Testimony to the House Committee on Taxation	
HB 2513: "AN ACT concerning taxation; relating to marketplace facilitators; requiring the collection and remittance for sales, compensating use and transient guest taxes made on platforms; removing click through nexus provisions; amending K.S.A. 79-3702 and repealing the existing section."	
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Chairman Johnson and Members of the Committee:

House Bill 2513 appears to be in response to *South Dakota v. Wayfair, Inc.*, and the issuance of Notice 19-04 by the Kansas Department of Revenue. Kansas Justice Institute[1] is neutral, and respectfully submits the below analysis. In sum, KJI has serious concerns about the Department's notice.

1. Overview

The Department of Revenue issued Notice 19-04 "Sales Tax Requirements for Retailers Doing Business in Kansas" on August 1, 2019. The Notice instructs remote sellers without a physical presence in Kansas "to begin collecting and remitting Kansas sales and/or remote use tax by October 1, 2019." (Notice, 1). The Notice defines a "marketplace facilitator" and suggests such facilitator "should contact the Department concerning entering into a voluntary compliance agreement with the Department." (Notice, 3).

The Department's Notice purportedly relies upon "the United States Supreme Court … decision in the case of *South Dakota v. Wayfair, Inc.* et al." (Notice, 1). The central issue raised is whether Notice 19-04 violates the United States Constitution as recently interpreted

[1] KJI is a non-profit, public-interest litigation firm committed to protecting individual liberty and the constitutional rights of all Kansans and is part of Kansas Policy Institute.

in *S. Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018). It does. The secondary issue is whether the Department has the authority to issue a "notice" that re-writes the tax code. It does not.

2. Federal Analysis Post-*Wayfair*

In 2016, South Dakota enacted a law requiring out-of-state sellers to collect and remit sales taxes on its behalf even though the sellers did not have any employees, real estate, or physical presence in the state. *Id.* at 2088-2089. South Dakota's act applied only to sellers who delivered more than $100,000 of goods or services into the state, or who engaged in 200 or more separate transactions. *Id.* South Dakota filed suit against the sellers to compel them to register, collect, and remit the taxes.

The *Wayfair Court* reiterated the long-standing principle that government taxing schemes involving out-of-state sellers must comport with 1) the federal Commerce Clause; and 2) the federal Due Process clause. *See Id.*

2.1 Commerce Clause Analysis

Compelling an out-of-state seller to collect and remit sales taxes violates the federal Commerce Clause unless there is a 1) substantial nexus between the state and the person, property, or transaction it seeks to tax; 2) the tax is fairly apportioned; 3) the tax does not discriminate against interstate commerce; and 4) the tax is fairly related to the services the state provides. *Id.* at 2091.

"Substantial nexus" is "closely related to the due process requirement that there be some minimum connection between the state and the person, property or transaction it seeks to tax" *Id.* at 2093, and is established only when taxpayer "avails itself of the *substantial privilege* of carrying on business in that jurisdiction." *Id.* at 2099 (emphasis added).

In *Wayfair*, South Dakota's taxing scheme passed the "substantial nexus" element because the seller – Wayfair – was a large, national company that maintained an extensive virtual presence in South Dakota. Its economic and virtual contacts were likewise extensive. Wayfair exceeded $100,000 in sales or conducted at least 200 transactions in the state. *Id.* at 2099.

That does not end the constitutional inquiry though. Taxing schemes could pass the "substantial nexus" element but still violate the Commerce Clause if they discriminated against, or unduly burdened, interstate commerce.

The *Wayfair Court* suggested the taxing scheme did not discriminate against, or unduly burden, interstate commerce for the following reasons:

1) the Act contained a "safe harbor" provision for those who transact limited business;

2) the Act did not authorize retractive collection of taxes;

3) South Dakota adhered to the Streamlined Sales and Use Tax Agreement, which:

a. Standardized taxes;

b. Simplified tax rate structures;

c. State provided free tax administration software to remote sellers;

d. State immunized sellers who used the software from audits.

Id. at 2099-2100.

The "safe harbor" provision was particularly important in the Court's analysis. By obviating the physical presence requirement, the Court was concerned that start-ups and small businesses would otherwise be exposed to the "daunting complexity and business-development obstacles" of sales tax collections. *Id.* at 2098, quoting Brief for Respondents. The "safe harbor" provision afforded "small merchants a reasonable degree of protection. The law at issue requires a merchant to collect the tax only if it does a *considerable amount* of business in the state[.]" *Id.* at 2098 (emphasis added).

In the instant matter, the Department's Notice seeks to compel *any* remote seller, regardless of its size or contacts with the state, to collect and remit taxes on its behalf. Unlike South Dakota's scheme, the Notice cannot pass the "substantial nexus" element because it seeks to compel the collection and remittance of taxes from the smallest of small businesses. A micro-business outside of Kansas with $5 of sales or just one transaction to a Kansan would fall under the Notice's provisions.

The Department's Notice likewise discriminates against, or unduly burdens, interstate commerce. Again, unlike South Dakota's scheme, the Department's Notice does not afford small merchants any protection, let alone a reasonable degree of protection, from the State's taxing scheme. There is no *Wayfair* "safe harbor."

The limited compliance window unduly burdens interstate commerce as well. The

Notice was issued August 1, 2019. Small merchants without a physical presence in Kansas have never been compelled to collect and remit taxes on the State's behalf, until now. And the Department had only given them until October 1, 2019, to come into compliance. This is precisely the kind of "daunting complexity" and "business-development obstacle" the *Wayfair Court* sought to avoid.

In sum, the Department's Notice violates the Commerce Clause as interpreted in *Wayfair*.[2]

2.2 Due Process Clause Analysis

Due process requires "some definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax." *Id.* at 2093 (cleaned up). The income "attributed to the state for tax purposes must be rationally related to values connected with the taxing State" as well. *Quill Corporation v. N. Dakota By & Through Heitkamp*, 504 U.S. 298, 307 (1992) (overruled on other grounds).

The *Wayfair Court* did not specifically address whether South Dakota's scheme offended due process because relief for "de minimis contacts" was not raised.

However, due process must comport with "traditional notions of fair play and substantial justice." *International Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945). Due process requires continuous and systematic general business contacts. *Goodyear Dunlop Tires Operations, S.A. v. Brown*, 564 U.S. 915, 919 (2011). And due process requires "purposeful avail[ment]" of the market. *J. McIntyre Mach., Ltd., v. Nicastro*, 564 U.S. 873, 880 (2011).

In this instance, the Department's Notice seeks to force a remote seller into collecting and remitting taxes on its behalf even if it transacts only $1.00 of business in Kansas.

The Department's Notice violates the Due Process Clause.[3]

3. The Department of Revenue Cannot Legislate by Notice

The secondary issue is whether the Department has the authority to issue a "notice" that re-writes the tax code. It does not.

[2] For the same reasons, KSA § 79-3702(h)(1)(F) is unconstitutional.
[3] For the same reasons, KSA § 79-3702(h)(1)(F) is unconstitutional.

"[E]ach rule and regulation issued or adopted by a state agency shall comply with the requirements of the rules and regulations filing act." KSA § 77-415(b)(1). A "rule and regulation," "rule," and "regulation" means a "standard, requirement or other policy of general application that has the force and effect of law, including amendments or revocations thereof, issued or adopted by a state agency to implement or interpret legislation." KSA § 77-415(c)(4).

In this instance, the Department's Notice was a requirement of general application that had the force and effect of law. By its own terms the Department's Notice ordered remote sellers to "register and begin collecting and remitting Kansas sales and/or use tax by October 1, 2019" and warned sellers "that failure to register may result in administrative enforcement action." (Notice, 1-2). The Department did not exercise any discretion in applying the notice to remote sellers.

Because the Department's Notice meets all the characteristics of a rule or regulation, the Department was required to follow KSA § 77-415, *et seq*. It did not. As such, the rule or regulation "not filed and published … shall be of no force or effect[.]" KSA § 77-425. *See also American Trust Administrators, Inc. v. Sebelius*, 273 Kan 694 (2002) (Department's "bulletin" was a rule or regulation requiring filing and publication); *Bruns v. Kansas State Board of Technical Professions*, 255 Kan. 728 (1994) (Agency's "policy" was a rule or regulation requiring filing and publication).

Notwithstanding the above, the Notice impermissibly seeks to re-write or otherwise amend KSA § 79-3702(h)(1)(F) and/or KAR 92-20-7.

The legislative power of the state "shall be vested in a house of representatives and senate." Kans. Const. Art. 2 § 1.

The legislature "may enact general provisions for regulation and grant to state agencies certain discretion in filling in the details, provided it fixes reasonable and definite standards to govern the exercise of such authority. *Gumbhir v. Kansas State Bd. of Pharmacy*, 228 Kan. 579, 584 (1980). However, the "authority to make obligatory rules and provide penalties for breach of said rules belongs to the legislature. An unlawful delegation of legislative power is contrary to the public policy expressed in the Constitution." *Id.* at 582. (cleaned up).

KSA § 79-3702(h)(1)(F) defines a "retailer doing business in this state" as "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." It is not an enabling statute. It is a definitional statute. KAR 90-20-7 deems certain retailers as doing business in the state.

Although the Legislature granted some authority to the Secretary of Revenue to adopt the rules and regulations for the administration of the Act, KSA § 79-3707, it did not grant the authority to rewrite the act. But that is precisely what the Department attempts to do by defining "marketplace facilitator." (Notice, 3).

In sum, the Department's Notice was not properly promulgated. The Legislature did not, nor could it, grant the authority to re-write the tax code or the regulations by fiat. For all of these reasons, the Department's Notice is invalid as a matter of law and therefore unenforceable.