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July 18, 2018

Ms. Jennifer Hays
CSA Appropriations and Revenue Committee
Room 160, Capitol Annex
Frankfort, Kentucky 40601

Dear Jennifer:

These questions came up during my testimony on June 28. I am submitting these responses for your consideration and comments.

Conversation #1: Chairman Rudy asked about the potential for Streamline to fall apart due to the *South Dakota v. Wayfair Inc.* decision.

My answer at the Committee was vague and, at first, I failed to understand the Chairman's reason for asking the question. There are some whispers about the agreement breaking down, but the latest information we have suggests that Streamline will likely survive and potentially flourish under *Wayfair*.

The SST Governing Boards (hereafter GB) contract with the CSPs (Certified Service Providers) contain a provision that specifies that within six months of Congressional or Court action granting remote collection authority the contract will be renegotiated. Compensation will undoubtedly be lowered but likely not brought down to the maximum \$50 per filing period that main street retailers receive. It is important to keep in mind that the contract and compensation is with the CSP providing taxability services, collections and payment services to voluntary sellers -- not compensation to the sellers themselves. While it is true that post *Wayfair* most sellers registering will not be volunteers, the sellers reporting in multiple jurisdictions across the country still need the valuable tax services provided by CSP's. The GB certifies the CSP tax software, so that if sellers have collection errors on the sales into Kentucky or any other SST state because of treatment determined in the software, the sellers are held harmless and the CSP's must address any tax shortfall. From the Supreme Court opinion, it is clear that SD's membership in the SST agreement and availability of CSP services contributed to the decision to overturn *Quill*. Yes, the dynamic is changing from the voluntary model, but there is still justification for some level of compensation to the CSP's for services rendered.



The member states will be participating in ongoing contract negotiations to address the new model of mandated collections. Keep in mind that there will still be voluntary sellers coming through central registration (those who choose to register and collect sales tax from all member states even though sales thresholds in some jurisdictions are below the mandate).

Some of the reasons we believe Streamlined will survive include:

- By registering through Streamlined, new companies can avoid the informational cost of learning how to register in the many states and local jurisdictions where they are now required to pay.
- Additional states may become members or at least participate to some extent to gain access to central registration and CSP services.
- Streamlined has a network of certified service providers that prepare returns and indemnify companies from penalties of misfiling.
- Streamlined is well accepted in the retail community, free to register, and their services will be more useful than ever after *Wayfair*.

Conversation #2: Representative Tipton – Expansion of sales tax, nonprofits 501(c)(3), and the recent Supreme Court case decision – Can you shed more light on this? – Senator McDaniel – HB 487 intended to pick up for-profit entities for tax, the court case ruling picked up the nonprofit entities.

Answer: The recent court case, I believe, was the so-called *Interstate Gas Supply, Inc.* case. The opinion came down in March 22 of 2018. A conclusion from that case is copied below. The opinion of the Supreme Court seems to support Senator McDaniel's comments made in the committee hearing. Senator McDaniel said that, despite the intentions of the General Assembly to exempt charities from sales tax law changes, some of the provisions of HB 487 do indeed apply to charities because the Supreme Court ruled in the *Interstate Gas Supply, Inc.* case that Section 170 of the Kentucky Constitution applies only to ad valorem (property) taxes. Sales and use taxes are not sufficiently similar to property taxes to get the tax prohibition contemplated in the Kentucky Constitution.

Editorial: While I agree the combination of HB 487 and the Court decision have created some unforeseen consequences, there was no explicit or implied intent within the legislation to address the taxability of non-profits. To be precise, the only impact of the *Interstate Gas Supply* case regarding taxing non-profits is related to the area of admissions. The Supreme Court's ruling clarified that Department of Revenue had no justification to continue exempting receipts for sales of admissions from certain non-profits. This change in combination with HB 487's expanded definition of admissions serves to more broadly impact the nonprofit community than would have been the case absent the legislation. In regard to nonprofit's sales of tangible personal property, these retail sales were taxable prior to the law change with only narrow exclusions existing within the sales tax law under KRS Chapter 139.

Supreme Court of Kentucky.

COMMONWEALTH of Kentucky, Finance and Administration Cabinet, Department of Revenue, Appellant v. INTERSTATE GAS SUPPLY, INC., FOR the USE AND BENEFIT OF TRI-STATE HEALTHCARE LAUNDRY, INC., Appellee

2016-SC-000281-DG

Decided: March 22, 2018

Conclusion: In sum, the tax exemption granted “institutions of purely public charity” by § 170 of the Kentucky Constitution applies only to property taxes. The use tax at issue is not a property tax nor should it be characterized as sufficiently similar to a property tax to bring it within the ambit of § 170, as the City of Elizabethtown opinion erroneously did. Accordingly, we hereby reverse the decision of the Court of Appeals and reinstate the Judgment of the Franklin Circuit Court finding IGS/Tri-State is not entitled to an exemption from the Kentucky use tax.

- Summary as it pertains to charities going forward:
- Due to the expanded definition of admissions in HB 487 and recent guidance from the Kentucky Supreme Court in the *Interstate Gas Supply* case, non-profit 501(c)(3) groups must collect sales tax on their charges for all categories of taxable admissions for periods beginning July 1, 2018, forward.
- In its decision, the Supreme Court confirmed the Ky. Constitution Sec. 170 exemption for charitable institutions applied only to property taxes and not to excise taxes (sales and use tax).
- The only sales tax exemptions for 501(c)(3) charitable, educational and religious organizations are those explicitly listed in KRS Chapter 139.
- Sales tax law (KRS 139.497) provides an exemption for sales by elementary or secondary schools or by their nonprofit school-sponsored or school affiliated groups if the net proceeds from the sales are used solely for the benefit of the elementary or secondary school or its students.

Conversation #3: Senator West – Prior to Wayfair, we had the streamline process, do you happen to know the revenue or transaction thresholds for the streamline process? Was it a voluntary process?

Answer: The Streamlined process continues and has never been subject to revenue minimum threshold. It started as a voluntary program and remains that way today. Some taxpayers (like Amazon) choose not to participate in the Streamlined process but still remit sales tax to Kentucky. However, many of Amazon’s third party sellers located outside Kentucky were not registered to collect taxes anywhere other than in their home state.

Total amount collected from SST sellers in FY18 was \$36,475,465.

Jennifer Hays
July 18, 2018
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From: Brown, Cynthia (LRC) <Cynthia.Brown@LRC.KY.GOV>
Sent: Tuesday, July 03, 2018 4:48 PM
To: Harkenrider, Greg (OSBD) <Greg.Harkenrider@ky.gov>
Cc: Hays, Jennifer (LRC) <jennifer.hays@LRC.KY.GOV>; Tipton, James (State Rep.) (LRC) <James.Tipton@LRC.KY.GOV>; Willey, Frank (LRC) <Frank.Willey@lrc.ky.gov>; Bondurant, Jim (LRC) <Jim.Bondurant@LRC.KY.GOV>; Rowe, Jennifer (LRC) <Jennifer.Rowe@LRC.KY.GOV>; West, Steve (State Sen.) (LRC) <Steve.West@LRC.KY.GOV>
Subject: Follow-up to questions asked at the June 28th A&R Committee meeting

Greg,

I am writing as a follow-up to the Appropriations and Revenue Committee meeting last week where you were going to research some of the legislators' questions and provide information. Below are the three conversations where information was requested. I have included the link to the KET taping of the A&R Committee meeting and the approximate time of when the questions were asked for your convenience.

Link to KET taping of the A&R meeting:

<https://www.ket.org/legislature/?archive&program=WLEGP&epoch=2018&nola=WLEGP+018010>

Conversation One:

37:00 minutes - Representative Rudy – Is the streamline agreement going to fall apart? Will Kentucky no longer have to give the companies that voluntarily file under the streamline agreement the voluntary collection allowance of 8%, which is greater than the amount brick-and-mortar stores receive? Should Kentucky treat the companies that fall under streamline the same as everyone else and cap them at \$50 a month, instead of the 8% with no cap?

Conversation Two:

45:00 minutes – Representative Tipton – Expansion of sales tax, nonprofits 501(c)(3), and the recent supreme court case decision – Can you shed more light on this?

47:39 minutes – Senator McDaniel – HB 487 intended to pick up for-profit entities for tax, the court case ruling picked up the nonprofit entities.

48:00 – Representative Tipton – Clarification is needed on this topic

Conversation Three:

49:20 – Senator West – Prior to Wayfair, we had the streamline process, do you happen to know the revenue or transaction thresholds for the streamline process? Was it a voluntary process?

Once you receive the information, please forward it to the A&R staff.

Sincerely,

Greg Harkenrider
Deputy Executive Director
Governor's Office for Economic Analysis