

## Kansas Must Act to Protect Small Sellers from Remote Sales Tax Law

By Michael Austin,  
Andrew Moylan, and  
Andrew Wilford  
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Following the Supreme Court's *South Dakota v. Wayfair* decision, 44 states and the District of Columbia have assessed sales tax collection on out of state remote sellers. However, only one of those 45 jurisdictions levied taxes with no consideration to its burden of interstate commerce. Kansas has no small-seller exemption to its sales tax rules, making it the most burdensome and constitutionally suspect sales tax regime in the country.

Kansas lawmakers should act swiftly to fix this problem. Failure to do so will place an undue burden on thousands of small businesses, encourage passing that burden to Kansas consumers, and risk embroiling the state in expensive litigation it is likely to lose.

### ■ BACKGROUND: The “*Wayfair* Checklist”

Under the *Wayfair* decision handed down by the U.S. Supreme Court, states have the authority to tax online sales made by out-of-state retailers in a manner that does not pose undue burdens on interstate commerce. One reason the Supreme Court chose to rule in favor of South Dakota in the *Wayfair* decision is that it was convinced by the state's arguments that its economic nexus law would not place undue burdens on interstate commerce.

Justice Anthony Kennedy's opinion laid out a *few key factors* present in South Dakota's law that made its case convincing:

1. A safe harbor or de minimis threshold that exempted those who conduct limited business in the state from sales tax obligations.
2. State-level administration of all sales taxes in the state.
3. Uniform definitions of products and services.
4. A statutory prohibition on retroactive taxation.
5. A simplified tax rate structure.
6. Access to sales tax administration software provided by the state to ease compliance.
7. Immunity from audit liability for those using sales tax software.

According to K.S.A. 79-3702, retailers must remit sales tax to Kansas government if they have sufficient nexus in Kansas. Unfortunately, the term “nexus” is ill-defined, meaning the ability for the state to collect tax revenue lies entirely with the state's enforcement. The *Wayfair* decision redefined nexus to be that of an economic rather than physical presence and strongly suggested Kansas not discriminate against or unduly burden interstate commerce.

Kansas contains no statutory prohibition on retroactive enforcement of new sales tax rules. Kansas also claims membership in the voluntary sales tax simplification compact known as the Streamlined Sales and Use Tax Agreement (SSUTA). SSUTA members agree to state-level sales tax administration, largely uniform sourcing rules and tax definitions, and free use of tax preparation software. These are important innovations to reduce compliance burdens, but they do not eliminate them *entirely*.

Kansas must take action to codify no retroactive taxation and ensure limited Kansas sales from out of state sellers are not subject to taxation.

In fact, even if all 44 states and D.C. were to take up membership in SSUTA, it would not eliminate compliance concerns entirely. While standardized tax definitions, exemptions, and sourcing rules make for an easier process, the infrastructure necessary to accurately collect and remit sales taxes to dozens of states is extensive. Filing sales tax returns and being subject to audit and enforcement actions in dozens of states across the country will necessarily require substantial time investment even with the aid of software, just as an individual having to file income taxes in as many jurisdictions would find it burdensome despite the existence of TurboTax.

### Kansas' Unwise Path to Economic Nexus

Kansas's initial efforts to implement so-called “economic nexus” rules, whereby the state can impose tax collection responsibilities not just on Kansas-based businesses but on any company nationwide that sells into the state, were initially fairly by-the-book. Two bills

that included the standard \$100,000 small-seller exemption, Senate Bill 22 and House Bill 2033, were passed and sent to Governor Kelly's desk in March and May of 2019, respectively. Kelly vetoed both of these bills, ostensibly over concerns that the bills would reduce revenue overall, despite the fact that the economic nexus provisions in both bills would have raised revenues.

After Kansas's legislature went on recess, having failed to implement a remote seller law, the state's Department of Revenue took it upon itself to do so by executive action. On August 1, 2019, the Department of Revenue issued Notice 19-04, a guidance for remote sellers that imposed tax collection and remittance requirements by administrative fiat. However, the guidance failed to include any mention of a safe harbor for small sellers.

Two months after the issuance of Notice 19-04, state Attorney General Derek Schmidt drafted a legal memorandum stating that the Department of Revenue lacked the legal authority to issue Notice 19-04, declaring it of no legal effect. In the face of opposition to its scheme, the Department of Revenue has stuck to its guns. The state Department of Revenue quickly responded, arguing that the state's participation in the SSUTA, a voluntary association of states seeking to simplify sales tax compliance, essentially eliminates any administrative or compliance burdens that small sellers might otherwise have faced. Governor Laura Kelly has backed up the Department of Revenue's position, claiming that Notice 19-04 is "about protecting our friends and neighbors doing business on Main Street."

## **Undue Burden on Kansas Commerce**

The Department of Revenue claims that it lacks the legal authority to authorize exemptions, but that's a faulty argument — if it truly lacked enforcement discretion, it would also not be able to prohibit retroactive enforcement as Notice 19-04 explicitly does.

And unfortunately, the small businesses affected by Notice 19-04 almost by definition lack the resources to mount a legal challenge to the Department of Revenue's unilateral imposition of tax collection and remittance responsibilities. Kansas recently announced that it had collected \$5 million from small sellers who otherwise would have been exempt were a safe harbor in place for sellers with less than \$100,000 in sales into the state. For a sum that represents just 0.03 percent of the state's budget, the Department of Revenue has likely done a great deal of harm to small sellers around the country.

*Thomson Reuters* estimated that a meager 8 percent of *mid-sized* firms were prepared to handle the compliance burdens of the landscape shift *Wayfair* was ushering in.

And the smaller the firm, the less employee hours are available to dedicate to tax compliance. A 2014 study by the National Association of Manufacturers found that tax compliance cost businesses with less than 50 employees an average of over \$1,500 per employee, but cost businesses with over 100 employees an average of under \$700 per employee. Requiring e-retail firms with just a single employee dedicated to complying with tax rules to file taxes in many times more states than before is a significant burden.

Further complicating the issue is that many businesses remain unaware of the decision. As recently as this past March, 36 percent of business owners remained unaware of the *Wayfair* decision, even after being prompted with a brief overview. It's unlikely to have increased much since then — businesses struggling to keep their heads above water during the pandemic probably have not been spending much free time reading up on sales tax law updates.

But while politicians like Governor Kelly often claim that economic nexus rules are about bringing e-retail giants like Amazon and Walmart on a level playing field with Main Street, in truth, those businesses had entered into voluntary agreements to do what economic nexus rules require them to do already prior to *Wayfair*. In truth, economic nexus rules bring smaller online retailers in line with Amazon and Walmart, not Main Street.

That is why failure to include a safe harbor should be to the *Wayfair* checklist what crashing into another car is to a driving test — an automatic failure. The *Wayfair* checklist is about ensuring that a given economic nexus law does not unduly burden interstate commerce, but by failing to ensure that businesses least prepared to handle an inundation of compliance burdens are protected from them, Kansas's rule fails the most basic element of this.

From a legal perspective, the interstate commerce implications are clear. Compliance obligations that target small businesses with no safe harbor protections represent a clear distortion of the market, one that is likely to create significant issues for small businesses around the country in the best of times, let alone in the midst of depressed consumer demand due to shutdowns and the pandemic. Small businesses with small levels of sales into Kansas that lack the resources to comply with the state's tax regime may simply choose not to sell to Kansas, a clear interstate commerce burden.

## **Kansas Invites Legal Challenge**

Kansas' lack of a similar exception thus renders its remote sales tax rules uniquely vulnerable to legal challenges arguing that the state's system is unconstitutionally burdensome. Kansas's status as the

only state that will seek to enforce its tax obligations on the first dollar of sales puts it at the top of the list of states risking legal trouble.

It is essential to note that Kansas government is in a precarious fiscal position. The state's spending continues to outpace its receipts, using transfers and delayed loan repayments to make ends meet. This fiscal imbalance already includes the fact Kansas has the 8th highest sales tax rate in the nation, passed what was then the largest tax increase in state history with a 2015 sales tax hike, and then passed another record tax increase in 2017. The attempt to force compliance of out of state sellers irrespective of *Wayfair* strongly suggests an effort to finance more deficit spending.

It's worth noting that just about every state has pushed the boundaries of the Court's guidance regarding safe harbors. Most states have directly adopted South Dakota's transaction thresholds of 200 transactions or \$100,000 in sales into the state, arguing that those numbers have been blessed by the Court. But the Court said nothing about those specific numbers, merely indicating that it provided adequate protection for small businesses selling into South Dakota.

The thing is, South Dakota is the country's 47th largest economy. To truly follow the spirit of the Court's guidance, state safe harbors should be scaled proportionally based on the difference in state GDP, not merely copied. In other words, Kansas should be discussing a safe harbor of \$325,000, not \$100,000.

## ■ CONCLUSION

As it stands, Kansas taxpayers are likely on the hook for a quixotic legal battle. Kansas's economic nexus rules represent the most significant flouting of the *Wayfair* decision seen yet and are unlikely to stand up to legal challenges. Doubtless most Kansans would prefer to stop attacking small businesses rather than fund an unethical legal defense.

Fortunately, the solution to this problem is just as easy as it has always been — Kansas's legislature needs only to pass a safe harbor for small businesses. Doing so would put the state in line with the rest of the country and signal that the state is not hostile to small businesses. As the Department of Revenue's own numbers show, the amount of revenue foregone by such an action would be negligible.

Kansans deserve better than a petty political squabble by an over-eager Department of Revenue. Tax policy is best put into place by a legislature, as this episode has so clearly illustrated.

## ■ ABOUT THE AUTHORS

**Michael Austin** is the Director of the Sandlian Center for Entrepreneurial Government at the Kansas Policy Institute. In this role he is responsible for educating public organizations and the public on taxes and budget, using economic research to turn government inefficiencies into effective policy solutions. Before joining the Sandlian Center, Michael served as an economist in various roles of Kansas state government. As an adviser to former Kansas Governor Sam Brownback, Michael's work made him the first to discover the drop in commodity and energy prices that plagued Kansas and the region, later termed "The Rural Recession." Most recently as Chief Economist in the Kansas Department of Revenue, his research and presentation on the Federal Tax Cuts and Jobs Act, and its effects on Kansans jumpstarted discussions ensuring it will be a key concern in the upcoming Kansas legislative session.

**Andrew Moylan** and **Andrew Wilford** lead the Interstate Commerce Initiative at the National Taxpayers Union Foundation (NTUF), a project which seeks to protect taxpayers from the pernicious effects of states attempting to exercise power outside their borders.

NTUF is a nonpartisan research and educational organization that shows Americans how taxes,



government spending, and regulations affect them.



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**Wichita Office:** 250 N. Water St., Suite 216 | Wichita, KS 67202 | 316.634.0218

**Overland Park Office:** 12980 Metcalf Ave., Suite 130 | Overland Park, KS 66213 | 913.213.5038

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