

MINUTES OF THE HOUSE TAXATION COMMITTEE

The meeting was called to order by Chairman Kenny Wilk at 9:00 A.M. on January 21, 2005 in Room 519-S of the Capitol.

Committee members absent: Representative Nile Dillmore- excused  
Representative Nancy Kirk- excused  
Representative Bruce Larkin- excused

Committee staff present: Chris Courtwright, Legislative Research Department  
Richard Cram, Department of Revenue  
Rose Marie Glatt, Committee Secretary

Conferees appearing before the committee:  
Representative Paul Davis, Legislator  
Representative Mario Goico, Legislator  
Secretary Wagon, Department of Revenue

Others attending:  
See attached list.

The Chairman opened the floor for bill introductions

Representative Davis made the motion that a bill be introduced regarding sales tax exemption for "Friends of the Library". Representative Treaster seconded the motion. The motion carried.

Representative Goico made the motion that a bill be introduced relating to a sales tax exemption for the purchase of materials for a playground for mentally challenged children. Representative Owens seconded the motion. The motion carried.

Mr. Courtwright provided an overview of Streamlined Income Tax. Copies of a briefing paper, by Martha Dorsey, Principal Analyst were distributed (Attachment 1).

Chronology of Kansas-related events and the Summary of Key Kansas Legislation were reviewed.

Discussions followed regarding: differences between streamline sales tax and destination sourcing, ramifications of changes to Kansas businesses, impact of the new local use tax, and a moratorium on streamlined sales tax.

Staff agreed to provide information reflecting the amount of revenue generated during the initial stage of destination sourcing.

Secretary Wagon cited the Department's efforts to facilitate new tax law conversions for small businesses, giving several examples. She introduced staff in attendance. Steve Stotts - Director of Taxation, Rick Clelland and Chad Sullivan - Customer Relations and Gary Centlivre - Manager of Electronic Commerce and Taxation stating that they had worked with a variety of businesses in order to initiate problem solving. The amount of businesses reporting has increased significantly while the number of calls for help are minimal. The total results will not be known until February 25<sup>th</sup>, when January sales taxes returns are due, providing their first real compliance measure. There has been a 34% increase in the number of people reporting on the state tax long form and reporting in multiple jurisdictions. Kansas is working with Tennessee, Ohio and Utah who are currently going through the conversion process.

The meeting was adjourned at 9:58 a.m. The next meeting is January 25, 2005.





## Taxation

V-3

### Streamlined Sales Tax Program

Other Taxation reports available:

V-1

### Low-Income Tax Relief

V-2

### 1992 School Finance Law Tax Provisions

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# Kansas Legislator Briefing Book 2005

## Taxation

### V-3 Streamlined Sales Tax Program

In 2002, the Legislature authorized the Kansas Department of Revenue (KDOR) to begin preparations for involving the state of Kansas in the multistate streamlined sales and use tax agreement (2002 SB 472). The law has been modified since then but is still in effect. Frequently referred to as the Streamlined Sales Tax Project by participating states, the purpose of the project is stated as being to "simplify and modernize sales and use tax collection and administration" (<http://www.streamlinedsalestax.org>, Executive Summary). The program has drawn significant attention at the national, state and local levels; in Kansas, most of this attention centers around the difficulty of changing from a source-based to a destination-based method of determining sales tax rates charged. The purpose of this topic is to outline (a) the history and legislative progression of the measure, and (b) the major points and their effect(s).

A chronology of Kansas-related major events follows:

**March 2000**—Streamlined Sales Tax Project is organized nationally.

**May 2000**—Kansas authorizes participation via SB 59 - Streamlined Sales Tax System for 21<sup>st</sup> Century Act. The Act allows the Kansas Department of Revenue to enter into discussions and agreements with other states in an effort to collect taxes on transactions involving remote sellers.

**May 2002**—SB 472 is enacted, authorizing the Kansas Department of Revenue to become a signatory to the multistate streamlined sales and use tax agreement and make preparations for its implementation.

**May 2003**—HB 2005 is enacted, making changes to state and local sales tax laws necessary to bring Kansas into compliance with requirements set forth in the multistate Streamlined Sales and Use Tax Agreement, most notably, the change to destination-based sourcing.

**Summer/Fall 2003**—Governor Sebelius establishes a "period of relaxed enforcement," stating retailers may use either the old origin-based sourcing rules or the new destination-based sourcing rules.

**May 2004**—Substitute for SB 147 is enacted, in which retailers are statutorily authorized, prior to January 1, 2005, to elect to use origin-based sales tax sourcing provisions in effect on June 30, 2003, as an alternative to the destination-based sourcing provisions which became effective July 1, 2003.

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## Background: National Perspective

- **The importance of the use tax grows**
  - The vast majority of states that impose a sales tax also impose a *compensating*, or *use*, tax if the sales tax does not apply to the transaction in question.
  - Nationally, the popularity of remote sales (those from mail-order and catalog establishments) grew in the late 1950's and early 1960's.
  - This trend raised the question of when a state could constitutionally impose a legal collection duty on remote sellers.
    - (Source: *A Lawmaker's Guide to the Streamlined Sales Tax Project*, 2002, The Deloitte & Touche Center for Multistate Taxation, Page 30.)
  
- **1967: *National Bellas Hess v. Illinois* (386 U.S. 753) - U.S. Supreme Court found:**
  - "... [A] state could not impose the duty of use tax collection and payment upon a seller whose only connection with customers in the State was through a common carrier or the U.S. mail."
  - "[T]he imposition of a collection duty on National Bellas Hess was unconstitutional, largely due to the burden imposed by the complexity of state sales tax systems."
  - "The majority opinion's finding of unconstitutionality was based, in part, on a recognition that "... the tests for determining violations of the Due Process Clause and the Commerce Clause [of the U.S. Constitution] were similar."
  - "[S]trongly worded dissent ... noted that such large-scale, systematic, continuous solicitation and exploitation of the Illinois consumer market is a sufficient nexus to require National Bellas Hess to collect from Illinois customers and to remit the use tax."
    - (Source: *A Lawmaker's Guide to the Streamlined Sales Tax Project*, 2002, The Deloitte & Touche Center for Multistate Taxation, Pages 30-31.)
  
- **The Subsequent 25 Years**
  - Mail order and catalog industry continues to grow very rapidly, as does the amount of uncollected use tax from individual consumers.
  - Late 1980's: State legislatures begin enacting legislation that "closely mirror[s] the language in the *National Bellas Hess* dissent."
  - State departments of revenue begin issuing use tax assessments against mail order/catalog sellers "... that were engaged solely in the exploitation of a local market on a regular, continuous and systematic basis."
    - (Source: *A Lawmaker's Guide to the Streamlined Sales Tax Project*, 2002, The Deloitte & Touche Center for Multistate Taxation, Page 31.)

- **1992: Quill Corporation v. North Dakota (504 U.S. 298)**
  - “The Supreme Court of North Dakota had upheld the state’s use tax assessment against Quill, based on a finding that the tremendous social, economic, commercial, and legal innovations since *National Bellas Hess* had rendered its holding obsolete.”
  - [The U.S. Supreme Court] “... for the first time differentiated between the tests for determining whether a tax was constitutional under the Due Process Clause or the Commerce Clause.... the Court found that *National Bellas Hess* had established a physical presence requirement before a state can impose sales and use taxes under the Commerce Clause.”
  - “[T]he Court noted that the underlying issue, collection of use taxes on remote sales, is not only one that Congress has the power to resolve, but is an issue that Congress may be better qualified to resolve. By separating the Due Process determination (where Congress has no power to act) from the Commerce Clause standard, the Court effectively cleared the way for Congress to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes.”
    - (Source: *A Lawmaker’s Guide to the Streamlined Sales Tax Project*, 2002, The Deloitte & Touche Center for Multistate Taxation, Pages 31-33.)
  
- **The Streamlined Sales Tax Project (SSTP)**
  - An effort created by state governments, with input from local governments and the private sector, “... to simplify and modernize sales and use tax collection and administration.” The SSTP was organized in March 2000.
  - “Forty-two states and the District of Columbia are involved in the SSTP. Forty-five states and the District of Columbia impose a sales and use tax.”
  - Goal: To provide states with a system that includes a number of features, including the following:
    - Uniform definitions within tax laws.
    - Rate simplification.
    - State level tax administration of all state and local sales and use taxes.
    - Uniform sourcing rules: Will be destination-based.
    - Simplified exemption administration for use-and entity-based exemptions: Purchasers, not sellers are to be responsible for paying the tax and, therefore, liable for uncollected tax.
    - Uniform audit procedures.
    - State funding of the system: States are to “... assume responsibility for funding some of the technology models.”
    - (Source: [www.streamlinedsalestax.org](http://www.streamlinedsalestax.org))

## Summary of Key Kansas Legislation

**2000 SB 59.** This bill included the Streamlined Sales Tax System for the 21<sup>st</sup> Century Act, which provided for the following:

- Authorized the Department of Revenue to enter into discussions and agreements with other states in an effort to construct a system to collect taxes on transactions involving remote sellers.
- Included explicit findings by the Legislature that state and local tax systems should treat transactions in a competitively neutral manner to strengthen and preserve sales and use taxes as a vital revenue source, and that states working together have the opportunity to develop a simple, uniform, and fair system of taxation absent federal “mandates of interference.”
- Authorized the Department of Revenue to develop along with other states “joint requests of information” from potential public and private parties governing the specifications for a multi-

state, voluntary, streamlined system of sales and use tax collection and administration. The Department also is authorized to participate in a sales tax pilot project with other states and selected businesses to test methodologies for simplifying administration of the system.

- Established a legislative oversight committee (including the chairpersons and ranking members of standing tax committees) and required the Department to report to legislative leadership (majority and minority) and the oversight committee by March 1, 2001, on the status of the multi-state discussions and to recommend whether the state should participate in any proposed system arising out of such discussions.

**2002 SB 472.** This legislation included enactment of the Kansas version of the Streamlined Sales and Use Tax Administration Act, which provided for the following:

- Authorized the Department of Revenue to become a signatory to the multistate Streamlined Sales and Use Tax Agreement.
- Prohibited Streamlined Sales and Use Tax Agreement from being implemented in Kansas until such time as the Legislature has taken further action to bring the state's laws into compliance with the Agreement.
- Required the Department to identify all changes in law and rules and regulations necessary and sufficient to meet the Agreement's compliance requirements.
- Authorized the Secretary of Revenue or the Secretary's designee to represent Kansas before other states participating in the Streamlined Sales Tax Project or that are signatories to the Streamlined Sales and Use Tax Agreement. Other appointees authorized to represent Kansas at the meetings are the Senate President, the House Speaker, and the Minority Leaders of both chambers.

**2003 HB 2005.** This legislation included a number of changes to state and local sales tax laws necessary to bring Kansas into compliance with the uniformity and simplification requirements set forth in the multistate Streamlined Sales and Use Tax Agreement adopted by the implementing states (including Kansas) on November 12, 2002. These changes included the following:

- Sourcing Rules - Prior Kansas law generally used an "origin-based" sourcing rule, applying the local sales tax in effect at the retailer's business location. The Agreement required changing to a "destination-based" sourcing rule to determine the applicable local sales or use tax. Specifically:
  - Sales remained "sourced" to the retailer's location for buyers taking possession of merchandise on site, but sales of shipped merchandise are sourced to the buyers' location for local sales or use tax purposes.
  - Exceptions in the Agreement to the "destination-based" sourcing include sales of watercraft, modular homes, manufactured homes or mobile homes, and the sale of certain motor vehicles, trailers, semitrailers or aircraft not used in interstate commerce. These sales remained sourced to the retailer's location.
  - Special sourcing rules were to be provided for specific categories of sales:
    - Leases of motor vehicles and aircraft not used in interstate commerce - All periodic lease payments are sourced to the primary property location. If there is only one lease payment, it is sourced under the general rules.
    - Retail sale and leases of motor vehicles and aircraft used in interstate commerce - These are sourced under the general "destination-based" rules.
  - When the purchased item can be used in several different locations (such

- as computer software purchased by a large company for use in its offices located in several states), the purchaser may give the seller a “multiple points of use” exemption certificate. The seller is then relieved of the obligation of collecting sales or use tax, and the purchase assumes the burden to properly apportion the use tax among the jurisdictions in which the item is being used.
- Under a similar provision relating to direct mailing to addresses in several states, the purchaser of the mailing may give to the printer a “direct mail form” showing the multiple jurisdictions where the mailing is to be sent. The printer is then relieved of the obligation to collect sales or use tax, and the purchaser assumes the obligation to directly remit the tax to the appropriate taxing jurisdictions, based on the mailing.
  - Telecommunications service has its own sourcing rules consistent with the federal Mobile Telecommunications Sourcing Act, the provisions of which had already been adopted by Kansas.
- Uniform Definitions. The Agreement requires that, if a state's sales tax laws use certain terms, or if those terms fall within a state's sales tax impositions or exemptions, the definitions of those terms contained in the Agreement must be adopted. The bill added several new definitions to Kansas sales tax law, because they are terms frequently used within the Agreement. Other existing definitions were revised as follows:
    - Under prior Kansas law, tangible personal property is defined to include computer software (both custom and canned) and prepaid telephone calling cards. The Agreement treats custom software as a service and defines canned software as tangible personal property; it also defines prepaid calling cards as a service. The bill revised Kansas law to conform to the Agreement definitions.
    - Minor changes were made to the sales tax exemption for prescription drugs, in order to conform to the Agreement definition of “drug.”
    - Kansas law's exemption for “medical equipment” was expanded by adding “durable medical equipment” and its definition.
  - Uniform State and Local Sales Tax Bases. The Agreement requires that by 2006, the sales tax base (*i.e.*, items subject to sales tax) must be identical at the state and local level, except for taxes on motor vehicles, aircraft, watercraft, modular homes, manufactured homes or mobile homes. In Kansas, the sale of water, natural gas, electricity and heat delivered through mains, lines or pipes for residential or agricultural use is exempt from state sales tax but subject to local sales tax.
    - Part of this was resolved by authorizing a ‘zero’ state sales tax rate, as authorized by the Agreement, on sales of piped natural or artificial gas, electricity, or other heating fuels delivered by the seller.
    - This left sales of water for residential or agricultural use as the only state vs. local sales tax base issue for Kansas. The bill amended the local sales tax statutes to exempt such sales on January 1, 2006.
  - Local Use Tax. Unlike many other states, Kansas did not have a local use tax, except for boats and motor vehicles (when the local use tax is paid upon registration). In order to level the playing field for Kansas retailers relative to

out-of-state retailers, and in order to allow local governments to participate in the benefits of the voluntary collection efforts of out-of-state retailers registering under the Agreement, the bill imposed a local use tax on all other transactions that are subject to the state use tax.

**2004 Sub. for SB 147.** This legislation included authorization for retailers, prior to January 1, 2005, to elect to use origin-based sales tax sourcing provisions that were in effect on June 30, 2003, as an alternative to the destination-based sourcing provisions that became effective July 1, 2003.

- On and after January 1, 2005, all retailers are required to be in full compliance with the destination-based sourcing provisions.
- However, the Secretary of Revenue is authorized to waive penalties and interest that would otherwise be imposed relative to the subsequent failure of taxpayers to properly implement destination sourcing, provided such failure is due to "reasonable" causes.

The following is a glossary of terms associated with the issues of streamlined sales tax.

### **Glossary of Relevant Terms, Key Legislation, and Commonly Used Names/Abbreviations**

***Compensating (Use) tax*** - Transaction tax on the sale of tangible personal property or services that is imposed if the ultimate storage, use or consumption of the product or service is in a taxing jurisdiction different from the jurisdiction of the sale. (Source: *A Lawmaker's Guide...*, Page 30) For Kansas: All property purchased or leased within or outside Kansas, which is subsequently used, stored, or consumed in Kansas is subject to the compensating tax if the same property or transaction would have been subject to the state retail sales tax had the transaction been made wholly in Kansas. In effect the tax is imposed on Kansas consumers who make retail purchases from out-of-state retailers. (Source: *Kansas Tax Facts*, Seventh Ed., December 2000, Page 54)

***Destination-based sourcing*** - Application of the local sales tax rate in effect at the purchaser's location, or at the delivery destination.

***House Bill 2005*** - Kansas legislation, enacted in 2003, that made changes to state and local sales tax laws necessary to bring KS into compliance with requirements set forth in the multistate Streamlined Sales and Use Tax Agreement, most notably, the change to destination-based sourcing.

***Origin-based sourcing*** - Application of the local sales tax rate in effect at the retailer's business location.

***Period of relaxed enforcement*** - A policy established by Governor Sebelius in 2003, stating retailers could continue to use the old origin-based sourcing rules (in lieu of the new destination-based sourcing rules) until such time as the Department of Revenue had determined that full compliance was administratively feasible.

***Sales tax*** - Transaction tax on the sale of tangible personal property or services. (Source: *A*



*Lawmaker's Guide to the Streamlined Sales Tax Project*, 2002, The Deloitte & Touche Center for Multistate Taxation, Page 30)

**Streamlined Sales and Use Tax Administration Act** - Enacted in Kansas by 2002 SB 472, this bill authorized the Kansas Department of Revenue to become a signatory to the multistate streamlined sales and use tax agreement and make preparations for its implementation.

**Streamlined Sales and Use Tax Agreement** - The multistate agreement, the purpose of which is "... to simplify and modernize sales and use tax administration in the member states in order to substantially reduce the burden of tax compliance. The Agreement focuses on improving sales and use tax administration systems for all sellers and for all types of commerce...." (Source: Streamlined Sales and Use Tax Agreement, Adopted November 12, 2002 [from [www.ncsl.org](http://www.ncsl.org)]).

**Streamlined Sales Tax Project** - An effort created by state governments, with input from local governments and the private sector, to simplify and modernize sales and use tax collection and administration. The SSTP was organized in March 2000. (Source: [www.streamlinedsalestax.org](http://www.streamlinedsalestax.org))

**Streamlined Sales Tax System for 21<sup>st</sup> Century Act** - Enacted by 2000 SB 59, this bill began Kansas' statutory involvement in the process by authorizing the Department of Revenue to enter into discussions and agreements with other states in an effort to collect taxes on transactions involving remote sellers.

**Substitute for SB 147** - 2004 Kansas legislation in which retailers are statutorily authorized, prior to January 1, 2005, to elect to use origin-based sales tax sourcing provisions in effect on June 30, 2003, as an alternative to the destination-based sourcing provisions which became effective July 1, 2003.

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