

MINUTES OF THE HOUSE TAXATION COMMITTEE

The meeting was called to order by Chairman Richard Carlson at 9:00 a.m. on February 3, 2010, in Room 783 of the Docking State Office Building.

All members were present except:

Representative Lisa Benlon - excused

Committee staff present:

Gordon Self, Office of the Revisor of Statutes

Scott Wells, Office of the Revisor of Statutes

Chris Courtwright, Kansas Legislative Research Department

Brandon Riffel, Kansas Legislative Research Department

Marla Morris, Committee Assistant

Conferees appearing before the Committee:

James Bartle, General Counsel, Kansas Department of Revenue

Richard Cram, Kansas Department of Revenue

Others attending:

See attached list.

Introduction of Bills:

Representative Hawk moved to introduce a bill for the city of Ogden to gain an easement through state owned property to complete a sewer system. Representative Schwartz moved to second the motion. The motion carried.

Chairman Carlson opened the hearing on:

HB 2520 - Defining "willfully" for failure to collect taxes and other violations of Kansas tax law

Staff Chris Courtwright, Kansas Legislative Research Department, presented a summary on **HB 2520**. The bill amends several Kansas statutes to specifically define the term "willfully" relative to the persons who willfully fail to collect state taxes, to mean the same as the term for federal tax purposes under the Internal Revenue code. He stood for questions.

Proponent presenting testimony on **HB 2520**:

James Bartle, General Counsel, Kansas Department of Revenue, a proponent of **HB 2520**, stated the proposed amendment to the statutes will provide a clear definition of willfulness that is easily understood by taxpayers, practitioners, the Department, and the courts (Attachment 1). He stated the purpose of this amendment is to explicitly state that the word "willfulness" means the same in Kansas as it does for federal tax purposes. **HB 2520** would ensure that persons responsible for withholding tax, sales tax, and liquor excise tax known as "trust fund taxes" will likewise be responsible for Kansas trust fund taxes. Mr. Bartle stood for questions.

There were no opponents testifying on **HB 2520**.

Chairman Carlson closed the hearing on **HB 2520**.

The Chair opened the hearing on:

HB 2519 - Amendments to sales tax law to provide conformity with streamlined sales and use tax agreement act

Richard Cram, Kansas Department of Revenue, presented an overview of the changes needed to Kansas sales administration tax statutes, in order to conform to recent amendments to the Streamlined Sales and Use Tax Agreement (Attachment 2). He outlined the modifications necessary to conform to the 2009 amendments of the Agreement. Kansas will be determined not in compliance and lose its' Member State of the Governing

CONTINUATION SHEET

Minutes of the House Taxation Committee at 9:00 a.m. on February 3, 2010, in Room 783 of the Docking State Office Building.

Board of the Agreement without passage of **HB 2519**. Mr. Cram stood for questions.

Chairman Carlson provided a brief history on "destination sourcing" and "origin sourcing" as it applies to the Streamline Sales and Use Tax Agreement .

There were no opponents testifying on **HB 2519**.

Chairman closed the hearing on **HB 2519**:

Discussion and action on:

HB 2465 - Limitations on certain income tax credits.

Staff Gordon Self, Office of the Revisor of Statutes, gave a brief summary on **HB 2465**. He stood for questions.

The Committee held a discussion and on a proposed balloon amendment.

Representative Meghni moved to pass out of Committee favorably **HB 2465**. The motion was seconded by Representative Hawk.

Representative Menghini made a motion to adopt the balloon amendment. The motion was seconded by Representative Frownfelter. Representative Menghini closed on the amendment to **HB 2465**. The motion to pass favorably **HB 2465** with amendment carried.

Discussion and action on:

HB 2464 - Establishing service fee for taxpayer with delinquent taxes who must enter into installment plans with the Kansas department of revenue

Staff Gordon Self presented a brief summary on **HB 2464**. Revisor Self directed the Committee to the corrected bill that has been placed in their binder. The corrected bill is marked "reprinted" and reflects a correction to a misprint in the original copy of the bill.

Representative Menghini moved to pass **HB 2464** out favorably. The motion was seconded by Representative Hawk.

Representative Goico moved to amend **HB 2464** to exempt individuals with income less than \$75,000. Representative Siegfried seconded the motion. After discussion, Representative Goico moved to amend **HB 2464** to exempt individuals with an income less than \$ 75,000, who are delinquent. The change was approved by Representative Siegfried.

Representative Brown moved to table **HB 2464**. Representative Frownfelter seconded the motion. The non-debatable motion to table **HB 2464** carried.

Chairman Carlson requested Committee members to consult with staff with amendments to **HB 2464**.

The Chair closed the hearing on **HB 2464**.

Representative Rardin introduced his Legislative Pages from Overland Park: Cooper Patterson and Steven Erbacher, Dorothy Moody Elementary School; Vincent Autrey, Indian Woods School; Eleanor Prevot, West Ridge Middle School.

The next meeting is scheduled for February 4, 2010.

The meeting was adjourned at 10:36 a.m.

House Taxation Committee

James Bartle, General Counsel
Robert Challquist, Legal Services Attorney

February 3, 2010

Testimony in Support of House Bill 2520

Representative Carlson, Chair, and Members of the Committee:

Taxes such as withholding tax, sales tax, and liquor excise tax are known as “trust fund taxes.” Businesses collect these taxes from employees and customers, hold the funds in trust, and later remit them to the Department of Revenue. Kansas statutes provide that any person who is responsible for collecting and remitting these taxes on behalf of a business entity shall be personally liable for any unpaid tax liabilities, provided he or she “willfully” fails to collect and remit the amounts owed.

HB 2520 would amend the applicable Kansas personal responsibility statutes to provide that the term “willfully” shall have the same meaning as when used in a comparable context in the Internal Revenue Code. This bill is in response to the recent decision by the Court of Tax Appeals in *In re Appeal of Hirt*, Docket No. 2006-8531-DT (copy attached), which held that the willfulness requirement contained in Kansas statutes is more restrictive and requires a higher standard of proof than under federal law. Enactment of HB 2520 would ensure that individuals who are found to be personally responsible for federal trust fund taxes will likewise be responsible for Kansas trust fund taxes.

In re Hirt

The individual in question was found not to be responsible for the payment of Kansas trust fund taxes owed by a bar he had opened. The Kansas Business Tax Application, the Retail Liquor Excise Surety Tax Bond, and the Escrow Agreement for Guarantee of Kansas Retail Liquor Excise Tax Liability filed with the Department of Revenue and the Articles of Incorporation filed with the Kansas Secretary of State all identified him as the owner of the business. The Department sought to recover the unpaid tax liabilities of the business by issuing assessments against the owner in his individual capacity pursuant to K.S.A. 79-2971, K.S.A. 79-32,107 and K.S.A. 79-3643.

The Court of Tax Appeals held that the owner did not act “willfully” in failing to collect or account for and pay over the taxes. The Court ruled that the term “willfully” means the individual in question must act with a design, purpose or intent to do wrong or cause injury. Consequently, a person who files all the necessary registration paperwork with the State in order for the business to be operational and simply neglects or omits to pay

the taxes owed will not be held liable unless it can be shown that there was a design, purpose or intent not to pay the taxes.

The proposed amendment to the statutes will provide a clear definition of willfulness that is easily understood by taxpayers, practitioners, the Department, and the courts. A person acts willfully when he or she acts with reckless disregard of a known or obvious risk that the applicable taxes are not being paid. This is the definition used by the Internal Revenue Service under 26 U.S.C. 6672. It is also similar to the statutes of many other states.

We estimate that HB 2520 would have a positive fiscal note of \$438,000 in FY 2011 by increasing our effectiveness in recovering "responsible party" assessments. Our fiscal note is attached.

The provisions of House Bill 2520 are the same as in Senate Bill 427, heard in Senate Committee on Assessment and Taxation on January 27, 2010.

BEFORE THE COURT OF TAX APPEALS
STATE OF KANSAS

IN THE MATTER OF THE APPEAL
OF HIRT, TERRY/GOOD TIMES
RESTAURANT & SPORTS CLUB, I
FROM AN ORDER OF THE
DIVISION OF TAXATION ON
ASSESSMENT LIQUOR EXCISE,
RETAILERS' SALES AND
WITHHOLDINGS TAX

Docket No. 2006-8531-DT

ORDER

Now the above-captioned matter comes on for consideration and decision by the Court of Tax Appeals of the State of Kansas. The Court conducted an evidentiary hearing in this matter on March 6, 2008. The taxpayer appeared by his counsel of record, Benjamin J. Neill of Neill, Terrill & Embree. The Kansas Department of Revenue, Division of Taxation (the "Department") appeared by its counsel of record, Jay D. Befort.

The Court has jurisdiction of the subject matter and the parties, as an appeal has been properly and timely filed pursuant to K.S.A. 2008 Supp. 74-2438.

I.

This appeal is from a personal liability assessment of liquor excise, retailers' sales and withholding tax. The material facts of this case are as follows. In Spring 1999, taxpayer Terry Hirt established a relationship with Anthony and Linda Walters. In August or September 1999, Mr. Walters told Mr. Hirt that he and his wife were in financial trouble and asked Mr. Hirt if he would be willing to back them financially in operating a bar/restaurant business in Baldwin, Kansas. The Walters informed Mr. Hirt that they were unable to get financing themselves. Mr. Hirt also was advised that the Walters were unable to get the required liquor and business licenses. In order to finance the undertaking, Mr. Hirt co-signed a loan for \$10,000 and pledged his pickup truck as collateral.

In September 1999, Mr. Hirt executed various documents on behalf of Good Times Restaurant and Sports Club, Inc. On September 16, 1999, he signed three documents as "owner": a Kansas Business Tax Application, a Retail Liquor Excise Surety Tax Bond, and an Escrow Agreement for Guarantee of Kansas Retail Liquor

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Excise Tax Liability. On September 22, 1999, Mr. Hirt filed Articles of Incorporation with the Kansas Secretary of State to formally establish the corporate entity. Mr. Hirt was not involved in the operations of the restaurant/bar. In the nine months the business was open he was in the business location approximately eight times. On a few of those occasions he acted as doorman.

In March 2000, the bank notified Mr. Hirt that the loan he had co-signed was in default. Good Times Restaurant and Sports Club closed a month later. The Walters declared bankruptcy. Mr. Hirt first learned about the tax delinquencies in 2002, approximately two years after the restaurant had closed.

In September 2002, the Department assessed personal liability to Mr. Hirt for liquor excise, retailers' sales, and withholding taxes pursuant to K.S.A. 79-2971, K.S.A. 79-3643, and K.S.A. 79-32,107. After exhausting his administrative remedies with the Department, Mr. Hirt appealed to this Court.

II.

The first issue presented is whether the Court should sustain the Department's objection to Mr. Hirt's attempt to admit certain documents not exchanged or disclosed in accordance with K.A.R. 94-2-13. (*See* Trans. p. 49: lines 13-25; p. 50: lines 1-2). The Court's regulations establish clear deadlines for exchange of documents and disclosure of witnesses. The potential consequence for failing to meet these deadlines is exclusion of the documents or witnesses not exchanged or disclosed. *See* K.A.R. 94-2-13(e). We find exclusion of the evidence to be appropriate here. The Department's objection is sustained.

III.

The next issue presented is whether there is a rational basis for the Department's personal liability assessment against Mr. Hirt in view of the evidence and under the applicable legal authorities.

Actions of administrative agencies carry a rebuttable presumption of validity. *Country Club Home, Inc. v. Harder*, 620 P.2d 1140, 1147 (Kan. 1980). The burden to overcome this presumption rests squarely on the party challenging the agency's actions. *Id.* The Kansas Supreme Court recently stated as follows:

Interpretation of a statute is a question of law. Special rules apply, however, when considering whether an administrative agency erroneously interpreted or applied the law: The interpretation of a statute by an administrative agency charged with the responsibility of enforcing that statute is entitled to

judicial deference. This deference is sometimes called the doctrine of operative construction [I]f there is a rational basis for the agency's interpretation, it should be upheld on judicial review [However,] the determination of an administrative body as to questions of law is not conclusive and, while persuasive, is not binding on the courts. Deference to an agency's interpretation is especially appropriate when the agency is one of special competence and experience. However, the final construction of a statute always rests with the courts.

Coma Corp. v. Kansas Dept. of Labor, 154 P.3d 1080, 1083 (Kan. 2007) (internal quotations and citations omitted) (alterations in original). Based on the doctrine of operative construction, the Department's final determination must be affirmed unless Mr. Hirt can prove there is no rational basis for the Department's determination. The applicable statutes are K.S.A. 79-3643, K.S.A. 79-2971 and K.S.A. 79-32,107.

During the period in question, K.S.A. 79-3643 imposed personal liability on the following:

Any individual who is responsible for the collection or payment of sales or compensating tax or control, receipt, custody or disposal of funds due and owing under the Kansas retailers' sales and compensating tax acts who willfully fails to collect such tax, or account for and pay over such tax, or attempts in any manner to evade or defeat such tax or the payment thereof shall be personally liable for the total amount of the tax evaded...

The statute imposing personal liability for liquor excise tax, K.S.A. 79-2971, is effectively similar to K.S.A. 79-3643. The statute imposing personal liability for withholding tax differs from the other two statutes. Despite differences in the statutes, the parties nonetheless have chosen to address all three assessments by analyzing the elements of liability under K.S.A. 79-3643 as interpreted by K.A.R. 92-19-64a. During the hearing, counsel appeared to agree that the three separate assessments, although governed by different statutes, all require two predicate findings: (1) that Mr. Hirt was a "responsible individual" and (2) that Mr. Hirt acted willfully in failing to collect, account for, or pay the taxes. The Court will accept the parties' analytical framework for purposes of this case.

The first question is whether Mr. Hirt is a "responsible individual." The Department has defined that term to mean "any person with sufficient status, duties, and authority to have significant control over business finances or the disbursement of business funds." K.A.R. 92-19-64a(b). The regulation provides a list

of indicia that are considered in determining whether an individual has significant control over business finances or the disbursement of business funds. An individual is a "responsible individual" if he has any of the following:

- (1) a significant ownership interest in a business;
- (2) a significant involvement in the day-to-day management of the business;
- (3) the authority to sign business checks or tax returns;
- (4) the authority to direct payment of business funds to creditors;
- (5) the authority to pledge business assets as collateral for loans, advances, or lines of credit for the business;
- (6) the authority to bind the business to contracts entered into as part of the day-to-day business operations; or
- (7) the authority to hire or fire employees who are authorized to perform any act described in paragraphs (3) through (6) of this subsection.

Mr. Hirt is the only shareholder and the only director listed in the Articles of Incorporation. Mr. Hirt also admits he has a significant ownership interest in the business. Yet he claims that ownership alone is not sufficient to prove that he is a "responsible individual." We disagree. K.A.R. 92-19-64a(b) provides that only one of the indicia must be present in order to establish that a person is a "responsible individual." We find Mr. Hirt is a "responsible individual" under Kansas law.

We now turn to the question of whether Mr. Hirt's conduct warrants the imposition of personal liability for the taxes assessed in this case. In order for liability to accrue, Mr. Hirt must have acted willfully in failing to collect or account for and pay over the taxes. See K.S.A. 79-3643(a).

K.A.R. 92-19-64a(e) provides examples of acts and omissions indicating that a responsible individual acted willfully in failing to collect, account for, or pay taxes. Such acts and omissions include the following:

- (1) making a deliberate choice that the business should pay other creditors in spite of having knowledge that taxes collected are not being remitted to the state of Kansas;
- (2) having knowledge of the tax delinquency and failing to exercise authority to rectify it if funds were available to pay the state of Kansas;

- (3) performing a voluntary or intentional act or failing to perform such an act with knowledge that the act or omission will result in the failure of the business to collect, account for, or remit taxes owed to the state of Kansas;
- (4) failing to investigate or to correct mismanagement after notice that taxes owed to the state of Kansas are not being remitted;
or
- (5) embezzling business funds.

This list is not exhaustive. *See id.* ("Acts or omissions showing that a responsible individual acted willfully in failing to collect, account for, or remit taxes *may include* one or more of the following.")

We find no evidence that Mr. Hirt had actual notice or knowledge that taxes were not being collected or paid until approximately two years after the restaurant had closed; thus subsections (1), (2), and (4) do not apply. There also is no evidence that Mr. Hirt embezzled business funds, which makes subsection (5) inapplicable. The issue, then, is whether willful conduct can be found under subsection (3), or without specific reference to the examples contained in the regulation.

Subsection (3) instructs that a responsible individual acts willfully if he voluntarily or intentionally acts or fails to perform an act "with knowledge that the act or omission will result in the failure of the business to collect, account for, or remit taxes owed to the state of Kansas." K.A.R. 92-19-64a(e)(3). The Department argues that willfulness is established in this case by virtue of Mr. Hirt's position as owner, incorporator, principal, depositor and financier. According to the Department, Mr. Hirt's position made him "duty-bound" to discover the restaurant's tax collection and remittance status. The Department does not, however, allege with any specificity any voluntary or intentional acts Mr. Hirt performed, or failed to perform, with knowledge that the acts or omissions would result in non-payment of taxes.

It is a fundamental rule of statutory construction to which all other rules are subordinate that the intent of the legislature governs, if that intent can be ascertained from the plain language of the statute. *State v. Scherzer*, 869 P.2d 729, 735 (Kan. 1994). Our interpretation of the meaning of the statutes in question must therefore begin with the text of the statutes.

We note that the Kansas statutes in question contain language similar to language contained in analogous portions of the Internal Revenue Code. We also note that the arguments offered by both parties are based either on the text of the Kansas statutes and regulations or on federal case law interpreting the analogous

federal statute, 26 U.S.C. § 6672. The parties appear to agree that federal cases interpreting the federal law should be considered when interpreting the Kansas laws in question.

It has long been held that Kansas statutes adopted from another jurisdiction carry with them the construction placed on the statutes by the courts of the jurisdiction from which the statutes were adopted. *See Edgington v. City of Overland Park*, 815 P.2d 1116, 1122 (Kan. Ct. App. 1991); *Republic Natural Gas Co.*, 415 P.2d 406, 411 (Kan. 1966); *State v. Underwood*, 693 P.2d 1205, 1209 (Kan. Ct. App. 1985). Here, there is no indication that the Kansas statutes in question were actually adopted from their federal analogues. In fact, while there are similarities between the Kansas and federal laws, there also are many significant differences. We must therefore find the federal cases submitted by the parties to be persuasive, but not binding, authorities.

The willfulness requirement under federal law has been addressed in numerous cases from various jurisdictions. A review of those cases reveals that federal courts roundly conclude that the willfulness requirement under 26 U.S.C. § 6672 may be satisfied if the responsible individual has acted with "reckless disregard of a known or obvious risk" that the applicable taxes are not being paid. *Denbo v. United States*, 988 F.2d 1029, 1033 (10th Cir. 1993); *Malloy v. United States*, 17 F.3d 329, 332 (11th Cir. 1994); *Gustin v. United States*, 876 F.2d 485, 492 (5th Cir. 1989); *Caterino v. United States*, 794 F.2d 1 (1st Cir. 1986); *Monday v. United States*, 421 F.2d 1210, 1215 (7th Cir. 1970). Evil motive and specific intent are not necessary elements. *Harrington v. United States*, 504 F.2d 1306, 1311 (5th Cir. 1974); *Monday*, 421 F.2d at 1216. Mere negligence, however, does not rise to the level of willfulness. *Feist v. United States*, 607 F.2d 954, 961 (1979); *Dudley v. United States*, 428 F.2d 1196, 1200 (9th Cir. 1970).

Under 26 U.S.C. § 6672, where proof of a reckless disregard for an obvious risk is sufficient proof to establish willful conduct, Mr. Hirt's acts and omissions would arguably provide a rational basis for the Department's personal liability assessments. Under Kansas law, however, more is required to find willful conduct.

In Kansas, reckless disregard or indifference to the consequences of one's actions is wanton conduct, not willful conduct. *See Willard v. City of Kansas City*, 681 P.2d 1067, 1070 (Kan. 1984); *Anderson v. White*, 499 P.2d 1056 (1972). Wanton conduct is less egregious than willful conduct. *See Gruhin v. City of Overland Park*, 836 P.2d 1222, 1225 (Kan. 1992) (wanton conduct requires something more than ordinary negligence but something less than a willful act.) Acts of omission can rise to the level of wanton conduct since reckless disregard and indifference are characterized by a failure to act when action is necessary. *Id.* In contrast, a willful act is one indicating a design, purpose, or intent on the part of a person to do wrong

or cause injury to another. *Anderson* 499 P.2d at 1058; *Holder v. Kansas Steel Built, Inc.*, 582 P.2d 244, 249 (Kan. 1978). Whether conduct in a given case rises to the level of willful conduct is a question of fact. *Id.*

The Court acknowledges that the Department's assessment carries a presumption of validity and is entitled to deference. Nevertheless, the government's taxing authority is penal in nature. *J.G. Masonry, Inc. v. Department of Revenue*, 680 P.2d 291, 294 (Kan. 1984). Tax statutes will not be extended by implication, and their operation will not be enlarged so as to include matters not specifically embraced. *Director of Taxation v. Kansas Krude Oil Reclaiming Co.*, 691 P.2d 1303, 1307 (Kan. 1984). Here, the statutes in question require the responsible individual's conduct to be willful. Willfulness requires an indication of design, purpose, or intent to do wrong or cause injury to another. Based on the weight of the evidence, we find that while Mr. Hirt's conduct might have been negligent – and perhaps even reckless – his conduct was not willful as that term is defined under Kansas law.

There is no evidence that Mr. Hirt ever prepared or approved tax reports or was involved in matters of bookkeeping for the business. There also is no evidence that Mr. Hirt ever directed nonpayment of taxes or suggested that other creditors receive preference over the government. In fact, nothing in the record indicates that Mr. Hirt had any knowledge that taxes were delinquent until two years after the business had closed. Under the evidence we cannot find that Mr. Hirt acted with the design, purpose, or intent to do wrong or cause injury. *See Holder*, 582 P.2d at 249. We must therefore conclude that Mr. Hirt did not willfully fail to collect or account for and pay over the taxes in question. Nor did he attempt to evade or defeat the taxes or their payment.

The Department's personal liability assessment lacks a rational basis under the evidence.

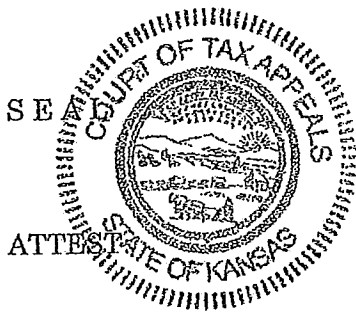
IT IS THEREFORE ORDERED, for the reasons stated above, that the Department's personal liability assessment is reversed.

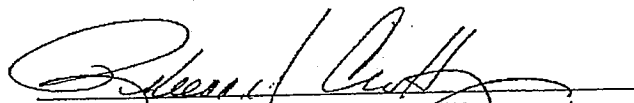
Any party to this action who is aggrieved by this decision may file a written petition for reconsideration with this Court as provided in K.S.A. 2008 Supp. 77-529. The written petition for reconsideration shall set forth specifically and in adequate detail the particular and specific respects in which it is alleged that the Court's order is unlawful, unreasonable, capricious, improper or unfair. Any petition for reconsideration shall be mailed to: Secretary, Court of Tax Appeals, Docking State Office Building, Suite 451, 915 SW Harrison St., Topeka, KS 66612-1505. A copy of the petition, together with any accompanying documents, shall be mailed to all parties at the same time the petition is mailed to the Court. Failure to notify the opposing party shall render any subsequent order voidable. The written

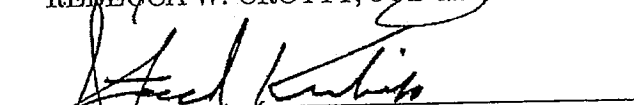
petition must be received by the Court within fifteen (15) days of the certification date of this order (allowing an additional three days for mailing pursuant to statute). If at 5:00 pm on the last day of the specified period the Court has not received a written petition for reconsideration of this order, no further appeal will be available.

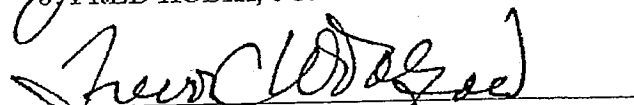
IT IS SO ORDERED

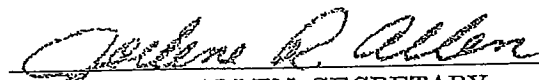
THE KANSAS COURT OF TAX APPEALS




REBECCA W. CROTTY, JUDGE


J. FRED KUBIK, JUDGE


TREVOR C. WOHLFORD, JUDGE PRO TEM


JOYLENE R. ALLEN, SECRETARY

CERTIFICATE OF SERVICE

I, Joelene R. Allen, Secretary of the Court of Tax Appeals of the State of Kansas, do hereby certify that a true and correct copy of this order in Docket No. 2006-8531-DT and any attachments thereto, was placed in the United States Mail, on this 14th day of May, 2009, addressed to:

Hirt, Terry/Good Times Restaurant & Sports Club, I
28962 NW Chase Rd
Garnett, KS 66032

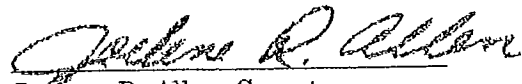
Benjamin Neill
Neill, Terrill & Embree, L.L.C.
4707 West 135th Street, Suite 240
Leawood, KS 66224

and a copy was placed in capitol complex building mail, addressed to:

James Bartle
General Counsel
Legal Services Bureau
Department of Revenue
DSOB, 915 SW Harrison, 2nd Floor
Topeka, KS 66612

Jay Befort
Attorney
Legal Services Bureau
Department of Revenue
DSOB, 915 SW Harrison, 2nd Floor
Topeka, KS 66612

IN TESTIMONY WHEREOF, I have hereunto subscribed my name at Topeka, Kansas.


Joeline R. Allen, Secretary

BEFORE THE COURT OF TAX APPEALS
STATE OF KANSAS

IN THE MATTER OF THE APPEAL
OF HIRT, TERRY/GOOD TIMES
RESTAURANT & SPORTS CLUB,
INC. FROM AN ORDER OF THE
DIVISION OF TAXATION ON
ASSESSMENT LIQUOR EXCISE,
SALES, AND WITHHOLDING TAX

Docket No. 2006-8531-DT

ORDER DENYING RECONSIDERATION

The Court has jurisdiction of the subject matter and the parties, as an appeal has been properly and timely filed pursuant to K.S.A. 2008 Supp. 74-2438 and a timely Petition for Reconsideration having been filed pursuant to K.S.A. 2008 Supp. 74-2426 and K.S.A. 2008 Supp. 77-529.

The Department requests reconsideration and modification of the May 14, 2009 final order reversing the personal liability assessment of liquor excise, retailers' sales and withholding tax. The Department asserts that the order is erroneous because it is based on an improper legal standard for willful conduct under K.S.A. 79-3643, K.S.A. 79-2971 and K.S.A. 79-3643. The Department asserts that instead of applying the definition of "willfulness" found in Kansas case law, this court should have applied the less restrictive definition found in circuit court decisions interpreting an analogous federal tax statute, 26 U.S.C. 6672. In support of its position, the Department offers a March 18, 1999 Department of Revenue memorandum presented to the chair of the House Taxation Committee, which discusses the willfulness requirement.

The taxpayer did not respond to the Department's Petition for Reconsideration.

It has long been held that the text of a statute is of primary importance and, therefore, any inquiry into a statute's interpretation must begin there. The rule of statutory construction to which all other rules are subordinate is that the intent of the legislature controls if the intent can be ascertained from the plain language of the statute. *See State ex rel. Stephen v. Board of Seward County Comm'rs*, 866 P.2d 1024, 1026 (Kan. 1994). When a statute is clear and unambiguous, there is no room for statutory construction. *See id.*

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This court recognizes the rule that when the legislature adopts a statute from another jurisdiction, it is presumed also to have adopted the judicial construction placed on the statute by the originating jurisdiction. See *Edgington v. City of Overland Park*, 815 P.2d 1116, 1122 (Kan. Ct. App. 1991). Nevertheless, in this case it is unclear whether the Kansas Legislature actually adopted the analogous federal statute when it amended K.S.A. 79-3643 and K.S.A. 79-2971. The text of the Kansas and federal statutes are not *verbatim* but are in fact dissimilar in many respects. And, while the Department's March 18, 1999 memorandum to the chair of the House Taxation Committee states that the federal statute as well as other state statutes include a willfulness requirement, there is no indication that the Kansas Legislature intended for federal law, instead of Kansas law, to provide the standard for willful conduct.

This court is bound by the published decisions of the Kansas appellate courts. K.S.A. 2008 Supp. 74-2433(a). The Kansas Supreme Court has enunciated a standard for willful conduct that is more restrictive than the standard found in the federal cases cited by the Department. This court is obliged to apply the Kansas standard in this case.

For these reasons, the Department's Petition for Reconsideration is denied.

IT IS THEREFORE BY THE COURT OF TAX APPEALS OF THE STATE OF KANSAS CONSIDERED AND ORDERED that the above captioned Petition for Reconsideration is denied.

This is a final order of the Court of Tax Appeals and constitutes final agency action. Any party choosing to appeal this order must do so by filing a petition for judicial review within 30 days from the date of certification of this order. See K.S.A. 77-613(c). The petition for judicial review shall be filed with the Kansas Court of Appeals. See K.S.A. 2008 Supp. 74-2426(c)(2). The Court of Tax Appeals shall not be party to the petition for judicial review but shall receive service of a copy of the petition. Pursuant to K.S.A. Supp. 77-529(c), any party choosing to petition for judicial review of the Court's decision is hereby notified that the Secretary of the Court of Tax Appeals is to receive service of the petition for judicial review.

IT IS SO ORDERED

THE KANSAS COURT OF TAX APPEALS



Rebecca W. Crotty
REBECCA W. CROTTY, JUDGE

J. Fred Kubik
J. FRED KUBIK, JUDGE

Trevor C. Wohlford
TREVOR C. WOHLFORD, JUDGE PRO TEM

Joelene R. Allen
JOELENE R. ALLEN, SECRETARY

CERTIFICATE OF SERVICE

I, Joelene R. Allen, Secretary of the Court of Tax Appeals of the State of Kansas, do hereby certify that a true and correct copy of this order in Docket No. 2006-8531-DT and any attachments thereto, was placed in the United States Mail, on this 17TH day of June, 2009, addressed to:

Terry Hirt
Good Times Restaurant & Spor
28962 NW Chase Rd
Garnett, KS 66032

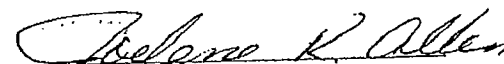
Benjamin J. Neill, Esq
Neill, Terrill & Embree
4707 West 135th Street, Suite 240
Leawood, KS 66224

and a copy was placed in capitol complex building mail, addressed to:

James Bartle
General Counsel
Legal Services Bureau
Department of Revenue
DSOB, 915 SW Harrison, 2nd Floor
Topeka, KS 66612

Robert Challquist
Attorney
Legal Services Bureau
Department of Revenue
DSOB, 915 SW Harrison, 2nd Floor
Topeka, KS 66612

IN TESTIMONY WHEREOF, I have hereunto subscribed my name at Topeka,
Kansas.


Joelene R. Allen, Secretary

MEMORANDUM

To: Mr. Duane Goossen, Director
Division of Budget

From: Kansas Department of Revenue

Date: 01/27/2010

Subject: House Bill 2520
Introduced as a House Bill

Brief of Bill

House Bill 2520, as introduced, amends KSA 79-2971 to provide that the term "willfully" shall have the same meaning as the term has for federal tax purposes in 26 USC 6672.

Section 2 amends KSA 79-32,100c to provide that the term "willfully" shall have the same meaning as the term has for federal tax purposes in 26 USC 6672.

Section 3 amends KSA 79-32,107 to provide that the term "willfully" shall have the same meaning as the term has for federal tax purposes in 26 USC 6672.

Section 4 amends KSA 79-3643 to provide that the term "willfully" shall have the same meaning as the term has for federal tax purposes in 26 USC 6672.

The effective date of this bill is on publication in the statute book.

Fiscal Impact

Passage of this bill could increase state general fund receipts by \$.438 million in fiscal year 2011.

Conforming the state's definition of "willfully" to the federal definition should make administration easier and increase collections in personal liability cases by about \$.5 million.

In fiscal year 2008 and 2009, the department collected \$7.4 million and \$8.8 million from personal liability assessments. If the statute is changed to the federal definition of "willfully", it is estimated an additional 5%, or \$438,000, could be collected from personal liability assessments.

Administrative Impact

None.

Administrative Problems and Comments

Taxpayer/Customer Impact

Legal Impact

Approved By:

A handwritten signature in cursive script that reads "Joan Waggon". The signature is written in black ink and is positioned below the "Approved By:" text.

Joan Waggon
Secretary of Revenue

House Taxation Committee

Richard Cram

February 3, 2010

Testimony in Support of House Bill 2519

Representative Carlson, Chair, and Members of the Committee:

House Bill 2519 includes several amendments to Kansas sales tax administration statutes, in order to conform to recent amendments to the Streamlined Sales and Use Tax Agreement (Agreement). Kansas is a Member State of the Governing Board of the Agreement and must annually undergo a review of its statutes and regulations in order to be determined not out of compliance with the Agreement. Unless these amendments are adopted, Kansas will be found out of compliance during the 2010 Governing Board review process later this fall. As a Member State in good standing, Kansas benefits from the voluntary registration by participating remote retailers (located outside the state geographic boundaries) in collecting and remitting Kansas sales and use tax on remote transactions with Kansas customers. Currently, Kansas receives approximately \$35 million in sales and use tax remittances from remote retailers. Should Kansas lose its status as Member State in good standing, Kansas stands to lose to benefit of those substantial revenues.

The Department's statutes governing the administration and contents of sales tax exemption certificates, K.S.A. 2009 Supp. 79-3609 and 79-3651, need to be modified to conform to 2009 amendments to Section 317 of the Streamlined Sales and Use Tax Agreement.

Section 1

Section 317 of the Agreement concerns administration of sales tax exemptions, particularly how retailers may use sales tax exemption certificates to protect against liability for failing to collect, report and remit sales tax on taxable transactions identified in an audit. Section 317 provides that Member States must relieve a retailer from liability for failure to collect tax when the retailer obtains a fully completed exemption certificate from the purchaser at the time of the transaction or within 90 days thereafter. Even if the retailer did not obtain an exemption certificate within that time frame, when a Member State revenue department notifies the retailer of an audit and requests copies all exemption certificates, the Member State must allow the retailer 120 days thereafter to obtain exemption certificates from the purchaser, "taken in good faith." The 2009 amendment to Section 317 defines what "taken in good faith" means:

The seller obtain[s] a certificate that claims an exemption that (i) was statutorily available on the date of the transaction in the jurisdiction where the transaction is sourced, (ii) could be applicable to the item being purchased, and (iii) is reasonable for the purchaser's type of business.

The amendment to Section 317 further provides that, for exemption certificates provided during the 120 days after audit notification and not obtained within 90 days of the transaction, if the Member State establishes that the retailer knew the information on the exemption certificate was materially false, or had reason to know it, or knowing participated in activity purposefully evading the tax, then the exemption certificate will not relieve the retailer from liability for the tax.

Section 1 of House Bill 2519 would amend K.S.A. 2009 Supp. 79-3609 to conform to the above amendments to Section 317 of the Agreement.

As part of that compliance review process completed in late 2009, a compliance issue was raised concerning Kansas exemption certificate forms. Under Section 317 of the Agreement, Member States are allowed to promulgate their own sales tax exemption certificate forms, but they must also honor the generic exemption certificate form adopted by the Governing Board. In addition, if Member States have their own exemption certificate forms, those cannot require any information from purchasers that is not required on the Governing Board-approved generic exemption certificate form. Member States can request such additional information, but they cannot require it. A copy of the Governing Board-approved generic exemption certificate form is attached.

Section 2

K.S.A. 2009 Supp. 79-3651(f) specifies the contents of sales tax exemption certificates for entity-based exemptions. K.S.A. 2009 Supp. 79-3651(f) needs to be amended as shown in Section 2 of House Bill 2519 to strike the provisions stating that the purchaser must indicate on the exemption certificate form the specific statutory subsection under which the exemption is being claimed, that the certificate must be signed by an officer, manager, or other administrator of the non-profit entity, and that payment must be made by the exempt entity's check, voucher or warrant, in order for the retailer to be protected from liability for the tax. The signature on the exemption certificate must be an "authorized signature"—but the retailer does not have to verify that the signature is an officer, manager or other administrator of the exempt entity. Also, the retailer may condition honoring the exemption claim on payment being made by check, voucher or warrant of the exempt entity. But if the retailer does not require payment by exempt entity check, voucher or warrant, the retailer will still have liability protection for failing to collect the tax, assuming the exemption certificate is fully completed.

Section 3

Section 304 of the Agreement was recently amended to require for state sales tax rate changes, there must be at least 30 days between the effective date of a law enacting a state rate change and the date when the new rate actually starts to apply, or if not, retailers will be held harmless for failing to collect the correct rate for 30 days after date

of enactment of the law raising the rate. Section 3 would amend K.S.A. 2009 Supp. 79-3666 to conform to this requirement. For example, if legislation raising the state sales tax rate were enacted on June 15, 2010 and provided that the increase in rate was to take effect on July 1, 2010, retailers could not be held liable for failing to collect at the higher rate until the date starting 30 days after June 15, 2010, i.e., July 15, 2010.

Section 4

Conforming amendments need to be made the “direct mail” sourcing provisions at K.S.A. 2009 Supp. 79-3672. These are required by amendments to Section 313 of the Agreement, which concerns the sourcing of “direct mail.” These changes are the result of several years of negotiations between the direct mail industry and the states that are members of the Governing Board, in order to develop practical solutions for applying destination sourcing to direct mail.

The Agreement and Kansas sales tax statutes define “direct mail” as:

printed material delivered or distributed by United States mail or other delivery services to a mass audience or to addressees on a mailing list provided by the purchaser or at the direction of the purchaser when the cost of the items are not billed directly to the recipients. Direct mail includes tangible personal property supplied directly or indirectly by the purchaser to the direct mail seller for inclusion in the package containing the printed material. Direct mail does not include multiple items of printed material delivered to a single address.

K.S.A. 2009 Supp. 79-3602(j). Originally, “direct mail” was thought of as “junk mail,” i.e., advertising brochures, catalogs, etc. K.S.A. 2009 Supp. 79-3672 contains the initial sourcing rule for direct mail in the Agreement: direct mail is sourced to the mailbox of the recipient for sales tax purposes, subject to some exceptions. If the purchaser of the direct mail (such as a retailer sending out an advertising brochure to customers) provides the seller of the direct mail (such as the printer and mailer of the brochure) a direct pay permit or a direct mail form, then the purchaser has the obligation to self-accrue, report and remit the applicable sales tax on the transaction, and the seller of the direct mail is relieved of that obligation of collecting sales tax on the transaction. If the purchaser of direct mail provides the seller of direct mail information showing the jurisdictions to which the direct mail is delivered to recipients, then the seller is obligated to collect and remit sales tax on the transaction, sourcing it to the appropriate jurisdictions of the recipients. If the purchaser did not provide to the seller a direct pay permit, direct mail form, or taxing jurisdiction information on the recipients, then as a “default” rule, the seller can source the sale to the seller’s location.

Later interpretations of the term “direct mail” broadened it to include other types of mass-mail business correspondence, such as monthly account statements, invoices and privacy statements. Once it was clear that “direct mail” included these as well, the direct mail industry and businesses that purchased direct mail wanted to define 2 different types of direct mail: “advertising and promotional direct mail” (junk mail) and “other direct mail” (anything else mailed to a mass audience). They also wanted a different “default” sourcing rule for “other direct mail.” When the purchaser did not provide the seller a

direct pay permit, direct mail form, or taxing jurisdiction information, the seller should source "other direct mail" to the purchaser's billing address, instead of the seller's location.

Businesses were also concerned that this broader definition of "direct mail" might somehow encompass purchases of data processing services that were involved in producing direct mail, creating the risk that a state that did not impose sales tax on data processing services, by adoption of the Agreement definition of "direct mail," could take the position that it now imposed sales tax on certain data processing services. For example, a Kansas utility provider might retain a data processing firm to maintain the accounts of its utility customers. Data processing services are not taxable in Kansas. That information would be used to produce the monthly billing statements for those customers. Although those monthly billing statements are considered "direct mail" and Kansas does tax "direct mail", the charges for the data processing services to produce the information contained in those billing statements is not considered "direct mail" and are not taxable in Kansas.

The amendments to K.S.A. 2009 Supp. 79-3672 shown in House Bill 2519 accomplish the above changes. Attached are 2 examples to illustrate how the "default" direct mail sourcing rules apply to "advertising and promotional direct mail" and "other direct mail."

The provisions in House Bill 2519 are the same as the provisions in Senate Bill 429, heard Senate Committee on Assessment and Taxation on January 27.

Direct Mail Sourcing Examples

Example 1—Advertising and Promotional Direct Mail

Manhattan clothing store contracts with a Topeka printing company to print and mail out sale advertisement flyers to the clothing store's customers with 1/3 of the flyers mailed to Manhattan customer addresses, 1/3 to Topeka customer addresses, and 1/3 to Nebraska customer addresses.

The flyers are “advertising and promotional direct mail.”

The clothing store does not give the Topeka printing company a direct pay permit, direct mail form, or information showing the jurisdictions to which the direct mail is delivered to recipients. Topeka printing company prints and mails the flyers, then bills the clothing store \$100 for the printing costs and \$25.00 for mailing costs (note: separately stated mailing costs are not subject to sales tax per K.S.A. 79-3602(i)).

The printing costs are subject to sales tax. K.S.A. 79-3672, to be amended by HB 2519, addresses the sourcing of the sales tax for these “advertising and promotional direct mail” printing costs. Because the purchaser, the clothing store, did not provide the seller with a direct pay permit, direct mail form, or information showing the jurisdictions to which the direct is delivered to recipients, the “default” sourcing rule applies, and the sales tax on the printing costs is sourced to Topeka, the location of the seller, the printing company, so the state and local sales tax rate in effect for Topeka applies.

Example 2—Other Direct Mail

Topeka bank contracts with a Wichita printing company to print and mail out to its customers a bank “privacy policy” notice, with 1/3 of the notices going to customers in Topeka, 1/3 to Lawrence, and 1/3 to Emporia.

The “privacy policy” notices are “other direct mail.”

The Topeka bank does not give the Wichita printing company a direct pay permit, direct mail form, or information showing the jurisdictions to which the direct mail is delivered to recipients. The Wichita printing company prints and mails the notices, then bills the bank \$200 for the printing costs and \$40.00 for mailing costs.

The separately stated mailing costs are not taxable, but printing costs are subject to sales tax, and per K.S.A. 79-3672, to be amended by HB 2519, the sales tax is sourced under the “default” rule for “other direct mail” to the billing address of the Topeka bank, the purchaser, so the Topeka sales tax rate will apply to the printing costs.

This is a multi-state form. Not all states allow all exemptions listed on this form. Purchasers are responsible for knowing if they qualify to claim exemption from tax in the state that would otherwise be due tax on this sale. The seller may be required to provide this exemption certificate (or the data elements required on the form) to a state that would otherwise be due tax on this sale.

The purchaser will be held liable for any tax and interest, and possibly civil and criminal penalties imposed by the member state, if the purchaser is not eligible to claim this exemption. A seller may not accept a certificate of exemption for an entity-based exemption on a sale made at a location operated by the seller within the designate state if the state does not allow such an entity-based exemption.

1. Check if you are attaching the Multi-state Supplemental form.
 If not, enter the two-letter postal abbreviation for the state under whose laws you are claiming exemption.
2. Check if this certificate is for a single purchase and enter the related invoice/purchase order # _____

3. **Please print** _____
 Name of purchaser

Business Address		City	State	Zip Code
Purchaser's Tax ID Number		State of Issue	Country of Issue	
If no Tax ID Number	FEIN	Driver's License Number/State Issued ID Number		Foreign diplomat number
Enter one of the following:		State of Issue: _____	Number _____	
Name of seller from whom you are purchasing, leasing or renting _____				
Seller's address		City	State	Zip code

4. Type of business. Circle the number that describes your business

- | | |
|---|---------------------------------------|
| 01 Accommodation and food services | 11 Transportation and warehousing |
| 02 Agricultural, forestry, fishing, hunting | 12 Utilities |
| 03 Construction | 13 Wholesale trade |
| 04 Finance and insurance | 14 Business services |
| 05 Information, publishing and communications | 15 Professional services |
| 06 Manufacturing | 16 Education and health-care services |
| 07 Mining | 17 Nonprofit organization |
| 08 Real estate | 18 Government |
| 09 Rental and leasing | 19 Not a business |
| 10 Retail trade | 20 Other (explain) _____ |

5. Reason for exemption. Circle the letter that identifies the reason for the exemption.

- | | |
|---|---|
| A Federal government (department) _____ | H Agricultural production # _____ |
| B State or local government (name) _____ | I Industrial production/manufacturing # _____ |
| C (name) _____ | J Direct pay permit # _____ |
| D Foreign diplomat # _____ | K Direct mail # _____ |
| E Charitable organization # _____ | L Other (explain) _____ |
| F Religious or educational organization # _____ | |
| G Resale # _____ | |

6. Sign here. I declare that the information on this certificate is correct and complete to the best of my knowledge and belief.

Signature of Authorized Purchaser _____ Print Name Here _____ Title _____ Date _____