Approved April 23, 1986
Date

MINUTES OF THE SENATE COMMITTEE ON LABOR, INDUSTRY AND SMALL BUSINESS.

The meeting was called to order by Senator Dan Thiessen at
Chairperson

1:30 a.m./p.m. on Tuesday, April 1, 1986 in room 527-S of the Capitol.

All members were present except:
Senator Eric Yost (excused)

Committee staff present:
Jerry Ann Donaldson, Research Department
Gordon Self, Revisor
Marion Anzek, Committee Secretary

Conferees appearing before the committee:
Senator Ben Vidricksen
Bill Edds, Department of Revenue
Representative, Don Sallee
Ernie Mosher, League of Municipalities
Meredith Williams, Post Audit

The meeting was called to order by the Chairman at 1:30 p.m.

Motion was made by Senator Morris to approve the minutes of March 24, 1986 and March 25, 1986, seconded by Senator Ehrlich. Motion carried.

A hearing was held on SCR1643-memorializing Congress to take action on House Resolution 4365 and House Resolution 3549 relating to the collection of sales and use taxes on out-of-state mail order sales.

The following were proponents of SCR1643.

Senator Ben Vidricksen I think we are very much aware that most of the States in this Nation are facing serious financial problems. I would like to talk about the fundamental problem. The 50 States are faced with approximate Revenue losses totaling over 1½ billion dollars, the losses should rightfully be collected from the retail industry in sales use taxes. State tax authorities are becoming increaslingly concerned about their inability to collect the sales use tax, because their residents, purchase goods from out of State mail order firms. An example, Consumer A, buys at a local retail store where the firm collects $20 in Kansas sales tax and remits it to Topeka. Consumer B buys from a catalog, with headquarters in Chicago and because this same firm has outlets in Kansas, that firm collects and remits $30 in use tax. Consumer C buys from a catalog seller in Maine, that has no business location in Kansas and he pays neither sales nor use tax.

If we in Kansas raise our sales tax 1%, this figure could amount to $16.M to $18.M (See Attachment A and B)

Senator Werts Do I understand you would like to have SB1510 amended into the resolution on line, 61?

Senator Ben Vidricksen Yes, I ask this committee to amend SB1510, line 61 into SCR1643.

Bill Edds Secretary Duncan had a prepared statemnt, and could not be here today, and I would like to present it to the committee for him (See Attachment C) We support the adoption of SCR1643, and the adoption by the 1986 Legislature could prove to be extremely important and well timed, with State organizations, including the National Congress of State Legislatures, National Interest Association, State Tax Commissions and the National Association of Tax Administrators, are all working to encourage Congress to adopt legislation overturning the National Bellas Hess decision (See Attachment C).

Discussion followed and hearings were concluded on SCR1643.

E10 4

MINUTES OF THE SENATE COMMITTEE ON LABOR, INDUSTRY AND SMALL BUSINESS,

room 527-S, Statehouse, at 1:30 ~~xxx~~./p.m. on Tuesday, April 1, 1986

Senator Werts moved to amend SCR1643, by adding SCR1510 on line 61 into SCR1643, and to adopt as amended, seconded by Senator David Kerr. Motion carried.

Hearings were held on HB2753 concerning the Kansas prompt payment act;amending K.S.A. 75-6402 and repealing the existing section.

A proponent of the bill, Representative Don Sallee HB2753 was amended in the House Federal State Affairs Committee, and would now bring all political or taxing subdivisions of the State under the prompt payment act. The original bill was any State Agency, Library, Community College or Unified School District. The School Districts are already under the prompt payment act, and we are merely asking to bring everyone else under the bill. I ask this committee to pass the bill favorably.

Opponents of HB2753

Ernie Mosher I have a couple of reasons for being a opponent. I wonder if there is a need for the State Government to require every little taxing subdivision in the State and tell them how they have to pay their bills. The principle on line 31, every political or taxing subdivision. I'm not sure how many we have but I am told there are at least 3,000 taxing subdivisions and at least another 2,000 political subdivisions, and this makes us talking about 5,000 and notice on lines 33 and 34 that apply to agencies that require whole or part by the public funds, certainly for example the alcohol and drug abuse programs, that are financed by contributions, the city or county would be affected by this proposal. Another aspect of it is some council in smaller towns, meet once a month and this would cause some practical problems for them. Finally there is another section, school districts, amend it out and make it applicable and also to the thousands of other political tax exemptions.

Meridith Williams I have no question, and typically established vendors, know it. They will have a longer accounts receivable, longer than someone with a large size operation. It takes longer to get paid and I don't think there is any excuse for a local taxing unit not to pay on time.

Ernie Mosher The original bill applied only to community colleges and libraries but it got amended to every taxing unit, and that is our opposition.

Discussion by the committee members ended hearings on HB2753.

HB2761 concerning the employment security law.

Senator Morris moved to report HB2761 favorably for passage, seconded by Senator Kerr. Motion carried.

HB2849 concerning worthless checks, providing certain civil remedies; increasing the service charge.

Senator Morris moved to amend HB2849, by taking out SB228 that was amended into the bill, seconded by Senator Werts. Motion carried.

Senator Morris moved to report HB2849 favorably for passage, as amended, seconded by Senator Ehrlich. Motion carried.

SB723 concerning the employment security act; relating to the definition of employment.

Senator Morris moved to report SB723 unfavorably for passage, seconded by Senator Kerr.

Discussion on why the move was made to report unfavorably for passage was discussed by the committee members and Jerry Donaldson reviewed the Kansas Supreme Court decision Case No. 55,788 Vernon O. Wallis, Kirby Vacuum Cleaner Company, Dodge City, KS appellee, v. Secretary of Kansas Department of Human Resources, State of KS, Appellant. (See Attachment D)

After more discussion, the Chairman asked if the members were ready to vote on the above motion to report SB723 adversely. The motion carried.

MINUTES OF THE SENATE COMMITTEE ON LABOR, INDUSTRY AND SMALL BUSINESS,

room 527-S, Statehouse, at 1:30 xxx.m./p.m. on Tuesday, April 1, 1986

SCR1636 directing the Kansas Department of Economic Development to implement a Kansas Product Promotion Program that identifies Kansas products for consumers.

Senator Morris moved to amend by adding the word fish on line 29, seconded by Senator Feleciano. Motion to amend SCR1636 carried.

Senator Werts moved to amend line 50 to change must to encourage to, and line 51 change shall to would and line 60 to change directed to requested, seconded by Senator Norvell. Motion to amend carried.

Senator Feleciano moved to pass SCR1636 as amended, seconded by Senator Morris. Motion carried.

HB2753 concerning the prompt payment act.

Chairman Thiessen called for action on HB2753. No action was taken.

The meeting adjourned at 2:30 p.m.

GUEST LIST

COMMITTEE: SENATE LABOR, INDUSTRY & SMALL BUSINESS DATE: 4-01-86

NAME (PLEASE PRINT)	ADDRESS	COMPANY/ORGANIZATION
R.G Hodges	Topeka	KCCI
Bill Clawson	"	DHR
Paul Bicknell	"	DHR
Jim Yonally	Overland Park	NFIB/Kansas
Don Dalle	Troy	LCG,
Ernie Mosher	Ft.	League of Municip
JOHN RATHMEL	TOP.	KDHR/WC
Bill Morrissey	"	"
Larry Wilgort	"	DITR
Marjorie VanBuren	Topeka	Office of Jud. Administrati
BILL EDDS	"	DEPT OF REVENUE
Rod GRANT	"	KCCI
Meredith Williams	"	Post Audit
Con Sorrough	Topeka	Walker Enterprises Inc
Janet Stubbs	"	KBAK

TO: LABOR, INDUSTRY AND SMALL BUSINESS COMMITTEE

FROM: SENATOR BEN VIDRICKSEN

RE: SCR 1643

MR. CHAIRMAN, MEMBERS OF THE COMMITTEE:

WE ARE ALL VERY MUCH AWARE THAT MOST OF THE STATES IN THIS NATION ARE FACING SERIOUS FINANCIAL PROBLEMS. I WON'T WASTE YOUR TIME ELEABORATING ON THIS POINT, IT'S COMMON KNOWLEDGE.

THE SUBJECT I WISH TO TALK ABOUT TODAY DEALS WITH A FUNDAMENTAL PROBLEM, AT LEAST ON THE SURFACE IT SEEMS THAT WAY, BUT AS YOU DELVE INTO THIS SUBJECT IT BECOMES VERY COMPLICATED AND VERY INVOLVED.

THE 50 STATES ARE FACED WITH APPROXIMATE REVENUE LOSSES TOTALING OVER 1½ BILLION DOLLARS. THESE LOSSES ARE NOT LOSSES FROM CURRENT FUNDS, THESE ARE LOSSES THAT RIGHTFULLY SHOULD BE COLLECTED FROM THE RETAIL INDUSTRY IN SALES/ USE TAXES.

THE PROBLEM: ENFORCEMENT OF THE SALES/USE TAX LAW

STATE TAX AUTHORITIES ARE BECOMING INCREASINGLY CONCERNED ABOUT THEIR INABILITY TO COLLECT THE SALES/USE TAX IN A GROWING NUMBER OF CASES IN WHICH THEIR RESIDENTS PURCHASE GOODS FROM OUT OF STATE MAIL ORDER FIRMS. THEIR ENFORCEMENT CONCERN IS ILLUSTRATED BY THE FOLLOWING HYPOTHETICAL EXAMPLE IN WHICH THREE KANSAS CONSUMERS PURCHASE CAMPING EQUIPMENT FOR $1,000.

CONSUMER A BUYS AT A LOCAL RETAIL STORE WHERE THE FIRM COLLECTS $30 IN KANSAS SALES TAX AND REMITS IT TO TOPEKA.

CONSUMER B ORDERS FROM THE SEARS, ROEBUCK CATALOG HEADQUARTERS IN CHICAGO. BECAUSE SEARS ALSO HAS OUTLETS IN KANSAS (AND HENCE A BUSINESS PRE-SENCE), THAT FIRM COLLECTS AND REMITS $30 IN USE TAX.

CONSUMER C BUYS FROM A CATALOG SELLER IN MAINE THAT HAS NO BUSINESS LOCATION OR FACILITIES IN KANSAS. HE PAYS NEITHER SALES NOR USE TAX.

THE POINT MUST BE EMPHASIZED THAT CONSUMER C IS LEGALLY LIABLE FOR THE PAYMENT OF THE KANSAS USE TAX ON THE EQUIPMENT HE PURCHASED AND HAD SENT INTO THE STATE. THE ONLY ISSUE IS HOW TO BEST ENFORCE THE SALES/USE TAX LAW.

SALES AND USE TAXES' ARE LEVIED ON THE FINAL PURCHASER BUT COLLECTED PRIMARILY THROUGH THE VENDOR. FOR IN-STATE SALES, THE FACT THAT THE SALES TAX NORMALLY RESTS ON THE PURCHASER, BUT IS COLLECTED BY THE VENDOR PRESENTS NO SERIOUS PROBLEMS.

IF WE IN KANSAS RAISE OUR SALES TAX 1% THIS FIGURE COULD AMOUNT TO 16 TO 18 MILLION DOLLARS. THIS ALSO INCREASES THE LEVEL OF UNFAIRNESS TO KANSAS BUSINESS AND THE KANSAS TAXPAYER IN GENERAL.

Senate Labor, Industry & Small
Business-Attachment A 4-01-86

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I REALIZE THAT RESOLUTIONS SUCH AS THIS MAY NOT CARRY THE PUNCH WE NEED. IF WE, AS STATE SENATORS AND ALSO THE MEMBERS OF THE HOUSE WOULD INDIVIDUALLY URGE OUR FEDERAL ELECTED OFFICIALS TO ACT, THIS TYPE OF ACTION WOULD PROBABLY HAVE MORE POWER, BUT THIS IS DIFFICULT TO OBTAIN, SO WE TAKE THIS ROAD. WE WILL HOPE THAT THE INDIVIDUALS AFOREMENTIONED WILL URGE SOME ACTION ON THESE MEASURES.

IT IS MY PLAN TO WRITE ALL THE PRESIDENTS OF EACH STATE SENATE TO CONSIDER ACTION OF THIS TYPE ALSO.

THE CURRENT PROHIBITIONS ON STATE EFFORTS TO COLLECT SALES TAXES ON SUCH TRANSACTIONS WAS IMPOSED BY THE UNITED STATES SUPREME COURT IN THE 1967 CASE, NATIONAL BELLAS HESS, INCORPORATED V. DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS, 386 US 753. IN RECENT YEARS, AS STATE AND LOCAL GOVERNMENTS HAVE INCREASED THEIR RELIANCE ON THE SALES TAX, THERE HAS BEEN GROWING INTEREST IN REMOVING OR REDUCING THE BELLAS HESS RESTRICTIONS.

THE U.S. SUPREME COURT DECISION IN THE BELLAS HESS CASE WAS BASED ON THE COMMERCE CLAUSE TO THE UNITED STATES CONSTITUTION. HOWEVER, IN ITS OPINION, THE COURT INDICATED THAT CONGRESS COULD ENACT LEGISLATION REQUIRING INTERESTATE SELLERS TO COLLECT AND PAY STATE SALES AND USE TAXES. SUCH LEGISLATION HAS RECENTLY BEEN INTRODUCED IN BOTH THE U.S. HOUSE AND SENATE. SENATE BILL S. 1510 HAS BEEN INTRODUCED BY SENATOR MARK ANDREWS (R-N.D). IN THE HOUSE, CONGRESSMAN BYRON L. DORGAN (D-N.D.) HAS INTRODUCED H.R. 3549. BOTH BILLS REMAIN IN COMMITTEE. THE ONLY ACTION TO DATE WAS A NOVEMBER 15, 1985, HEARING ON S. 1510 BY THE SENATE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT. A MEMBER OF THE COUNCIL OF STATE GOVERNMENTS' STAFF HAS INDICATED THAT ACTION ON EITHER OF THESE BILLS IS DOUBTFUL DURING THE CURRENT SESSION.

S.C.R. 1643 MERELY POINTS OUT OUR CONCERN REGARDING THIS PROBLEM. IT WOULD URGE CONGRESS TO ACT ON THE MEASURES PENDING BEFORE THEM. WE WOULD HOPE IN HASTE.

THE 3 BILLS BEFORE CONGRESS ARE:

HR 4365 SPONSORED BY CONGRESS MAN DORGAN (D-N.D.) REQUIRE I.R.S. TO FURNISH INFORMATION FROM FILES ON INTERSTATE SALES TO STATES TO HELP TRACK THOSE SALES. WOULD REQUIRE MAIL ORDER RETAILERS TO COLLECT SALES TAX AND REMIT TO STATES.

HR 3549 - MAIL ORDER COMPANIES REQUIRED TO COLLECT SALES AND USE TAXES ON INTERSTATE SALES.

ANOTHER NOT MENTIONED IN THE RESOLUTION: S.B. 1510 - MARK ANDREWS (R-N.D. ELEMINATE RESTRICTIONS OF THE TAXING POWER OF THE STATES TO IMPROVE, COLLECT AND ADMINISTER STATE AND LOCAL SALES AND USE TAX ON SALES IN INTERSTATE COMMERCE.

I WOULD APPRECIATE IT IF THE COMMITTEE WOULD AMEND THE RESOLUTION TO INCLUDE SB 1510.

MR. CHAIRMAN: I WILL NOT PREEMPT THE SECRETARY OF REVENUE WHO HAS SUPPLIED US WITH INFORMATION REGARDING THIS MATTER. I'M SURE HE PLANS TO SHARE THE FEELINGS OF THE TAX COLLECTING DEPARTMENT OF OUR STATE AND THE FEELINGS OF HIS COUNTER PARTS FROM THE OTHER STATES.

I WOULD HOPE THE COMMITTEE WOULD TAKE FAVORABLE ACTION ON THIS RESOLUTION PROMPTLY.

THANK YOU AND I STAND FOR QUESTIONS.

Table 1
REVENUE LOSS ESTIMATES (IN $ THOUSANDS)
FROM MAIL ORDER AND DIRECT MARKETING SALES
1985

State	Conservative Estimate Mail Order[1]	Conservative Estimate Direct Marketing[1]	Total[1]	Higher Estimate
Alabama	$ 1,857	$ 723	$ 2,579	$ 6,064
Alaska[1]	2,807	1,100	3,907	9,187
Arizona	6,339	1,821	8,160	19,167
Arkansas	13,910	5,449	19,359	45,519
California	35,434	9,667	45,101	106,047
Colorado	4,231	1,234	5,465	12,850
Connecticut	3,490	1,208	4,698	11,046
District of Columbia	472	135	606	1,425
Florida	15,704	4,431	20,135	47,344
Georgia	13,993	5,458	19,451	45,735
Hawaii	140	55	195	459
Idaho	3,875	1,515	5,390	12,674
Illinois	22,676	6,993	29,669	69,761
Indiana	9,588	2,789	12,377	29,102
Iowa	6,743	1,935	8,678	20,405
Kansas	8,154	3,190	11,343	26,671
Kentucky	17,056	4,920	21,976	51,673
Louisiana	16,953	4,841	21,794	51,245
Maine	5,151	1,516	6,667	15,676
Maryland	7,625	2,193	9,818	23,085
Massachusetts	2,995	1,099	4,094	9,626
Michigan	15,760	4,496	20,556	48,334
Minnesota	9,372	3,722	13,094	30,788
Mississippi	14,787	5,787	20,574	48,376
Missouri	18,019	6,980	24,999	58,781
Nebraska	5,676	1,638	7,314	17,198
Nevada	4,235	1,226	5,641	13,264
New Jersey	5,481	2,085	7,566	17,790
New Mexico	7,488	2,451	9,939	23,370
New York	19,303	5,501	24,804	58,322
North Carolina	18,697	7,305	26,002	61,139
North Dakota	3,363	968	4,331	10,184
Ohio	16,397	4,631	21,028	49,444
Oklahoma	11,706	4,548	16,254	38,218
Pennsylvania	15,621	6,021	21,642	50,887
Rhode Island	306	116	422	992
South Carolina	9,020	3,835	13,855	32,107
South Dakota	2,918	1,142	4,058	9,542
Tennessee	24,074	9,376	33,450	78,652
Texas	35,753	10,207	45,960	108,067
Utah	3,308	1,288	4,596	10,807
Vermont	2,591	750	3,341	7,856
Virginia	13,814	5,432	19,246	45,253
Washington	18,689	5,323	24,022	56,483
West Virginia	12,422	3,580	16,002	37,626
Wisconsin	11,418	3,377	14,795	34,788
Wyoming	2,316	909	3,225	7,583
Total estimated U.S. revenue loss	$667,678 to 1,570,612			

Source: ACIR staff computations

[1]Local sales tax only

Senate Labor, Industry & Small Business, Attachment B
4-01-86

nology. The Small Business Administration (SBA) develops size standards for various industries which define maximum sales levels below which firms are eligible for the services of the SBA. For mail order firms, the 1984 SBA threshold sales volume was set at $12.5 million.

Large firms are more likely to meet the business presence test in more than one jurisdiction and therefore have greater familiarity with complying with multiple sales and use tax requirements than smaller firms. Few firms, however, are presently involved in collecting taxes for a large number of states. A rough measure of those who meet the nexus requirement in more than one state is the number of multi-establishment firms. Census data indicate that in 1982, only 18 of 5,858 firms which list mail order as their primary classification operated five or more establishments. No comparable data are available for firms whose secondary industrial classification is mail order.

The Options

In September, the Commission considered four alternatives relating to the collection of sales and use taxes on out-of-state mail order sales. The Commission recommended enactment of federal legislation to enable states to require the collection of use taxes on interstate mail order sales without reference to nexus requirements. It favored enabling federal legislation because of the serious drawbacks to be found in each of the three other options it considered:

- to affirm the status quo;
- to encourage state-initiated litigation to overturn *National Bellas Hess;* and
- to recommend Congressional legislation providing for a direct federal tax on mail order sales across state lines.

The Commission found affirmation of the status quo unsatisfactory because the problems caused by the existing situation are too serious to be ignored. Enforcement problems plague state tax administrators, who have no way of assessing or collecting use taxes on many mail order purchases coming into their state. Because of these problems in collecting sales and use taxes on mail order sales, state tax administrators find that the integrity of their tax bases is being undermined, and that severe damage has been done to the perceived equity of their tax systems. In-state merchants feel that they are placed in an unfair competitive position compared to many out-of-state mail order houses who do not collect sales/use taxes.

The Commission also rejected the alternative that states actively pursue litigation intended to modify or overturn the nexus standards established in the *National Bellas Hess* case, and if successful, then implement collection of use taxes on interstate mail order sales through multistate cooperative agreements. This option was found to be unsatisfactory because litigation addresses the problem in a piecemeal fashion, requiring a long series of court decisions to resolve the issues involved; the litigation process has no possibility of addressing the political-administrative problems involved in taxing mail order sales, such as compliance costs or the multiplicity of state-local tax rates; and even successful litigation cannot resolve most enforcement problems.

The Commission also was presented with a third alternative—to recommend enactment of federal legislation imposing a national mail order sales tax at a single rate on all sales to customers outside the state in which the mail order firm is located. Although the relative simplicity and minimal compliance costs for the seller are attractive, the Commission could not endorse a direct federal tax because it would represent a major federal intrusion into state taxing authority. It also would impose sales and use taxes on mail order sales in states which do not presently levy such taxes on in-state sales, putting mail order houses at a competitive disadvantage in those states.

The Commission chose to recommend corrective federal legislation negating the *National Bellas Hess* decision, thereby enabling states which have sales and use taxes to enforce use tax collection. This solution offers the most direct and comprehensive resolution of the competitive fairness, tax revenue, and compliance costs issues without requiring drastic federal intervention. Federal legislation would define nexus standards (the degree of business presence needed to require collection of the use tax) clearly and uniformly in all situations at the same time.

In sharp contrast to a judicial solution of the problem, Congressional action could weigh a broader business presence standard against legitimate business concerns about compliance costs and protection for small firms. Business interest in a *de minimis* rule, uniform state-local rates, and amnesty for prior taxes could be addressed in legislation. All of the economic issues—tax revenues, competitive fairness, and compliance costs—could be resolved through appropriate legislation.

Legislation also could address the current problem of enforcement. State officials feel that a central issue is the uniform enforcement of a clearly established use tax liability in order to promote tax fairness, as well as to prevent further erosion of the sales and use tax revenue base. The sales and use tax is the only broad-based tax that is primarily—if not exclusively—available for state government since property taxes are primarily local, and the federal government makes intensive use of the individual income tax. Thus, its perceived fairness and the integrity of its sales base should be safeguarded.

Congressional action at this time would be a particularly appropriate instance of intergovernmental comity because it would assist states in collecting revenues owed to them at a time when grants from the federal government to states and localities are being cut, and there is a prospect of further grant reductions and devolution of responsibilities.

Critics may argue that corrective federal legislation would reverse a long-standing decision of the Supreme Court. They point to a legal disagreement as to whether it is possible for the Congress to overrule the *National Bellas Hess* decision. However, the Supreme Court decision in *National Bellas Hess* invited congressional action. If the action taken by the Congress is felt by some to be inappropriate, it can be tested through subsequent litigation.

Both proponents and critics of federal legislation overturning the *National Bellas Hess* decision recognize that resorting to a federal legislative solution in-

MEMORANDUM

TO: The Honorable Dan Theissen, Chairman
Senate Committee on Labor, Industry and Small Business

FROM: Harley T. Duncan, Secretary
Kansas Department of Revenue

RE: Senate Concurrent Resolution 1643

DATE: April 1, 1986

Thank you for the opportunity to appear before you today on Senate Concurrent Resolution 1643. We heartily support adoption of this resolution.

SCR 1643 memorializes the U.S. Congress to adopt legislation allowing states to require that out-of-state retailers collect and remit state and local sales taxes on purchases made to and delivered to in-state residents. Under a 1967 U.S. Supreme Court decision in **National Bellas Hess v. Illinois,** states can require the collection of sales tax only if the retailer has some physical presence or "nexus" (e.g., sales personnel, a store, etc.) in the state. The Court specifically held that a mail order business of merely soliciting sales through a catalog and delivering the merchandise by a common carrier did not constitute sufficient nexus to trigger the sales tax collection requirement.

The effect is that the vast majority of mail order sales go untaxed. The sales tax is still owed on mail order purchases, but it is up to the individual purchaser to figure the tax and remit it to the Department of Revenue. You and I both know that this seldom happens and that the Department has no capacity to collect from individual purchasers.

As a result, state and local governments in Kansas are losing sales tax revenues and in-state, main street retailers are at a competitive disadvantage with respect to the mail order houses. The mail order business is a large and growing sector. Estimates are that direct mail order business totals over $50 billion annually at the present time and is

growing at a rate in excess of 10 percent per year. The Advisory Commission on Intergovernment Relations projects that states lose over $1.0 - $1.5 billion annually in sales taxes and that in Kansas alone,the loss is $11-12 million. As you can see, the effect on the State and the main street retailer is substantial.

Adoption of this resolution by the 1986 Legislature could prove to be extremely important and well-timed. A variety of state organizations, including the National Conference of State Legislatures, the National Governors' Association, the Multistate Tax Commission and the National Association of Tax Administrators are all working to encourage Congress to adopt legislation overturning the **Bellas Hess** decision. It is very likely that consideration will be given to the matter as a part of the tax reform discussions. A strong expression of support for Kansas retailers from the Kansas Legislature would be extremely beneficial to the members of the Kansas delegation.

In short, the taxation of mail order sales is an area of growing concern to state governments and the retail sales industry. Only federal legislation is capable of solving the current problem. I encourage your strong support of SCR 1643. If approved this year, it could prove extremely helpful.

Thank you for the opportunity to appear. I would be glad to answer any questions.

No. 55,788

VERNON O. WALLIS, KIRBY VACUUM CLEANER CO., DODGE CITY, KANSAS, *Appellee*, v. SECRETARY OF KANSAS DEPARTMENT OF HUMAN RESOURCES, STATE OF KANSAS, *Appellant*.

(689 P.2d 787)

SYLLABUS BY THE COURT

1. ADMINISTRATIVE LAW—*Adoption of Hearing Officer's Findings of Fact by District Court—Court Limited to Considering Questions of Law.* Where the district court adopts the hearing officer's findings of fact in total, it is then limited by K.S.A. 44-710b(b) to considering questions of law.
2. SAME—*Appellate Review of Agency's Findings When Findings Contrary to Evidence.* Where the findings of the hearing officer and the Secretary of Human Resources are contrary to the evidence, it presents a question of law which is always open to review by the courts. In reviewing questions of law, the trial court may substitute its judgment for that of the agency, although ordinarily the court will give great deference to the agency's interpretation of the law.
3. INDEPENDENT CONTRACTOR—*Definition.* An independent contractor is generally described as one who, in exercising an independent employment, contracts to do certain work according to his own methods, without being subject to the control of his employer, except as to the results or product of his work.
4. SAME—*Determination of Whether Person Is Independent Contractor or Employee.* There can be no absolute rule for determining whether an individual is an independent contractor or an employee. It is the facts and circumstances in each case that determine whether one is an employee or an independent contractor.
5. EMPLOYER AND EMPLOYEE—*Test for Determination of Employer-Employee Relationship.* The primary test used by the courts in determining whether the employer-employee relationship exists is whether the employer has the right of control and supervision over the work of the alleged employee, and the right to direct the manner in which the work is to be performed, as well as the result which is to be accomplished. It is not the actual interference or exercise of the control by the employer, but the existence of the right or authority to interfere or control, which renders one a servant rather than an independent contractor. *Jones v. City of Dodge City*, 194 Kan. 777, 402 P.2d 108 (1965).

Appeal from Ford district court, DON C. SMITH, judge. Opinion filed October 26, 1984. Reversed.

H. Dean Cotton, of Topeka, argued the cause and was on the brief for appellant.

Eldon L. Ford, of Cosgrove, Webb & Oman, of Topeka, argued the cause and was on the brief for appellee.

The opinion of the court was delivered by

LOCKETT, J.: This is an appeal from the District Court of Ford

County. The trial judge reversed the findings and rulings of the Secretary of Human Resources and found certain persons selling vacuum cleaners were independent contractors rather than employees.

The plaintiff, Vernon O. Wallis (Wallis), is the proprietor of Kirby Vacuum Cleaner Co. (Kirby), Dodge City, Kansas. The Kansas Department of Human Resources (KDHR) conducted a hearing on December 21, 1981, to determine whether individuals who are dealers of Kirby Vacuum Cleaners were employees of Wallis or were independent contractors under K.S.A. 44-703(i)(1)(B) and K.S.A. 44-703(i)(3)(D). The hearing officer made findings of fact and determined that the dealers were employees and not independent contractors and that assessments of unemployment taxes made by the KDHR against plaintiff for such individuals were owed. Wallis requested a review by the Secretary of Human Resources (Secretary). The Secretary adopted the hearing officer's findings of fact and determined the individuals were employees of Wallis, not independent contractors.

Wallis petitioned for judicial review pursuant to K.S.A. 44-710b(b). The district court heard the matter on January 14, 1983, and issued a decision containing findings of fact and conclusions of law. The district court adopted the findings of fact of the hearing officer, and found the jurisdiction of the district court was confined to questions of law. The district court determined that the dealers were independent contractors, not employees under common law rules and statutory definitions, and accordingly abated the taxes collected.

The findings of fact adopted by the district court are:

"(1) Vernon O. Wallis hereinafter referred to as the appellant, is the proprietor of Kirby Vacuum Cleaner Company of Dodge City, Kansas performing services at 306 West Highway 56, Dodge City, Kansas. Mr. Wallis is a direct factory distributor of the Kirby Company including all accessories to the sweeper, customarily produced by such company. Mr. Wallis is the distributor for the western section of the State of Kansas.

"(2) Within the premises found at 306 West Highway 56, Dodge City, Kansas, are housed a service technician, an office for Mr. Wallis, and a display area wherein two secretaries perform the clerical function of the business. Incorporated within the duties of the secretaries is the sale of the product to those who might enter the premises to purchase the cleaner or accessories thereto on a retail basis.

"(3) Mr. Wallis is in the business of selling vacuum sweepers generally on a door-to-door basis within area of the distributorship. To accomplish the aforego-

ing, Mr. Wallis recruits through advertisements and by word of mouth potential 'dealers' to carry out the sale of vacuum sweepers within his distributorship. Prior to beginning the process of selling, dealers sign what is designated as an independent dealer agreement as set forth in Exhibit #1 during the course of the hearing.

"(4) The newly associated dealers began a training course carried out by key personnel including Mr. Wallis, his son, Mr. Cole, and other experienced and qualified sales personnel. New dealers are oriented with the product and counselled with regard to beneficial sales techniques with reference to such product. New dealers are accompanied by more experienced dealers during the early course of their sales experience on a door to door basis. Each dealer receives 'a sales kit' from Mr. Wallis.

"(5) A 'sales receipt' is effectuated between the dealer and the distributor to provide the dealer with a vacuum sweeper to sell. The receipt requires the dealer to be responsible to the distributor for the machine and its value irrespective of damage or loss to the machine while in the keeping of the dealer. The dealers are expected to compensate Mr. Wallis for the machine within a 30 day period from the date the receipt is effectuated. The machine dispersed by Mr. Wallis may be returned if unsold.

"(6) Dealers in an effort to sell Kirby vacuum sweepers, are not compensated or reimbursed for expenses incurred nor do they receive a minimum salary or other fringe benefits save only what has been eluded to on page 69 and 70 of the transcript as a profit sharing plan provided by Mr. Wallis to his dealers. The profit sharing plan is to help compensate those who train other dealers as such new dealers will sell the product therein creating more revenue for dispersal among those who share within the plan. Dealers generally are free to establish their own hours of service and the territories they shall serve.

"(7) Dealers who are distributed to by Mr. Wallis are not responsible for the repossession of sweepers previously sold. Dealers are provided no office space to perform services within, and do not sell competing products. Dealers may negotiate the price of the product to the customer with the proceeds and the contract of sale to be reviewed for acceptance by the distributor, in this instance, Mr. Wallis, as set forth on page 19, line 6. Dealers do not service the equipment sold and must complete and process warranty cards prior to their receipt of the proceeds from the sale. All monies as herebefore set out are deposited with Mr. Wallis then dispensed back to the dealer subsequent to the three day waiting period required under Kansas Statutory Law for sales of this nature.

"(8) In Section 8 of the Independent Dealer Agreement as herebefore set out, are set forth the provisions of the time for which this agreement is entered into and the right of either party to cancel such agreement. Mr. Wallis, as a distributor, provides that within 30 days written notice the agreement may be terminated with a dealer and vice versa. The distributor may withhold the product to be sold by dealers as another avenue to terminate the agreement as herebefore set out. Mr. Wallis as set forth in line 23 of the transcript on page 28, further terminates the agreement in those instances wherein he finds the dealer to be not representative of the product or the product line as he shall 'let him go' with reference to a dealer who does not conform with the expectations of the distributor.

"(9) The dealer who sells Kirby vacuum sweepers on a door-to-door basis has

not a business to offer for sale within the market place. The dealer must work through the distributor or other dispersing agents of the Kirby Company to obtain the product he or she sells to the customer."

After receiving the decision of the court dated January 27, 1983, but prior to the filing of the Journal Entry, KDHR filed a first Notice of Appeal on February 28, 1983. The Journal Entry was filed on May 9, 1983. On May 31, 1983, KDHR filed a second Notice of Appeal.

KDHR raises two issues:

1. Whether the district court applied the proper standard for a review of an administrative officer's findings of fact under K.S.A. 44-710b(b).

2. Whether the district court correctly determined the question of law based on the findings of fact.

The statutory provision granting judicial review of decisions rendered by the Secretary concerning tax assessments is K.S.A. 44-710b(b). The relevant part of the statute states that "In any proceeding under this subsection the findings of the secretary of human resources as to the facts, if supported by evidence and in the absence of fraud, shall be conclusive and the jurisdiction of said court shall be confined to questions of law."

The only case in which this section of the statute has been mentioned is *Wesley Medical Center v. McCain*, 226 Kan. 263, 597 P.2d 1088 (1979). The case actually dealt with the constitutionality of the Kansas Employment Security Act. The court held the Act did not violate either the due process or equal protection clauses of the 14th Amendment to the Constitution of the United States or Section 18 of the Bill of Rights of the Constitution of the State of Kansas. In one paragraph, Justice Herd mentioned the pertinent section of the statute:

"As a parting shot under the second issue of error, appellants argue the 'array method' of computing contribution rates under K.S.A. 1975 Supp. 44-710a was not followed by the Department of Human Resources in determining appellants' rate. This is a question of fact. On appeal this court's jurisdiction is confined to questions of law if the Secretary of Human Resources' findings are supported by some evidence, absent fraud. K.S.A. 1978 Supp. 44-710b(*b*). There is no allegation or evidence of fraud against the Secretary of Human Resources and we find there is evidence to support his findings. The findings of the Secretary of Human Resources will therefore not be disturbed." 226 Kan. at 272.

The KDHR argues that since the *McCain* case said only "some" evidence was needed to support the Secretary's find-

ings, the district court should not have reversed the Secretary. Wallis, however, argues that "substantial" evidence is required before a district court must follow an administrative decision. The statute itself says only "evidence."

At the judicial review, the district judge stated that he would examine the evidence to determine "whether or not there is substantial evidence"; that determination was never made since the judge made no findings of fact but adopted the findings of fact of the hearing officer. Where the district court adopts the hearing officer's findings of fact in total, it is then limited by K.S.A. 44-710b(b) to considering questions of law.

The trial judge correctly stated the question of law to be: "Do the findings of fact create an employee-employer relationship as a matter of law?" To make that determination the district court, when reviewing the Secretary's ruling, considers the statutes and Kansas cases discussing the employer-employee relationship. K.S.A. 44-703(i)(1)(B) provides:

"(i) 'Employment' means:

"(1) Subject to the other provisions of this subsection, service, including service in interstate commerce, performed by

. . . .

"(B) Any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee."

K.S.A. 44-703(i)(3)(D) provides:

"(D) Services performed by an individual for wages or under any contract of hire shall be deemed to be employment subject to this act unless and until it is shown to the satisfaction of the secretary that: (i) Such individual has been and will continue to be free from control or direction over the performance of such services, both under the individual's contract of hire and in fact; and (ii) such service is either outside the usual course of the business for which such service is performed or that such service is performed outside of all the places of business of the enterprise for which such service is performed."

Where the findings of the hearing officer and the Secretary are contrary to the evidence, it presents a question of law which is always open to review by the courts. In reviewing questions of law, the trial court may substitute its judgment for that of the agency, although ordinarily the court will give great deference to the agency's interpretation of the law. *Richardson v. St. Mary Hospital*, 6 Kan. App. 2d 238, 242, 627 P.2d 1143, *rev. denied* 229 Kan. 671 (1981).

The hearing officer based his ruling on K.S.A. 44-703(i)(1)(B), K.S.A. 44-703(i)(3)(D), and *McCarty v. Great Bend Board of Education*, 195 Kan. 310, 403 P.2d 956 (1965). *McCarty* is a workers' compensation case. The defendants claimed McCarty was an independent contractor at the time of his injury. In discussing the applicable rules, this court stated:

"[A]n independent contractor is one who, in the exercise of an independent employment, contracts to do a piece of work according to his own methods and who is subject to his employer's control only as to the end product or final result of his work. (*Krug v. Sutton*, 189 Kan. 96, 366 P.2d 798.) On the other hand, an employer's right to direct and control the method and manner of doing the work is the most significant aspect of the employer-employee relationship, although it is not the only factor entitled to consideration. An employer's right to discharge the workman, payment by the hour rather than by the job, and the furnishing of equipment by the employer are also indicia of a master-servant relation. (*Jones v. City of Dodge City*, [194 Kan. 777].)" 195 Kan. at 311-12.

The *McCarty* court found more of these factors present than not and ruled the plaintiff was an employee.

An independent contractor is generally described as one who, in exercising an independent employment, contracts to do certain work according to his own methods, without being subject to the control of his employer, except as to the results or product of his work.

There can be no absolute rule for determining whether an individual is an independent contractor or an employee. It is the facts and circumstances in each case that determine whether one is an employee or an independent contractor.

Under K.S.A. 44-703(i)(1)(B) the court must look to case law to determine when there is an employer-employee relationship.

This court has often been asked to determine whether an individual is an employee or an independent contractor under the common law. It is often difficult to determine whether a person is one or the other, since there are elements pertaining to relations which occur without being determinative of the relationship. There is no exact method which may be employed to determine whether one is an employee or an independent contractor.

The primary test used by the courts in determining whether the employer-employee relationship exists is whether the employer has the right of control and supervision over the work of the alleged employee, and the right to direct the manner in

which the work is to be performed, as well as the result which is to be accomplished. It is not the actual interference or exercise of the control by the employer, but the existence of the right or authority to interfere or control, which renders one a servant rather than an independent contractor. *Jones v. City of Dodge City*, 194 Kan. 777, 402 P.2d 108 (1965).

In *Phillips Pipe Line Co. v. Kansas Cold Storage, Inc.*, 192 Kan. 480, 389 P.2d 766 (1964), one issue was whether a certain individual was an employee or an independent contractor. A landowner hired the person to clean silt out of a drainage ditch at a specified rate of pay per hour. No directions were given as to how the work was to be done and it was done by the workman with his own equipment according to his own methods. In determining as a matter of law that the relationship was that of independent contractor, this court stated:

"At most, Phillips' evidence disclosed that Wirth entered into a contract with Steele whereby Steele was to clean the silt out of the north drainage ditch at a predetermined rate per hour. Nothing else was said; no specifications were given, and the manner in which the work was to be done was left entirely up to Steele. While Phillips' evidence was that Wirth inspected the work and conversed briefly with Steele's employee Southworth, it can by no means be inferred that he reserved the right to direct and control the means or method of performing the work. Wirth's and the appellant's interest was in the result of the undertaking, that is, having the ditch cleaned of silt rather than in the particular method or means by which it was accomplished, and as previously indicated, no right of control was retained by Wirth on his behalf or the appellant's behalf.

"The appellee suggests that since Steele was to be paid at an hourly rate for the work, this was strong evidence of an employer-employee relationship existing between Wirth, the appellant, and Steele. The point is not well taken. In *Smith v. Brown*, 152 Kan. 758, 107 P.2d 718, evidence of payment at an hourly rate for services was introduced in support of an employer-employee relationship, but this court determined that the general law was applicable; that it was the question of the right of control which determined the relationship and affirmed the trial court's order sustaining a demurrer to the plaintiff's evidence." 192 Kan. at 485-86.

There are no Kansas cases with facts similar to those of this case. There are, however, several cases from other jurisdictions with similar facts. In *Kirby Co. of Bozeman v. Employment Sec.*, _____ Mont. _____, 614 P.2d 1040 (1980), a vacuum cleaner distributor filed a petition for judicial review of the decisions of the Board of Labor Appeals finding that the distributor's dealers were employees within the meaning of the state unemployment insurance law. The plaintiff was a direct factory distributor of

vacuum cleaners, purchasing the products directly from the manufacturer and selling them to area distributors and dealers. The dealers were recruited by Kirby. Salespersons signed a one-year written agreement when they became dealers. A Kirby officer gave product demonstrations to new dealers, provided a sales guide booklet, conducted sales clinics for the dealers and furnished leads to the dealers. No hours or territories were set for the dealers, who were not reimbursed for expenses, guaranteed minimum earnings or provided with any fringe benefits. Dealers bought the products from Kirby for cash or on a 30-day open account. Dealers could resell the products at any price and negotiate their own terms on the contracts.

The Montana court discussed two tests for determining whether there was an employer-employee relationship. The statutory test looked at the control an employer has over an individual, whether the service is outside the usual course of the business, and whether the individual is customarily engaged in an independently established trade or business. Under the common law test the court looked at the control the employer had over the individual.

Applying these tests, the court determined that the dealers were employees of the distributor based on the amount of control the distributors had over the dealers. The factors that the court considered relevant were:

> "Kirby trained the dealers in the method of marketing Kirby products by giving them initial demonstrations of the products, providing them with a sales guide booklet, and conducting sales clinics. Kirby regulated the price dealers charged for the products by suggesting retail prices which the dealers generally adhered to. Kirby customarily received the dealers' sales receipts and paid the dealers their commissions. Finally, and possibly most importantly, dealers had to be authorized through a wholesale outlet like Kirby to sell Kirby products and Kirby could terminate the contract granting the dealers that authorization without cause on thirty days' notice." _____ Mont. _____, 614 P.2d at 1044.

The same result was reached in *Kirkpatrick v. Peet*, 247 Or. 204, 428 P.2d 405 (1967). The case involved basically the same facts as the Montana case. The court used a statutory test similar to that in *Kirby Co. of Bozeman*, _____ Mont. _____, 614 P.2d 1040, *i.e.*, control by the employer, whether there was an independently established occupation, and whether the dealers were customarily engaged in the business. The court found that the dealers were employees of the distributor:

"The manner in which the dealer's activities were interwoven with those of the plaintiff makes it evident that there was not the independence of occupation contemplated by the statute. We have already alluded to the direction and control under which the dealers operated — direction and control with respect to price, territory and training. Other aspects of the activities of the dealers and plaintiff were interrelated. As we previously mentioned, plaintiff's office was the headquarters and clearing house for the dealers, plaintiff did the bookkeeping and accounting for the dealers, the dealers assigned their conditional sales contracts to plaintiff, the advertising program by which appointments could be made for the dealers was carried on by plaintiff, and there were other interconnected activities. Considering all of the foregoing factors in relation to the objectives of the Unemployment Insurance Act, we are of the opinion that plaintiff is engaged in employment within the meaning of the Act." 247 Or. at 214-15.

Bevan v. California Emp. Stab. Com., 139 Cal. App. 2d 668, 294 P.2d 524 (1956), involved basically the same facts as the Montana and Oregon cases. The court, however, considered only the common law definition of employer-employee and independent contractor. The court found there was sufficient control present to make the vacuum cleaner dealers employees. Similar results under similar facts were also reached in *Hart v. Johnson*, 68 Ill. App. 3d 968, 386 N.E.2d 623 (1979), and *Beaman v. Superior Products, Inc.*, 89 Ariz. 119, 358 P.2d 997 (1961).

The only case which has reached a different result is *Speaks, Inc. v. Jensen*, 309 Minn. 48, 243 N.W.2d 142 (1976). The Kirby vacuum cleaner distributors had been found liable for unemployment compensation under virtually the same circumstances as in the other cases. On appeal, the court, using the common law definition of master-servant, reversed the administrative tribunal. The court said that the degree of control necessary to bring the relationship between the distributor and its dealers within the definition of employment was not present in the record.

In *Read v. Warkentin, Commissioner*, 185 Kan. 286, 341 P.2d 980 (1959), the court considered whether taxicab drivers were employees or independent contractors for purposes of unemployment compensation assessments. We said:

"In giving consideration to appellee's position respecting his status, and that of his drivers, under the contract, the evidence and the administrative findings, we can turn to our own decisions for general rules defining masters and servants and independent contractors. See *Houdek v. Cloyd*, 152 Kan. 789, 107 P.2d 751, where it is held:

"'A master is a principal who employs another to perform service for him, and who controls or has the right to control the physical conduct of the other in the performance of such service, and the servant is the person so employed.

"'An independent contractor is generally one who, exercising an independent employment, contracts to do a piece of work according to his own methods and without being subject to the control of his employer, except as to the result of his work.' (Syl. ¶¶ 2, 3.)

"For more recent decisions approving the foregoing rules, see *Sims v. Dietrich*, 155 Kan. 310, 124 P.2d 507; *Bush v. Wilson & Co.*, 157 Kan. 82, 86, 87, 138 P.2d 457.

"With respect to the 'right to control,' mentioned in the first of the foregoing rules, it has frequently been pointed out that this means the right to control, not the actual interference or exercise of control, by an employer. (*Bush v. Wilson & Co.*, supra, page 86; *Sims v. Dietrich*, supra, page 312; *Schroeder v. American Nat'l Bank*, 154 Kan. 721, 121 P.2d 186; *Mendel v. Fort Scott Hydraulic Cement Co.*, 147 Kan. 719, 78 P.2d 868.)" 185 Kan. at 292-93.

The *Read* court determined that the drivers were employees because the employer not only had the right and authority to direct and control the manner in which his drivers carried on their operations, but to a certain extent actually exercised these rights.

In the present case, the district judge found that Wallis "had no right to direct and control the method and manner of the dealers in selling vacuum sweepers." Wallis does not provide offices, desk space, or business phones, nor pay dealers' expenses and does not withhold social security or income tax from them.

Wallis does maintain direction and control with respect to the training of dealers as well as price of products. Dealers must be authorized through Wallis who retains the right to terminate the contract without cause on 30 days notice. While the dealers may sell the products in whatever method they feel best accomplishes their goals, Wallis can terminate the contract with the dealer "in those instances wherein he finds the dealer to be not representative of the product or the product line." Other interconnected factors are also present. Wallis, his son, and other experienced dealers accompany newly associated dealers during the early course of their sales experience. Wallis has a profit-sharing plan provided by the distributor for dealers who help train other dealers. Dealers are not responsible for repossession of the vacuum cleaner when installment contracts fall through. Dealers do not service the equipment, but a service technician in Wallis' office does. The distributor's business is limited to selling and servicing.

In *Read*, the court said the right to control, not the actual

exercise of the right, determines whether there is control. Here the distributor has the right to control the dealers, but has not exercised that right. Wallis and the salesmen are both engaged in a service within the usual course of the business for which the service is performed, the sale of Kirby vacuum cleaners. In addition, all the services of selling are not performed outside Wallis' place of business. Therefore, their relationship under the common law and the statutes is that of employer-employee and not that of independent contractor.

Here the district court incorrectly determined the question of law based on the adopted findings of fact. Both the hearing officer and the Secretary had correctly determined from the facts the salesmen were employees of Wallis. The trial court is reversed and its order abating the taxes collected is set aside.