

REVENUE FOR THE 21ST CENTURY

Taxing Internet Sales in Kansas



KANSAS LAWMAKERS SHOULD ENACT LEGISLATION TO COLLECT SALES TAX DUE ON INTERNET PURCHASES TO MODERNIZE KANSAS' TAX CODE, LEVEL THE PLAYING FIELD FOR SMALL BUSINESSES, AND CAPTURE A SUSTAINABLE AND RENEWABLE SOURCE OF REVENUE THAT OUR STATE SORELY NEEDS.

Legislators reversed course in 2017 on Governor Sam Brownback's tax experiment, but that was only a first step. Their reforms didn't address necessary modernization of Kansas' tax code. As Kansas builds a sensible fiscal foundation for the future, legislators must revisit Kansas' antiquated sales tax. One important thing the state can do is implement a more robust strategy for collecting the sales taxes due on internet purchases.

Although this fact is not widely understood, every purchase made online is subject to sales tax if it would be taxable as a store purchase.¹ (Technically, the tax due is called the "use tax."²) For example, if a Kansan purchased an iPad online from BestBuy.com, the purchase would be subject to the same Kansas sales tax that would have been charged if the purchase had been made at a Hays brick-and-mortar store.

But while sales tax may be due on the online purchase, it may not be readily collectible. That is because the U.S. Supreme Court ruled in its 1992 Quill Corp. v. North Dakota decision that out-of-state retailers cannot be required by a state to collect and remit sales tax from state residents unless the retailers have a physical presence in the state.³ Purchasers are legally obligated to pay the sales tax due on their purchases directly to their states' revenue departments, but this obligation is neither widely known nor widely followed.⁴

As is the case in every state, the Quill decision has seriously hurt Kansas small businesses, as they must charge combined state and local sales taxes that can reach between 6.5 and 10.6 percent⁵, while many online competitors don't charge sales tax at all. It also deprives Kansas and its local governments of taxes they are legally owed and

with which they could finance critical services such as education and health care; **the federal Government Accountability Office recently estimated the revenue losses as ranging between \$113 million and \$170 million in 2017.**⁶

What Kansas Can Do

Recently, states have implemented various strategies to recapture the lost Internet sales tax revenue and level the competitive playing field for local retailers. Kansas itself has adopted one of them. In 2013, taking advantage of a strategy that the Quill decision did not preclude, it passed Senate Bill 83.⁷ The legislation required large Internet retailers with no direct physical presence in Kansas to collect and pay state sales tax on all of their sales to Kansas residents if:

- There is an agreement between the out-of-state retailer and a Kansas resident (most likely a Kansas-based website) in which the retailer pays the resident to host a link for the retailer on the resident's website and bases the payment on the value of sales made at the website accessed through the link. These relationships are referred to as "click through" or "affiliate" agreements.
- AND, the retailer's overall gross receipts from Kansas sales made through these links exceeds \$10,000 in the prior year.⁸

Senate Bill 83 was a good first step, but Kansas can do more. States have implemented four broad approaches to taxing Internet sales that Kansas should consider emulating:



APPROACH #1

Enact an “Economic Nexus” Law

States pass a so-called “economic nexus” law requiring online sellers with no physical presence to collect sales tax if they make sales in the state above a stated dollar threshold.⁹ This approach was intended to bring the “physical presence” standard back before the United States Supreme Court in hopes that it would overturn the Quill decision.¹⁰

States: Alabama, South Dakota, Wyoming, and others

Status: In January 2018, the United States Supreme Court announced it would accept a case challenging South Dakota’s “economic nexus” law, in effect, revisiting Quill.¹¹ Oral arguments in the case have been scheduled for April, and a final decision is expected in June.¹²

Significance for Kansas: Kansas should consider enacting an “economic nexus” law modeled on that of South Dakota in anticipation of a possible reversal of Quill. Unlike Kansas’s current law, South Dakota’s law states that an out-of-state retailer with no physical presence in the state does not have to collect and remit the state’s sales tax unless it has annual sales in the state of at least \$100,000 or at least 200 separate transactions with state residents.¹³ It is quite possible that a Supreme Court decision reversing Quill would be conditioned on the existence in South Dakota’s law of such a “de minimis” provision, and Kansas’s adoption of one now would put it in position to immediately enforce the economic nexus standard if the Court upholds it.



APPROACH #2

Require Internet “Marketplaces” to Charge Sales Tax

Amazon.com and several other large Internet retailers allow and encourage smaller, independent retailers to sell products on their websites, operating essentially as online consignment stores. Minnesota has enacted a law that requires companies with a nexus in the state that operate marketplaces to charge sales tax on these third-party sales.¹⁴

States: Minnesota, New York (proposed), others

Status: It does not appear that Minnesota’s law has been challenged to date, although Amazon is in court challenging South Carolina’s attempt (without an explicit law like Minnesota’s) to collect from the company taxes the state claims it should have remitted on past marketplace sales.¹⁵

Significance for Kansas: If the Supreme Court overturns Quill later this year, there arguably would be little need for such a law, since the state would be empowered to require most third-party retailers to remit the tax themselves. Nonetheless, it would simplify administration if the state received one report and remittance from the marketplace rather than potentially thousands of sales tax returns from individual small retailers. As the Supreme Court’s decision is as yet unknown, there is a strong case for Kansas to emulate Minnesota’s law.



APPROACH #3 "Cookie" Nexus

The Massachusetts Department of Revenue has adopted a regulation defining the in-state "physical presence" of an out-of-state retailer as including software on in-state smartphones, computers, or other devices.¹⁶ Such software could include retailers' smartphone shopping "apps" and Web browser "cookies," text files that websites place in browsers to identify and track users. In other words, using this approach, even if retailers do not have employees or property in the state, their digital footprints on consumer devices have been declared to constitute a physical presence.

States: Massachusetts and Ohio

Status: Massachusetts amended its tax regulations to put the "cookie" nexus requirement in place.¹⁷ Legal challenges of both the Massachusetts regulation and the Ohio law are underway.^{18, 19}

Significance for Kansas: If Quill is overturned, there will be little if any need for a law like this, since the state will be able to require most or all companies with this form of physical presence in the state to collect sales taxes. Should Quill not be overturned, however, and should the Massachusetts regulation be upheld, Kansas' adoption of this strategy could ensure a substantial share of currently uncollected tax would be remitted; both Massachusetts and Ohio have presented substantial evidence that the use of cookies and other types of in-state software is essential to facilitate Internet commerce.



APPROACH #4 Notification and Reporting Law

Colorado enacted legislation requiring online sellers that are not required to charge Colorado sales tax because of Quill to report (only) the dollar volume of online purchases by residents to the Colorado Department of Revenue and to inform buyers they owe a tax on their online purchase.²⁰ Because it does not require tax collection, it remains constitutional under Quill and also improves purchaser compliance with their self-remittance requirements by notifying them they could be held accountable by the state for unpaid taxes.²¹

States: Colorado, Washington, others

Status: After years of litigation, in 2016 the United States 10th District Court of Appeals ruled that the law was constitutional, and the U.S. Supreme Court declined an appeal of the decision.²²

Significance for Kansas: While there will be relatively little need for such laws if the Supreme Court reverses Quill later this year, there could still be a residual benefit of having legislation such as this on the books. It is possible Congress would react to a reversal of Quill by enacting legislation establishing a sales threshold below which out-of-state retailers would not be obligated to collect and remit tax. A Colorado-style reporting requirement would facilitate collection of the tax from customers of Internet retailers whose in-state sales fell below such a threshold.

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