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MEMORANDUM

TO: Senator Julia Lynn, Chairperson
Special Committee on Economic Recovery

FROM: Mark A. Burghart, Secretary
Kansas Department of Revenue

RE: *South Dakota v. Wayfair, Inc.* and It's Kansas Impact

DATE: November 16, 2020

Thank you for the opportunity to address the Joint Committee on the impact that the 2018 United States Supreme Court decision in *South Dakota v. Wayfair, Inc.* has had on the State of Kansas compensating use tax receipts.

I. KANSAS COMPENSATING USE TAX REGIME RELATING TO OUT-OF-STATE RETAILERS

In 1937, the Kansas Legislature enacted the Kansas Retailers' Sales Tax Act at K.S.A. 79-3601 *et seq.* That enactment imposed sales tax on the sales of tangible personal property and certain enumerated services in the state. At the same time, the Legislature enacted a complimentary compensating use tax at K.S.A. 79-3701 *et seq.* That Act provides that a tax shall be collected from every person in this state for the privilege of using, storing or consuming within this state any article of tangible personal property. All sales tax exemptions and administrative provisions apply to purchases subject to the compensating use tax. The use tax is required or Kansas in-state businesses would be at a distinct competitive disadvantage with out-of-state retailers.

Eight years later, in 1945, the Legislature enacted K.S.A. 79-3705c which required retailers doing business in the state and making sales of tangible personal property for use, storage or consumption to collect the compensating use tax from the consumer.

In 1967, the United States Supreme Court decided *National Bellas Hess, Inc. v. Illinois Department of Revenue*, 386 U.S. 753 (1967) in which the Court held that a mail order business could not be subjected to a state's tax collection duty based merely upon the retailer's in-state contacts of U.S. Mail and common carrier delivery. The Court's ruling was based on the application of Commerce Clause and Due Process principles. Much of the Court's analysis focused on the burden of compliance on out-of-state retailers at the time due to the variety of state tax compliance provisions among the states.

Subsequently, in 1990, the Legislature amended the definition of retailer doing business in the state set forth in K.S.A. 79-3702(h) to include any retailer “... engaging in regular or systematic solicitation of sales of tangible personal property in this state by the distribution of catalogs, periodicals, advertising flyers, or other advertising, by means of print, radio or television media, or by mail, telegraphy, telephone, computer data base, cable, optic, microwave or other communication system for the purpose of effecting retail sales of tangible personal property...” The definition was amended at that time in anticipation of what was hoped to be a favorable United States Supreme Court decision in *Quill v. North Dakota*, 504 U.S. 298 (1992) that would hopefully overturn *National Bellas Hess*. (1990 S.B. 488 passed the Kansas House of Representatives, 117-4 and the Kansas Senate, 37-0.)

In 1992, the United States Supreme Court affirmed its prior holding in *National Bellas Hess* with its decision in *Quill*. The Court reaffirmed its prior holding in part on the theory that Congress was better suited to address the interstate commerce questions presented.

That same statutory definition appearing in K.S.A. 79-3702 was again amended in 2003 to provide that a retailer doing business in the state means “... (G) any retailer who has any other contact with this state that would allow this state to require the retailer to collect and remit tax under the provisions of the constitution and laws of the United States.” Once again, this statutory change was designed to posture Kansas such that it could take advantage of any favorable United States Supreme Court decision that would overturn the physical presence requirement established in *National Bellas Hess* and *Quill*. (2003 H.B. 2416 passed the Kansas House of Representatives 122-0 and the Kansas Senate 38-1.)

In 2003, Kansas adopted the Streamlined Sales Tax System for the 21st Century, K.S.A. 79-3653 *et seq.* One of the legislative findings supporting the Act is that remote sellers should not receive preferential tax treatment at the expense of local “main street” merchants, nor should such vendors be burdened with special, discriminatory or multiple taxes.

Suffice it to say that a legislative plan to structure the tax code to take full advantage of a favorable United States Supreme Court ruling has been in place for 30 years. The decision in *South Dakota v. Wayfair, Inc.*, 585 U.S. ___ (2018) which overruled the physical presence requirement imposed under *National Bellas Hess* and *Quill*, has removed any constitutional impediment to the enforcement of the tax collection statute which is now presumed to be constitutional. In its decision, the Supreme Court noted that while an out-of-state retailer may not have a physical presence in a state, it was clear to the Court that through the internet they have an economic and pervasive virtual nexus (or presence) in the state that obligated them to collect and remit a state’s taxes. It also is noteworthy that the Court did not specifically hold that a statutory “safe harbor” based on the value of goods or services sold or number of transactions is required under the Commerce Clause.

II. NOTICE 19-04 AND ATTORNEY GENERAL OPINION NO. 2019-8

The Department, charged with the duty to administer and enforce the tax laws of Kansas pursuant to K.S.A. 79-3618 and K.S.A. 79-3702(b), published Notice 19-04 on August 1, 2019. The Notice did nothing more than publicize the *Wayfair* decision, the controlling state statute and directions for how out-of-state retailers can begin to comply with the Kansas statute.

The Notice is not a regulation with the force and effect of law and the Department has never contended that the Notice had the force and effect of law. No regulation is needed because the controlling statutes are self-executing.

On September 30, 2019, the Kansas Attorney General issued Attorney General Opinion No. 2019-8 for which the following synopsis was provided:

“Kansas has no legally adopted standard by which the Department of Revenue may comply with the command of K.S.A. 79-3702(h)(1)(F) that the statute be applied only to those retailers required “to collect and remit tax under the provisions of the constitution and laws of the United States.” The Department’s new policy interpreting the scope of K.S.A. 79-3702(h)(1)(F), as described in Notice 19-04, is of no force or legal effect because it was not lawfully adopted in compliance with Kansas law.”

III. MARKETPLACE FACILITATOR LEGISLATION

1. Governor’s Council on Tax Reform Recommendation

K.S.A. 79-3705c allows Kansas to require out-of-state retailers to register and collect and remit compensating use tax on sales of tangible personal property into the State of Kansas. The existing statutory scheme does not allow Kansas to require marketplace facilitators to do the same. A marketplace facilitator is a person who facilitates sales by an internet retailer through a physical or electronic marketplace. Kansas is one of only three states that has not enacted a marketplace facilitator provision. The Governor’s Council on Tax Reform recommended that the 2020 Legislature consider and pass legislation that would require marketplace facilitators to register and begin collecting compensating use tax on sales to Kansas customers. This legislation would further level the tax playing field that has for 53 years been skewed in favor of out-of-state retailers and against in-state main street Kansas retailers.

2. Council Bills

- 2020 S.B. 399 – Died in Senate Committee on Assessment and Taxation
- 2020 H.B. 2657 – Died in House Committee on Taxation

3. Summary of Legislation

S.B. 399 and H.B. 2657 would require marketplace facilitators to begin collecting and remitting sales and use tax on goods sold into the State of Kansas. The bills contain a comprehensive definition of marketplace facilitator which generally includes a person that has an agreement with marketplace sellers to facilitate sales through a physical or electronic marketplace.

4. Other Bills

- 2020 House Sub. for S.B. 266 – Died on House Calendar
- 2020 S.B. 369 – Died in Senate Committee on Assessment and Taxation
- 2020 H.B. 2513 – Died in House Committee on Taxation
- 2020 H.B. 2014 – Introduced by Representative Stephen Johnson;
*Special Session Died in House Committee on Taxation

IV. NEW REGISTRATIONS AND INCREASED RECEIPTS

On June 21, 2018, the United States Supreme Court issued its decision in the case of *South Dakota v. Wayfair, Inc.* On August 1, 2019, KDOR released Notice 19-04 – Sales Tax Requirements for Retailers Doing Business in Kansas (Notice). Since August 1, 2019, 5,362 remote sellers have registered with Kansas. This represents a 53% increase in the number of remote seller accounts.

The growth in online purchases combined with the increased number of registered remote sellers collecting and remitting has increased compensating use tax receipts as shown below:

**State
Retailers Use Tax Gross Receipts
(Millions)**

| <u>Fiscal Year</u> | <u>Amount</u> | <u>Change</u> | <u>% Change</u> |
|--------------------|---------------|---------------|-----------------|
| 2016 | \$ 285.5 | | |
| 2017 | \$ 294.9 | \$ 9.4 | 3.3% |
| 2018 | \$ 321.4 | \$ 26.5 | 9.0% |
| 2019 | \$ 345.2 | \$ 23.8 | 7.4% |
| 2020 | \$ 410.2 | \$ 65.0 | 18.8% |

**Local
Retailers Use Tax Gross Receipts
(Millions)**

| <u>Fiscal Year</u> | <u>Amount</u> | <u>Change</u> | <u>% Change</u> |
|--------------------|---------------|---------------|-----------------|
| 2016 | \$ 79.0 | | |
| 2017 | \$ 100.3 | \$ 21.3 | 27.0% |
| 2018 | \$ 102.1 | \$ 1.8 | 1.8% |
| 2019 | \$ 111.1 | \$ 9.0 | 8.8% |
| 2020 | \$ 131.1 | \$ 20.0 | 18.0% |

At four months into FY2021, state compensating use tax receipts are up \$33.7 Million over the same time in FY2020. Further growth in this tax source is expected if the Legislature enacts a marketplace facilitator measure. A conservative estimated fiscal impact for such legislation is \$30 Million annually.