MEMORANDUM

To: Mr. Larry Campbell, Director
Director of Budget
From: Kansas Department of Revenue
Date: 03/28/2019
Subject: 2019 Senate Bill 22
Enrolled Copy of the Bill

Brief Of Bill

The enrolled copy of the bill amends the bill to strike language excluding candy, dietary supplements, food sold through vending machines, and soft drinks from the definition of food. The definition of food and food ingredients was amended to include any items eligible to be purchased with food stamps issued by the USDA. The amendment also struck the definitions of bottled water, candy, food sold through vending machines, prepared food, soft drinks, and dietary supplements from the bill.

Fiscal Impact

Sections 1 through 3:

Income

Table 1: Summary of Fiscal Impact

(Dollars in Millions)

Business Provisions	FY 2020*	FY 2021	FY 2022
Limitation on Deduction for Interest	-53.1	-25.5	-30.6
Repatriation	-10.5	-0.4	-0.2
GILTI	-70.9	-24.7	-24.2
Limitation on Deduction for FDIC Premiums	-2.7	-1.3	-1.3
Revision of treatment of contributions to capital	Negligible	Negligible	Negligible

Notes:
*The fiscal impact of FY20 is comprised of the sum of business provisions from FY18 and FY19 due to the amendment providing retroactivity.

Section 1 and 3:

These sections would decouple the impact of the 2017 federal policy changes of repatriation, global intangible low-taxed income (GILTI), limitation of business interest, capital contributions and FDIC premiums on Kansas. Decoupling the impact of the 2017 federal policy changes would decease state general fund revenues. The estimated impact of the federal policy changes on Kansas was calculated based on the 2017 Joint Committee on Taxation's report.

Table 2: Summary of Fiscal Impact Cont.

(Dollars in Millions)

	FY 2020	FY 2021	FY 2022
Allowing Switching to KS Itemized Deductions*	-50.1	-60.3	-60.9

Notes:
*The baseline in the simulation is **2017 tax return data** (which is the most current data) with policy changes of 2017 federal tax law changes from the H.R. 1 (Tax Cuts and Jobs Act). The provision would take effect in tax year 2018. We assume the amended returns for 2018 are filed in fiscal year 2020.

Section 2:

This section would allow switching to Kansas itemized deductions which has a negative impact on SGF for tax year 2018 and every year thereafter. The impact on tax year 2018 returns included in FY20 are due to the amendment providing retroactivity.

Income:

Fiscal Impact:

FY 2020: Negative $187.3 Million in SGF

FY 2021: Negative $112.2 Million in SGF

FY 2022: Negative $117.2 Million in SGF

Kansas Main Street Parity Act

In November 2017, the US Government Accountability Office (GAO) released a study on sales taxes, including estimates on revenues states could gain from expanded authority, including increased sales tax collections on out-of-state remote sellers. According to the GAO, Kansas could potentially gain $113 million to $170 million in increased collections due to expanded collection authority.

Using the GAOs lower estimate and removing amounts already received through Streamlined Sales Tax Volunteer Filers and amounts collected on behalf of local government, it is estimated that Kansas could potentially gain $70.9 million with expanded sales tax collection authority, including $59.5 million to the State General Fund and $11.5 million to the State Highway Fund.

The GAO provided national estimates on potential gains from business-to-consumer transactions, including internet retailers, e-marketplaces, and other remote sellers. The GAO estimates were applied to Kansas to estimate the annual impact.

	FY 2020	FY 2021	FY 2022
SGF	$18.2 million	$27.7 million	$28.2 million
SHF	$3.5 million	$5.4 million	$5.5 million
TOTAL	$21.7 million	$33.1 million	$33.7 million

Local governments would see an unknown increase in sales and use tax collections as a result of the Act.

Kansas Main Street Parity Act:

Fiscal Impact:

FY 2020: Positive $18.2 Million in SGF and Positive $3.5 Million in SHF. Total: Positive $21.7 Million

FY 2021: Positive $27.7 Million in SGF and Positive $5.4 Million in SHF. Total: Positive $33.1 Million

FY 2022: Positive $28.2 Million in SGF and Positive $5.5 Million in SHF. Total: Positive $33.7 Million

Food and Food Ingredients rate reduction to 5.5%

	FY 2020	FY 2021	FY 2022
SGF	-$36.5 million	-$55.4 million	-$56.3 million
SHF	-$7.0 million	-$10.7 million	-$10.8 million
TOTAL	-$43.5 million	-$66.1 million	-$67.1 million

Note:
Sales tax estimates are based on the November 2018 CRE. Collections from the sales of food are estimated to be 15% of the total collections.

Food and Food Ingredients rate reduction to 5.5%:

Fiscal Impact:

FY 2020: Negative $36.5 Million in SGF and $7.0 Million in SHF. Total: Negative $43.5 Million

FY 2021: Negative $55.4 Million in SGF and $10.7 Million in SHF. Total: Negative $66.1 Million

FY 2022: Negative $56.3 Million in SGF and $10.8 Million in SHF. Total: Negative $67.1 Million

Administrative Impact

The total administrative impact is **$3,330,140 (Total Administrative Cost+Total IT Impact).**

Administrative costs, $177,896.25 - INCOME

- Changes to K120 Instructions
- Changes to K40 form and Instructions
- KCSC (Kansas customer service center) edit updates (WebFile).
- Changes to Efile
- Updates to Channel and ATP edits (Multiple edits will need to be created for each line on Part C of the Schedule S).
- New edits will need to be added in 2020 to verify Amended returns filed.
- 3 Customer Rep Seniors due to additional phone calls and filed returns.
    - One time cost ($4,105.65x3) $12,316.95
    - Annual Expenditures ($1,417.87x3) - $4,253.61
    - Annual Salary ($53,593.73x3)- $160,781.19
    - **Total - $177,351.75**
- The fiscal impact assumes there will be nearly 200,000 returns filed that itemize in Kansas and take standard at the federal level. If 20% of those returns hit a worklist for additional information requests, 3 FTEs is probably a minimum requirement
- Create new adjustment letters, reason codes and paragraphs
    - 3 x $181.50 = $544.50
    - **Total = $544.50**

Administrative costs, $894,803.64 - SALES

- Update the following forms; CT-9U, CT-1OU, ST-16, ST-36, or possible create new form for all retailer sales and comp.
- Update Pub. 1216, 1510, 1520, 1527, 1550, 1525, 1560, 1526 &1700. Cost $1000.00 per form and $600.00 per publication for a total cost of **$9,400.00**
- New notice@ **$1,000.00**
- ATP, channel, and web file edits
- Revisions to currents letters and addition reason codes and paragraphs. Cost to revise forms and create new paragraphs. Total **$544.50**
- Major EFT deposit and RA Admin deposit changes will also be needed to determine the Sales/Compensating at regular state rate and at the Food Sales rate.
- Updates to Audit System
- 3rd party vendor contracts for private collection agencies would have to be reviewed due to the increase in volume of sales/use tax accounts this bill will create.
- New Employees
    - FTEs for **Revenue Recovery** to handle additional collections and phone calls. 2 CR Seniors (2 x $53,593.73 = $107,187.46)
    - One Time and Annual Other Operating Expenditures (2 x $5,523.52 = $11,047.04) Total cost **=$118,234.50**

- FTEs for **Customer Relations** to handle additional phone calls, accounts and registrations due to change in nexus and sales tax reduction on food.
- 5 CR Specialists (5 x $60,506.13 = $302,530.65)
- One Time and Annual Other Operating Expenditures (5 x $5,523.52 = $27,617.60)
- Total cost = **$330,148.25**
- 5 CR Seniors (5 x $53,593.73 = $267,968.65) to handle additional phone calls, accounts and registrations due to change in nexus and sales tax reduction on food
- One Time and Annual Other Operating Expenditures (5 x $5,523.52 = $27,617.60) Total cost = **$295,586.25**
- 1 Public Service Administrator II (1 x $68,336.97) to handle additional phone calls, accounts and registrations due to change in nexus and sales tax reduction on food.
- One Time and Annual Other Operating Expenditures (1 x $5,523.52 = $5,523.52) Total cost = **$73,860.49**
- FTE for **Audit** to handle additional accounts.
- 1 CR Specialist $60,506.13
- One Time and Annual Other Operating Expenditures $5,523.52
- Total cost = **$66,029.65**

The total IT impact is **$2,257,440 (CGI Cost+ KOOR IT Cost)**.

Here is the breakdown:

CGI		hourly rate	Travel expense @ 21.25 per hr	Rate X Hr	Total
ATP System Development	2160	94	$45,900.00	$203,040.00	$248,940.00
Channel Development	920	91	$19,550.00	$83,720.00	$103,270.00
E-Commerce Development	3240	91	$68,850.00	$294,840.00	$363,690.00
ACM Development	80	94	$1,700.00	$7,520.00	$9,220.00
System Testing	5720	86	$121,550.00	$491,920.00	$613,470.00
Analysis and Design	3200	86	$68,000.00	$275,200.00	$343,200.00
Project Management and Oversight	1600	140	$34,000.00	$224,000.00	$258,000.00
CGI hours of work	16,920				

KDOR		hourly rate
E-Services hours of work	100	50
KDOR UAT hours of work	5720	50
Project Management hours of work	533	50
KDOR-IT hours of work	6353	

KDOR IT Cost ($317,650)
CGI IT Cost ($1,939,790)

Grand Total **($2,257,440)**

KOOR will prioritize with other work as part of the CGI contract and bank of hours. If all of the prioritized work can't be completed within the allotted hours, KOOR may elect to pursue a change order. All contract rates and terms apply.

Administrative Problems and Comments

ADMINISTRATIVE PROBLEMS AND COMMENTS - INCOME:

- This will increase the number of Amended returns received. This will increase phone calls received
- The Department will be unable to verify the State information filed by looking at the Federal return as they will not match.
- Software Vendors will have to change/update Software allowing the Taxpayer to change data that was brought over from the Federal Return.

ADMINISTRATIVE PROBLEMS AND COMMENTS - SALES:

- This bill would increase the number of registrants, returns and correspondence.
- October 1, 2019 will not give the department enough time to implement if this bill passes.
- Will the CSPs be entitled to an allowance for those retailers that already volunteer to file?
- As a member of Streamlined Sales Tax (SST), Kansas receives a significant number of returns and payments through Certified Service Providers (CSPs). Approximately $6.4 Million of volunteer dollars were collected through CSPs for the period of October 2017 September2018. Our basic definition of a volunteer is an entity that, based on pre-Wayfair rules, had no legal obligation to collect and remit taxes to Kansas for sales made into the state. States participating in SST provide an allowance to CSPs for volunteer dollars they bring in. The general allowance Kansas absorbs for these volunteer dollars is 8% of the tax to be remitted. Based on the amount of sales for this period, our allowance costs to receive these dollars ran about $512 Thousand.
- If the same volunteer definition is used for new participants recruited through SST, we can expect our allowance costs to increase. Without additional information on how many new businesses and taxes we would expect falling within these parameters, we would not be able to project how much we would have to absorb. Additionally, SST has the option to negotiate with the CSPs to reduce the compensation rate.
- There are advantages to maintaining our relationship with SST. We do not have to build and/or maintain a unique system to interact with international customers. Most of our interaction is with a small group of CSPs that act as agents for the taxpayer. The CSPs do the work to recruit taxpayers and assist with processing their returns. There are currently 25 states involved with SST with this number expected to grow. The Supreme Court specifically mentioned SST as a service that could provide free software to taxpayers for the purpose of collecting and remitting tax.

- It is possible due to the threshold we could lose some registrants that are currently volunteering to file but are under the threshold amount.
- Switching from the current combined rate would be a more complex system for taxpayers. Additional staff and training would be necessary in order to respond to increased volume of questions received.
- Defining food as those products eligible under the USDA SNAP program would create a compliance issue with the states membership in the Streamlined Sales Tax project. This is due to differences between the USDA SNAP definition of food and the Streamlined definition of food and food ingredients. The differences in the definitions would result in additional burdens on in-state businesses (particularly multistate businesses with Kansas locations), remote sellers based in Kansas and shipping products into other Streamlined states, and remote sellers located outside Kansas and making sales into Kansas.
- In calendar year 2018, a total of $32.9 million in sales tax collections were remitted to Kansas through the Streamlined Sales Tax system, including $18.7 million through volunteer sources. In the Supreme Courts Wayfair decision, the Court specifically referenced the Streamlined Sales Tax project as a framework to calculate and remit taxes nationally. The assumption is that the Court felt the Streamlined system eased an undue burden on business. If Kansas were not to participate in Streamlined, a different method for remote sellers to remit taxes would need to be developed. Having a proprietary method solely for Kansas might be considered burdensome to out-of-state sellers, resulting in the potential loss of collections currently received through the Streamlined system.

Taxpayer/Customer Impact

Legal Impact

As enrolled, the bill proposes to do the following:

- Reduces the sales tax rate on food sales. The enrolled bill substitutes the definition of food under SNAP for the definition of food under Streamlined Sales Tax. There are significant differences between the two, and the amended language appears to deviate from the parameters of food in Streamlined. This will throw the State out of compliance with Streamlined. Being removed from Streamlined may have a significant, negative fiscal effect of several millions of dollars per year;
- Requires market place facilitators to collect and remit sales tax on behalf of sellers selling property and service taxable under the Retailers' Sales Tax Act on the facilitator's platform. This language is patterned closely after similar language used in the states of Washington, Minnesota and Pennsylvania. While the language may be challenged, the Department believes the bill is on strong enough footing to withstand a legal challenge;
- Defines persons selling property and services taxable under the Retailers' Sales Tax Act on the internet to Kansas consumers as "retailer's doing business in Kansas," and imposes collect and remit requirements on those retailers on their sales ta Kansas consumers. While these provisions may be challenged, the US Supreme Court decision in Wayfair v. South Dakota provides the Department a solid base to defend the bill;

- Removes certain accommodation brokers from the definition of marketplace facilitators. This is counter to how many states are moving. Moreover, Kansas currently has three of the largest accommodation brokers in the country collecting and remitting both sales and transient guest taxes. The Department is currently receiving approximately $1.2 million annually from these companies. If the proposed amendment on accommodation sellers goes through, there may well be a constitutional issue under the Equal Protection Clause. This would, most likely, require the Department to cease collecting from the sellers currently collecting and remitting, thus having a negative effect on receipts;
- The amendments remove digital property from the sales tax base under K.S.A. 79-3603. This too is counter to how the vast majority of states are dealing with digital goods/property. Most states with a sales tax are bringing these types of transactions within their sales tax base; and
- Leaves the income tax based on the original SB 22 untouched. No significant legal effect is anticipated with this portion of the amended bill.

Approved By:

Mark A. Burghart

Mark Burghart
Secretary of Revenue