Approved: January 28, 2003
Date

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE

The meeting was called to order by Chairperson David Corbin at 10:40 a.m. on January 22, 2003, in Room 519-S of the Capitol.

All members were present except: Senators Lee and Pugh

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

Conferees appearing before the committee: Joan Wagnon, Acting Secretary, Kansas Dept. of Revenue
Richard Cram, Kansas Department of Revenue

Others attending: See attached list.

Senator Corbin reminded the Committee that the 2002 interim taxation committee recommended the formation of a working group composed of House and Senate members to study the issue of the property tax exemption for independent living units owned by not-for-profit nursing homes and to develop appropriate legislation by February 1, 2003. He announced that the Senate members of the working group will include himself, Senator Clark, and Senator Goodwin. The group will meet during the week of January 27.

Update on the Streamlined Sales Tax Project

Senator Corbin pointed out that the Streamlined Sales Tax Project involves a voluntary system and that implementing states cannot mandate the collection of sales tax on remote sales by retailers who have no physical presence in the state until Congress gives them the authority to do so. He observed that, if enough states support the Streamline Sales Tax Project this year, Congress will seriously reconsider the moratorium on state and local government taxation of electronic commerce. He went on to inform the Committee that he has been actively involved in meetings for implementing states during the past six months. In addition, Rick Clelland, Kansas Department of Revenue, attended the meetings. They were able to vote on the adoption of the final version of the Streamlined Sales Tax Agreement at a meeting held in Chicago in November 2002. He noted that the entire Streamlined Sales Tax Agreement can be downloaded from the following website: www.stremlinedsalestax.org.

Joan Wagnon, Acting Secretary, Kansas Department of Revenue, expressed her support for the streamlined sales tax, noting that it responds to concerns about the loss of tax revenue on remote sales she has heard in the past both as a state legislator and as Mayor of the City of Topeka. She informed the Committee that Mr. Clelland just left for Florida to participate in a study of issues involving proposals for future additions to the Streamlined Sales Tax Agreement, although the Agreement will not be amended further until participating state legislatures have had the opportunity to adopt conforming legislation this year.

Ms. Wagnon followed with a summary of her written testimony regarding the current status of the Streamlined Sales Tax Project and the legislation needed to conform to the Agreement. (Attachment 1) She pointed out that the Project is currently in Phase 2, which involves the adoption of the Streamlined Sales Tax Act by participating state legislatures. She explained that Phase 3 involves implementation of the Agreement, which will take effect once at least ten states with at least 20 percent of the total population of states imposing sales tax have adopted the Act and have made the necessary legislative changes to meet the uniformity requirements. The goal is to have the Agreement implemented by fall of this year. With regard to her summary of legislation recommended by the Department, she noted that the major changes in Kansas law will involve the following issues: (1) Equalizing the state and local tax bases for water utility sales for residential or agricultural use, (2) Uniform sourcing to determine the correct local sales tax applying to the transaction, and (3) Compensating use tax at the local level. She noted that the Department's proposed bill is in the process of being drafted and will not take effect until July 1, 2004. In conclusion, she held up a copy of a booklet explaining the streamlined sales tax which the Department has recently made available to the public.

Richard Cram, Director of Policy and Research for the Kansas Department of Revenue, joined Ms. Wagnon in answering Committee questions regarding the compensating use tax. Noting that the unfair advantage remote retailers have over local retailers is a real problem, Ms. Wagnon assured the Committee that the Department is willing to work on a sensible solution.

Senator Corbin informed the Committee that a more in depth explanation of the Streamlined Sales Tax Agreement will be presented at a future meeting. In addition, Mr. Clelland will report on the Florida meeting. He commented that the driving force behind the streamlined sales tax is the fact that all states are having revenue problems. In addition, the telecommunication industry and large retailers such as Wal-Mart and Sears support the streamlined sales tax because it will clarify and simplify the collection of sales taxes.

Senator Clark moved to approve the minutes of the January 14 and January 15 meetings, seconded by Senator Donovan. The motion carried.

The meeting was adjourned at 11:25 a.m.

The next meeting is scheduled for January 28, 2003.

SENATE ASSESSMENT AND TAXATION COMMITTEE
GUEST LIST

DATE: January 22, 2003

NAME	REPRESENTING
Ron Seeber	Hein Law Firm
Ann Durkes	DOB
Joan Wagnon	KDOR
Richard Cram	KDOR
Steve Stotts	KDOR
Danielle Noe	Johnson County
Jackie Clark	Hallmark Cards
Erik Sartorius	City of Overland Park
Tom Bruno	GBBA
John Frederick	Boeing
Derenda Mitchell	KLA
Todd Johnson	KLA
Michael White	Kearney & Assoc.
Donn Teske	Ks Farmers Union
Michael Hooper	intern Sen. Lee
Carolyn McNamara	Intern Sen. Allen
Martha Neu Smith	KMHA
Doug Smith	PSA
Mike Taylor	City of Wichita

SENATE ASSESSMENT AND TAXATION COMMITTEE
GUEST LIST

DATE: January 22, 2003

NAME	REPRESENTING
Deann Williams	KMCA
Brian Shepard	Intern. Rep. Miller
Larrie Ann Lower	KS Govt Consulting
Mike Irvin	Kansas Farm Bureau
Janet McPherson	" " "
Larry R Baer	LKM
Judy Moler	KAC

KANSAS

JOAN WAGNON, ACTING SECRETARY

DEPARTMENT OF REVENUE
OFFICE OF THE SECRETARY

KATHLEEN SEBELIUS, GOVERNOR

January 22, 2003

To: Senator David Corbin, Chair
Senate Committee on Assessment and Taxation

From: Joan Wagnon

Re: Current Status of the Streamlined Sales Tax Project
Summary of Legislation Needed to Conform to the Agreement

The Streamlined Sales Tax Project (SSTP) responds to the concerns of merchants about the difficulties in dealing with different States' sales tax laws, and to State and local government concerns about loss of revenues from remote retail sales by mail-order, telephone and the Internet. The SSTP also seeks to "level the playing field" between in-state and out-of-state merchants regarding the tax burden on retail sales to customers in the taxing State. The SSTP's goal is to make administration of State sales and use tax laws more uniform, efficient, and less burdensome on multi-state merchants. The SSTP seeks to provide incentives for multi-state merchants to voluntarily collect and remit use tax on sales to customers in States where they may not have any physical presence or legal obligation to collect and remit. If the SSTP is successful in demonstrating to Congress significant reform in making sales tax laws more uniform and less administratively burdensome on multi-state retailers, then Congress may decide to authorize those States to impose use tax collection duties upon remote retailers. The SSTP enjoys the strong support and active involvement of 34 participating States, as well as the National Governors Association (NGA), National Conference of State Legislatures (NCSL), Federation of Tax Administrators (FTA) and the Multistate Tax Commission (MTC). More information on this Project is available by visiting the following website: www.streamlinedsalestax.org.

Phase 1

Phase 1 of the Streamlined Sales Tax Project began in March, 2000 and involved the drafting and approval of the Uniform Sales and Use Tax Administration Act ("Act") and Streamline Sales and Use Tax Agreement ("Agreement") (available on the website) by the participating States. The Act and Agreement were submitted to the participating States for consideration by their respective legislatures, beginning in January of 2001. However, two versions of the Agreement existed at that time, one version approved by the SSTP, and another, containing several changes, approved by the National Conference of State Legislatures (NCSL).

Phase 2

Senate Assessment + Taxation
1-22-03
Attachment 1

Phase 2 encompassed the efforts by the legislatures of the participating States in adopting the Act and making the legislative changes necessary to conform to the uniformity requirements of the Agreement. At present, at least 32 States (including Kansas, after passage of 2002 Senate Bill 472) and the District of Columbia have passed some form of the Act and are now considered Implementing States. South Carolina most recently joined this group (July 2002). Wyoming, Minnesota, Illinois and North Carolina have adopted both the Act and the Agreement.

Phase 2 also involved consideration and approval by the Implementing States of various amendments and additions to the Agreement, in order to produce one version of the Agreement acceptable to all. An inaugural meeting of the Implementing States of the Streamlined Sales Tax Project was held November 28-29, 2001, in Salt Lake City, Utah. The NCSL and National Governors' Association (NGA) worked closely with this group. The Implementing States finalized and approved the amendments, and one version of the Agreement was adopted at the Chicago meeting held November 12, 2002. Senator David Corbin and Rick Clelland from the Department participated in that historic meeting. Now that the Agreement has been finalized, participating States' legislatures will be need to consider the sales tax statutory changes needed to conform to the uniformity requirements of the Agreement this year.

The Streamlined Sales Tax Project group, which serves in an advisory capacity to the Implementing States and consists largely of tax administration officials from participating states, will be meeting in Tampa, Florida on January 23-24 to study issues involving proposals for future additions to the Agreement. Rick Clelland of the Department will be attending the Tampa meeting. Although future additions to the Agreement will be discussed, the Agreement will not be amended further until participating State legislatures have had the opportunity to adopt legislation conforming to it this year. The text of the Agreement (69 pages) can be downloaded from the Project website.

The Department is working with the Revisor of Statutes on the draft legislative proposal containing the sales tax law changes that will need to be made in order for Kansas to join the Agreement. A summary of the legislative changes needed to conform to the Agreement is attached.

Phase 3

Phase 3 will involve implementation of the Agreement. Under the governance language in the Agreement recently approved by Implementing States, the Agreement will take effect once at least 10 States with at least 20% of the total population of States imposing sales tax have adopted the Act, made the necessary legislative changes to meet the uniformity requirements, and joined the Agreement. Those States will make the Streamlined Sales Tax System operational. The goal of the participating States is to have the Agreement implemented by the fall of this year, with the required number of States having joined the Agreement by then.

Moratorium on Internet Taxation

The Internet Tax Freedom Act (ITFA), passed by Congress in 1998, placed a moratorium on State and local government taxation of Internet access fees and imposition of multiple or discriminatory taxes on electronic commerce. Although the moratorium expired on October 21, 2001, Congress re-imposed the moratorium in H.R. 1552 (signed into law November 28, 2001) for two years until November 1, 2003. Several legislative proposals were introduced in Congress during the months leading up to the October 21, 2001 expiration date, raising two issues: (1) whether States' progress on streamlining sales tax laws should be coupled with Congressional authorization for States to impose use tax collection duties on remote retailers; and (2) whether Congress should legislate higher nexus standards for various state business taxes. Neither of these issues were resolved and both will likely continue to be debated during the current two-year moratorium.

During the debate over whether to extend the ITFA moratorium, the lobbying efforts of the NGA, NCSL, MTC and FTA, as well as retail organizations and various States, communicated to Congress the current tight fiscal situation of the States, the serious loss of uncollected tax revenues occurring with Internet and other remote retail sales, and the importance to the States of linking progress on sales tax simplification with Congressional authorization for States to impose use tax collection duties on remote retailers. With the two-year re-imposition of the moratorium, the States have the opportunity to show Congress significant progress on sales tax simplification by the time the moratorium approaches expiration next fall. The groundwork has been laid for Congress to address the authorization issue then. Implementation of the Agreement by a sufficient number of States prior to next fall will go a long way toward making the necessary demonstration of sales tax simplification reform to Congress.

The report entitled "State and Local Sales Tax Revenue Losses from E-Commerce: Updated Estimates" (and its earlier version) by Donald Bruce and William F. Fox, Center for Business and Economic Research, University of Tennessee, dated September 2001 (copy available), has been cited to Congress by those testifying in support of the SSTP and the need for Congress to authorize States to require remote retailers to collect and remit use tax on retail sales. This report estimated that for 2001, States would collectively lose $7 billion in new sales/use tax revenue from e-commerce retail sales. Of that $7 billion figure, the report estimates that $71.2 million is Kansas' loss.

Conclusion

The Implementing States finalized and approved the Agreement last fall. State legislatures will need to consider sales tax law changes to conform to the Agreement in this year, in order for those States making the necessary legislative changes to be able to join the Agreement. Congress has approved a new two-year moratorium on Internet access fees and discriminatory taxes, which expires November 1, 2003. States involved in the SSTP now have the opportunity to demonstrate progress in the sales tax simplification effort by implementing the Agreement and raising the issue of Congressional authorization for States to impose use tax collection duties upon remote retailers.

SUMMARY OF KANSAS LEGISLATIVE CHANGES REQUIRED BY STREAMLINED SALES TAX AGREEMENT

Effective Dates of Changes
The Department's legislative proposal generally provides that the legislative changes will not take effect until on or after July 1, 2004. In some instances, certain provisions would become effective upon Kansas joining the Agreement, and in a very few instances, the provision would become effective as of July 1, 2003.

State Administration of Local Sales and Use Taxes
Already in place in Kansas.

State and Local Tax Bases Identical
After December 31, 2005, state and local tax bases must be identical. With the provision allowing for multiple rates for food and food ingredients, and excepting out sales of electricity, gas, other heating fuels, motor vehicles, aircraft, watercraft, modular homes, manufactured homes and mobile homes from the "one rate" requirement, the only state vs. local tax base disparity that will need to be legislatively addressed concerns water utility sales. Water utility sales for residential or agricultural use are exempt from state sales tax but are not exempt from local sales tax. Our legislative proposal eliminates the state-level exemption for water utility sales for residential or agricultural use, thus equalizing the state and local tax bases.

Adoption of Broad Local Use Tax
Many states have a local use tax, along with a state use tax. In Kansas, the local use tax applies only to out-of-state purchases of boats and motor vehicles. In order to level the playing field between in-state "brick and mortar" retailers and remote retailers concerning the tax burden on retail sales to Kansas customers, a broad local use tax should be enacted. This would also permit local governments to benefit from use tax collections from remote sales. Our legislative proposal includes a broad-based local use tax, which would automatically go into effect at the same rate as any local sales tax in place, although this is not a requirement of the Agreement.

Include "Services" in Use Tax Imposition
Many states (including Kansas) only impose use tax on out-of-state sales of tangible personal property used or consumed in the taxing state. Other states impose use tax on both tangible personal property and services "used" or "consumed" in the state. The Agreement imposes no requirement either way on states in this regard. A state may choose to impose use tax on tangible personal property, services, or both. Our legislative proposal includes extending the use tax to services, as well as tangible personal property. Again, if the objective is to level the playing field between in-state retailers and remote retailers concerning the tax burden on retail sales to Kansas customers, use tax should be imposed on both tangible personal property and services used or consumed in the state.

Seller Registration
Provide for electronic seller registration, registration by an agent for the seller, and no written signature requirement on the seller, no registration fees for voluntary registrations.

State and Local Tax Levies
Provide advance notice of state sales tax rate changes to retailers, limit effective date of rate change to first day of the calendar quarter (no June 1 effective dates). Kansas law currently provides no notice requirement for state rate changes.

Provide uniform rule for effective dates of rate changes on services for period starting before and ending after rate change.

Local sales tax rate changes will not apply to printed catalog purchases until 1st day of calendar quarter after 120 days notice to sellers. Otherwise, local sales tax rate changes will not apply until the 1st day of the quarter after 60 days notice to sellers.

State must provide and maintain database of all boundary changes for taxing jurisdiction, including effective dates of local rate changes. Boundary changes will not apply until the 1st day of the quarter after 60 days notice to sellers.

State must provide and maintain database of all sales and use tax rates for all taxing jurisdictions in state, using Federal Information Processing Standards in format jointly agreed to by states.

The database must assign 5 and 9 digit zip codes within State to proper rates and taxing jurisdictions.

State must participate with other member states in developing address-based system for assigning taxing jurisdictions, meeting federal Mobile Telecommunications Sourcing Act requirements.

Sellers are relieved of liability for charging incorrect rates, if they relied on State's database for the rates/boundaries.

The database development requirements of the Agreement will involve significant administrative costs for the Department. However, these database requirements do not need to be implemented prior to the State joining the Agreement.

Uniform Sourcing Rules
This will require a major change to Kansas sales tax law, which generally sources retail sales to the retailer's business premises. Sourcing refers to the process of identifying the location for purposes of determining the correct local sales (or use) tax that should apply to the transaction. The Agreement requires that sales be sourced to the seller's business location if the product is received at that location, if not, to the location where the product is received by the purchaser, if known, or if not, to the address provided by the purchaser to the seller. There are special rules for sourcing telecommunications services. The Agreement excepts out sales of motor vehicles, aircraft, watercraft, modular homes, manufactured homes or mobile homes from the sourcing provisions. The existing origin-based sourcing rules (source to the retailer's business location) will apply to sales of those items.

Administration of Exemptions
Purchasers can claim sales tax exemptions at the time of purchase using electronically filed exemption certificates that need not be signed if electronically filed. So long as the seller collects the information required on the exemption certificate at the time of purchase and maintains that information for the state to audit, the seller is relieved of liability for the tax, if the

purchaser has improperly claimed the exemption. Kansas law currently imposes a "good faith" obligation on the seller in accepting an exemption certificate and only provides for signed exemption certificates. The "good faith" acceptance obligation is eliminated under the Agreement.

Uniform Tax Returns

The Agreement requirements can be met with minor statutory changes.

Uniform Rules for Remittances of Funds

Most of the Agreement requirements can be met with minor statutory changes. However, a state has the option of requiring all remittances from Model 1, 2 and 3 sellers to be electronic. The proposal includes the electronic remittance requirement for Model 1, 2 and 3 sellers.

Uniform Rules for Recovery of Bad Debts

Uniform procedures for bad debt recovery are provided. States retain the option of allowing parties other than the seller (such as a third party financier) to recover bad debts. Kansas law does not provide bad debt recovery for third parties other than the seller. The proposal includes a statutory provision that essentially outlines Kansas' current policy with regard to bad debt recovery.

Confidentiality and Privacy Protections

Confidentiality requirements must be imposed on Certified Service Providers. Existing law confidentiality requirements remain in place.

Sales Tax Holidays

The Agreement imposes certain restrictions on sales tax holidays. Since Kansas law does not provide for any sales tax holidays, no legislation is necessary. Should a sales tax holiday be enacted at some point, it will be subject to those restrictions.

Caps and Thresholds

The Agreement restricts caps and thresholds after December 31, 2005, but these restrictions do not apply to sales of motor vehicles, aircraft, watercraft, modular homes, manufactured homes or mobile homes. Kansas law currently has no caps or thresholds, except with respect to manufactured homes. No legislation should be necessary.

Rounding Rule

Rounding to the third decimal; tax may be computed on an item or invoice basis. Bracket systems must be eliminated; rounding rules should be applied to aggregated taxes. Kansas currently follows the rounding rule proposed in the Agreement. Legislation would only be needed to codify existing practice.

Uniform Definitions

Definitions in the Agreement of terms that are used in Kansas statutes must be adopted. Tangible personal property—the Agreement does not include custom software in the definition, although it does include prewritten (canned) software. Custom software must be defined as a service under the Agreement, creating the anomaly that canned software is tangible personal property, but custom software is a service. This past session, the Kansas legislature included custom software in the definition of tangible personal property and imposed sales tax on it. Given that custom software is treated as a service under the Agreement, it is important to extend the use tax imposition in Kansas to include services.

The following other definitions in the Agreement are currently used in Kansas sales tax statutes: computer-related terms, food-related terms, tangible personal property, drug, prescription, durable medical equipment, prosthetic device, mobility enhancing equipment, lease or rental, and need to be adopted. The following definitions in the Agreement are not used in Kansas sales tax statutes, so would not need to be added: candy, prepared food, soft drinks, clothing, clothing accessories and equipment, sport or recreational equipment, protective equipment, over-the-counter-drug, grooming and hygiene products.

Seller Registration
Uniform seller registration provisions are required. A newly registering seller must be given amnesty for uncollected sales tax for periods prior to registration, absent fraud (unless the seller has registered in Kansas within the 12 months prior to Kansas joining the Agreement). Kansas sales tax law currently has no amnesty provisions.

Provider and System Certification
Certification procedures are provided.

Monetary Allowances (Subject to Cost of Collection Study)
Certified Service Providers under Model 1, and sellers under Models 2 and 3 must be provided a monetary allowance by the state (base rate and for first 24 months a percentage or revenue collected from retailers registering and collecting voluntarily, rates to be contractually negotiated between certified service providers and the governing board of the member states). States have the option of providing vendor discounts on a permanent basis. Kansas law currently does not provide any compensation to sellers for collecting sales or use tax. The legislative proposal does not address this issue, because the compensation rates are subject to future negotiations. Once those compensation rates are established, the needed legislative change can be made to adopt those rates.