

MINUTES OF THE HOUSE TAXATION COMMITTEE

The meeting was called to order by Vice-Chair Carlson, at 9:00 A.M. on March 8, 2007 in Room 519-S of the Capitol.

All members were present except:
Representative Kenny Wilk- E

Committee staff present:
Chris Courtwright, Legislative Research Department
Martha Dorsey, Legislative Research Department
Gordon Self, Office of Revisor of Statutes
Kathy Beavers, Office Assistant

Conferees appearing before the Committee:
Richard Cram, Department of Revenue
Representative Arlen Siegfried
Ron Gaches, Kansas Association of Financial Services
Raye Elliott, Akerman Senterfitt
Marlee Carpenter, Kansas Chamber of Commerce (written only)
Greg Harris, Group Director, Business Analysis for HSBC Retail Services

Others attending:
See attached list.

HB 2511 - Concerning sales taxation; relating to bad debts; deductions or refunds; requirements and procedures therefor; amending K.S.A. 2006 Supp. 79-3674 and repealing the existing section.

Ron Gaches, Kansas Association of Financial Services, stated that the intent of **HB 2511** is consistent with K.S.A. 2006, Supp. 79-3674. "A seller is allowed a deduction from taxable sales for bad debts attributable to taxable sales of such seller that have become uncollectible." Private label credit cards are used by consumers at only the retail store named on the card itself. The company issuing the card is at risk for the bad debts - not the retail store. The issuing company wants to be able to collect a refund on a portion of the sales tax paid on bad debt (Attachment 1).

Raye Elliott, Akerman Senterfitt, was introduced by Ron Gaches. Ms. Elliott submitted testimony in support of **HB 2511**. She stated that twenty-two other states allow this credit to financial institutions. As it stands now, the Kansas Department of Revenue (KDOR), under current law, grants claims by retailers that finance their own sales. This bill would clarify the retailers' entitlement to the refund and would be limited to private label credit card lenders to benefit Kansas based retailers (Attachment 2).

Written testimony was submitted by Marlee Carpenter, Kansas Chamber of Commerce, in support of **HB 2511** (Attachment 3). She states in her testimony that this bill would provide financial relief to retailers who are required to pay sales tax on purchases not compensated for by bad debt.

Greg Harris, Group Director, Business Analysis for HSBC Retail Services, Raye Elliott and Ron Gaches answered questions by the committee members concerning the credit card application process and statistics noted in the testimony submitted by HSBC Retail Services.

Richard Cram, KDOR, spoke briefly in opposition to **HB 2511** (Attachment 4). After much discussion and clarification by Ron Gaches, Raye Elliott, and Greg Harris regarding the specifics of private label credit cards versus credit cards such as, VISA and MasterCard, Mr. Cram stated he would submit another fiscal note to clarify the requirements specific to private label credit cards.

Vice-Chair Carlson, closed the hearing on **HB 2511**.

HB 2495 - Decrease in the income tax surtax on corporations.

The committee returned to **HB 2495**, previously heard by the committee. There is concern that

CONTINUATION SHEET

MINUTES OF THE House Taxation Committee at 9:00 A.M. on March 8, 2007 in Room 519-S of the Capitol.

language in the amendment would destroy jobs in the state.

Representative Siegfried submitted "Corporate Income and Financial Institution Tax Liabilities by Bracket" information to clarify percentages per taxable income (Attachment 5).

Due to time constraints, Vice-Chair Carlson, closed the hearing on **HB 2495** at 10:25 a.m.

The next meeting is March 9, 2007.

TAXATION COMMITTEE

DATE: MARCH 8, 2007

NAME	REPRESENTING
Ron Gaches	KAPS
Raye Elliott	HSBC Group
GREG HARRIS	HSBC
Chad Sullivan	Dept. of Revenue
Lori McNary	Dept of Revenue.
JEFF GLENDENING	KS CHAMBER
John Breiner	Rep Ward
Donna Owens	guest Rep Owens
Dave Owen	✓
Kathy Olsen	KS Bankers Assn.
Bernie Koch	Wichita Metro Chamber
Lindsey Douglas	Hin Law Firm
JOHN C. BOTTENBERG	BOTTENBERG & ASSOC
Duane Simpson	KGFA-KARA
TONY A. SCOTT	KSCPA
DOUG SMITH	Pinegar, Smith & Associates
TOM PALACE	PMCA OF KS
Lueky DeFries	CD&V/Kan. Chamber
KEN DANIEL	KS SMALLBIZ.COM

TAXATION COMMITTEE

DATE: MARCH 8, 2007

NAME	REPRESENTING
Ben Cleaves	DOIR
Steve Spotts	KDOR
Bruce Fark	KDOR
David Hanson	Kansas Insur. Assns
Jim Hacc	ACHI



GACHES, BRADEN, BARBEE & ASSOCIATES

PUBLIC AFFAIRS & ASSOCIATION MANAGEMENT

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**House Taxation Committee
Testimony of Kansas Association of Financial Services
Presented by Ron Gaches, Executive Director
In support of HB 2511 regarding Private Label Credit Card Bad Debt
Thursday, March 8, 2007**

Thank you Mr. Chairman and members of the committee for this opportunity to support enactment of HB 2511 that pertains to recovery of sales tax paid on bad debt by private label credit cards.

Decades ago the State of Kansas determined that retailers should be entitled to a credit or refund for sales taxes paid on bad debt. This policy was adopted during a time that many, perhaps most, retailers financed many of the purchases by their customers. The law reads simply:

"A seller is allowed a deduction from taxable sales for bad debts attributable to taxable sales of such seller that have become uncollectible." KSA 2006 Supp. 79-3674.

The intent of HB 2511 is completely consistent with this established policy but recognizes that the overwhelming majority of retailers no longer finance purchases by their own customers. Many retailers are now offering their customers private label credit cards to "charge" purchases from their store.

Private label credit cards are not your typical credit card. They are not like a Visa, MasterCard or American Express card that can be used to charge purchases at thousands of locations around the world. Instead, private label credit cards are exclusively accepted by the store or chain that issues the card. For example, you can't take your Best Buy card and charge your next gas or grocery purchase on that card. The card is good exclusively at Best Buy.

**HS TAXATION COMMITTEE
3-8-2007
ATTACHMENT 1**

Private label credit cards have a store name on them, but the credit is not issued by the store and the retailer is at no risk of getting stuck with bad debt. Instead the company that issues the card for the retailer assumes the risk. Many of companies that issue these cards are diversified financial services firms like Wells Fargo, Citi Financial Services, Bank of America, and HSBC, all members of the Kansas Association of Financial Services.

Unfortunately, the modern business practice of using an outside financial services company to administer your retail company's private label credit card prevents the recovery of the state sales tax paid on bad debt. Because the retailer did not actually suffer the loss of the bad debt, the retailer is not entitled to claim the refund or credit for the bad debt. And because our current statutes do not recognize that the private label credit card issuer now stands in the place of the retailer, the card issuer is not able to claim a credit or refund for sales tax paid on bad debt even though they have experienced a loss.

The current statutory provision that forces the private label credit card company to absorb the losses for bad debt sales tax ultimately increases the costs on all other consumers. Meanwhile, the state is enriched unjustly by keeping sales tax revenue that was never paid by the consumer.

The policy of the state has been to allow the retailer to recover bad debt sales tax. We believe the private label credit card issuer should be entitled to the same recovery when the retailer has not born the financial risk and the card issuer has.

In recent days we've heard a lot about current trends in state taxation. The trend is to allow private label credit card companies to receive a credit or refund for bad debt sales taxes. We urge you to favorably consider adding Kansas to the list of states that recognize the fundamental equity of this position and support passage of HB 2511.

House Tax Committee
Testimony of Raye Elliott, Akerman Senterfitt
On behalf of HSBC
In Support of HB 2511: Bad Debt Sales Tax Credit/Refund
Thursday, March 8, 2007

Kansas' sales tax laws impose 100% of the sales tax up front on the full amount of the expected purchase price in installment or credit sales at the time of the sale even though the customer has not paid the full sales price for the goods. However, the general rule of sales tax is that sales tax is due only on the purchase price actually paid. Therefore, to ensure that sales tax is paid only on the actual price paid for credit or installment sales, the legislature enacted K.S.A. § 79-3674 to provide for a refund or deduction of the sales tax in credit sales if the customer defaults because the customer would not have paid the full sales price for the goods.

K.S.A. § 79-3674 provides that "[a] seller is allowed a deduction from taxable sales for bad debts attributable to taxable sales of such seller that have become uncollectable." The amount of the refund or deduction is the unpaid percentage of the taxable purchase price multiplied by the amount of sales tax paid. For example, if there is a \$100 credit sale and one-half of the payments are not paid, then one-half of the sales tax is refunded. This ensures that only the actual purchase price paid is subject to tax.

HB 2511 amends K.S.A. § 79-3674 to clarify that a retailer and a private label credit card lender may jointly claim a sales tax refund or deduction when sales tax is paid up front on the entire amount of the sales price of the goods in a credit sale and a portion of the purchase price is charged off for federal income tax purposes. A private label credit card lender is a company that provides financing for the sales of individual merchants. Private label credit cards are credit cards that have the name or logo of a retailer listed on the face of the card and can only be used by customers to make credit purchases in one of the retailer's stores (i.e., a Best Buy credit card). This is completely different from VISA/MasterCard because the issuing bank has no direct relationship with the retailer and the card can be used at any retailer's store. Private label credit cards issued by private label credit card companies allow Kansas retailers' customers to afford more purchases, thereby increasing sales in Kansas stores and to free the capital of Kansas retailers to be used to acquire more inventory, also increasing sales.

Under current law, Kansas merchants should be entitled to the refund when sales tax is paid up front on credit sales and the accounts are charged off. However, because the Department of Revenue under current law grants claims by retailers that finance their own sales but denies retailers' claims that outsource their financing, this bill is necessary to clarify the retailers' entitlement to the refund, to ensure that the legislature keeps pace with the fact that many retailers outsource their financing and to ensure consistent treatment for all retailers.

The language of the bill is limited to private label credit card lenders, as opposed to VISA/MasterCard lenders, to specifically and narrowly benefit Kansas based retailers. Due to the direct contractual relationship between Kansas retailers and the private label credit card companies, the Kansas retailers receive a direct benefit from this bill because the retailers receive the direct benefit of the deduction and, to the extent the retailer allows the lender to claim the refund, the private label credit card company is able to reduce its losses to the extent of the refund which will allow the lender to loosen its credit criteria and achieve the same return, thereby allowing Kansas retailers to increase their sales (because more of the retailer's customers are able to obtain financing and, therefore make additional sales).

The fact that HB 2511 does not apply to sales financed with VISA/MasterCard credit cards is consistent with the purpose of the bill to benefit Kansas retailers because VISA/MasterCard lenders do not have a contractual relationship with the retailers whereas private label credit card lenders and Kansas retailers work together to increase the retailers' sales and target credit standards and expected losses. Retailers whose sales are financed by VISA/MasterCard lenders and VISA/MasterCard issuers have not tried to qualify for bad debt sales tax recoveries in states that have adopted similar legislation.

Approximately 22 states allow the deduction or refund proposed in HB 2511. In addition, this same legislation has been either passed or is pending in 7 states. The States of California, Texas, New York and Georgia have all passed this bill and similar legislation is currently pending in Indiana, Pennsylvania and Florida. New York was in 2006, California was in 2000, Texas was in 1999 and Georgia was in 1998. This bill has proven to work well and be easy to administer in all of these states.

HB 2511 would have no real revenue impact because it is a technical correction that clarifies that Kansas retailers are entitled to this refund. In the States of Georgia and Texas, prior private label credit card legislation was assigned a "zero" revenue impact. In California, prior

private label and automobile financing legislation (which this bill does not include) was assigned a \$4 to \$6 million annual revenue impact. In addition, HB 2511 would correct an inequity that results in the Department's current refusal to refund sales tax when a private label credit card account becomes worthless – i.e. where no sale has occurred. The Kansas Department of Revenue always intended that Kansas retailers that financed their own credit sales be entitled to this refund or deduction. This same result should not change solely because the Kansas retailers are outsourcing their financing to private label credit card lenders.

HB 2511 is designed to allow the Department the same protection afforded the Departments in states with similar legislation (i.e., election form requirement).

House Tax Committee
Attachment of Raye Elliott, Akerman Senterfitt
On behalf of HSBC
In support of HB 2511: Bad Debt Sales Tax Credit/Refund
Thursday, March 8, 2007

79-3674.

(a) A seller is allowed a deduction from taxable sales for bad debts attributable to taxable sales of such seller that have become uncollectable. Any deduction taken that is attributed to bad debts shall not include interest.

(b) In the case of private label credit card accounts, a seller or lender who makes a proper election pursuant to subsection (c), or an assignee or affiliate of such seller or lender, shall be entitled to claim a deduction on its sales and use tax returns or file a claim for refund of state sales tax (but not any local sales tax) that the seller has previously reported and paid to the department, if all of the following conditions are met:

(1) No deduction or refund was previously taken or allowed with respect to the portion of the account written off as a bad debt;

(2) the account has been found worthless and written off, either in whole or in part, as a bad debt on the books and records of the lender or an affiliate of the lender; and

(3) the account has been deducted as a bad debt for federal income tax purposes under section 166 of the federal internal revenue code of 1986 (public law 99-514, 26 U.S.C. § 166) by the seller, the lender or an affiliate of the seller or lender.

(c) In order for an entity to be eligible for a deduction or a refund under subsection (b), the lender and the seller shall execute and maintain a joint election, signed by both parties, designating as between the lender and seller the entity that is entitled to claim or assign the deduction or refund. This election may not be revoked unless a written notice is signed by the parties that signed the election being revoked.

~~(b)~~ *(d) The amount of the bad debt deduction shall be calculated pursuant to 26 U.S.C. § 166(b), except that such amount shall be adjusted to exclude financing charges or interest, sales or use taxes charged on the purchase price, uncollectable amounts on property that remain in the possession of the seller until the full purchase price is paid and expenses incurred in attempting to collect any debt and repossessed property.*

~~(e)~~ *(e) Bad debts may be deducted on the return for the period during which the bad debt is written off as uncollectable in the seller's books and records and is eligible to be deducted for federal income tax purposes. For purposes of this subsection, a seller who an entity that is not required to file federal income tax returns may deduct a bad debt on a return filed for the period in which the bad debt is written off as uncollectable in the seller's books and records and would be eligible for a bad debt deduction for federal income tax purposes if the seller entity was required to file a federal income tax return.*

~~(d)~~ *(f) If a deduction is taken or a refund is received for a bad debt and the debt is subsequently collected in whole or in part, by the seller or the lender, or an affiliate or assignee of either, the entity that took the deduction or received the refund shall remit the tax on the amount so collected must be paid and reported on the return filed for the period in which the collection is*

made. *If the entity is not required to file periodic returns, the entity shall remit the proportional tax to the department with any other return.*

~~(e)~~ (g) When the amount of bad debt exceeds the amount of taxable sales for the period during which the bad debt is written off, a refund claim may be filed by the seller within the applicable statute of limitations for refund claim pursuant to subsection (b) of K.S.A. 79-3609 and amendments thereto; however, the statute of limitations shall be measured from the due date of the return on which the bad debt could first be claimed *three years from the date the account is determined to be worthless.*

~~(f)~~ (h) Where filing responsibilities have been assumed by a certified service provider, the service provider may claim, on behalf of the seller, any bad debt allowance provided by this section. The certified service provider must credit or refund the full amount of any bad debt allowance or refund received to the seller.

~~(g)~~ (i) For the purposes of reporting a payment received on a previously claimed bad debt, ~~any payments made on a debt or account must first be applied proportionally to the taxable price of the property or service and the sales tax thereon, and secondly to interest, service charges and any other charges~~ *payments by the purchaser may be applied ratably against the various elements comprising the debt the purchaser contracted to pay, as provided in the contract of sale, as provided by the seller or lender's systems maintained in the ordinary course of business, or under any other method which reasonably determines the original purchase price and the sales tax due on the sale. Payments made on any transaction which includes both taxable and nontaxable components shall be allocated proportionally between the taxable and nontaxable components.*

~~(h)~~ (j) In situations where the books and records of the seller, or certified service provider on behalf of the seller, claiming the bad debt allowance support an allocation of the bad debts among the member states, such an allocation is permitted. *If a seller remits sales or use tax to the state and to one or more other states, the entity claiming any deductions or refunds under this section may use an apportionment method to substantiate the amount of Kansas tax included in the bad debts to which the deduction or refund applies. The apportionment method must use the seller's Kansas and non-Kansas sales, the seller's taxable and non taxable sales and the amount of tax the seller remitted to Kansas. In the alternative, the entity claiming the deductions or refund may treat a specified percentage of accounts as giving rise to a deduction or refund under this section, which percentage is derived from a sampling of the applicable records in accordance with a methodology to be agreed upon by the department and the entity claiming the deduction or refund.*

(k) *As used in this section: (1) "Affiliate" means any person who is either an affiliated entity under section 1504 of title 26 of the United States code of a person described in (2)(A) or (2)(B), an entity that would be an affiliated entity under section 1504 of title 26 of the United States code, but for the fact that such entity is not a corporation, or an assignee or other transferee of a person described in (2)(A) or (2)(B);*

(2) "lender" means any of the following:

(A) Any person who owns or has owned a private label credit card account which that person purchased directly from a seller who reported the tax;

(B) any person who owns or has owned a private label credit card account pursuant to a contract directly with the seller who reported the tax; or

(C) any person who is either an affiliate of a person described in subsection (k)(2)(A) or (k)(2)(B), or an assignee or other transferee of a person described in (k)(2)(A) or (k)(2)(B); and

(3) "private label credit card" means any charge card, credit card or other instrument serving a similar purpose that carries, refers to or is branded with the name or logo of a seller that

can be used for purchases from the seller whose name or logo appears on the card or instrument or for purchases from any of the seller's affiliates. In the case of a card or instrument which may also be used to make purchases from persons other than the seller whose name or logo appears on the card or instrument, or the seller's affiliates, only sales by the seller and the seller's affiliates which are identifiable apart from any sales by such unrelated persons shall be treated as sales made pursuant to a private label credit card. Nothing in this subsection authorizes any credit or refund with respect to bad debts attributable to sales by such unrelated persons.

Legislative Testimony

HB 2511

March 8, 2007

Testimony before the House Committee on Taxation by Marlee Carpenter, Vice President of Government Affairs
The Kansas Chamber

Chairman Wilk and members of the committee:

I am Marlee Carpenter testifying in support of HB 2511 on behalf of the Kansas Chamber and our over 10,000 members. HB 2511 would provide financial relief to retailers who are required to pay sales tax on purchases not compensated for by bad debt. By establishing a process to provide a sales tax deduction for taxable sales related to bad debt, businesses small and large will benefit, creating more revenue for the economy.

The current status of taxable sales on bad debt in Kansas needs to be changed. As of now, businesses are required to pay sales tax immediately to the state on purchases, even if they do not receive compensation for the products themselves. For example, if a customer pays for their merchandise with a check or credit card, and the funds are later deemed to be insufficient, the retailer is still required to pay sales tax to the state in addition to taking a loss on the product. HB 2511 allows retailers to deduct sales tax paid on bad debt, a positive alternative, considering the loss on the product is still acquired. Retailers should not be accountable for bad debt, and further, should not be penalized by paying sales tax on uncollectible taxable sales.

The Kansas Chamber represents businesses of all sizes and more than 95% of our members have less than 50 employees. The process as defined in HB 2511 will especially provide relief for small businesses who are not as equipped to handle the costs associated with the current system.

Thank you for your time.

The Kansas Chamber, with headquarters in Topeka, is the statewide business advocacy group moving Kansas towards becoming the best state in America to do business. The Kansas Chamber and its affiliate organization, The Kansas Chamber Federation, have more than 10,000 member businesses, including local and regional chambers of commerce and Chamber represents small, medium and large employers all across

HS TAXATION COMMITTEE

3-8-2007

ATTACHMENT 3



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Testimony to the House Taxation Committee

Richard Cram

March 8, 2007

Opposition to House Bill 2511

Representative Wilk, Chair, and Members of the Committee:

House Bill 2511 is a dramatic departure from current Kansas law, which limits the ability to take a bad debt deduction on the sales tax return to the retailer making the sale and collecting and remitting the sales tax. This proposal will allow 3rd parties (credit card companies, auto finance companies, financial institutions) that were not a party to the original sale and did not report and remit the tax to the department, but who financed the sale, to receive sales tax refunds on uncollectible debt. The fiscal note on this proposal (attached) is significant: estimated at negative \$38 million.

Under Kansas law, the retailer, or seller, is liable for the proper collection, reporting and remittance of sales tax. Appropriately, only the registered retailer is allowed a deduction from taxable sales for bad debts. If the retailer sells an item and provides financing of the purchase price, the seller collects and remits sales tax on the purchase price. If the transaction later goes into default, the retailer can deduct that sale from taxable sales as a "bad debt" on the retailer's sales tax return when the write-off occurs. Unlike a registered retailer, a third-party financing entity has no responsibility for collection, reporting and remittance of sales tax.

When a large-ticket item (such as a car or major appliance) is purchased, it is often financed by a third party. The sales tax on the purchase is paid up front, and the retailer may "sell" or assign the sale contract for the merchandise, without recourse, to a finance entity for a discounted price, the finance entity assuming the risk of collection on the financed amount. That risk of collection includes the sales tax paid up front on the purchase transaction. Presumably, that finance entity is being compensated for assuming such risk. This proposal would shift to the State and local governments the risk of collection on a financed transaction for the state and local sales tax, allowing the finance entity to recover that sales tax, plus interest, on a bad debt many years after the initial purchase transaction. The bill provides that the three-year statute of limitations for the finance entity to file the refund claim does not start to run until the date of the write-off. By the time the finance entity seeks its "bad debt" refund of sales tax (with interest), that previously remitted sales tax has long been spent by the State and local governments. Any refund on the bad debt, plus interest, will be coming out of new sales tax revenues.

The department successfully litigated the tax policy of limiting deductions for bad debts to the retailer, and not allowing sales tax refunds on bad debts to third-party finance entities, in *In re the Appeal of Ford Motor Credit Company*, 275 Kan. 857, 69 P.3d 612 (2003). The amount in dispute in that case was approximately \$4 million in sales tax and interest. This proposal would legislatively reverse that decision.

The proposal permits the finance entity to estimate the amount of sales tax to be refunded and use an apportionment method to determine the amount of Kansas sales tax at issue if the bad debt is spread across several states. The department will face the difficult, if not impossible, task of attempting to verify whether the sales tax sought to be refunded was ever actually remitted to Kansas. Often, the finance entity cannot easily determine where the sale took place and what state and local taxes are involved for refund purposes. At best, they can only guess where the buyer purchased goods. A credit card company may have contracted with hundreds of businesses in many states to jointly issue these private label credit cards. Refund requests based on estimates can potentially result in over-refunding sales tax on transactions that may not have occurred in Kansas.

This proposal also contains provisions contrary to the uniformity requirements in Section 320 of the Streamlined Sales and Use Tax Agreement, which are contained in 2006 Supp. K.S.A. 79-3674. Subsection G of Section 320 and K.S.A. 79-2674(g) requires that for purposes of reporting a payment received on a previously claimed bad debt, any payment later recovered on a debt previously written-off must be applied first proportionally to the taxable price of the property or service and the sales tax, and second to interest, service charges, and any other charges. The bill deletes that language and substitutes what is shown at page 2, lines 36 through 43, allowing those payments to be applied using any method that "reasonably determines the original purchase price and sales tax due," and further providing for allocation between taxable and nontaxable components. These provisions could be used to minimize recoupment of sales tax returned to the State on any recovered payments from bad debts.

Other concerns with the proposal include:
Lines 34 through 39 on page 1 describe the joint election executed between the seller and lender as to who gets to claim the refund. This document needs to be provided to the department.

At line 12 through 19, page 2, the bill provides that when an entity receiving a bad debt refund later recovers any portion of that debt and the entity is not required to file periodic returns with the department, the entity can remit the tax on "any other return." This language should be changed to "a return as furnished by the secretary of revenue."

2007 House Bill 2511b Fiscal Note

Introduced as a House Bill

Brief of Bill

House Bill 2511, as Introduced, amends K.S.A 79-3674 of the retailers' sales tax act. The proposal allows private label credit card accounts to receive a sales tax credit or refund on uncollectible bad debts. The proposal sets the requirements that must be met to qualify for the credit or refund of tax. The proposal modifies the statute to allow a the credit card entity, vs. the seller, to apply for the credit or refund. The proposal allows for the entity claiming the credit or refund to use an apportionment method to determine the amount of Kansas sales tax to be credited or refunded if the bad debt is spread across several states. Only bad debts determined to be worthless on or after July 1, 2007 would qualify for the credit or refund.

The Act would be effective July 1, 2007.

Fiscal Impact

The proposal could result in the loss of \$38 million annually in state sales tax revenue. Loss in the state general fund is estimated at \$33.3 and \$4.7 to the state highway fund. The estimate is based on national consumer credit data which shows credit card debt and vehicle loans total approximately \$2.4 trillion nationally. The current charge-off percentage for consumer loans is 2.12%, taken from charge-off rates published by the Federal Reserve Bank. (This percentage fluctuates, as it was nearly 3% in the 2nd half of 2005.) In addition to consumer debt, there are business loans for vehicles, equipment and services that would be at least twice the consumer debt, for a total of \$4.8 trillion. Of the \$4.8 trillion, some would be the purchases of services that are tax exempt. If 25% of the debt was for tax exempt purchases, it would leave \$3.6 trillion of consumer debt which if charged-off could have a sales tax refund issued. Assuming 1% of that debt belongs to Kansas residents, or \$36 billion, and there is a charge-off rate of 2% (\$720 million), the potential loss of sales tax annually would be \$38 million annually. The loss of local sales tax is estimated at \$9.5 million.

	All Funds	SGF	Highway	Local
2008	\$ 38.0	\$ 33.3	\$ 4.7	\$ 9.5
2009	\$ 39.3	\$ 34.5	\$ 4.8	\$ 9.8
2010	\$ 40.7	\$ 35.7	\$ 5.0	\$ 10.2
2011	\$ 42.2	\$ 37.0	\$ 5.2	\$ 10.5
2012	\$ 43.7	\$ 38.3	\$ 5.4	\$ 10.9

Administrative Impact

The proposal will result in the revision of sales tax publications at a cost of \$18,500.

Administrative Problems and Comments

The proposal is a dramatic departure from current tax policy in which credits and refund of tax on bad debts is limited to the retailer who made the sale. This proposal will allow 3rd parties (credit card companies, finance companies, financial institutions) what were not a

party to the original sale but who assumed the financing of the sale to received sales tax credits or refunds on uncollectible debt. The proposal would include major credit card companies such as VISA and MasterCard, including those that may appear to be a department store card. Auto financing companies and other lending institutions would be able to request a credit or refund on bad debts.

From a tax policy standpoint, the seller of the goods is allowed a deduction from taxable sales for bad debts. When the seller "sells" the financing for a product to a financial institution, the financial institution assumes the debt and the inherent risks of collection. The ability to recover sales tax should the debt be deemed uncollectible is not available to the financial institution. This proposal would change that and allow the financial institutions to recover sales tax on a bad debt. The tax policy of limiting credits or refunds of tax to a seller was successfully argued at the Kansas Supreme Court *In re the Appeal of Ford Motor Credit Company*, 275 Kan. 857, 69 P.3d 612 (2000). There are numerous other cases that have been successfully argued in other states as well.

The proposal allows for the amount of sales tax to be credited or refunded to be estimated. Often, the credit institution cannot easily determine in what state the sale should be situated for refund purposes. At best, they can only guess at where the buyer purchased goods. While the credit industry undoubtedly will assert that they will work closely with the business named on the private label credit card to correctly situs the refund, the bill contains no incentive to do so. A credit card company may have contracted with hundreds of businesses to jointly issue these private label credit cards. Accordingly, it should be anticipated that all of the refund requests filed by credit institutions will be based on estimates, potentially resulting in over refunding sales tax. .

Other concerns with the proposal include:

- The joint election executed between the seller and lender as required by 79-3674(c) should be required to be sent to the Secretary of Revenue.
- In 79-3674(f) it states for an entity which does not file sales tax returns with Kansas and the bad debt previously claimed is subsequently paid, the entity must report the tax on "any other return." This language is vague and may lead to processing concerns. It is suggested the language to be changed to " a return as furnished by the secretary of revenue"
- 79-3674(g) gives the entity three years from the date the account is determined to be worthless to claim the refund. This phrase is too vague and may lead to refund claims for sales made many years earlier. It is in essence throwing out the 3-year statute of limitations. If this proposal is to be enacted, the department respectively suggests existing statutory language be maintained.

Taxpayer/Customer Impact

Legal Impact

Corporate Income and Financial Institution Tax Liabilities by Bracket
Tax Year 2004 Returns Filed In Calendar Year 2005

Corporate Income Tax Liability By Taxable Income Bracket

<u>Taxable Income Brackets</u>	<u>Number Returns</u>	<u>Percent of Total Returns</u>	<u>Tax Liability</u>	<u>Percent of Total Liability</u>
No Taxable Income	19,044	62.0%	\$0	0.0%
\$0 - \$75,000	9,197	30.0%	\$5,263,547	3.3%
\$75,000.01 - \$100,000	457	1.5%	\$1,798,217	1.1%
\$100,000.01 - \$500,000	1,316	4.3%	\$15,633,497	9.8%
\$500,000.01 - \$1,000,000	284	0.9%	\$11,479,486	7.2%
\$1,000,000.01 - Over	397	1.3%	\$126,161,052	78.7%
Total	30,695	100.0%	\$160,335,800	100.0%

3 95.6%

Bank Tax Liability By Taxable Income Bracket

<u>Taxable Income Brackets</u>	<u>Number Returns</u>	<u>Percent of Total Returns</u>	<u>Tax Liability</u>	<u>Percent of Total Liability</u>
No Taxable Income	65	16.3%	\$0	0.0%
\$0 - \$500,000	163	41.0%	\$1,316,501	6.1%
\$500,000.01 - \$1,000,000	68	17.1%	\$1,959,201	9.1%
\$1,000,000.01 - Over	102	25.6%	\$18,154,042	84.7%
Total	398	100.0%	\$21,429,744	100.0%

Savings and Loan Tax Liability By Taxable Income Bracket

<u>Taxable Income Brackets</u>	<u>Number Returns</u>	<u>Percent of Total Returns</u>	<u>Tax Liability</u>	<u>Percent of Total Liability</u>
No Taxable Income	12	31.6%	\$0	0.0%
\$0 - \$500,000	9	23.7%	\$59,297	0.9%
\$500,000.01 - \$1,000,000	1	2.6%	\$27,875	0.4%
\$1,000,000.01 - Over	16	42.1%	\$6,502,266	98.7%
Total	38	100.0%	\$6,589,438	100.0%

SMALL "C" CORPS - MARGINAL COMBINED RATE
C.I.T. & I.I.T.

@ \$50,000 36.21%
@ 75,000 46.86%
@ 100,000 53.93%

Annual Report

PERSONAL @ \$50,000 30
@ \$100,000
@ 100,000

21.25%
31.45%
31.45%

HS TAXATION COMMITTEE

3-8-2007

ATTACHMENT 5