

## AUDIT PROPOSAL

### **Reviewing the Department of Revenue's Procedures to Ensure Correct Payment of Sales and Compensating Use Taxes on Motor Vehicle Sales**

#### **SOURCE**

This audit proposal was requested by Representative Carl Turner.

#### **BACKGROUND**

Motor vehicle sales in Kansas are subject to sales and compensating use taxes. The state imposes a sales tax of 6.5% and cities and counties impose a local sales tax of up to 4.25% on vehicles purchased in Kansas. The state also imposes a compensating use tax on vehicles purchased out-of-state but that are registered in Kansas. The compensating use tax rate is equal to the combined state and local sales tax rate where the vehicle was purchased.

Individuals can purchase vehicles from a dealer or another individual. Both sales are taxable. For vehicles purchased from a dealer, individuals pay the sales tax to the dealer. The dealer is then responsible for remitting the sales tax to the appropriate state and local government. For a vehicle purchased from another individual, the buyer self-reports the sales price and pays the sales tax on that self-reported price to the county treasurer when they register the vehicle.

Accurate reporting and collection of these taxes is significant. In 2021, Kansas collected \$469 million in sales and compensating use taxes from vehicle sales. That is 12% of total sales and use tax collections in that year. In a 2003 audit we found that the Kansas Department of Revenue did not have adequate policies or practices to ensure the state received the correct amount of sales and use taxes on vehicle sales. The sample of vehicle purchases we reviewed at that time showed dealers and individuals did not always collect and remit all sales and use taxes like they were supposed to. Legislators are interested in knowing whether and to what extent these types of issues still exist and if the state isn't receiving sales and use taxes it should.

#### **AUDIT OBJECTIVES AND TENTATIVE METHODOLOGY**

*The audit objectives listed below are the questions we would answer through our audit work. The steps listed for each objective convey the type of work we would do. These may change as we learn more about the audit issues.*

**Objective 1: Does the Kansas Department of Revenue (KDOR) have adequate procedures to ensure all sales and compensating use taxes due on vehicle sales are remitted to the state?** Our tentative methodology would include the following:

- Work with KDOR staff and review available sales tax data to understand the different ways vehicles are sold and the taxes on those sales are collected (e.g., through a dealer, from an individual, online). This would include calculating the percentage of sales and use taxes collected from dealers and county treasurers in the most recent year.

- Review state laws and regulations to identify the requirements for remitting sales and compensating use taxes on vehicle sales.
- Interview KDOR staff and review agency policies to determine what KDOR's practices are to ensure the correct amount of sales and compensating use taxes are collected and remitted to the state for vehicle sales. This would include a review of any audits KDOR has conducted of dealers or online vehicle sellers such as Vroom or Carvana.
- Review a sample of in-state, out-of-state, and online vehicle sales from dealers and private individuals to determine if the state receives the correct sales and use taxes. This would include evaluating the sales taxes a sample of in-state dealers collected and remitted in recent years. It also would include evaluating the sales and use taxes a sample of individuals paid on both in-state and out-of-state vehicle purchases in recent years. If possible, it also would include evaluating sales and use taxes for online vehicle sales through a sample of marketplace facilitators and remote sellers.
- Talk to KDOR staff, vehicle dealers, and other stakeholders to understand the reasons for any issues we identify. This would include whether KDOR's policies and practices are adequate.

#### **ESTIMATED RESOURCES**

We estimate this audit would require a team of **3 auditors** for a total of **4 months** (from the time the audit starts to our best estimate of when it would be ready for the committee).