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November 25, 1985

ATTORNEY GENERAL OPINION NO. 85- 162

The Honorable Homer E. Jarchow
State Representative, Ninety-Fifth District
2121 West Douglas
Wichita, Kansas 67213

Re: Kansas Constitution--Finance and Taxation--Uniform
and Equal Rate of Assessment and Taxation

Taxation--Merchants--Inventory of Merchant; Listing
for Taxation; Fair Market Value in Money

Synopsis: Based upon the Kansas Supreme Court's differentiation
of "permissible" and "impermissible" partial exemptions,
and the legislative history of 1971 Senate Bill No. 28,
it cannot be concluded as a matter of law that the
portion of K.S.A. 79-1001b which provides for a maximum
40% reduction in the fair market value of property held
as inventory by a merchant is prohibited by Article 11,
Section 1 of the Kansas Constitution. Cited herein:
K.S.A. 79-1001a, 79-1001b, 79-1004a; Kan. Const., Art. 11,
§1.

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Dear Representative Jarchow:

You request our opinion concerning the constitutional validity of
K.S.A. 79-1001a and 79-1001b. The former statute provides that,
for purposes of property taxation, the fair market value of
personal property held by a merchant shall be:

"an amount equal to the average of the fair market value in money of the personal property held as inventory within the state of Kansas for sale by such merchant during his tax year (as established for reporting for federal income tax purposes) next preceding the time of filing the statement of personal property."
(Emphasis added.)

K.S.A. 79-1001b prescribes the following formula for determining "the average of the fair market value" of merchant's inventory:

"The average of the fair market value of the personal property held as inventory for sale by a merchant during the preceding tax year, as established for reporting for federal income tax purposes, shall be determined in the following manner:

"(a) Add the fair market value of personal property held as beginning inventory by such merchant on the first day of such tax year, as reported for federal income tax purposes for such year, to the fair market value of personal property not reflected in such beginning inventory which is consigned to and held for sale by such merchant on such date;

"(b) add to the amount computed in subsection (a) the fair market value of personal property held as ending inventory by such merchant on the last day of such tax year, as reported for federal income tax purposes for such year and the fair market value of personal property not reflected in such ending inventory which is consigned to and held for sale by such merchant on such date;

"(c) divide the amount computed under subsection (b) by two. If any merchant establishes by means of actual inventories taken throughout such tax year and reflected in the records of such merchant's business that the average of the fair market value of inventory computed in the manner hereinbefore provided does not reflect the true average of the fair market value of property held as inventory during such tax year, the average of the fair market of property held as inventory

by such merchant shall be computed by averaging the fair market value of property included in the actual inventories taken by such merchant during such year; and

"(d) subtract from the average of the fair market value of property held as inventory, as computed under subsection (c), the operating and administrative costs and expenses of the business for which such inventory is listed and reported, including overhead and obsolescence or depreciation in value not reflected in determining the value of inventory under the provisions of subsections (a), (b) and (c), not exceeding an amount equal to 40% of the average value of the inventory of such business as determined under the provisions of subsection (c)."

You question whether the underscored provisions in the above-quoted statute, which provide for a reduction in the fair market value of merchants inventory for operating and administrative costs and expenses of the business (not exceeding 40% of the average value of the inventory), violate Article 11, Section 1 of the Kansas Constitution. That constitutional provision, in part relevant to your inquiry, states: "The legislature shall provide for a uniform and equal rate of assessment and taxation."

A determination of the validity of K.S.A. 79-1001b under the uniform and equal clause of the Kansas Constitution requires a consideration of two recent cases dealing with partial exemptions from property tax. In State ex rel. Stephan v. Martin, 227 Kan. 456 (1980), the Kansas Supreme Court found that a provision reducing the appraised valuation of certain farm machinery and equipment was a partial exemption from taxation, and intimated that partial exemptions were unconstitutional. (See Kansas Attorney General Opinion No. 82-234.) However, in Von Ruden v. Miller, 231 Kan. 1 (1982) the court modified its position on partial exemptions, and indicated that such an exemption is permissible under Article 11, Section 1 so long as the exemption is "based on a purpose promoting the general welfare" and is not merely "for the purpose of benefiting a particular class of persons." (See 231 Kan. at 15; Kansas Attorney General Opinion No. 82-234.) As the maximum 40% reduction in fair market value provided for in K.S.A. 79-1001b constitutes a partial exemption under the court's analysis in Martin, supra, it is necessary to consider the purpose of the exemption in order to determine its validity under Article 11, Section 1.

K.S.A. 79-1001a and 79-1001b were enacted in 1971 as part of Senate Bill No. 28 (L. 1971, ch. 296), which bill was the culmination of several years of legislative study of problems associated with assessing merchants' inventories. Prior to 1971, there was no deduction for operating and administrative expenses, and studies indicated that there was a low degree of compliance with the requirement of assessing merchants inventory at 30% of value. [See Final Report of the Joint Interim Committee on the State Tax Structure, Vol. I, p. 56 (January, 1970)]. Spokesmen for various trade associations testified that full enforcement of the existing law in valuing merchants inventory "would make it impossible for many firms to remain in business." (Id. at 57.) Additionally, it was noted that under existing statutes there was no check on the degree of compliance by merchants in reporting their inventories, and that tax officials were forced to accept the merchant's word. (See 1969 Journal of the Kansas Senate at 120.)

After considering 8 possible legislative solutions to problems associated with assessing merchants' inventory, the committee recommended a plan which included the maximum 40% reduction in fair market value prescribed by K.S.A. 79-1001b, and the requirement incorporated in K.S.A. 79-1004a that merchants include in their statement of property a copy of the inventory portion of their federal income tax return. (See 1971 Journal of the Kansas Senate at 78.) Evidence before the committee indicated that the proposed plan would result in a substantial increase in taxes on inventories paid by most classes of retail business:

"[D]ata from a survey conducted by the County Attorney of Johnson County in 1969 indicates that, if such data is representative of the situation in most counties, reasonable compliance with the proposed basis for valuing inventories of merchants, even if the 40% deduction were taken in all cases, probably would result in a substantial increase in taxes on inventories paid by most classes of retail business." (1971 Journal of the Kansas Senate at 78.) (Emphasis added.)

The legislative history summarized above suggests that the partial exemption prescribed by K.S.A. 79-1001b is "based on a purpose promoting the general welfare." Specifically, in our judgment the legislature found that such an exemption was needed to prevent numerous business failures and other adverse consequences for an important segment of the Kansas economy. Additionally, it can hardly be said that 1971 Senate Bill No. 28


was enacted merely for the purpose of benefiting merchants, since the only evidence before the Joint Tax Study Committee was that the bill "would result in a substantial increase in taxes on inventories paid by most classes of retail business."

In summary, it is our opinion that based upon the Kansas Supreme Court's differentiation of "permissible" and "impermissible" partial exemptions, and the legislative history of 1971 Senate Bill No. 28, it cannot be concluded, as a matter of law, that the portion of K.S.A. 79-1001b which provides for a maximum 40% reduction in the fair market value of property held as inventory by a merchant is prohibited by Article 11, Section 1 of the Kansas Constitution.

Very truly yours,



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