

# Legislative Post Audit Performance Audit Report Highlights

## Online Sales Tax: Reviewing Issues Related to Online Sales Tax Laws in Kansas

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### **QUESTION 1: How Do Kansas' Online Sales Tax Laws Compare to Those in a Sample of Other States?**

#### **Background Information**

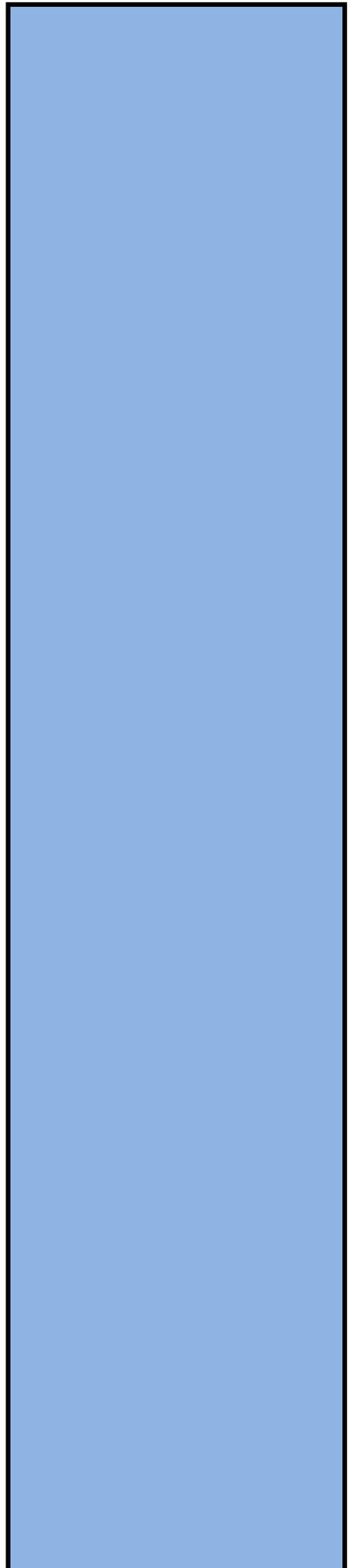
*Sales and use taxes apply to most tangible goods and some services with a few exceptions. Certain organizations such as schools and government agencies are exempt from paying sales tax. Additionally, certain items such as prescription drugs and farm machines are exempt.*

*The sales or use tax rate the consumer must pay is a combination of the state rate of 6.5% plus a local rate that can range from 0% to 5.0%.*

*In FY 2018, sales and use taxes generated about \$2.7 billion in revenue for Kansas.*

- In Kansas, all brick and mortar retailers and certain online retailers are required to collect and remit sales or use tax. (p.1)
  - In Kansas, a consumer must pay sales tax on most items purchased in the state or pay a use tax on items purchased out-of-state that will be used or stored in Kansas.
  - For items purchased in brick and mortar stores or through certain online retailers, the retailer must collect and remit it to the state. If an online retailer does not have an obligation to collect and remit the tax the consumer is required to report the purchase and pay the appropriate tax.
- A 2018 Supreme Court case now allows states to collect sales tax from retailers without a physical presence in the state. (p.1)
  - In 1992, the Supreme Court reinforced a previous ruling that it was unconstitutional to require retailers that did not have a physical presence in the state to collect and remit sales tax.
  - In 2016, South Dakota passed a law that required out-of-state retailers to collect sales tax if they generated more than \$100,000 in revenue from sales into the state or had more than 200 separate sales in the state.
  - In 2018, the Supreme Court ruled that online retailers engaging in a significant amount of business within a state may be required to collect and remit sales tax even if the retailer lacks a physical presence in the state.
- Currently, Kansas law specifically requires certain online retailers to collect and remit sales tax. (p.2)
  - In 2013, Kansas passed two laws that expanded the definition of which retailers were considered to be conducting business in the state.
  - K.S.A. 79-3702 (2)(B) defines a retailer that is affiliated with a business that has an obligation to collect and remit tax (either because they have a physical presence or operate in other statutory defined ways) as a retailer that is considered to be conducting business in the state (this is referred to as an affiliate nexus).
  - K.S.A 79-3702 (2)(C) defines a retailer that makes a sale through a link on a Kansas resident's website and has gross sales to Kansas customers of at least \$10,000 in the last 12 months as a retailer conducting business in the state (this is often referred to as a click-through nexus).

- Kansas lacks two specific laws that would require more online retailers without a physical presence in the state to collect and remit sales tax. (p. 2)
  - Kansas lacks a law to require online retailers conducting a minimum amount of business in the state to collect and remit sales tax (this is referred to as an economic nexus).
  - Kansas lacks a law to require a marketplace facilitator to collect and remit sales tax on behalf of its retailers. Typically, a marketplace facilitator is defined as a retailer that coordinates the sale of another retailer's product through an infrastructure that brings buyers and sellers together (such as Amazon or Ebay).
- Several factors should be considered for laws that specify which retailers must collect and remit sales tax. (p.4)
  - The Supreme Court noted three important points that made the South Dakota law constitutional including setting a threshold of sales below which retailers would be exempt from the law, provisions that prohibit retroactive collections, and provisions that reduce administrative burden on retailers.
  - A Tax Foundation report mentioned several other ways states could create laws to reduce administrative burden. These included setting an enforcement start date that provided enough time for retailers to prepare, simplifying the collection of local sales tax rates, and repealing click through nexus laws.



**QUESTION 2: How Much Revenue Would the State Generate Under a Sample of Additional Online Sales Tax Laws?**

- Many large online retailers already collect and remit sales tax under current Kansas law. (p.5)
  - We estimated that under current law and with voluntary remittances, the state already collects at least 90% of the sales and use tax that it can collect from all online purchases.
- We estimate the state could collect an additional \$40 million to \$70 million in sales tax revenue annually over what the state collected in FY 2018 if it had two additional laws related to an economic nexus and marketplace facilitator. (p.5)
  - We used additional data provided by the GAO and Department of Revenue to adjust the state online sales tax estimates from a 2017 U.S. Government Accountability Office report.
  - We estimate state general fund revenues could increase \$35.0 million to \$60.0 million and state highway fund revenues could increase \$5.0 to \$10.0 million annually over what the state collected in fiscal year 2018 (for a total increase of \$40 million to \$70 million). Additionally, local governments could see an increase in sales tax revenues of \$10 million to \$25 million.
  - Our estimate is similar to an estimate the Kansas Department of Revenue created for the November Consensus Revenue Estimating Group.
- Our estimate of additional sales tax revenue could be slightly overstated. (p.6)
  - Due to a lack of data, we were not able to account for a few factors that could overstate our results. For example, we did not establish a threshold under which retailers would not have to collect and remit sales tax, we could not control for sales tax exemptions, and we were unable to estimate the effect of potential changes in consumer shopping patterns.
- Some retailers could incur costs related to collecting and remitting sales tax and indirect costs from changes in consumer behavior. (p.7)
  - We did not quantify how much it might cost retailers to collect and remit sales tax but identified potential costs related to reporting, auditing, and buying and updating software.
  - Larger multi-state retailers may be in a better position to absorb the costs of collecting and remitting sales tax than smaller retailers.
  - Consumer shopping patterns could change which could shift business away from some types of retailers but towards other types of retailers.

## **SUMMARY OF RECOMMENDATIONS**

We did not have any recommendations.

## **AGENCY RESPONSE**

Department officials generally concurred with our findings but provided additional comments in several areas. (p. 9)

### **HOW DO I REQUEST AN AUDIT?**

By law, individual legislators, legislative committees, or the Governor may request an audit, but any audit work conducted by the division must be directed by the Legislative Post Audit Committee. Any legislator who would like to request an audit should contact the division directly at (785) 296-3792.

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