

SESSION OF 2003

**CONFERENCE COMMITTEE REPORT BRIEF  
HOUSE BILL NO. 2005**

As Agreed to May 5, 2003

**Brief \***

HB 2005, as amended by the Senate Committee of the Whole, would clarify the intent of legislation enacted originally in 2002 by repealing the extension to non-railroad state assessed public utility property of income tax credits offsetting a portion of certain personal property taxes timely paid.

Provisions of SB 162

Other provisions would reenact for the 2003-2004 and 2004-2005 school years (property tax years 2003 and 2004) the 20-mill mandatory school district general fund property tax levy and the \$20,000 residential exemption therefrom.

Provisions of SB 115

The bill further would make several statutory adjustments relative to the State Board of Tax Appeals (SBOTA). The number of members would be reduced from five to three, effective January 15, 2003. The bill would provide that no successors be appointed for the two SBOTA members whose terms expired on that date.

The bill also would make several adjustments to statutory requirements concerning SBOTA members. Under current law, at least one member must be appointed from each of the state's congressional districts. The bill would amend that requirement such that no more than one member may be appointed from any one congressional district. Current law also requires that three of the five SBOTA members either have been regularly admitted to practice law or have been engaged in the practice of law for at least five years or

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have been a certified public accountant who has maintained registration as an active attorney. That requirement would not be amended such that at least one member would still have to meet such requirement; and a second member would have to be a certified public accountant.

A requirement that the votes of at least three members are necessary for SBOTA to take any action would be amended such that a minimum of two votes would be necessary.

The bill also allows SBOTA to charge and collect filing fees through the establishment of rules and regulations. No filing fees may be imposed with regard to single-family residential property. In addition, the bill limits the fee for not-for-profit organizations to \$10 or less for property with a valuation of not more than \$100,000.

#### Provisions of HB 2416

A tax amnesty would be provided under certain circumstances that would forgive penalties and interest assessed on certain unpaid taxes if the outstanding liability is paid in full from October 1, 2003, to November 30, 2003. Included in the amnesty provisions would be financial institution privilege taxes; estate taxes; income taxes; withholding and estimated taxes; cigarette and tobacco products taxes; sales and use taxes; liquor enforcement taxes; liquor drink taxes; and severance taxes.

The amnesty for income and privilege taxes would be for liabilities for tax periods ending on or before December 31, 2001. For all other taxes, the amnesty would be for tax periods ending on or before December 31, 2002.

The amnesty provisions would not apply if any of the following has occurred on or after February 6, 2003:

1. The taxpayer has received notice of the commencement of an audit;
2. An audit is in progress;
3. The taxpayer has received notice of an assessment pursuant to KSA 79-2971 or 79-3643;
4. The taxpayer has received notice of a proposed or estimated assessment or notice of assessment as the result of an audit;
5. The time to appeal administratively an issued assessment has not yet expired;

6. An assessment resulting from an audit, or any portion of such assessment, is pending in the administrative appeals process before the Secretary of Revenue, Board of Tax Appeals, or the judicial review process.

Amnesty also would not apply to any matter that is the subject of an assessment, or any portion of an assessment, which has been affirmed by a reviewing state or federal district or appellate court.

Amnesty further would not apply to any party to any criminal investigation or to any civil or criminal litigation that is pending in any court for nonpayment, delinquency, or fraud in relation to any tax imposed by the State of Kansas.

The Secretary of Revenue would be required to develop application forms for the amnesty.

Taxpayers electing to participate in the amnesty would be making "an express and absolute relinquishment of all administrative and judicial rights of appeal" with respect to the affected liability. Amnesty payments would be ineligible for refunds or credits. Any payments of penalties or interest made prior to October 1, 2003, would be ineligible for the amnesty.

For tax returns for which amnesty has been requested, nothing in the legislation would be interpreted to prohibit adjustments to such returns resulting from audits.

Finally, fraud or intentional misrepresentation of a material fact in connection with an amnesty application would void the application and any waiver of penalties and interest; and discovery of fraud relating to the underlying tax liability would void the abatement of any liability pursuant to the amnesty.

#### Provisions of SB 94

Another section would repeal retroactive to its date of enactment the succession tax enacted in 2002 and would provide for refunds of any such taxes which have already been paid. The succession tax is imposed on the privilege of succeeding to the ownership of property by someone who is not a spouse, sibling, lineal ancestor, or lineal descendant of the decedent.

Additional provisions of the bill would provide a number of amendments to the Kansas Estate Tax Act designed to improve administration and enforcement. Specific definitions would be provided for “decedent”, “distributee”, and “tax situs”, and persons spending more than six months of a calendar year immediately preceding their death would be defined as a “resident decedent”.

New language would clarify who is responsible for filing estate tax returns with the Department of Revenue. Closing letters provided by the Department would be deemed applicable only with respect to assets reported in returns which have been filed.

Kansas estate tax returns would be required to be filed on or before the date federal estate tax returns are required to be filed, except that the extensions may be provided upon a showing of good cause. Failure to timely file a return or pay any estate tax liability due under the act would result in a penalty assessment of one percent of the unpaid balance of the tax due for each month, up to 24 percent, plus interest as prescribed by subsection (a) of KSA 79-2968 from the date the tax was due until paid. If the Director of Taxation were to determine that underpayment of tax was due to a failure to have made a reasonable attempt to comply with the act, an additional 25 percent penalty of the unpaid balance of the tax would be levied. Failure to file a return or the filing of an incorrect or insufficient return would trigger a provision requiring the Director of Taxation to estimate the value of the taxable estate and assess a 50 percent penalty thereon, plus interest. Any personal representative acting with fraudulent intent would be subject to a penalty of 100 percent of the tax due, plus interest. Personal representatives intentionally signing fraudulent returns would be deemed guilty of a felony and subject to imprisonment of up to five years.

Additional provisions authorize under certain circumstances the filing of tax liens and provide for the issuance of tax warrants.

Finally, another item not currently in SB 94 but agreed to by conferees would conform the Kansas estate tax exemption filing threshold to the federal threshold, effective for estates of decedents dying on and after January 1, 2007.

Local Sales Tax Provisions (HB 2237 and HB 2005 as Amended by Senate COW)

Additional language would classify all Wyandotte County cities as "class D" cities for purposes of local sales taxation, granting such cities additional local sales tax authority of up to 0.75 percent for economic development or strategic planning initiatives or for public infrastructure projects. Sumner County also would be authorized to impose a local sales tax of up to 1.0 percent without sharing the monies with cities located therein, provided the revenues are pledged to finance a courthouse, jail, law enforcement center, or county administrative facility.

Other local sales tax language would provide new sales tax authority of 0.4 percent for Jackson County, with the revenues earmarked 50 percent for economic development initiatives and 50 percent for public infrastructure projects. Any such tax imposed would be required to sunset after seven years.

Additional provisions of the bill would provide special local sales tax authority for Chase and Shawnee counties. Chase County would be authorized to impose a tax of up to one percent without being required to share the revenues with cities located therein, provided the monies are earmarked for financing the construction or remodeling of a courthouse, jail, law enforcement facility, or other county administrative facility. Any such tax imposed would be required to sunset upon the payment of all costs incurred in the financing of such facilities. Shawnee County would be granted new authority of one quarter percent for the purposes of pledging the monies to the city of Topeka to finance the costs of rebuilding the Topeka Boulevard Bridge and other public infrastructure improvements associated therewith. Any such tax imposed would be required to sunset upon the payment of all costs incurred in the financing of such projects.

#### Provisions of Sub SB 170

Additional sections would amend income tax withholding statutes to:

- Require withholding on management and consulting fees that are paid in the ordinary course of trade, business, or other for-profit venture to a nonresident of the State of Kansas.
- Clarify in a number of places that withholding is required by employers, payers, persons, or organizations deducting and withholding tax. Current law refers to the employer or payor only.

- Make a number of adjustments to the definition section of current withholding law.
- Clarify that S corporations, partnerships, and limited liability companies (LLCs) are required to withhold tax on distributions to nonresident shareholders, partners, and members.
- Require that S corporations, partnerships, and LLCs file a return on withholding and furnish nonresident shareholders, partners, and members with a written statement as proof of the amount of his or her share of distributed or undistributed income that has been withheld.
- Waive the withholding requirement if the nonresident shareholder, partner, or member is income tax exempt and provides a statement to that effect including pertinent information.
- Waive the withholding requirement if the nonresident shareholder, partner, or member files an affidavit agreeing to be subject to personal jurisdiction of the Department of Revenue and the Kansas courts for tax purposes.

#### Streamlined Sales Tax Provisions

Other provisions of the bill would make a number of changes to state and local sales tax laws necessary to bring Kansas into compliance with the uniformity and simplification requirements set forth in the multistate Streamlined Sales and Use Tax Agreement (Agreement) adopted by the Implementing States (including Kansas) on November 12, 2002.

#### **Uniform Definitions**

The Agreement requires that if a state's sales tax laws use certain terms, or if those terms fall within a state's sales tax impositions or exemptions, then the definitions of those terms contained in the Agreement must be adopted. HB 2005 would add several new definitions to Kansas sales tax law. A number of terms would be added, not because they are required definitions, but because they are terms frequently used within the Agreement, including agent, certified automated system, certified service provider, model 1 seller,

model 2 seller, model 3 seller, purchaser, registered under this agreement, seller, sourcing rules, agreement, and member state. Additional terms are in fact uniform definitions required by the Agreement and also would be added to the Kansas law, including delivery charges, direct mail, lease or rental, purchase price, retail sale (differs slightly from current Kansas definition), sales or selling price, computer, computer software (differs from current Kansas definition), delivered electronically, electronic, load and leave, pre-written computer software, tangible personal property (differs slightly from current Kansas definition), alcoholic beverages, food and food ingredients, tobacco, drug (differs from current definition), durable medical equipment (differs from current Kansas definition of "medical equipment"), mobility enhancing equipment, prescription, and prosthetic device (differs from current Kansas definition).

Under current Kansas law, tangible personal property is defined to include computer software (both custom and canned) and prepaid telephone calling cards. The Agreement treats custom software as a service and defines canned software as tangible personal property. The Agreement also defines prepaid calling cards as a service. Changes to Kansas law would be made to conform to the Agreement definitions.

Adoption of the Agreement definition for "drug" further requires some cosmetic changes to the sales tax exemption for prescription drugs, which would be made in KSA 79-3606(p).

Kansas law contains an exemption for "medical equipment," but excluding items customarily used for human habitation purposes. KSA 79-3606(hh). The Agreement contains a required definition for "durable medical equipment," and this new term would be inserted in the exemption statute.

Kansas law contains an exemption for prescribed prosthetic and orthopedic appliances in KSA 79-3606(i). The Agreement contains required definitions for "prosthetic devices" and "mobility enhancing equipment" which should not substantively change the exemption.

### **Uniform State and Local Sales Tax Bases**

The Agreement requires that by 2006, except for motor vehicles, aircraft, watercraft, modular homes, manufactured homes or mobile homes, the sales tax base (*i.e.*, the items subject to sales tax) must

be identical at the state and local level. If an item is subject to state sales tax, it must also be subject to local sales tax, and vice versa. In Kansas, sales of water, natural gas, electricity and heat delivered through mains, lines or pipes for residential or agricultural use is exempt from state sales tax but subject to local sales tax. However, the Agreement does allow a state to impose a zero state sales tax rate on sales of piped natural or artificial gas, electricity, or other heating fuels delivered by the seller. Thus, the only state vs. local sales tax base issue for Kansas concerns sales of water for residential or agricultural use. HB 2005 would amend the local sales tax statutes to exempt on January 1, 2006, such sales. The bill also provides on that date a “zero” percent state sales tax rate on the sales of natural gas, electricity, and heat delivered through pipes, lines or mains for residential or agricultural use, and a “zero” percent state sales tax rate on the sales of propane, LP gas, coal, wood and other fuels for residential use. But no policy change is being made with respect to such sales, which are currently exempt from state (but not local) taxes.

### **Local Use Tax**

Unlike many other states, Kansas does not have a local use tax, except for boats and motor vehicles (when the local use tax is paid upon registration). In order to level the playing field for Kansas retailers relative to out-of-state retailers, and in order to allow local governments to participate in the benefits of the voluntary collection efforts of out-of-state retailers registering under the Agreement, a local use tax would be imposed on all other transactions which are subject to the state use tax.

### **Seller Registration**

The Agreement requires that states develop uniform registration procedures that would apply to out-of-state sellers voluntarily registering under the Agreement to collect sales or use tax. This includes electronic registration and registration through an agent. KSA 79-3608, the sales tax registration statute, would be amended accordingly. Retailers obligated to register in Kansas (because they are located in Kansas or “doing business” in Kansas) would remain subject to the existing registration requirements.



### **Notices to Retailers of Tax Rate, Effective Date, and Taxing Jurisdiction Boundary Changes**

One of the major goals of the Agreement is to give retailers sufficient lead time to implement changes in state and local sales tax rates and taxing jurisdiction boundaries. Current law contains no requirement for any lead time for a change to the state sales tax rate. The Agreement requires that state sales tax rate changes can be effective only on the first day of a quarter and requires revenue departments to make a reasonable effort to provide sellers as much advance notice of changes as is practical. HB 2005 would enact these changes and would provide that for certain services covering a period including a rate change, the rate change would go into effect for the first billing period starting on or after the rate change.

The statute governing local sales tax rate and boundary changes, KSA 12-191, was amended in 2001 to accommodate some of the Agreement requirements regarding lead time for local rate and boundary changes. HB 2005 amends that statute again to make additional required changes. Local rate changes would not apply to catalog purchases until the first day of the quarter following 150 days after the city or county had provided notice to the department of the change. Once the department had received such notice, the department would be given 30 days to send notice of such change to sellers. Existing law provides that for other than catalog purchases, local rate and boundary changes can become effective on the first day of the quarter following the 90th day after the city has provided the department notice of the change. HB 2005 requires that after receiving such notice, the department would have to give sellers notice of the change within 30 days.

### **Database for Rate and Boundary Changes**

The Agreement requires that, as of the date that a state joins the Agreement, the state must develop and maintain an electronic database (in downloadable format) of all taxing jurisdiction boundaries, rates and the effective dates of any changes, pursuant to certain standards. The state must further develop and maintain a database that assigns each 5 and 9 digit zip code to the proper rates and taxing jurisdictions. The state must also participate with other member states in developing an address-based system for assigning taxing jurisdictions, meeting the requirements of the federal Mobile Telecommunications Sourcing Act. Once these databases are

developed, sellers would be relieved from liability for charging the wrong rates if the state's databases contained erroneous rate information, and sellers relied on that information. However, no liability relief is provided if the state develops an address-based system meeting the requirements of the federal Mobile Telecommunications Sourcing Act. HB 2005 would enact these provisions.

### **Sourcing Rules**

Current Kansas law generally uses an "origin-based" sourcing rule, applying the local sales tax in effect at the retailer's business location. The Agreement requires a change to a "destination-based" sourcing rule to determine the applicable local sales or use tax. Sales would remain "sourced" to the retailer's location for buyers taking possession of merchandise on site, but sales of shipped merchandise would be sourced to the buyers' location for local sales or use tax purposes.

Exceptions in the Agreement to the "destination-based" sourcing rule would include sales of watercraft, modular homes, manufactured homes or mobile homes, and the sale of certain motor vehicles, trailers, semitrailers or aircraft not used in interstate commerce. Such sales would remain sourced to the retailer's location, as under current law.

Special sourcing rules would be provided for specific categories of sales. For leases of tangible personal property in which periodic payments are made, the first lease payment would be sourced under the general "destination-based" sourcing rules but subsequent payments would be sourced to primary property location. For leases with only one payment, the sale would be sourced under the general "destination-based" rules. (These provisions are essentially consistent with current Kansas law.) For leases of motor vehicles and aircraft not used in interstate commerce, all periodic lease payments would be sourced to the primary property location. If there is only one lease payment, it would be sourced under the general rules. Retail sale and leases of motor vehicles and aircraft used in interstate commerce would be sourced under the general "destination-based" rules.

When the purchased item can be used in several different locations (such as with computer software purchased by a large company for use in its offices located in several states), the purchaser may give the seller a "multiple points of use" exemption certificate.

The seller would then be relieved of the obligation of collecting sales or use tax, and the purchaser would assume the burden to properly apportion the use tax among the jurisdictions in which the item is being used.

Under a similar provision relating to direct mailing to addresses in several states, the purchaser of the mailing may give to the printer a "direct mail form" showing the multiple jurisdictions where the mailing is to be sent. The printer would then be relieved of the obligation to collect sales or use tax, and the purchaser would assume the obligation directly remit the tax to the appropriate taxing jurisdictions, based on the mailing.

Telecommunications service has its own sourcing rules consistent the federal Mobile Telecommunications Sourcing Act, the provisions of which have already been adopted by Kansas.

### **Administration of Exemptions**

A purchaser claiming an exemption for sales tax must give to the seller a properly completed exemption certificate at the time of purchase, documenting the reason for the exemption and providing information concerning the sale and the identify of the purchaser. (The seller then need not charge sales tax on the transaction, but would be required to retain the exemption certificate and make it available upon audit.) The Agreement removes the "good faith" burden on sellers established by current Kansas law for the acceptance of an exemption certificate. Under the new provisions, the seller would need not make any independent judgment (absent fraud) as to whether the exemption claim is valid, so long as the seller obtained a properly completed exemption certificate. Additional language provides that exemption certificates may be filed electronically.

### **Uniform Returns**

The Agreement authorizes sellers who are not obligated to register in a state to voluntarily register and collect and remit sales and use tax. The state may require electronic filing by these sellers and can approve a simplified format for the return, which must be filed at least annually, unless collections exceed \$1600 in a month, in which case, returns must be filed monthly thereafter.

### **Electronic Remittances**

Under the Agreement, a state may require model 1, 2, or 3 sellers to make sales or use tax remittances electronically.

### **Uniform Bad Debt Recovery Rules**

When a seller sells merchandise, receives only partial payment, but has remitted the full amount of sales tax owed on the transaction (as required), the seller may incur a “bad debt” if the buyer later defaults on the transaction. Typically, the seller can take a “bad debt deduction” for sales tax previously remitted on defaulted sales transactions. Some states allow the party providing financing for the defaulted sales transaction to take the “bad debt deduction.” Kansas currently allows only sellers the bad debt deduction. (Third-party financiers are not eligible.) Under the Agreement, a state retains the option whether to allow only sellers to receive the bad debt deduction. However, member states use uniform rules governing how sellers are permitted to deduct bad debts. The bad debt deduction rules in the Agreement are essentially in line with current Kansas policy.

### **Confidentiality and Privacy Protections**

Confidentiality and privacy protection already exists under current law with respect to taxpayer information from sellers required to register. ( KSA 79-3614) The Agreement focuses on ensuring that states have in place confidentiality and privacy protections with respect to “personally identifiable information” that certified service providers must collect concerning consumers when handling the sales and use tax collection, reporting and remitting responsibilities for model 1 sellers. New language would provide these provisions.

### **Uniform Rounding Rules**

Rounding rules apply to determine when a sales tax amount calculation should be “rounded up” to the nearest whole cent. The Agreement requires that member states use a uniform rounding rule, and that the tax computation should be carried to the third decimal place, and rounded up to the next cent whenever the third decimal

place is greater than four. (This is consistent with current policy, which would be codified statutorily for the first time).

### **Customer Refund Procedures**

The Agreement requires that member states include in their refund procedures a provision that requires a purchaser, before suing a seller for over-collected sales tax, to give the seller 60 days written notice and an opportunity to respond. New language would enact this requirement in KSA 79-3650(b).

### **Taxability Matrix**

The Agreement requires that a member state must maintain a "taxability matrix" in a database in downloadable format that will list the products and services taxable in the state. Sellers and certified service providers would be relieved from liability to the state or local jurisdiction for having charged or collected incorrect amounts in reliance on erroneous data contained in the taxability matrix.

### **Seller Participation**

The Agreement requires that member states develop an online central registration system for out-of-state sellers volunteering to register under the Agreement. Sellers already obligated to register (because they have nexus with the state) must comply with the existing state registration rules. The fact that a seller voluntarily registers under the Agreement cannot be used as a factor in determining whether that seller has nexus with the state.

### **Amnesty for Registration**

Amnesty for past sales or use tax collections is available to a seller registering under the Agreement, provided the seller was not registered with the state within the 12-month period preceding the effective date of the state's joining the Agreement, and the seller registers within the 12-month period following that effective date. Amnesty is not available to sellers under audit. The seller must continue to remain registered and collect taxes for at least 36 months for the amnesty to be effective.

## **Method of Remittance**

Sellers registering under the Agreement may select 1 of 3 models to operate under: model 1 (seller relies on a certified service provider to perform all tax functions on its sales), model 2 (seller relies on a certified automated system to calculate the tax on each transaction, but the seller performs all other tax functions), or model 3 (seller utilizes a certified proprietary automated sales tax system).

## **Registration By An Agent**

The Agreement requires that member states permit sellers to register through a duly appointed agent. That requirement would be added to KSA 79-3608.

## **Background**

Legislation enacted in 1998 provided refundable income, premiums, and privilege tax credits beginning in tax year 1998 to offset 15 percent of property taxes actually and timely paid on commercial and industrial machinery and equipment and certain mineral leasehold machinery and equipment.

Subsequent legislation enacted in 2002 provided for an increase in such credits to 20 percent beginning in tax year 2005; and to 25 percent beginning in tax year 2007. The bill also made the credits initially available in 2005—at the 20 percent level—for taxes actually and timely paid on railroad property. These new credits also are scheduled to increase to the 25 percent level beginning in tax year 2007.

At the conclusion of an interim study, the Special Committee on Assessment and Taxation found the language amending KSA 2001 Supp. 79-32,206 unintentionally expanded the credits to property taxes paid by *all* public utility tangible personal property (in lieu of only such taxes paid by railroads). That committee then recommended introduction of HB 2005 to clarify the intent of the 2002 legislation.

The Department of Revenue has observed that if the tax credits were in fact to be extended to all state assessed public utilities

beginning in tax year 2005, the unanticipated fiscal impact would be at least \$42 million beginning in FY 2006.

The Senate Assessment and Taxation Committee removed a House Taxation Committee amendment that would have made the credit available to railroads at the 15 percent level for tax years 2003 and 2004. That provision would have reduced State General Fund receipts in FY 2004 by \$1.372 million and in FY 2005 by \$1.412 million.

During the interim, the Property Valuation Division testified that it was not entirely clear that the Legislature was legally compelled by The Railroad Revitalization and Regulatory Reform Act of 1976 (the 4-R Act) to extend the credits to railroads in the first place.

The Senate Committee of the Whole amended the bill to include the streamlined sales tax provisions as they were embodied in SB 192 as that legislation left the Senate. The only change to that version of the streamlined legislation relates to making most provisions effective July 1, 2003. Most provisions in SB 192 would have been effective July 1, 2004.

Kansas could become a Member State of the Agreement when the changes in law take effect.

A recent study has suggested that Kansas by 2006 may be losing as much as \$246 million in state and local sales and use taxes from Internet transactions.

The Senate Committee of the Whole also added the local sales tax provisions for Wyandotte and Sumner counties.

The Conference Committee on May 5 agreed to add all of the other provisions hereinbefore described.

### **Fiscal Impact**

#### **SGF Receipts (\$ in millions)**

	<u>FY 2003</u>	<u>FY 2004</u>
SB 94	(\$3.000)	(\$3.000)
Amnesty	--	\$19.500

TOTAL	(\$3.000)	\$16.500
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Other fiscal provisions of note include the elimination of SBOTA positions, which would reduce expenditures by roughly \$0.3 million on an annualized basis; and the SBOTA fees are anticipated to provide \$0.337 million in FY 2004.

Finally, the federal conformity with respect to the estate tax threshold is expected to reduce SGF receipts by \$8.5 million in FY 2008 and by \$11.2 million in FY 2009.