

Approved: 2-17-00
Date

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE.

The meeting was called to order by Chairperson Senator Audrey Langworthy at 11:10 a.m. on February 15, 2000, in Room 519-S of the Capitol.

All members were present except:

Committee staff present: Chris Courtwright, Legislative Research Department
April Holman, Legislative Research Department
Don Hayward, Revisor of Statutes Office
Shirley Higgins, Committee Secretary

Conferees appearing before the committee: Shirley Sicilian, Kansas Department of Revenue
Randy Allen, Kansas Association of Counties
Don Moler, League of Kansas Municipalities
Dana Fenton, Johnson County Government

Others attending: See attached list.

SB 560—Enacting the streamline sales tax system for the 21st century act

Shirley Sicilian, Kansas Department of Revenue, explained that **SB 560** is uniform language endorsed by the National Conference of State Legislatures (NCSL), the National Governor's Association, and members of the "Big 7" national associations of state and local government. It would enable Kansas to join with other states in taking the first real steps toward addressing Internet taxation issues. Ms. Sicilian summarized the Internet taxation issue, noting that the issue is about making sure that remote sales, whether made over the phone, fax, mail, or Internet, do not have a tax advantage over local sales. She discussed sales taxation as it applies to a Kansas Seller, an out-of-state seller with nexus, and an out-of-state seller without nexus.

Ms. Sicilian observed that a rapidly expanding Internet market, together with a burgeoning catalogue market, is turning retailing into a regional and sometimes a national industry, wherein a seller often has no physical presence in the buyer's state. She commented on the growing percentage of the retail markets supplied by remote sellers which cannot be required to collect Kansas use tax. She noted that local businesses, consumers, and state and local governments all have a stake in rectifying the current situation. She discussed approaches to address the issue at the federal level and at the state level (**SB 560**). In conclusion, Ms. Sicilian outlined the following provisions of **SB 560** which pertain to the Department: (1) Participation in discussions, (2) Participation in a joint request for information, (3) Participation in the pilot project, (4) Confidentiality concerns, and (5) Structured legislative oversight. She informed the Committee that meetings will begin in March and April to begin developing specifications for a pilot model system. (Attachment 1)

Ms. Sicilian called attention to a handout entitled, "With Trusted Third Party" and went through each step of the proposed plan. (Attachment 2) The first step is when the consumer orders something from a vendor. Through software, the trusted third party is then contacted by the vendor. The trusted third party then submits tax information about what tax is due to the vendor. The vendor gives that information to the consumer. If the consumer agrees to buy and pay for the product, the vendor submits the consumer's credit card information to the credit card company. The credit card company then remits the payment for the product to the vendor and remits the tax dollars to the trusted third party. The trusted third party distributes the tax dollars to the states.

Senator Langworthy explained further that **SB 560** would allow pilot projects to be created in order to determine how the "trusted third party" system works. If that system works, the federal government will be totally bypassed; therefore, uniformity will no longer be the issue as it has been in meetings at the federal level.

CONTINUATION SHEET

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE
Room 519-S, Statehouse, at 11:10 a.m. on February 15, 2000.

Randy Allen, Kansas Association of Counties, testified in support of **SB 560**. In light of the relatively large percentage of sales being conducted over the Internet and by mail order, Mr. Allen expressed concern about the continued viability of the state and local option sales taxes to finance basic services. He noted that, without dependable local-option sales taxes, counties will be even more dependent upon the property tax to finance basic services. He strongly supports the basic premise of the bill that all sales, wherever they take place, should be treated the same with respect to taxation. He emphasized that Kansas' participation in discussions with other states is an important first step. (Attachment 3)

Don Moler, League of Kansas Municipalities, gave further testimony in support of **SB 560**. His testimony echoed Mr. Allen's testimony. Mr. Moler emphasized that, while **SB 560** allows for voluntary compliance with the state compensating use tax at a 4.9 percent rate, it would not allow local units of government to recover locally lost sales taxes, which are in addition to the state rate. As "on line" sales continue to increase and, consequently, sales taxes are not collected at the local level, local tax revenue will slowly disappear. Mr. Moler cautioned that, unless legislators at the state and federal level respond to this issue, a huge amount of the tax base of local government will disappear. Without the local effort on sales tax, many local services cannot be provided. If the sales tax is undercut, local governments will have to offset that loss by increasing property taxes or by asking the state for more tax money. (Attachment 4)

Dana Fenton, representing Johnson County Government, gave final testimony in support of **SB 560**. He complimented Ms. Sicilian for her detailed explanation and agreed with the testimony given by previous conferees. His written testimony states, "A key goal of Johnson County's 2000 Federal and State Legislative Platform is the extension of sales and use taxes to remote sellers." Johnson County supports the bill as a step in the path towards realizing this goal. (Attachment 5)

Marlee Berthoff, Kansas Chamber of Commerce and Industry, submitted written testimony in support of **SB 560** as a sound step towards addressing the difficult issues of multi-state compacts and tax simplification. (Attachment 6)

Senator Langworthy closed the hearing on **SB 560** and turned the Committee's attention to a previously heard measure, **SCR 1629**, which would allow the Legislature to change the classification on boats and airplanes.

Senator Praeger moved to report SCR 1629 as favorable for passage, seconded by Senator Bond. The motion carried.

Senator Bond moved to report SB 560 as favorable for passage, seconded by Senator Steineger. The motion carried.

The meeting was adjourned at 11:55 a.m.

The next meeting is scheduled for February 16, 2000.

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Office of Policy & Research

TESTIMONY

To: Senator Audrey Langworthy
Chair, Senate Assessment and Taxation Committee
From: Shirley K. Sicilian
Re: SB 560 – Streamlined Sales Tax System for the 21st Century Act
Date: February 15, 2000

Senator Langworthy and members of the Committee, thank you very much for the opportunity to testify today regarding SB 560, the Streamlined Sales Tax System for the 21st Century Act. SB 560 is uniform language endorsed by the National Conference of State Legislators, the National Governor's Association and the other members of the "Big 7" national associations of state and local government. It would enable Kansas to join with virtually all other states in taking the first real steps toward addressing internet taxation issues.

1. Summary of the Issue

A first point to make is that the "internet taxation" issue is not about "taxing the internet." In fact, in 1998, Congress passed the Internet Tax Freedom Act¹, which placed a three year moratorium on taxing internet access, and on multiple or discriminatory taxes on electronic commerce. Kansas never has taxed internet access, nor have we ever enacted discriminatory or multiple taxes. So Kansas was not affected by the moratorium.

Rather, the "internet taxation" issue is about making sure "remote sales," whether made over the phone, fax, mail or internet, do not have a tax *advantage* over local sales. When a local Kansas merchant makes a sale (and delivery of a product) in Kansas, the merchant must collect state and local sales tax. When an out-of-state seller makes a sale to a Kansas resident, the sales tax does not apply. However, K.S.A. 79-3703 imposes a "use tax" "for the privilege of using, storing, or consuming within this state any article of tangible personal property." The use tax applies "if the same property or transaction would have been subject to the [sales] tax had the transaction been wholly within this state." In fact, the state may be able to require an out-of-state seller to collect the Kansas use tax, but only if the seller has a sufficient business presence, or "nexus," in Kansas. Local use tax would not usually apply because Kansas only imposes a local use tax on motor vehicles and boats.

However, if the out-of-state seller does not have nexus in Kansas, then we have no jurisdiction over that seller and cannot require it to collect the state use tax. The U.S. Supreme Court has ruled that "nexus" requires a physical presence in a state. Thus, the crux of the "internet taxation" issue is that a state cannot require an out-of-state seller with no physical presence in the state to

¹ Public Law 105-277 (1998).

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collect its sales or use taxes. In *Quill v. North Dakota*, the U.S. Supreme Court reviewed State arguments that, in the absence of a “physical presence,” an “economic presence” should be enough to satisfy the nexus requirement.² But the *Quill* Court balanced the State’s interests against the remote seller’s administrative burden of collecting tax for multiple states, and rejected the State’s argument. The Court found a remote seller does not have nexus when its only physical contact with a state is through the U.S. mail and common carriers.

When a remote seller does not collect our use tax, the Kansas buyer is required to pay the use tax directly to the state. Business customers buying from remote sellers *are* generally aware of the use tax requirement and will remit it to the state if the seller does not collect it up-front. KDOR auditors routinely audit for and assess any unpaid use tax during the course of a Kansas business’s sales tax audit. However, household customers are not generally aware of the use tax. If the remote seller does not collect the tax from them, it is likely to go unremitted. This gives the non-collecting remote seller a perceived price advantage, compared to a main street Kansas retailer who is required to collect sales tax. This price advantage is real to the extent that Kansas statutes do not allow the imposition of a *local* compensating use tax.

Summary

- Kansas Seller: Seller collects State and Local Sales Tax
 - Out of State Seller with Nexus: Seller collects State Use Tax
 - Out of State Seller with out Nexus: Buyer must remit State Use Tax
-

Years ago, this was not a big issue. Retail businesses were almost entirely local, and catalogue sales by remote sellers were a small part of the total retail market. Today, the internet is creating new, convenient ways to transact retail business with out-of-state sellers. A rapidly expanding internet market, together with a burgeoning catalogue market, is turning retailing into a regional or even national industry, where a seller often has no physical presence in the buyer’s state. A growing percentage of the retail market is supplied by remote sellers which cannot be required to collect our use tax. In fact, many internet sites now incorrectly advertise that purchases are “tax free,” further confusing household buyers who are trying to understand their responsibility to pay the use tax.

Local businesses, consumers, and state and local governments all have a stake in rectifying the current situation:

➤ **Local business.**

Remote sellers are competing with Kansas main street businesses. Kansas businesses are disadvantaged by having to collect and remit state and local sales tax, while remote sellers and their customers do not. Rectifying this imbalance is necessary to create a level competitive playing field for local Kansas businesses.

➤ **State and Local Government.**

Sales and use taxes are currently one of the largest revenue raisers at the state level. In fiscal year 1999, they accounted for \$1.6 billion, or 40.2%, of State General Fund revenue. Nationally,

² *Quill v. North Dakota*, 504 U.S. 298, 112 S.Ct. 1904 (1992).

these taxes are the largest state revenue raisers. For the year ending March 31, 1998, general state sales and use taxes produced \$150.1 billion, or 33.1% of total state tax collections.³

The expected growth in the market share of remote sales poses a significant risk to the Kansas retail sales tax base. Offsetting increases in Kansas compensating use tax collections are unlikely. And, at the local level, there is no chance of offset because Kansas local governments have no authority to impose a compensating use tax, with the exception of motor vehicle and boat sales. Assuming un-taxed internet consumer sales in the U.S. will reach \$100 billion by 2003, and assuming Kansas accounts for 1% of this electronic commerce, Kansas state sales/use tax foregone on internet remote sales would amount to approximately \$49 million by 2003. Based on a detailed 1994 study by the ACIR, we have estimated current fiscal year 2000 revenue loss from all remote sales (internet, mail, phone, fax or otherwise) to be approximately \$50 million.

➤ **Kansas Buyers.**

Kansas business and household buyers are currently required by law to remit the use tax directly to the state if the seller does not collect it. We believe these business taxpayers would rather the seller simply collect and remit the tax for them. Filling out and remitting another tax form is especially burdensome for household buyers struggling to comply with the law. Administratively, it is much more efficient to handle several hundred more use tax returns from sellers, than to receive several thousand more returns from buyers.

2. Efforts to Address the Issue.

A. Efforts at the Federal Level.

Efforts at the federal level are focused on the Advisory Commission on Electronic Commerce. This 19 member commission was given 18 months to produce a final report to Congress. Unfortunately, it got off to a slow start. It took the Commission 6 months to identify its membership and organize itself. To date, there is no consensus among the group. Six of the 19 members are proposing a recommendation to 1) extend the moratorium another five years or make it permanent, 2) encourage states to draft a Uniform State Sales and Use Tax Act within three years after the moratorium expires, and 3) "equalize the burden" between local and remote sellers using a mechanism for achieving revenue neutrality, so that extending sales tax collection to remote sellers would not result in a windfall to states.⁴ Some version of the proposal also calls for eliminating taxes on several types of telecommunication service. The Commission's final meeting is scheduled for this March and its final report is due in April.

B. Action at the State Level – SB 560.

On the state level, the approach has been very different. All of the major national associations of state and local governments have worked together to address the administrative burden which has been the barrier to voluntary collection by remote sellers. Led by the National Conference of State Legislators, these groups have envisioned a burdenless, simple, streamlined system that would use new software technology to collect sales and use taxes from mail-order and Internet sellers, rather than from their buyers. The system would be completely voluntary to states and to remote sellers. SB 560 is enabling legislation that allows the state of Kansas to participate in developing this system.

The language of SB 560 is uniform language developed by the National Conference of State Legislators and the National Governor's Association. As of last week, it has been endorsed by each of the "Big Seven:" the National Governor's Association, the National Conference of State

³ U.S. Bureau of the Census, National Totals for State Tax Revenue by Type of Tax (1999).

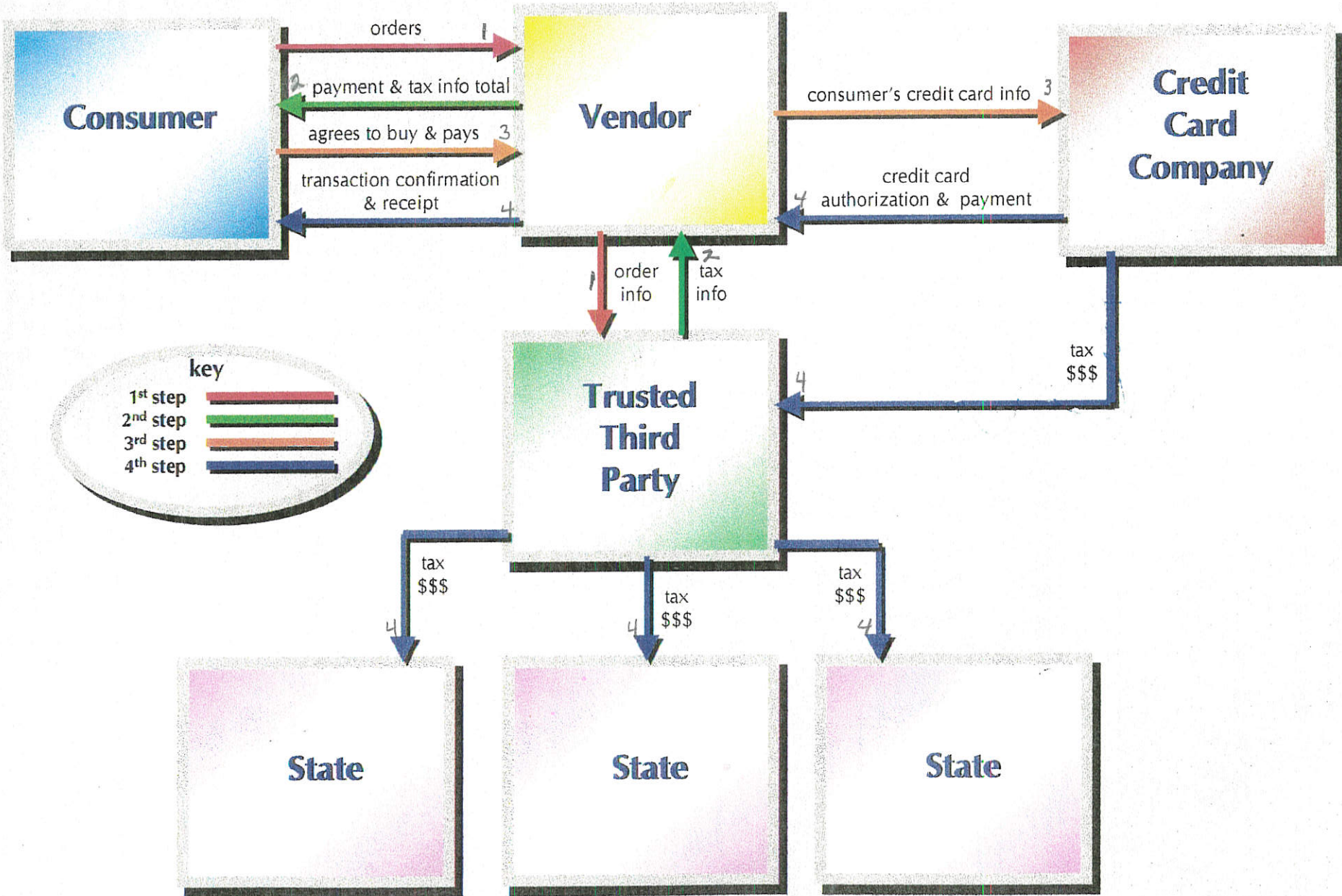
Legislatures, the Council of State Governments, the National Association of Counties, the National Conference of Mayors, the National League of Cities, and the International City/County Management Association. Already, there are at least 10 states in which bills have been introduced or some legislative-executive accord is being created.

SB 560 identifies its principles and intent as 1) competitive neutrality, 2) preserving state and local revenue, 3) providing neither discriminatory nor preferential treatment to remote sellers, 4) simplifying tax administration, and 5) promoting uniformity and fairness. SB 560 has five other main provisions.

- **Directs Participation in Discussions.** (section 3) The department of revenue is directed to enter discussions with other states for a streamlined sales and use tax collection system.
- **Allows Participation in a Joint Request for Information.** (section 3) It allows the department to join other states in issuing a "Joint Request for Information" regarding the development of a streamlined sales and use tax collection system.
- **Allows Participation in Pilot Project.** (section 4) It allows the department to enter into joint agreements for a pilot project:
 - The administration, imposition and collection of the tax under the pilot project must result in revenues that are the same as would be paid under existing law
 - The parties to the pilot project agreement are excused from complying with provisions of sales and use tax statutes to the extent a different procedure is required (e.g. returns not submitted by retailer, exemption certificates not submitted to retailer)
 - The agreement must terminate no later than December 31, 2001
- **Addresses Confidentiality Concerns.** (section 5) It provides explicit statutory authority for the parties to have access to confidential tax information and imposes the same confidentiality requirements on the parties as are currently imposed on the department. Our current statutes generally would allow this as they allow a third party vendor access to confidential information where the secretary of revenue determines that access is critical to the completion of a project.
- **Creates Structured Legislative Oversight.** (sections 6 and 7) It creates a Legislative Oversight Committee and directs the department to provide testimony and information quarterly and on an as requested basis. The department is also required to provide quarterly progress reports to the Governor, Speaker of the House, Minority Leader of the House, Senate President, and Senate Minority Leader, as well as the Legislative Oversight Committee. By March 1, 2001, the department is directed to provide a final report including a status of the discussions, a description of the proposed system, if any, and recommendation as to whether state should participate in the proposed system.

The NCSL, NGA, Federation of Tax Administrators, Multi-state Tax Commission and others will meet in March & April to begin developing specifications for a pilot model system.

With Trusted Third Party



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Attachment 2



Testimony concerning SB 560
Senate Assessment and Taxation Committee
February 10, 2000
Presented by Randy Allen, Executive Director
Kansas Association of Counties

Madam Chair and members of the committee, my name is Randy Allen, Executive Director of the Kansas Association of Counties. Thank you for the opportunity to testify *in support of SB 560*, directing the Department of Revenue to enter into discussions to develop a multi-state, voluntary, streamlined system to administer and collect sales and use taxes.

As the world of commerce continues to change and a relatively larger percentage of sales are conducted over the internet or by mail order catalogue, we are concerned about the continued viability of the state and local option sales taxes to finance basic services. We are concerned about the state sales and use tax because it is the source of two of three demand transfers for counties and other local governments (i.e. the Local Ad Valorem Tax Reduction Fund and the City-County Revenue Sharing Fund). Additionally, we are concerned about the viability of county option sales taxes levied in 74 of 105 counties. Without dependable local-option sales taxes, we would be even more dependent upon the property tax to finance basic services.

We strongly support the basic premise of the bill, i.e. that all sales, wherever they take place, should be treated the same with respect to taxation, without preference or disadvantage to vendors. We also believe in the fundamental right for states to establish their own sales tax rates and for local governments, within statutory guidelines, to adopt local-option sales taxes.

Kansas' participation in discussions with other states is important to assure that our interests in the state sales tax are protected. Full protection of the local-option revenue base is not assured, however, without applying the local use tax to all sales, in addition to only motor vehicles and watercraft as is currently done. At some point in the future, we hope to have a discussion with the committee about this related issue.

If you have questions, I would be happy to respond. Thank you.

The Kansas Association of Counties, an instrumentality of member counties under K.S.A. 19-2690, provides legislative representation, educational and technical services and a wide range of informational services to its member counties. Inquiries concerning this testimony should be directed to Randy Allen or Judy Moler by calling (785) 272-2585.

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League of Kansas Municipalities

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MEMORANDUM

TO: Senate Assessment and Taxation Committee
FROM: Don Moler, Executive Director
DATE: February 15, 2000
RE: Support for SB 560

First I would like to thank the Committee for allowing the League to appear today in support of SB 560. The League cannot overstate how important accurate, ongoing collection of the sales tax is to local government in this state. Specifically, there are two principle methods by which local government is funded in Kansas. Those being the property tax and the sales tax. As I am sure you are all aware, the sales tax is an intricate part of local financing and without it many local services could not be provided. As a result, anything which improves and strengthens the sales tax system of collection and enforcement is something the League is very interested in pursuing.

We believe the bill before you is a very good first step in attempting to respond to changes in technology and the ongoing sophistication of electronic commerce. As technology brings more and more people to the Internet, and thus to e-commerce, the issue of collecting sales tax on remote sales will become one of even greater significance. We are therefore very supportive of this initiative.

One aspect of the sales tax issue which we believe the state must explore is to impose a local compensating use tax which would allow for the collection of local sales tax by remote jurisdictions. While the current law, and SB 560, would allow for voluntary compliance with the compensating use tax at a 4.9% rate, which represents the state sales tax effort, it would not allow local units of government to recover locally lost sales taxes which should also be recovered. This is a key for the 21st century health of local governments in Kansas. Without the local effort on sales tax, many local services will not be provided. Thus we must not forget that a local compensating use tax is necessary to allow local governments to recover local sales taxes which otherwise will be lost to the citizens and the taxpayers of Kansas.

Thank you very much for allowing the League to speak here today in support of SB 560. I would be happy to answer any questions the Committee may have.

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Attachment 4



Johnson County, Kansas

Office of the County Administrator

**TESTIMONY ON SB 560
SENATE ASSESSMENT & TAXATION COMMITTEE
FEBRUARY 15, 2000
DANA FENTON, INTERGOVERNMENTAL RELATIONS COORDINATOR
JOHNSON COUNTY, KANSAS**

Madame Chair and members of the committee, my name is Dana Fenton, Intergovernmental Relations Coordinator for Johnson County, Kansas. Thank you for this opportunity to appear in front of the committee. I am here to express our SUPPORT for SB 560, the Streamlined Sales Tax System for the 21st Century.

Section 2 of this bill sets out several principles important to any system of taxation. Among these principles are that all transactions should be conducted in a competitively neutral manner. What this principle says to me is that sellers of the same products should have similar obligations to follow sales and use tax laws. Currently, out of state remote sellers do not have the obligation to collect and remit sales and use taxes to the State where the buyer is located. The in-state sellers, whether remote or not, have that obligation. As a result, State and local governments are losing needed sales and use tax revenues.

With the advent of the Internet, more sales will take place electronically due to its relative ease and comfort. However, this situation will further erode the sales and use tax bases of local and State governments. Sales and use taxes make up a significant portion of local and State government's revenue budgets. Thus, this situation must not be allowed to continue.

This bill, although it doesn't authorize the taxation of Internet sales, does authorize the State of Kansas to enter into discussions with other states to explore what could be done to minimize the administrative burden of out of state remote retailers if they were to collect sales and use taxes. Remote sellers often sell their products in all 50 states and many foreign countries. I am sure that the number of sales tax exemptions unique to the State of Kansas is considerable. Duplicate this situation in the other 49 states and a retailer has a potential compliance problem in the offing. One of the keys to compliance with any law is the ease of compliance. This bill would pave the way for making any system easy to use.

A key goal of Johnson County's 2000 Federal & State Legislative Platforms is the extension of sales and use taxes to remote sellers. We recognize that the path to realizing this goal may consist of several intermediate steps, such as passage of SB 560. Yet, we believe this is a necessary step. Madame Chair and members of the Committee, we respectfully request favorable consideration of SB 560.

Thank you and I will be glad to stand for questions.

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Attachment 5*

LEGISLATIVE TESTIMONY



The Unified Voice of Business

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SB 560

February 15, 2000

KANSAS CHAMBER OF COMMERCE AND INDUSTRY

Written Testimony Before the
Senate Assessment and Taxation Committee

by

Marlee Bertholf
Director of Taxation & Small Business

Madam Chair and members of the Committee:

My name is Marlee Bertholf and I am the Director of Taxation and Small Business for the Kansas Chamber of Commerce and Industry (KCCI). Thank you for the opportunity to provide written testimony in support of SB 560.

In the age of mail order transactions and internet commerce, complex problems arise in collecting and remitting the proper sales and use tax. There are thousands of taxing jurisdictions within the United States and many more when considering international markets. Unilateral or premature actions on the part of individual states or units of government could have an unintended effect on the growth and development of the internet and its contribution to our economy.

The Kansas Chamber of Commerce and Industry (KCCI) is a statewide organization dedicated to the promotion of economic growth and job creation within Kansas, and to the protection and support of the private competitive enterprise system.

KCCI is comprised of more than 2,000 businesses which includes 200 local and regional chambers of commerce and trade organizations which represent over 161,000 business men and women. The organization represents both large and small employers in Kansas, with 48% of KCCI's members having less than 25 employees, and 78% having less than 100 employees. KCCI receives no government funding.

The KCCI Board of Directors establishes policies through the work of hundreds of the organization's members who make up its various committees. These policies are the guiding principles of the organization and translate into views such as those expressed here.

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Yet, an issue of tax equity remains. KCCI's Taxation and Public Finance Committee adopted a policy in 1986 that supports voluntary, multi-state compacts and tax simplification. We believe that Kansas cannot solve these issues alone, but must work together with other states to overcome jurisdictional and international roadblocks.

KCCI supports SB 560 and believes that this a sound first step in addressing these very difficult issues.