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Kansas' new sourcing rules and local use tax raise tax, questions about SSTP

Some observers of the sales tax simplification project have predicted states would use streamlining conformity as an opportunity to broaden tax bases or impose new taxes. Kansas HB2005 appears to be a good case in point. For businesses selling in Kansas, sales tax simplification measures may appear to have a complicating effect.

Sellers must switch their tax collection systems to accommodate the new destination-based sourcing rule, and out-of-state sellers who collect the state's use tax now must also collect local use taxes.

In adopting HB2005 to conform Kansas law to the multistate Streamlined Sales Tax Agreement, state lawmakers added a local use tax in every locality where local sales tax is imposed, effective July 1.

Too tempting to ignore?

The Dept. of Revenue estimates the new local use tax could generate between \$30 million and \$50 million annually, says **Richard Cram**, director of policy and research with the DOR.

Numbers like those are one reason many businesses have been wary of the simplification effort. Though states never promised they wouldn't impose new taxes, "It's actually been a concern from the business side," says Diane Yetter, of Yetter Consulting Services in Chicago. "Are we going to see a real increase in taxes?"

She points to Minnesota's 2001 enactment of simplification provisions. Prior to adopting the law, Minnesota exempted clothing except items made from fur. But the streamlined definition of clothing did not include an exception for fur, so Minnesota exempted "clothing" and enacted a special fur excise tax.

Additionally, Minnesota eliminated an exemption for goods temporarily stored in the state and adopted the streamlined definition of sales price, making delivery and installation charges taxable for the first time.

New burden on business

The Kansas Chamber of Commerce and Industry opposed HB2005. **Marlee Carpenter**, director of taxation and small business with the KCCI, says businesses already pay about 80% of all use tax collected in the state.

Carpenter predicts the new local tax will affect a wide cross-section of industry, from manufacturers purchasing non-exempt items to retailers and telecommunications companies. Though individual consumers will pay some of the new revenues to remote sellers obligated to collect, Cram admits businesses will likely bear the brunt of the local tax because they are subject to use tax audits.

Destination-based sourcing

Not only will businesses pay more use tax on purchases, HB2005's destination-based sourcing provision means they will have a tougher time complying with collection and remittance rules. In-state sellers who previously had to collect local sales tax for only one jurisdiction where sales originated now must collect for every locality where they ship goods.

Cram admits the department has received many complaints about the new rule.

"The small businesses are definitely unhappy with destination sourcing, particularly if they are the type of business that does deliveries or mails things," he says. "They're not used to dealing with more than one local sales tax rate."

The provision was necessary to bring Kansas into conformity with the multistate simplification provisions, which require every state to use destination-based sourcing. However, Yetter says the measure achieves the opposite result. Until HB2005, she listed Kansas in a 'favorite state' column because its sales and use taxes were easy to administer. Not anymore.

"I think most business people are mortified that Kansas took the opportunity to make their tax more complex for remote sellers than it is today," she says. "If (the) Streamlined Sales Tax (Project) was to make the collection of tax easier for remote sellers, Kansas accomplished the opposite. Prior to the passage of HB2005, remote sellers would have only been required to collect the Kansas state use tax. Now they must collect all the local taxes."

Racing the clock

The law requires that the state provide retailers with a database matching tax rates to local jurisdictions by five-digit and nine-digit zip codes. For small and medium-sized businesses unable to afford the type of software that captures local tax data, such a database will be a necessity, predicts **Lucky DeFries**, a partner with the Topeka, Kan. law firm of Coffman, DeFries & Nothern.

DeFries says he has heard estimates the database will be ready by the end of 2003. Until it is, smaller businesses may be figuring multiple local tax remittances by hand.

From the law's passage until its July 1 effective date, retailers had little more than a month to prepare. Yetter points out that if lawmakers' intent was to comply with simplification measures, they already have violated that spirit: Streamlining provisions require a 60-day notice for rate changes.

In addition, the DOR has not provided preprinted returns with local tax rates, Yetter says. That means even taxpayers with existing software to calculate local taxes may be looking up rates and handwriting tax amounts for each locality.

But the July 1 deadline may not be as firm as it appears. Cram says the DOR realizes businesses will have a tough time complying by then.

"We've been telling folks that although the law goes into effect July 1 and it's on the books, we're not going to be looking at those new rules for a few months," he says. "We're going to give people about six months to get up to speed on this."

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