush, 2006*

### THE 21-Point Plan of the Kansas Health Policy Authority

Very few of the KHPA's 21 points will be of high concern to Kansas small businesses. Many of them concern public health or health care, while it is the cost of health insurance that is the main concern of small business owners.

Of the first eighteen points, small businesses will likely support or won't be concerned about sixteen.

The other two concern smoking – a statewide ban on smoking in public places, and a tax increase on tobacco products. Small business owners are split 50-50 on these issues.

The last three "points" concern "Providing and Protecting Affordable Health Insurance". There are actually many points contained in the three:

1. Increase the number of Kansas kids covered by HealthWave (Medicaid).
2. Mandate that some "children" of up to 25 years remain on their parents' health insurance coverage.
3. For those aged 19-24, allow special young adult policies with limited coverage.
4. Provide state-paid insurance policies or "premium assistance" for low-income Kansans. "Premium assistance" is reimbursing employees for their out-of-pocket costs of enrolling in their employer's plan.
5. Establish a "voluntary health insurance clearinghouse" to provide access to insurance to small employers.
6. Assist small employers in establishing tax-preferred Section 125 plans.
7. Lower the minimum employer "group" size from two to one.
8. Establish a new reinsurance program to spread costs of these new programs to all people with health insurance. Exception: No costs would be spread to large, self-insured employers.

9. The KHPA would “manage” the “voluntary health insurance clearinghouse.” All policies for groups of 1-10 employers and all young adult policies would have to be purchased through this KHPA clearinghouse.

Small business interests should strongly oppose all or parts of these nine items except #1, #3, and #6. Some of these nine points are discussed in the remainder of this chapter.

### **The Top Small Business Concern: Costs of Health Insurance**

Since 1984, small businesses owners have repeatedly identified health insurance costs and the availability of health care as their #1 concern on various surveys. In a 2004 survey of 4,603 small business owners, 65.6% rated health insurance costs as a “critical” problem.<sup>33</sup>

U.S. census data shows that 59% percent of the uninsured are from families in which the head of household is self-employed or working for a company with fewer than 100 employees<sup>34</sup>.

The “crisis” in U.S. health care is cost escalation far in excess of inflation. Payments by third parties, which insulate individuals from the financial consequences of their health care purchasing decisions and personal behavior, are the primary reason for that inflation.

First, do no harm. Kansas is in an enviable position. It has one of the lowest uninsured rates in the U.S., and some of the most affordable premiums and health costs. It has a high-risk pool, partial tort limits, and tax credits to help small businesses take up health insurance. The challenge is to improve without risking our present enviable record.

### **Solution: Promote and Nurture Consumer-Directed Health Plans**

HSAs and other consumer-directed plans appear to be the best solution to slow cost increases. “Consumer-directed” plans are those where the consumer knows the costs of the health care being provided, and participates in paying those costs.

Consumer-directed health care (CDHC) plans can be used to accomplish the separation of health care and health insurance. They empower the patient with a balance of insurance and direct pay, restoring the patient/physician relationship.

At the same time, they motivate competition to control costs. The most prominent consumer-driven arrangements are Health Savings Accounts (HSAs),

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<sup>33</sup> “Small Business Problems and Priorities”, National Federation of Independent Business, 2004. See Chapter 16 or [http://www.nfib.com/object/IO\\_16191.html](http://www.nfib.com/object/IO_16191.html).

<sup>34</sup> National Federation of Independent Business: Of the 46 million Americans with no health insurance, 27 million are small-business owners, their employees and dependents. <http://www.nfib.com/page/healthcare.html>

Health Reimbursement Accounts (HRAs), Flexible Spending Arrangements (FSAs), and 50-50 Shared Pay plans.

With CDHC plans, premiums are lower, as are premium taxes, insurance company assessments and administrative costs. They allow more choices and flexibility for patients.

Federal tax and insurance laws are kindest to HSA arrangements. Absolutely nothing should be done in Kansas that will limit or harm HSAs.

### **Transparency**

To allow the free markets to work, health care costs must be visible to patients and doctors. Ideally, both parties should know the costs when the patient leaves the doctor's office. This arrangement also enhances the doctor/patient relationship by pushing third-party payers into the background or out of the picture entirely.

Transparency can best be accomplished with web-enabled information for consumers, costs transparency, quality transparency, internet technology and computerization throughout the industry.

### **Strengthen and Nurture Individual Policies**

Virtually every uninsured Kansan can be covered by an individual policy, whereas group and government coverage is unavailable to many.

There are 175,000 Kansas business owners who work full-time in their businesses, but have no employees other than themselves. They are not allowed any tax deductions at all for their health insurance costs.

The most promising legislation in any state is "Missouri 818". It allows employers to help pay for the individually owned policies of employees, and for employees to pay their share with pre-tax money. Although Missouri is working with the federal government to make sure their law complies with federal laws, Kansas should do everything it can to incorporate Missouri 818 into Kansas law and to pressure the federal government to enable the Missouri plan.

HSAs are a great solution for the individual policy market. If the employer contributes to the savings account and not the insurance, all potential problems with federal ERISA regulations are overcome.

Kansas must avoid open enrollment for individual policies. Underwriting should continue to be allowed for all individual policies.

## **Strengthen and Promote the Kansas High Risk Pool**

The Kansas High Risk Pool should be modified to encourage more people to use it. Many restrictions to entry should be reduced or eliminated. Up-charges should be reduced, perhaps along the lines that Missouri adopted. New insurance products and programs should be added for diabetics and other “special needs” groups.

## **Strengthen, Nurture, and Lessen Red Tape For 2-10 Employee Groups**

Making it easy for small employers to apply for group insurance is a key factor. Some possibilities are:

- Establish a standard underwriting (employee health information) form.
- Establish an on-line application process that obtains competitive quotes.
- Small businesses with group health insurance should be allowed access to their own claims information.

More choices are needed – more insurers and more policy selection.

## **Tax Equity**

For health care, the income tax structure is stacked against small businesses and sole proprietors compared to big businesses, union members, and government workers. Tax equity must be established.

The move from employer plans to individually owned plans will occur naturally and quickly only when the tax advantages of individual ownership are increased and group plans are decreased enough.

Other measures:

- Promote Section 125 Plans (also known as cafeteria plans or P.O.P. plans).
- Eliminate premiums taxes on health insurance, or dedicate all the premium taxes to programs for those Kansans who are paying them.
- Establish employer tax credits, not just deductions, for providing health benefits, including contributions to employees’ HSAs.
- Establish individual tax credits, subsidies, or vouchers.

## **Promote Association Health Plans**

All “association health plans” are not created equal. Federal issues will be determined by Congress. But we can have Kansas plans, fully compliant with Kansas law, by having insurance companies involved. It is this latter approach that should be pursued in Kansas.

Statewide: Establish demonstration projects by statewide groups. Do testing in the State Employee Health Plan. Work on both insurance and non-insurance solutions.

Local: Establish demonstration projects by local groups. Work on both insurance and non-insurance solutions. National and state efforts to fix health care issues have largely failed, especially for small businesses. It is time to work on health insurance issues locally -- the needs and possibilities for businesses in Topeka are very different from those in Garden City.

### **Avoid and Reduce Mandates**

- Enact no employer mandates.
- Reduce or eliminate current “coverage mandates”.
- Reduce or eliminate current “provider mandates”.

Insurers should not be expected to lead the fights against mandates and other laws that drive up policy costs. Mandates are generally good for insurance companies. Mandates run up the costs of insurance, allowing insurance companies to put their markups on more dollars.

### **Reinsurance**

Insurance companies and self-insured groups purchase “reinsurance” or “stop-loss insurance.” This is the business that Lloyd’s of London is in.

One suggestion in Kansas is to provide state-controlled reinsurance for individual and small group policies to encourage more insurers to enter the Kansas small group market.

Large self-insured groups pay no premiums taxes in Kansas except on the relatively small portion of their insurance costs that is reinsurance. Governments pass their health insurance costs to taxpayers. Medicare and Medicaid insurance pay no premiums taxes.

That leaves small businesses to pay for the reinsurance if it is funded through insurance assessments or premiums taxes. This strategy is likely to drive small businesses away from health insurance. Government reinsurance will only work if the funds are from non-insurance sources.

### **Revise Small Group Laws**

“Small group reform” was brought about in the late 1980s for the explicit purpose of “stabilizing” the insurance market and protecting it from “too much competition.” It was not touted as a way to lower costs, and it hasn’t.

Small group reform has been astoundingly successful at driving a large percentage of competitors out of the small group market, stifling innovation, and removing restraints on price increases.

Small group reform prevents small employers from paying toward their employees' individually owned health insurance. Employers may pay for health insurance only if the employer has a group plan.

Group plans must feature "guaranteed issue", which forces the group to accept new participants without underwriting. Eligible participants can wait until they have a serious illness and then join the group, paying the same as the rest of the group.

Small groups are often subject to "community rating", whereby all members of a group – an employer group, all small businesses insured by an insurer, even all people with insurance in a city, county, or an entire state – are rated the same. Invariably, this causes healthier people to drop out and sicker people to stay in or join, based on the value they personally receive.

### **Electronic Health Records**

Medical providers are very rapidly purchasing computerized health record capability from a number of private-market software and hardware providers. This process should not be slowed by attempts to "govern" or "standardize" this process, whether it is on the state level or the federal level.

It may be a decade or never before any national standards are settled upon, adopted, and implemented. In the meantime, most of the benefits of EHRs can be reaped now through private systems.

### **Raising the Age of Dependents to 25**

One proposal before the 2008 Kansas legislature is to require insurance policies to include coverage for dependents up to age 26.

This should be no problem if the family is covered by an individual policy. If there are savings, the family will enjoy them. If there are extra costs, the family will pay them.

On the other hand, if these adults are forced into an employer policy, it will raise the costs of insurance for that employer and its other employees. It will increase the pressure to enlarge or combine pools, which are already failing in many cases.

Many adults 18-25 are in the workforce. It should not be the responsibility of the parents' employers to provide free insurance for other employers, or have their own group penalized when one of those young adults suffers catastrophic health losses.

This mandate is not needed. A healthy 23-year old can have their own personal HSA-compatible policy for \$37 per month for a male, \$44 per month for a female.

If a 21-year old becomes a drug or alcohol abuser, or is in a car or work accident, will that person be able to gain coverage under their parents' policy under guaranteed issue or open-enrollment periods? What about the children of these 18-25 year-olds? What about 18-25 year-olds living in remote states or countries?

Note that this idea applies only to those insured by companies licensed in Kansas. Self-insureds, multi-national corporations, and unions cannot be forced to comply.

## CHAPTER 4: SMALL BUSINESS FINANCE

It is important to distinguish between business capital and business operating funds.

Capital is the owner's permanent investment in a business, known as its net worth or owner equity. Almost all investment capital for small businesses comes from the personal funds of the owner and his or her family and acquaintances.

Instead of trying to figure out which small businesses to subsidize, legislators can invest in small business by keeping taxes on them in check. Moderate taxes will allow small business owners to keep some of their profits and plow them back into their businesses as growth capital.

The most important source of outside operating money is bank loans. Operating funds are needed to provide money for everyday operations, and are often borrowed. The loans are backed by the business capital and, usually, the business owner's personal guaranty.

In the final chapter of this report, we will see that obtaining long-term and short-term loans were #68 and #70 out of 75 small business problem areas – near the bottom of the list of concerns. If a business is viable or an idea sound, there are plenty of bankers willing to loan money.

If the business or idea is unproven, SBA guarantees can make the loan more attractive to a bank. Even SBA guarantees are fairly rare. There were 110,275<sup>35</sup> such guarantees in Fiscal 2007. Even if they all went to firms with employees, only one in 53 employer firms got an SBA-guaranteed loan in 2007.

### **Banks**

Banks are the irreplaceable foundation of nearly all small-business commercial loans. In 2003, 57% of small business loans were made by commercial banks<sup>36</sup>. Another 8% were made by other depository institutions, such as savings and loans and credit unions, bringing the total from depository institutions to 65%.

Banks have plenty of money to loan to small businesses and are eager to do so. They are very good and very efficient at it. They are an experienced source of excellent advice for small business owners. Most of them are small businesses themselves, and the owners and their employees are vital members of the communities in which they are located.

A strong argument can be made that all government-backed and tax-backed loans, grants, and guarantees for small businesses could be eliminated entirely and it would have a very minimal effect on the overall financing picture for small

<sup>35</sup> "SBA 2007 Year in Review", SBA, January 2008, page 7. The guaranteed loans totaled \$20.6 billion.

<sup>36</sup> "The Small Business Economy, a Report to the President", SBA, December 2007, page 33.

businesses. The exceptions are loans in rural and economically depressed areas, where grants, high-risk loans, or subordinated loans may be needed to make deals economically feasible for banks or investors.

Perhaps the biggest recent trend in small business banking has been the promotion and growth of “small business credit cards” by the huge banks and credit card companies. Often these replace short-term lines of credit in local banks. The bread-and-butter of small banks is short-term business loans, so these credit cards are taking away some of their lifeblood. The credit cards are not without risk to small business owners. Allowing multiple employees to use high-limit credit cards for which the business is responsible for paying is an aspect that should be considered.

### **Angel Investors**

The term “angel investor” can refer to family, friends and acquaintances of an entrepreneur who invest in the business. Or, it can refer to a formal arrangement whereby groups of “angels” get together and invest in small businesses that are seeking the help of such groups. This formal “angel” arrangement is outsiders not necessarily familiar with the entrepreneur, at least not in the beginning.

An October 2002 report by the Ewing Marion Kauffman Foundation<sup>37</sup> finds that angels--individuals who invest private funds into starting companies--are becoming far more important for small businesses than venture capital sources.

The study also found angel investors are beginning to spread out to rural areas, and many are specifically targeting women- and minority-owned companies in which to invest. However, while angels may be more willing to invest in risky start-ups than banks or other funding sources, the report says that many are beginning to ask for larger shares of ownership in return for their investments.

In 2006, the formal angel investor market funded 51,000 entrepreneurs with an average investment of \$500,000<sup>38</sup>.

### **Venture Capital**

Formal venture capital is not very important to small business. Venture capital is financing only one-tenth of one percent of all the employer firms in the U.S. In 2006, only 2,910 companies received venture capital funds in the entire U.S. Those deals averaged \$8.8 million each, involving mostly larger, established small businesses<sup>39</sup>.

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<sup>37</sup> “Business Angel Investing Groups Growing in North America”, October 2002, [www.emkf.org/pdf/angel\\_summit\\_report.pdf](http://www.emkf.org/pdf/angel_summit_report.pdf).

<sup>38</sup> “The Small Business Economy – A Report to the President”, SBA, December 2007, Pages 46-47.

<sup>39</sup> “The Small Business Economy – A Report to the President”, SBA, December 2007, Pages 42-47.

“Going Public” is another rarity these days. In 2006, there were only seven Initial Public Offerings (IPOs) in the U.S. among firms with less than \$10 million in assets, and only 18 in firms with less than \$25 million in assets<sup>40</sup>.

Interestingly, since 1990, about 25% of all U.S. firms backed with formal venture capital were started by immigrants or their children. Those firms have created more than 400,000 jobs and have a market value of half a trillion dollars. Eighty-seven percent of those firms operate in high value job sectors<sup>41</sup>.

### **Start-Up Kansas**

Start-Up Kansas was a part of the Kansas Economic Growth Act of 2004. It is a part of the Kansas Center for Entrepreneurship, which operates under the Kansas Small Business Development Centers, which are part of the Kansas Department of Commerce.

Start-Up Kansas now has \$2 million per year of Kansas Income Tax Credits to award donors to the Start-Up Kansas Fund.

Donors who donate directly to the Start-Up Kansas Fund receive state income tax credits equal to 75% of the donation. Start-Up Kansas is a 501c3 agency. Donors should consult their own tax experts to determine the overall effects on their taxes.

Start-Up Kansas uses its funds to match grants and loans to small businesses by local business support agencies. There are currently more than 400 such local and regional agencies including economic development agencies, chambers of commerce, and others. The funds must go to businesses in rural or economically depressed areas.

Start-Up Kansas made its first grants in September, 2006.

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<sup>40</sup> “The Small Business Economy – A Report to the President”, SBA, December 2007, Pages 44-45.

<sup>41</sup> National Dialogue on Entrepreneurship, [www.nde-news.org](http://www.nde-news.org).

## CHAPTER 5: BUSINESS INCOME TAXES IN KANSAS

Collectively, small businesses pay much more in income taxes on business income than big businesses.

In Fiscal Year 2007, total corporate income tax revenues were \$444.2 million, far outstripping the average of \$183.3 million for the previous five years<sup>42</sup>. At least 25% of those corporate income taxes are paid by small businesses.<sup>43</sup>

In contrast, on business income alone, Kansas small businesses pay at least \$600 million and perhaps more than \$1 billion per year in individual income taxes. This does not include income taxes on the salaries business owners pay themselves.

In a 2004 study, The Tax Foundation estimated that 54.3% of all federal personal income taxes were paid by business owners<sup>44</sup>. A little more than half of that income was from Schedule C (proprietorship income), Schedule E (partnership, S-Corp, and royalty income), and Schedule F (farm income).

Applying those percentages to Kansas, about \$652 million<sup>45</sup> of Kansas income taxes in Fiscal Year 2006 came from the business income on those three schedules alone. These do not include any salaries, interest, capital gains or other individual income that businesses generate to business owners.

In a different approach, for 2005, Kansas non-farm proprietors' income (Schedule C), only a partial measure of small business income, was \$8.8 billion<sup>46</sup>. Even at the lowest Kansas tax rate of 3.5%, this would produce \$308 million in individual income taxes. Nationally, S-Corporation dividends on Schedule E far exceed Schedule C income. S-Corp dividends are fully taxed as ordinary income. Not yet included are farm proprietors' income, personal rental income, interest income, capital gains and other taxable income produced by Kansas small businesses and farms.

About 97% of Kansas businesses pay income taxes as individuals and not as corporations. Even the majority of "C" corporations, which are subject to corporate income taxes, pass all their profits through to the owners as salary and pay individual income taxes instead of corporate income taxes.

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<sup>42</sup> "Update to Analysis of Kansas Corporate Income Tax Dated October 14, 2004 To Reflect Tax Year 2005 Sample Data", Kansas Department of Revenue, January 2, 2008.

<sup>43</sup> "Analysis of Kansas Corporate Income Tax 2000-2002", Kansas Department of Revenue Policy and Research, October 14, 2004. 74.6% of 2001 corporate income taxes were paid by the 237 firms with the highest liability. Some of those 237 and at least 93% of the rest were small businesses.

<sup>44</sup> "Wealthy Americans and Business Activity", The Tax Foundation, August 2004.

<sup>45</sup> Total FY2006 individual income tax revenues of \$2.371 billion times 27.5% equals \$652 million.

<sup>46</sup> "U.S. Small Business Administration, Office of Advocacy, 2007 Small Business Profile: Kansas, Page 1.

## Kansas Individual Income Tax Rates Compared to Other States

Comparing the top corporate income tax rates in the region:

NE 6.84%<sup>47</sup>, **KS 6.45%**<sup>48</sup>, OK 6.25%<sup>49</sup>, MO 5.156%<sup>50</sup>, IA 5.837%<sup>51</sup>, CO 4.63%<sup>52</sup>

Compared to all other states<sup>53</sup>, Kansas is 16<sup>th</sup> highest. Nine states have no individual income tax (AK, FL, NV, NH, SD, TN, TX, WA, WY).

## Kansas Corporate Income Taxes

Comparing the top corporate income tax rates in the region<sup>54</sup>:

IA 9.9%, NE 7.81%, **KS 7.35%**, OK 6.00%, MO 5.156%<sup>55</sup>, CO 4.63%

Compared to all other states<sup>56</sup>, Kansas is 22nd highest. Four states (NV, SD, WA, WY) have no corporate income tax.

Corporate income taxes are of little or no concern to the overwhelming majority of small businesses. Almost all small business owners pay individual income taxes instead of corporate income taxes, even if the small business is a “C” corporation.

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<sup>47</sup> Nebraska Department of Revenue, [www.revenue.state.ne.us/index.html](http://www.revenue.state.ne.us/index.html). No deduction for federal taxes. Does allow full deduction of health insurance costs by self-employed persons.

<sup>48</sup> No deduction for federal taxes.

<sup>49</sup> Oklahoma Tax Commission, [www.oktax.state.ok.us/oktax/](http://www.oktax.state.ok.us/oktax/). No deduction for federal taxes.

<sup>50</sup> Missouri Department of Revenue, [www.dor.state.mo.us/tax/](http://www.dor.state.mo.us/tax/). Allows a deduction for up to federal income taxes plus full deduction for Social Security and Medicare taxes.

<sup>51</sup> Iowa Department of Revenue and Finance, [www.state.ia.us/tax/index.html](http://www.state.ia.us/tax/index.html). The top rate is 8.98% but Iowa allows full deduction of federal income taxes and income taxes paid to other states and foreign countries, leaving an effective rate of 5.837%.

<sup>52</sup> Colorado Department of Revenue, [www.revenue.state.co.us/fyi/html/generl05.html](http://www.revenue.state.co.us/fyi/html/generl05.html). No deduction for federal taxes, but allows a deduction for sales taxes, which reduces the effective rate.

<sup>53</sup> Small Business & Entrepreneurship Council’s “Small Business Survival Index 2006”, October 2006, [www.sbecouncil.org](http://www.sbecouncil.org), page 28.

<sup>54</sup> Small Business & Entrepreneurship Council’s “Small Business Survival Index 2006”, October 2006, [www.sbecouncil.org](http://www.sbecouncil.org), page 23.

<sup>55</sup> The Missouri rate is adjusted from 6.25% to reflect the deductibility of federal income taxes there.

<sup>56</sup> Small Business & Entrepreneurship Council’s “Small Business Survival Index 2006”, October 2006, [www.sbecouncil.org](http://www.sbecouncil.org), page 29.

In 2004 there were approximately 29,057,000 business tax returns nationally<sup>57</sup>.

Business Returns from Individuals	65.4%
Business Returns from Farmers	5.8%
Partnership Returns	8.5%
"S" Corporation Returns	12.0%
"C" Corporation Returns	8.1%

Only the "C" Corporations, representing 8.1% of the total number of business returns, are subject to corporate income taxes.

In 2005, 30,695 tax returns for 2004 were filed by Kansas "C" corporations<sup>58</sup>.

- 62.0% paid no corporate income tax at all
- 31.5% paid taxes on less than \$100,000 of income
- 6.5% or 1,997 firms owed taxes on more than \$100,000

78% of all Kansas corporate income taxes were paid by only 397 firms.

Most small business "C" corporations pay little or no corporate income tax because the owners prefer to pay profits out as additional salaries to avoid double taxation. Big publicly owned corporations aren't very concerned about the double taxation because it is the stockholders that bear the second tax, not the management or the corporation.

If both individual and corporate income tax rates were raised the same, small businesses would bear the lion's share of the new burden, because, in recent years, the portion of individual income taxes attributable to business income has been three to ten times larger than all corporate income taxes combined. And, small business pays about 25% of the corporate income taxes, too.

Income tax increases on business should be avoided entirely. High corporate rates encourage big businesses to locate or expand elsewhere. Raising individual rates alone puts virtually all of the business tax increase on small businesses.

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<sup>57</sup> "Selected Returns and Forms Filed or To Be Filed by Type During Specified Calendar Years", IRS, <http://www.irs.gov/pub/irs-soi/04al22sr.xls>.

<sup>58</sup> "Annual Statistical Report", Kansas Department of Revenue, Fiscal Year ending June 30, 2006, page 30.

## CHAPTER 6: SALES, USE, & EXCISE TAXES

*“If, from the more wretched parts of the old world, we look at those which are in an advanced stage of improvement, we still find the greedy hand of government thrusting itself into every corner and crevice of industry, and grasping the spoil of the multitude. Invention is continually exercised, to furnish new pretenses for revenues and taxation. It watches prosperity as its prey and permits none to escape without tribute.” – Thomas Paine, “Rights of Man”, 1791*

Small businesses not only serve as the collectors of sales taxes, they pay them, too. One small wholesaling business in Topeka paid \$1,435 in sales tax per employee in 2003, greater even than the \$1,429 per employee it paid in property taxes<sup>59</sup>.

The increase in the State’s sales tax from 4.9% to 5.3% in 2002 is beginning to pale in comparison to constant increases in local sales, use, and excise taxes.

### Local Sales Taxes

Cities and counties were not given authority to levy sales taxes until 1970. Local use taxes were levied on vehicles in 1982, watercraft in 1987, and expanded to everything in 2003. In Fiscal Year 2007, local governments collected \$851.5 million<sup>60</sup> in local sales and use taxes, up 8.0% from the year before.

In 2006, cities alone were given an additional two cents of sales and use tax authority, an increase of \$842 million in local taxing authority statewide.

### Combined State and Local Sales & Use Taxes

The mix of state and local sales tax rates varies widely by state, making comparison of state rates alone meaningless.

The Small Business and Entrepreneurship Council uses a better method to rank the states on sales taxation<sup>61</sup>. It compares the totals of sales taxes, gross receipts taxes, and excise taxes other than fuels taxes with the total of state personal income. The Kansas burden is high compared to neighboring states.

### Sales, Gross Receipts, & Excise Taxes As a % of Personal Income, 2004:

NE 3.47%, MO 3.47%, **KS 3.36%**, OK 3.28%, CO 2.92%, IA 2.89%

<sup>59</sup> “Case Study: New Kansas Taxes and One Small Business”, www.KSSmallBiz.com, plus updates for 2003 computed on July 14, 2004.

<sup>60</sup> “Kansas Tax Facts”, Kansas Legislative Research Department, December 2007, page 10.

<sup>61</sup> Small Business & Entrepreneurship Council’s “Small Business Survival Index 2007”, November 2007, www.sbecouncil.org, page 33. SBEC used 2004-05, the latest state and local numbers available from the U.S. Bureau of the Census, U.S. Department of Commerce.

## CHAPTER 7: PROPERTY TAXES

Taken as a whole, Kansas property taxes on commercial property are much higher than any other state in our region.

Perhaps the most damaging have been the property taxes on business machinery and equipment (BM&E). Kansas' have been some of the highest in the nation. These have discouraged investment in new BM&E. Manufacturers could put new items in other states much more cheaply. As a result, Kansas plants have comparably older equipment, and labor productivity in Kansas has suffered.

Governor Sebelius and the 2006 Kansas Legislature eliminated property taxes on all new BM&E purchased on or after July 1, 2006.

They also raised the "de minimus exemption" on small items from \$400 to \$1500. Businesses no longer have to report or pay property taxes on BM&E items with a new cost of \$1500 or less. That includes items already owned. This relieves burdensome and despised red tape costs for almost all Kansas businesses. Those costs fell most heavily on smaller businesses.

The measure leaves only the existing old machinery and equipment on the tax rolls. The state income tax credit to offset part of these taxes will increase to 25% in 2007. Over a period of years, these items will depreciate in value or be replaced, reducing the property taxes until eliminating them entirely is easier. This is the method that was successfully used by Iowa.

### Commercial/Industrial Real Estate<sup>62</sup>

Since there are differences from state to state in the way property taxes are levied, the most meaningful comparison is taxes as a percentage of actual market value, which produces the "effective tax rate". (Effective Tax Rate = Taxes/Actual Market Value) The effective real estate tax rates on commercial real estate, based on 2002 data:

IA 2.79%, **KS 2.69%**, CO 2.07%, MO 2.06%, NE 1.82%, OK 1.07%

### Residential Real Estate<sup>63</sup>

Comparatively little residential real estate is owned by Kansas businesses. This does partially illustrate the fact that "per capita" tax statistics are not meaningful in deciding whether business taxes are high or not. The effective real estate tax rates on residential real estate, based on 2002 data:

NE 1.80%, IA 1.42%, **KS 1.25%**, MO 1.04%, OK .97%, CO .66%.

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<sup>62</sup> "Business Taxes and Costs: A Cross State Comparison, 2003 Update", Kansas Inc., February 2004, p 72.

<sup>63</sup> Ibid.

### Total State And Local Property Taxes As A Share Of Personal Income<sup>64</sup>

The Small Business and Entrepreneurship Council has another way to look at property taxes. Using 2003-2004 data from the Census Bureau and U.S. Department of Commerce, they compare total local and state property taxes with total personal income of the state.

The reader should note that this method does not take into account the fact that Kansas property taxes have extreme variations on properties with the same dollar value. By one estimate, Kansas businesses pay about 45% of all property taxes in Kansas, yet much business income is not included in personal income. This is true in all these states. The reader should consider this measure interesting but not definitive.

Total state and local property taxes as a percentage of total personal income:

NE 3.63%, IA 3.52%, **KS 3.42%**, CO 2.82%, MO 2.59%, OK 1.62%

### Per Capita Property Taxes<sup>65</sup>

Kansas	\$1187
Nebraska	\$1148
U.S. Avg.	\$1086
Colorado	\$1026
Missouri	\$ 747
Oklahoma	\$ 465

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<sup>64</sup> Small Business & Entrepreneurship Council's "Small Business Survival Index 2007", November 2007 [www.sbecouncil.org](http://www.sbecouncil.org), page 32.

<sup>65</sup> USA Today, July 28, 2006, based on Census Bureau data for 2004, the latest available.

## CHAPTER 8: KANSAS VEHICLE TAXES

In the early 1990s, the total Kansas taxes on vehicles were the very highest in the nation.

In 1991, in a study of the largest cities in each of the 50 states, Wichita families with family incomes of \$75,000 and \$100,000 had the very highest vehicle tax burden in the nation and those with incomes of \$25,000 and \$50,000 had the fourth highest.<sup>66</sup>

Included were property taxes, fuel taxes, registration fees, and title fees. Sales taxes were not included. Kansas also had relatively high sales taxes on motor vehicle purchases and still does today, in comparison to surrounding states.

As a result of the extremely high taxes on vehicles, the average vehicle on Kansas roads was much older than the national average, and the average new car sold was cheaper by far than the national average<sup>67</sup>.

After 1991, the reduction in property tax rates from reappraisal reduced the property tax burden on vehicles while vehicle tax burdens in other states were rising. In 1993, in an update of the earlier study, the tax burden for Wichita families had dropped to 7<sup>th</sup>, 6<sup>th</sup>, 11<sup>th</sup>, and 10<sup>th</sup> for family incomes of \$100,000, \$75,000, \$50,000, and \$25,000, respectively.<sup>68</sup> They remained the highest in the six-state region, however.

In 1995 and 1997, a package of laws was passed that, over a five-year period of time, lowered property taxes on motor vehicles of less than 20,000 pounds GVW (Gross Vehicle Weight) by approximately half. The package included the lowering of the assessment level from 30 percent to 20 percent and the elimination of school property taxes on these vehicles. These reductions benefited both individuals and businesses that own such vehicles.

For light vehicles, Kansas is now much more competitive with surrounding states.

Taxes on trucks larger than 20,000# GVW were not lowered. They continue to be among the very highest in the U.S. The assessment level continues at 30 percent and schools continue to levy taxes on them. There was a temporary dip of about 10% in the taxes on these trucks when the statewide school levy was reduced from 35 mils to 20 mils, but as tax lids have been removed and local option budgets increased, those savings have disappeared.

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<sup>66</sup> "The Property Tax on Motor Vehicles in Kansas", by The Hugo Wall School of Urban and Public Affairs, Wichita State University, February 1995, pages 16-17.

<sup>67</sup> Don McNeely of the Kansas Automobile Dealers Association, citing his memory of findings and articles from the first half of the 1990s.

<sup>68</sup> "The Property Tax on Motor Vehicles in Kansas", by The Hugo Wall School of Urban and Public Affairs, Wichita State University, February 1995, pages 18-20.

Trucks used by truck lines, “Motor Carriers for Hire”, are taxed differently. Those taxes are collected directly by the state and not by local taxing authorities, and the revenues go into the state general fund. Motor carriers are required to keep track of the miles their trucks travel in each state, and property taxes are prorated among those states according to that mileage. Two identical trucks, one owned in Kansas and one in Texas, that travel the identical number of miles in Kansas during the year, should pay the identical amount of Kansas property tax. The Kansas portion of the tax is based on an assessment level of 25 percent, and the mil levy is the statewide average mil levy for the preceding year.

Truck trailers, truck beds, and other equipment mounted on trucks and trailers are assessed at the 25% level.

### **Taxes on the Purchase of Motor Vehicles**

Kansas: Charges full state and local sales taxes on the purchase of vehicles at the higher of the two rates in effect at the locations of the purchaser and the seller. The value of a trade-in is deducted to lower the amount of the sale subject to sales taxes. State sales tax rate is 5.3%.

Oklahoma<sup>69</sup>: Instead of sales tax, charges a flat 3.25% excise tax on the sale of new and used vehicles. No local taxes apply. There is no deduction for a trade-in. On used cars, the excise tax is based on original new value less 35% per year, resulting in very low taxes on used cars.

Missouri<sup>70</sup>: Charges full state and local sales taxes based on the residence of the purchaser. Trade-ins are deducted. State sales tax rate is 4.23%.

Iowa<sup>71</sup>: Charges only the state use tax rate of 5%. No local sales taxes apply. Trade-ins are deductible.

Nebraska<sup>72</sup>: Charges full state and local sales taxes based on the delivery location. If delivery is taken at dealer’s location, the sales tax rate at that location applies. Trade-ins are deductible. State sales tax rate is 5.5%.

Colorado<sup>73</sup>: Charges full state and local sales taxes based on the location of the seller. Trade-ins are deductible. State sales tax rate is 2.9%.

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<sup>69</sup> Oklahoma Tax Commission, [www.oktax.state.ok.us/oktax/](http://www.oktax.state.ok.us/oktax/).

<sup>70</sup> Missouri Department of Revenue, [www.dor.state.mo.us/tax/](http://www.dor.state.mo.us/tax/).

<sup>71</sup> Iowa Department of Revenue and Finance, [www.state.ia.us/tax/](http://www.state.ia.us/tax/).

<sup>72</sup> Nebraska Department of Revenue, [www.revenue.state.ne.us](http://www.revenue.state.ne.us).

<sup>73</sup> Colorado Department of Revenue, [www.revenue.state.co.us](http://www.revenue.state.co.us).

## CHAPTER 9: UNEMPLOYMENT TAXES

As taxes go, unemployment taxes do not show up very prominently on the “tax radar screens” of small business owners. It is probably more common for a small business owner to get aroused over an unemployment insurance judge’s perceived unfair decision than over the taxes themselves.

In late 2004, however, many small business owners were complaining about big rate increases for 2003 and 2004 caused by automatic tax increases called for by state law.

Large corporate layoffs in 2000 through 2002 in Kansas had caused the balance of the Kansas Employment Security Trust Fund to drop considerably, which triggered the automatic rate increases. Some legislators wanted to increase the taxes by more than the automatic rate increases.

Wisely, the legislature allowed time for the automatic adjustments to work.

The automatic adjustments built into the system were enough -- the trust fund balances recovered. Here are the trust fund balances on Dec. 31 of recent years:

2001	\$474 million
2002	\$415 million
2003	\$294 million
2004	\$327 million
2005	\$448 million (Kansas Department of Labor Website)
2006	\$601 million (KDOL Weekly Review, 12-23-06)

Previous over-funding of the Trust Fund was the reason for the 5-year moratorium on unemployment taxes in the late 1990s. The purpose was to get the money back into the hands of businesses and allow it to be invested in the expansion of the Kansas economy.

Because the fund had grown unnecessarily large again, the 2007 legislature reduced the rates for all positive balance employers for two years, retroactive to January 1, 2007. Employers in groups 1-6 received 100% reduction, while all other positive balance employers received reductions of 40% or 50%.

## Comparisons to Other States

Unemployment taxes<sup>74</sup>: Adjusted rates based on maximum rate applied to the state unemployment tax wage base, with that amount as a share of the state average wage.

IA 5.29%, OK 2.35%, MO 1.85%, **KS 1.69%**, NE 1.42%, CO 1.30%

Another measure<sup>75</sup>, by the National Foundation for Unemployment Compensation and Workers' Compensation, computes employer U.C. tax rates based on total state wages for 2005:

**KS .9%**, IA .9%, OK .8%, CO .7%, MO .6%, NE .6%

## Important Factors in Unemployment Compensation

Important factors that affect the competitiveness of Kansas with other states in the cost of unemployment benefits are:

- The tax rates. Since all funds paid into the unemployment fund must be used for that purpose only, the challenge for legislators is to make sure the rates keep the fund solvent while avoiding an unwarranted buildup.
- The level of benefits provided. The higher the payouts, the higher the tax. Kansas benefits are the second highest in the region.
- The average length of time the benefits are paid. Employees from some industries will hang on longer hoping to go back to their old job. The industry mix in a state can affect the length of time people stay on unemployment. Kansans tend to stay on relatively longer than all surrounding states except Missouri.
- The number of firms being taxed to the maximum but running negative balances nonetheless. The payouts to employees of certain firms exceed the taxes the firm pays in. Examples are employers with large layoffs and businesses that are seasonal, for example some construction firms. The unpaid difference is made up by other employers through higher rates.

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<sup>74</sup> Small Business & Entrepreneurship Council's "Small Business Survival Index 2007", November 2007 [www.sbecouncil.org](http://www.sbecouncil.org), page 34. Maximum rate applied to state wage base as a share of state average annual pay.

<sup>75</sup> "Average Employer Tax Rates For Taxable and Total Wages", UWC Strategic Services, National Federation for Unemployment Compensation & Worker's Compensation. The total wage figures were chosen over the taxable wages figure because they are more comparable – taxable wages vary considerably from state to state.

## CHAPTER 10: FUEL TAXES

The following is based on information from the American Petroleum Institute<sup>76</sup> dated July, 2007. The figures include all state taxes including sales taxes, if applicable.

<b>Gasoline Taxes</b>		<b>National</b>
<b>Per Gallon Total of All State Taxes</b>		<b>Ranking</b>
Nebraska	27.90	18
<b>Kansas</b>	<b>25.00</b>	<b>21</b>
Colorado	22.00	29
Iowa	21.70	30
Arkansas	21.80	31
Texas	20.00	35
Missouri	17.60	45
Oklahoma	17.00	46

Kansas' Gasoline Tax is the second highest in the eight-state region. The 7.4-cent and 8-cent differences with Missouri and Oklahoma are the most problematic because of the concentration of Kansans along those borders. Four years ago, the difference was only six cents. Kansas has gotten even less competitive.

<b>Diesel Fuel Taxes</b>		<b>National</b>
<b>Per-Gallon Total of All State Taxes</b>		<b>Ranking</b>
Nebraska	27.30	20
<b>Kansas</b>	<b>27.00</b>	<b>21</b>
Iowa	23.50	29
Arkansas	22.80	32
Colorado	20.50	35
Texas	20.00	36
Missouri	17.60	44
Oklahoma	14.00	49

Kansas' Diesel Fuel Tax is the second highest in the eight-state region. The 9.4-cent difference with Missouri is the most problematic, while the thirteen-cent difference with Oklahoma is also a very big problem. Four years ago, the difference with Missouri was eight cents and the difference with Oklahoma was eleven cents. Kansas has gotten even less competitive.

<sup>76</sup> From the website of the American Petroleum Institute, [www.api.org](http://www.api.org).

## CHAPTER 11: LOCAL TAXES

*“Local governments continue to spend most of the state and local tax revenue. In FY2006, local government tax revenue was \$4.470 billion and local units received another \$3.142 billion from state taxes allocated to or shared with them. Thus, local units received \$7.612 billion, or about 69%, of total state and local taxes in FY2006<sup>77</sup>.” -- Kansas Legislative Research Division*

The following figures show only those local taxes that are tracked by the State of Kansas. There are many more local taxes, as will be shown below.

State sales tax revenues allocated to locals are not included in the figures below.

Fiscal Yr	Revenue (Billions)
FY1990	\$2.088
FY1996	\$2.622
FY1997	\$2.704
FY1998	\$2.724
FY1999	\$2.845
FY2000	\$3.019
FY2001	\$3.221
FY2002	\$3.497
FY2003	\$3.636
FY2004	\$3.862
FY2005	\$4.123
FY2006	\$4.470
FY2007	\$4.796

### OTHER LOCAL TAXES AND FEES

Following is a partial list of local taxes and fees not tracked by the state.

These other taxes are growing even faster than the ones tracked by the state. Statewide data is not available.

There are many other fees and licenses not listed here. Utility sales are listed because they are usually monopolies. Cities overcharge, then transfer money from the utility fund into the general fund through "payments in lieu of taxes" (PILOTS). Items like swimming pool charges are not listed, since the user gets value and has a choice of whether to use them or not.

Cable/CATV Franchise Fee Receipts  
 Electricity Franchise Fee Receipts  
 Natural Gas Franchise Fee Receipts  
 Telephone Franchise Fee Receipts

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<sup>77</sup> “Kansas Tax Facts”, Kansas Legislative Research Division, December 2007, Page 2.

Other Franchise Fee Receipts  
Business Improvement District Taxes  
Special Assessment District Taxes  
City Vehicle Taxes  
Emergency Phone/911 Taxes  
Transient Guest Taxes  
Intangibles Taxes  
Cable/CATV Sales, Fees, and Services  
Electricity Sales, Fees, and Services  
Natural Gas Sales, Fees, and Services  
Sewer/Wastewater Fees and Services  
Water Sales, Fees, and Services  
Storm Water Fees and Services  
Fines and Forfeitures Collected  
Municipal Court Costs Collected  
Dog and Cat Licenses  
Building and Construction Fees  
Building Permit Charges  
Contractor License Fees  
Contractor Examination Fees  
Dangerous Structure Removal Fees  
Mobile Home Permits  
Building Inspection Charges  
Street and Curb Cut Fees  
Zoning Amendment Fees  
Zoning Board of Appeals Fees  
Sign Permit Fees  
Special Use Permit Fees  
Street Vacation Fees  
Zoning Change Permit Fees  
Subdivision Plat Fees  
Excise Taxes on Building Developments (Johnson County)  
Excise Taxes on Event Tickets (Johnson County)

From 1990 through 2005, inflation was 54.2%. Local taxes tracked by the state were up 97.5%. The taxes not tracked by the state were up far more. Many of those taxes did not exist in 1990.

## CHAPTER 12: WORKER'S COMPENSATION

Most workplace accidents and injuries are the fault of the employee. Prior to the establishment of worker's compensation insurance, employees usually had to sue their employer to recover for workplace injuries, even if the employer was at fault, and did not win if the fault was their own.

Worker's compensation was established as a no-fault substitute. The employee gave up the right to sue the employer for workplace injuries and illnesses, and in return the employer paid for no-fault insurance that covers the employee for all workplace injuries no matter who is at fault.

Kansas law requires employers to provide workers compensation benefits to injured workers or to families in the event of a worker's death, and that they buy private insurance to provide those benefits. Several factors determine the cost of that insurance. The amount of benefits paid to injured workers, decided by state law, exerts a primary effect. So does the administration of workers compensation law--what is considered a total disability in one state might not be considered so in another. Other factors include the safety records of various industries and occupations within the state and state regulations that limit rate increases.

Workers compensation has been increasingly deregulated. States have started to allow price competition among providers, encouraging them to keep administrative costs low. Both Kansas and Missouri have been a part of this trend. Within a single state, the rate paid by an individual firm also depends on firm-specific factors as well as on industry and occupation. A firm's payments are modified depending on its individual safety record and on whether it qualifies for a volume discount.

In the 1990s, workers compensation systems came under pressure to increase their competitiveness and to lower costs. This resulted in rate structure changes in many states, including Kansas. In 1993, the Kansas Legislature passed a comprehensive Workers Compensation Reform Act that aimed at eliminating fraud and preventing accidents. It also redefined benefit schedules for various types of injuries.

At the same time, Kansas moved from a tightly regulated rating system to "loss cost" rates that encourage competition. Previously, administrative costs were simply built into the basic regulated rates. Insurers in Kansas now add their own administrative costs to the pure actuarial rates determined by the National Council on Compensation Insurance in order to determine their final rates, and the most efficient insurers can offer lower rates.

Since 1994, workers compensation rates in Kansas have improved greatly, as have those of surrounding states and the U.S. as a whole. Although Kansas costs did go up slightly in 2003, Kansas still had workers compensation costs in 2003 that were lower than the average costs for the region by 7 percent and lower than the national average by 5 percent.

Very good comparative data on workers compensation systems comes from a private actuarial firm, Actuarial and Technical Solutions. The firm constructs a measure of average benefits and average costs for each state, and then indexes them to nationwide norms. In other words, the data show the ratio of costs or benefits in a state to those in the nation.<sup>78</sup>

### **Workers Compensation Comparative Costs (adjusted), 2003**

<u>State</u>	<u>Index of Benefits</u>	<u>Index of Costs</u>
Colorado	1.34	1.03
Iowa	1.08	0.82
Kansas	0.83	0.95
Missouri	0.73	1.18
Nebraska	1.05	0.82
Oklahoma	0.88	1.26
U.S. Average	1.00	1.00

In recent years it has been increasingly apparent that some Kansas Administrative Law Judges, the ones who hear work comp cases, have been ignoring or even nullifying provisions of the 1993 work comp reform law.

New law is needed to bolster those 1993 provisions that have not been followed. Other new provisions and clarifications are needed. The Legislature passed these needed changes in 2006, but Governor Sebelius vetoed them.

*(Significant portions of the above were directly copied from Chapter 6 of Kansas, Inc.'s "Business Taxes and Costs: A Cross-State Comparison, February, 2004".)*

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<sup>78</sup> "Business Taxes and Costs: A Cross State Comparison, 2003 Update", Kansas Inc., Feb. 2004, Page 86.

## CHAPTER 13: STREAMLINED SALES TAX PROJECT

The “Streamlined Sales Tax Project” (SSTP) legislation was slipped into a huge omnibus bill in the final days of the 2003 Kansas legislature without having been properly reviewed or voted upon in either house.

There were several very unpleasant surprises in the legislation, including \$100 million per year in new local use taxes on businesses. But the most unpleasant surprise was “destination sourcing”, which overturned 70 years of Kansas law based on “origin sourcing” of sales.

With origin sourcing, the sales tax rate is determined by the location of the retailer. With destination sourcing, it is determined by the delivery location. For retailers who ship or deliver, the new paperwork burden is enormous and costly.

Prior to learning the details of the SSTP and destination sourcing, about half of small business owners were in favor of internet sales taxes, thinking it would “level the playing field for bricks-and-mortar main street retailers”.

Once small business owners realized all the repercussions of the SSTP, they became heavily opposed to it. In July 2003, NFIB<sup>79</sup> Kansas members voted by 84% to 11% to work to repeal the destination sourcing rules. WIBA<sup>80</sup> members had a similar vote on the issue.

Despite an intense effort by small business owners and groups during the 2004 legislative session to modify, stop, or delay the SSTP until such time as Congress makes it legal, they failed.

### Where Is Kansas Now?

- There is no longer any significant effort afoot to repeal destination sourcing or the SSTP in Kansas.
- The Department of Revenue continues to be very helpful and patient with Kansas small businesses having trouble complying.
- It is unlikely there will be any payback to state and local governments for years, maybe never. Small businesses have borne the enormous conversion costs with zero financial help by the State of Kansas. They continue to bear the red tape costs. While other states pay its retailers to collect sales taxes, Kansas retailers get nothing.
- Because of the high number of tax jurisdictions in Kansas, destination sourcing will be a continuing competitive disadvantage for Kansas retailers compared to those from other states.

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<sup>79</sup> National Federation of Independent Business.

<sup>80</sup> Wichita Independent Business Association.

- The SSTP gives a huge competitive advantage to big retailers over small retailers. Big retailers have lobbied hard for the SSTP, and they have won.

### **Sales Tax & Use Tax Collection Costs and Fees**

Destination Sourcing alone added an estimated \$50 million of annual sales tax red tape costs for Kansas retailers.

A 2006 study done in conjunction with the Streamlined Sales Tax Project was published in 2006. Here are its findings:

Sales under \$1 million	Costs the retailer 6.47% of the amount collected.
\$1 million to \$10 million	Costs the retailer 5.2% of the amount collected.
Over \$10 million in sales	Costs the retailer 2.17% of the amount collected.

Kansas is one of only 18 states that does not allow its businesses a fee for being their collection agent for sales taxes<sup>81</sup>. All states surrounding Kansas already pay their retailers collection fees for serving as the collecting agents for sales taxes:

Colorado allows 3.33% of the total tax due.

Nebraska allows 2.5% of the first \$3,000 remitted and .5% of excess over that.

Missouri allows 2.00% of total tax due.

Oklahoma allows 2.25% of tax due up to \$3,300 per reporting period.

Kansas and Iowa allow nothing.

Kansas pays retailers from surrounding states for collecting Kansas sales taxes, but it doesn't pay its own retailers. It is time for Kansas to start paying all of its retailers for this work, especially those who now have to collect and keep track of destination sales taxes.

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<sup>81</sup> "2003 All States Tax Handbook", Thompson RIA, pages 226-8.

## CHAPTER 14: STARTS AND STOPS

In 1999, the NFIB Education Foundation and Wells Fargo Bank<sup>82</sup> published a study concentrating on the year 1998. While this study is fairly old, most of the information is in percentages instead of hard numbers, and is still meaningful and in much more depth than other such studies.

The surveys it is based upon, done over a four-year period, were taken by the Gallup organization, and included 3,000 households per month. In the interviews, Gallup asked about household business start/stop activity within the past six months, and if any was reported, posed additional questions.

### Business Starts

- Americans formed 3.06 million businesses in 1998. 76.3% were started from scratch. 22.1% were purchased. The remainder consisted of inheritances and other.
- The number of active owners per business was 1.5. 69.9% percent were started by one active owner without partners, 15.3% by two, 5.6% by three, 8.6% by four or more.

(The following statistics are for people who started or purchased businesses.)

- 64.3% were aged 25-44. 64.1% were males.
- Highest level of education achieved: 6.3% did not have a high school diploma, 22.0% had a high school diploma, 29.8% had some college, 5.4% attended trade or vocational school, 23.9% had a college degree, and 11.6% had a post-graduate degree.
- Only 19.2% of startups and 37.4% of purchased businesses began as “employer firms”, with an employee other than the owners. (Overall – 23.1%.)
- 71.2% of startups and 50.3% of purchased businesses began as home-based. (Overall – 66.8%.)
- 34% were part-time (no breakdown of startups vs. purchased provided).
- The median capital (“owner equity”, “net worth”) for startups was \$4,250, purchased \$950, overall \$3,900. Definition of “median” -- half started with less and half with more.
- The average capital (“owner equity”, “net worth”) for startups was \$18,582, purchased \$16,505, overall \$18,113.

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<sup>82</sup> “Business Starts And Stops”, William J. Dennis, Jr., November 1999.

- 12% started with the active involvement of a family member, most often spouses and siblings. Of those 12%, Spouses were 29.9%, siblings 20.0%, parent 14.5%, child 11.2%, in-law 7.8%, other blood relative 10.2%.
- 84% were started by people who had not started a business before.

### **Business Stops**

- It is very hard to track terminations of the very smallest firms. Termination info tends to measure only the more substantive businesses.
- In most business terminations, only the owners suffer any financial losses, or no one does. Financial losses to creditors is relatively uncommon.
- Many other factors besides failure or bankruptcy play into business terminations – lack of profitability, retirement, other opportunities for the owners, and so on.
- Most businesses just fade away. During the last month of operation, 59% of owners worked less than 40 hours per week and 30% worked less than ten hours per week.
- For 1998, 65% of business owners reported they were better off financially after terminating the business than before they started it.
- In the 1998 surveys, the breakdown of business terminations was as follows: Sold or transferred 27.2%, closed 10.9%, allowed to become inactive 59.3%, other reasons 2.6%.
- Business stops per household: For 94.2%, it was the first termination. For 2.4%, it was the second. 3.0% had closed three or more.
- Active owners per stop: One owner 70.7%, two 16.6%, three 5.4%, four or more 6.0%.
- 69.9% of people closing a business were between 30 and 54 years of age.
- 63.9% of people selling a business were between 30 and 54 years of age. 15.2% were 65 or over.
- Of all the terminated businesses (closed, sold, or deactivated), only 10.6% terminated in under one year. 56% closed in 5 years or less.
- Of the closed businesses, 17.9% closed in under a year, 7.7% in 1-2 years, 24.8% in 3-5 years, 7.2% in 6-10 years, 19.6% in 11-20 years, 4.1% in 21+ years.

- Of the sold businesses, 3.6% were sold in under a year, 21.3% in 1-2 years, 15.3% in 3-5 years, 17.7% in 6-10 years, 12.9% in 11-20 years, 27.1% in 21+ years.
- Of the businesses that were allowed to go inactive, 12.9% were in less than one year, 30.2% in 1-2 years, 21.9% in 3-5 years, 12.8% in 6-10 years, 13.3% in 11-20 years, 7.2% in 21+ years.
- Of all the terminated businesses, 48.9% were profitable over the lifetime of the business, 23.6% broke even, and 26.9% lost money.
- 67.95% of the owners of the terminated businesses would go into business again, while 30.0% would not.

## CHAPTER 15: MISCELLANEOUS ISSUES

*“The more people who own little businesses of their own, the safer our country will be, for the people who have a stake in their country and their community are the best citizens.” – John Hancock*

### **Kansas Tax Revenues and Taxes Other Than Income Taxes**

When it comes to miscellaneous taxes, small business is a main target of the Kansas governmental entities, and Kansas is at the top of the nation in the number of such entities<sup>83</sup>.

Nearly 95% of the tax incentives and abatements handed out to Kansas businesses go to big businesses. Only a very tiny portion of Kansas economic development funds in the form of direct grants, free land, property tax abatements, sales tax abatements, sales tax exemptions, tax credits for jobs, targeted workforce training expenditures have been going to small businesses.

While farms and ranches enjoy favorable tax treatment, other small businesses in Kansas enjoy virtually none. Small businesses pay a disproportionate share of sales taxes, real estate taxes, personal property taxes, fuel taxes, franchise taxes, phone taxes, utility taxes, and insurance premium taxes.

This is changing somewhat. The Kansas Economic Growth Act, passed in 2004, was designed to provide millions per year of seed capital for small businesses in rural and economically disadvantaged communities. In 2007, these funds started to flow much faster. Previously, complicated stipulations and some wrong assumptions incorporated into the law still need to be fixed by the Legislature to speed up the processes.

### **Workforce Training**

An extensive nationwide Small Business Administration study<sup>84</sup> shows that small firms are less likely than large firms to know about and use government training programs, and their use of government training programs has been falling over time. The smaller the business, the less likely the owner knows anything about training programs. Among firms with less than 25 employees, only 24.2% have even heard of government training programs and only 4.5% have ever used a government training program<sup>85</sup>.

While the fraction of small businesses that have heard of government programs is very low and has dropped sharply over time, program administrators in general do not see the lack of information about their program as an important problem, yet only about a third of programs are operating near capacity. In general,

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<sup>83</sup> In 2001, the 4,004 taxing entities in Kansas was the highest of all states.

<sup>84</sup> “Value of Worker Training Programs to Small Business” Small Business Administration, September 27, 2001.

<sup>85</sup> Ibid, page iv.

training program administrators believe that their programs are working well, but there is no real consensus on what is a good program for small businesses and what is not.

Once small businesses start using the programs, most seem to be fairly happy with them. The programs appear to be filling the training needs of many businesses, they appear to improve retention in many businesses, and most say they would use them again. However, there is a sizeable minority that would not use government programs again.

*(This previous is an edited version of the conclusions section of the SBA study.)*

### **WIBA on Workforce Training**

In 2005, the Wichita Independent Business Association participated in a series of planning sessions about workforce training needs in the Wichita area. They found small business needs for training of health care workers, construction workers, and manufacturing employees of small manufacturers. In the end, all of these were ignored by the planning group.

This result is probably typical. Small businesses get few or no benefits from government workforce planning efforts.

### **Unfair Competition from Governmental Agencies**

In our 2003 Guide<sup>86</sup>, the story of how the Southeast Kansas Education Service Center, known as "Greenbush", used public funds to convert a for-profit small business into a not-for-profit entity. They used free facilities given by a school district, then competed with small private companies without paying property taxes, income taxes, franchise taxes, estate taxes, or succession taxes, and few sales taxes.

This type of wrong-headed thinking continues.

The Kansas Legislature should pass legislation to force public and non-profit entities to discontinue what the Legislature never meant for them to do—compete unfairly with private business. Or, such ventures should be required to pay all taxes and comply with all government regulations that a private business would.

### **Franchise Fees**

In 2004, the \$55 franchise fee was separated from the franchise tax. The tax is paid to the Department of Revenue, while the fee is paid to the Secretary of State. The \$55 fee supposedly funds the operations of the Secretary of State's office, but much of it ends up in the general fund and is spent elsewhere. The fee applies to all limited liability entities, even those under \$100,000 in net worth.

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<sup>86</sup> "2003 Guide to Kansas Small Business Issues", January 2003, page 36.

## Franchise Tax

The Kansas Franchise Tax is being eliminated. The 2007 Kansas Legislature passed a multi-year phase-out that will entirely eliminate the tax.

The Franchise Tax is an aggressively anti-business tax. It is basically a penalty for making permanent business investments in the state. Only 19 states have a franchise tax. Now at least two of those are phasing it out completely<sup>87</sup>.

The tax is levied on the net worth of corporations and limited liability partnerships. The "franchise" in the name of the tax refers to the right to operate in Kansas as a limited liability entity. (At least theoretically, the business can be sued, but the stockholders, owners, management and employees are protected from liability arising out of the business.)

The tax is a highly unfair tax. It is levied whether a business is profitable or not. Identical businesses, organized differently, will pay widely varying amounts. For most small business owners, much or all of their personal net worth is invested in their business, so this tax is nothing less than a tax on their life savings.

## Death Taxes

"Death Taxes", whether couched as inheritance taxes, estate taxes, succession taxes, or whatever, are among the most hated by small business owners for a number of reasons.

Governor Sebelius and the 2006 Kansas Legislature enacted a complete phase-out of the Kansas Death Tax, eliminating it entirely on January 1, 2010.

In the meantime, the Kansas tax is no longer tied to the federal Death Tax. This cures what has been an estate-planning nightmare for small business owners. Estate planning is vital to the survival of small businesses beyond the death of the owners. Getting rid of the uncertainty of death tax laws in Kansas is a huge help.

As to the federal tax, it disappears entirely in 2011 but will be reborn the following year unless Congress enacts new legislation. If not, the tax will go back to where it was before the phase-out was passed.

One of the compelling reasons for eliminating death taxes for small businesses is that much of that money has already been taxed, in some cases several times. Many family-owned businesses, especially family farms, have to be sold off to raise cash to pay the taxes after the owner dies. This is mainly a small-business phenomenon. Huge estates can use trusts and other expensive devices to avoid death taxes.

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<sup>87</sup> In addition to Kansas, Pennsylvania is in a franchise tax phase-out process.

## CHAPTER 16: SMALL BUSINESS PROBLEMS & PRIORITIES

Between January and March 2004, the National Federation of Independent Business Research Foundation conducted a nationwide survey of 4,603 small business owners<sup>88</sup>. They were asked to rank 75 types of problems on a scale of 1-7, with 1 being a “critical problem” and 7 being “not a problem”. The responses were then averaged and ranked.

<b>PROBLEM OR PRIORITY</b>	<b>Rank</b>	<b>Mean Rating</b>	<b>% Critical</b>
Cost of Health Insurance	1	1.75	65.6%
Cost and Availability of Liability Insurance	2	2.86	30.1%
Workers' Compensation (WC) Costs	3	3.03	32.8%
Costs of Fossil Fuels	4	3.03	26.1%
Federal Taxes on Business Income	5	3.05	23.2%
Property Taxes	6	3.18	22.7%
Cash Flow	7	3.25	21.6%
State Taxes on Business Income	8	3.35	20.2%
Unreasonable Government Regulations	9	3.35	19.5%
Electricity Costs (Rates)	10	3.42	15.1%
Locating Qualified Employees	11	3.55	18.8%
Poor Earnings	12	3.56	18.6%
FICA (Social Security Taxes)	13	3.59	14.3%
Cost of Supplies/Inventories	14	3.59	11.7%
Changes in Federal Tax Laws and Rules	15	3.72	12.7%
Telephone Costs and Service	16	3.72	9.7%
State/Local Paperwork	17	3.73	11.6%
Federal Paperwork	18	3.74	12.2%
Unemployment Compensation (UC)	19	3.80	14.4%
Fixed Costs Too High	20	3.80	11.4%
Cost of Outside Professionals	21	3.89	8.5%
Competition from Large Businesses	22	3.90	15.3%
Highly Variable Earnings (Profits)	23	3.93	10.6%
Ability to Cost-Effectively Advertise	24	3.95	11.0%
Projecting Future Sales Changes	25	3.95	7.4%
Controlling My Own Time	26	3.99	11.9%
Dealing with IRS/State Tax Agencies	27	4.00	10.1%

<sup>88</sup> “Small Business Problems and Priorities”, National Federation of Independent Business, 2004. See [http://www.nfib.com/object/IO\\_16191.html](http://www.nfib.com/object/IO_16191.html).

Keeping Skilled Employees	28	4.13	12.5%
Facilities Costs	29	4.15	8.6%
Health/Safety Regulations	30	4.17	10.4%
Applications for Licenses, Permits, Etc.	31	4.20	9.4%
Finding Out About Regulatory Requirements	32	4.22	7.3%
Inadequate Sales	33	4.26	10.7%
Delinquent Accounts/Customer Financing	34	4.27	9.5%
Pricing My Goods/Services	35	4.27	7.6%
Death (Estate) Taxes	36	4.28	17.3%
Training Employees	37	4.29	7.2%
Hiring/Firing Employment Regulations	38	4.30	7.6%
Locating Business Help When Needed	39	4.35	8.7%
Cost of Gov't Required Equipment/Procedures	40	4.36	8.9%
Frequency of Tax Withholding Deposits	41	4.40	8.1%
Keeping Up on Business and Market Developments	42	4.43	4.7%
Environmental Regulations	43	4.45	9.0%
Sales Too Dependent on One Business or Industry	44	4.51	8.6%
Using Computers or Technology Productively	45	4.56	5.0%
Low Employee Productivity	46	4.61	6.0%
Handling Business Growth	47	4.62	4.0%
Getting Information on Gov't Assistance Programs	48	4.65	8.5%
Rules on Retirement Plans	49	4.67	6.5%
Sales Too Seasonal	50	4.72	6.4%
Zoning/Land Use Regulations	51	4.75	9.4%
Bad Debts and/or Bankruptcies	52	4.76	6.5%
Employee Turnover	53	4.80	7.5%
Anti-Competitive Practices, e.g., Price Fixing	54	4.82	8.3%
Controlling Inventory	55	4.82	4.6%
Collecting Sales and/or Excise Tax for Gov't	56	4.85	7.2%
Minimum Wage/"Living" Wage	57	4.85	7.5%
Interest Rates	58	4.85	7.0%
False Insurance Claims, such as WC and UC	59	4.90	10.4%
Getting Useful Business Information	60	4.90	2.6%
Traffic, Parking, Highways	61	4.92	6.7%
Crime, including Identity Theft, Shoplifting, Etc.	62	4.94	6.4%
Solid and Hazardous Waste Disposal	63	5.07	6.1%
Costs and Frequency of Law Suits	64	5.09	9.9%

Credit Rating/Record Errors	65	5.09	6.2%
Cost-Effective Mail Service	66	5.12	3.5%
Protecting Intellectual Property	67	5.14	4.6%
Obtaining Long-Term (5 Yr+) Business Loans	68	5.21	6.7%
Winning Contracts from Federal/State/Local Gov'ts	69	5.22	6.6%
Obtaining Short-Term (<12 Mos) Business Loans	70	5.22	6.7%
Competition from Imported Products	71	5.25	9.2%
Increased National Security Procedures	72	5.37	3.1%
Competition from Internet Businesses	73	5.47	4.5%
Competition from Government or Non-Profits	74	5.65	3.8%
Exporting My Products/Services	75	6.06	2.2%

NFIB previously conducted these surveys in 1982, 1986, 1991, 1996, and 2000.

Cost of health insurance has been the #1 problem in all except the 1982 survey. Those who rated it "critical" rose from 47% in 2000 to 66% in 2004.

All of the top three problems for 2004 are insurance-related. Liability insurance rose from 13th to 2nd and worker's compensation from 7th to 3rd.

Applications for licenses/permits and inadequate sales each jumped 17 places from 2000 to 2004, the biggest jumps on the list.

Interest rate concerns dropped 29 places from 29th to 58th, the biggest drop by far from 2000 to 2004. Death taxes dropped 13 places as the federal death taxes began to phase out. Without more legislation, however, federal death taxes will be back in full in 2011.

(Hard copies of "Small Business Problems and Priorities" can be obtained from the NFIB Research Foundation, 1201 "F" Street NW, Washington DC 20004. Or, the entire 132-page report may be downloaded at [http://www.nfib.com/object/IO\\_16191.html](http://www.nfib.com/object/IO_16191.html) .)