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## MEMORANDUM

TO: Adam Smith, Chairman  
House Committee on Taxation

FROM: Michael Hale, Deputy General Counsel  
Kansas Department of Revenue

RE: HB 2395

DATE: March 16, 2021

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Thank you for the opportunity to appear before the Committee in support of H.B. 2395, a recommendation of the Governor's Council on Tax Reform that addresses the collection of compensating (use) tax on sales made by marketplace facilitators. The enactment of clear statutory language regarding the tax collection duties of marketplace facilitators has been endorsed by the Tax Foundation, the Kansas Chamber of Commerce ("Chamber") and the Urban Institute.

### **I. SUMMARY OF COUNCIL FINDINGS**

Forty-two of the forty-five states that have a retailer's sales tax, require marketplace facilitators to collect and remit sales and use tax on sales made into Kansas on their platforms. Reasons include:

1. Changes in technology have allowed otherwise taxable sales to not be subject to sales tax.
2. The technological advances in the sales and delivery of product were never contemplated by the Legislature in 1937 when the sales tax act was enacted, and this technology has effectively resulted in unintended exclusions from the state tax base.
3. The state and local sales tax base continues to shrink in light of these unintended exclusions; the reliability of the sales tax as a stable revenue source has declined.
4. The current statutory scheme is not fair and equitable. The inclusion of facilitated sales in the tax base would be a step toward leveling the playing field between brick and mortar stores and retailers selling through large platforms.

A book purchased on a platform should, for tax purposes, be treated in the same manner as a book purchased from a brick and mortar store.

## **II. GENERAL DESCRIPTION**

Large entities such as Amazon, Etsy, etc. have large warehouses, or fulfillment centers. Additionally, these entities maintain websites upon which third party sellers' products are offered for sale at retail. These entities are commonly known as Marketplace Facilitators (hereinafter, MPF). MPFs allow other, unrelated sellers to warehouse their product. When that product is sold via an internet sale it is shipped from the fulfillment center to the customer. This product is sold on the internet through a site often linked to the MPF and is escaping use taxation. MPFs know all the elements of the transaction: the seller, the ultimate customer, the destination of the sale, the item, quantity and the sales amount. They know all of this because they track it internally so that they can insure that they are getting properly paid by these third-party marketplace sellers for allowing them to use the warehouse space in their fulfillment centers, using the MPF's websites, etc. Thus, it is not an undue burden for them to collect and remit the Kansas sales tax on these transactions.

## **III. PROPOSED LEGISLATION**

HB 2395 emanates from the Governor's Council on Tax Reform, and shares many concepts and provisions that are of similar effect to those in the two bills proffered by the Kansas Chamber (SB 50 and HB 2173). For example, New Section 3 (c) concerning class action lawsuits in SB 50, which is pretty much identical to New Section 4 (d) in HB 2395. However, HB 2395 does vary in some key areas.

By way of background, HB 2395 is an outgrowth from 2020's HB 2657. Both the Chamber, the Department and some members of industry reviewed, discussed and came to mutually agreed-to amendments to 2020's HB 2657. Because of the pandemic, however, 2020's HB 2657 never got across the finish line.

Rather than re-introduce the original language from 2020's HB 2657 and have to re-meet, re-discuss and re-amend, this year's HB 2395 uses the language that had largely been agreed to by the Chamber, industry and the Department.

By way of example, 2020 HB 2657 had language addressing referrers. It was recommended from industry that language be amended out, and the Department agreed. The original 2020HB 2657

had a provision requiring the collection of any Kansas tax, but was objected to by industry, who wanted to limit that provision to 911 fees and transient guest taxes.

This was a substantial difference between industry and the Department as the Department believes, for example, significant amounts of tobacco products and alcohol (among other commodities) are being sold on-line without Kansas taxation. This hurts Kansas tobacco shops and liquor stores. The Committee will note that HB 2395 has no reference to referrers, and New Section 7(a) is limited to 911 fees and transient guest taxes as agreed to last year between the Chamber, industry and Department. That said, a number of commodities are being sold on the internet and it should come as no surprise when Kansas brick and mortars ask the Legislature to address those inequities.

There is one notable exception in difference: Like 2020's original HB 2657, this year's HB 2395 contains no *de minimus* provision. The concept of a bill with a \$100,000.00 *de minimus* or a bill with no *de minimus* was discussed at length last year, and there has been fair debate this session on both sides of the question. Both sides have merit.

#### **IV. KEY PROVISIONS OF HB 2395 (and differences with SB 50 and HB 2173)**

- 1) HB 2395 uses certain terms specific to the on-line sales model; HB 2395 defines these terms. Among these terms are “Affiliated Person,” “Cumulative Gross Receipts,” “Sales,” “Seller,” “Transaction.” Defining these terms is critical to the act as a whole and for both industry and the Department to administer and avoid litigation. Neither SB 50 nor HB 2173 define these terms. In 2020, neither the Chamber nor industry appeared to have significant issue with following the HB 2395 definitions, and the Department would urge their adoption in HB 2395.
- 2) HB 2395 employs a broader, more inclusive definition of MPF. All companies that bring buyers and sellers together are included. Fundamentally, if a company brings buyers and sellers together to consummate sales – which sales occur on that company's website – then the company should be treated as an MPF irrespective as to whether the company is involved in processing the sale. A company acting in this respect can say that it is agnostic about the details of the transaction, but if that is so, it is merely because it affirmatively chooses to be.

Not only are they bringing buyers and sellers together, but they are engaging in one or more of the activities listed in HB 2395, Sec. 2 (e)(1)(A) and (e)(1)(B). By engaging in these

activities, they are actively facilitating these transactions. They are in total control of these transactions they are facilitating.

By contrast, SB 50 definition of “MPF” is narrow, and appears to only require the marketplace to be directly or indirectly involved in the processing of the sale, and some companies are not necessarily involved, even indirectly, in such processing (*i.e.*, the processing is done by a third party). A company may collect under a narrow definition, but that is likely because the company still has some form of ownership relationship with the payment processor.

SB 50 appears to omit large, out-of-state, multi-national hotel related booking companies from the definition of MPF, but leaves in companies that facilitate lodgings of homes. This may result in an un-equal application of Kansas law, which will lead to litigation. Additionally, by omitting large, out-of-state, multi-national hotel related booking companies, the basis of Kansas sales tax being a “gross receipts” tax is undermined. The current Retailers’ Sales Tax Act (as virtually every sales tax act in the country) imposes tax on the total amount paid by the consumer. By omitting large, out-of-state, multi-national hotel related booking companies, the booking fees for a room paid by the consumer are omitted from the tax base. The Tax Foundation in 2019 commented that a state should seek to broaden the sales tax base, and the Department agrees. This provision in SB 50 and HB 2173 run counter to that standard and would actually shrink the tax base.

Finally, HB 2395 allows the Secretary to provide rules and regulations to address (*i.e.* narrow where necessary) the broader more inclusive definition. SB 50 does not appear to provide such a provision. And, a definition that is too narrow, given current and unknown future business models and technologies, cannot be broadened by mere rule or regulation.

The Department believes that the language in HB 2395 is more inclusive. In general, neither the Chamber nor industry, had significant issue with the language in 2020 HB 2657, which is now 2021 HB 2395. So, the Department would urge the more inclusive language in HB 2395.

HB 2395 only includes in the definition of MPF those businesses that are selling products or services taxable under the Retailers’ Sales Tax Act. This is a cleaner, more concise approach. SB 50, on the other hand, excludes the following from the definition of MPF: derivatives clearing houses, designated contract market, foreign board of trade, swap execution facilities, and clearing members, merchants and brokers. It is wholly unclear why this is in a bill related

to sales taxes. None of those activities are subject to Kansas sales tax, and it is entirely unnecessary to include them.

The Chamber expressed no significant issue with omitting this language.

- 3) HB 2395 requires collection and remittance on the first sale in the current or previous year. Conversely, under SB 50 and HB 2173, the MPF is only required to start collecting and remitting if the a *de minimus* threshold, if any, is satisfied in the previous year. Meaning, the MPF will go the rest of the current year not collecting and remitting sales tax.
- 4) HB 2395 applies the terms, definitions and administrative provisions of the Retailers' Sales Tax Act to this bill. This will treat MPF the same as in-state sellers and will make administration and compliance by the MPF much easier. SB 50 and HB 2173 fail to include the provisions of the sales tax act and leaves to chance compliance, administration, and will likely lead to litigation.

The Chamber expressed no issue with the language in 2020 HB 2657, which is now 2021 HB 2395 language.

- 5) HB 2395 does not allow MPFs and their sellers to contract away the MPF's statutory obligation to collect and remit or avoid collection and remittance altogether. SB 50 and HB 2173 do. In addition to defeating the very purpose of having an MPF bill (to have a "single source" of remittance for multiple sellers), it runs counter to the very notion of the sales tax itself, which is imposed on the buyer with the seller being required to collect and remit.

HB 2395 requires companies, such as food delivery companies to collect and remit on the total price paid by the consumer (most have a delivery charge and mandatory gratuity, both of which have been part of the sales tax base for decades). By allowing the restaurant to remit the tax rather than the actual food delivery platform, the tax base is effectively eroded under both SB 50 and HB 2173.

HB 2395 adheres to the long standing legislative intent that gross receipts be the tax base and avoids a platform circumventing their responsibility to collect on the gross receipts paid by the consumer by having an agreement with restaurants they sell for to do the remitting, or that their restaurants are already registered.

HB 2395 does not contain a provision that allows an MPF to contract away its obligation to collect and remit in the total selling price to the consumer, and there is no cogent reason to allow it. The Department would urge the HB 2395 on this point be adopted.

- 6) SB 50 and HB 2173 allow entities that have sales in excess of a billion dollars to skip using MPFs. There has been no clear, logical explanation for this exception. Anecdotally, the Department has been told the large telecoms wanted this provision for two primary reasons: fear that advertising would sweep them up into marketplace seller status, and fear that telecoms would have to continue to collect and remit non-sales tax fees (such as 911 fees), while another entity collects and remits sales taxes. This is their effort to avoid those scenarios.

HB 2395 does not have this exception because it does not attempt to tax advertising and places the burden on MPF's to collect and remit both 911 fees and transient guest taxes as well as sales taxes. The telecoms were in agreement with the language as set-forth in 2020 HB 2657, which is now 2021 HB 2395, and neither the Chamber nor industry generally opposed the it. There is, however, one and only one MPF that does not want the 911 fees to start until April 1, 2022.

- 7) If a *de minimus* is adopted, HB 2395 applies to gross sales, because Kansas sales tax is a gross receipts tax, always has been. Both SB 50 and HB 2173 apply to just "sales." This converts the tax to a "net" tax for out-of-state MPFs, while in-state sellers operate under a gross receipts tax. Neither the Chamber nor industry expressed any significant issue with the language in 2020 HB 2657, which is now 2021 HB 2395.
- 8) HB 2395 allows the Department the latitude necessary to audit sellers to assure compliance with state law by all parties. SB 50 and HB 2173 limit the Department from auditing the books and records to MPFs. However, audits of sellers are necessary from time to time to tie to and verify the books and records of MPFs to insure all parties are adhering to state law.
- 9) HB 2395 retains "Doing business in this state" which is already a defined term in K.S.A. 79-3702(h). However, SB 50 and HB 2173 New Sec. 3(a), p. 3, line 32, uses "doing business in the state" inconsistently. Pursuant to New Sec. 3(a), a MPF "doing business in this state under section 2, and amendments thereto, shall collect and remit the taxes..." "Doing business in this state" is already a defined term in K.S.A. 79-3702(h), and no reference to the term "doing

business in this state” can be found in New Sec. 2. The use of the term “doing business in this state” in New Sec. 3(a) is inconsistent and ambiguous with the rest of the sales/use tax statutes. The language of HB 2395 should be adopted to avoid confusion and the potential of litigation.

- 10) HB 2395 eliminates the language of “click through” nexus while retaining language applicable to telemarketers, or in-home “party plan” sellers that have been required to register and collect and remit for decades. HB 2395 also keeps constitutional nexus of an affiliate, which is the linchpin of *Wayfair*.

Both SB 50 and HB 2173 proposes to eliminate click through nexus, but also strikes out all agreements between sellers and their representatives, whether telemarketers, or in-home “party plan” sellers that have been required to register and collect and remit for decades. They both also strikes out any constitutional nexus of an affiliate, which is what this bill is supposed to be all about.

Neither the Chamber nor industry were opposed to this language in 2020 HB 2657, which is now 2021 in HB 2395.

The Department urges the Committee to favorably consider HB 2395. It accomplishes all that both SB 50 and HB 2173 seek to accomplish, but HB 2395 stays truer to the tenets of the Retailers’ Sales Tax Act, provides cleaner, more concise language, eliminates unnecessary sections that do not apply, and enhances the collection of legally due taxes, all of which is supported by the Tax Foundation and Chamber.

I would be happy to answer any questions you might have.