



Inter-Departmental Communication

Office of the City Auditor

Date: October 14, 2010

To: Councilman John Sharp, Chair, Legislative Committee

From: Gary L. White, City Auditor *g.l. white*

Subject: Sample Legislation for Sales and Use Tax Refund Regulations

Our January 2007 *Sales Tax Study Follow-Up*, included a recommendation that the city's state legislative agenda include legislation requiring vendors return any refunds of sales and use taxes to the original purchaser. During the Finance and Audit Committee's December 2, 2009 discussion of the Finance Department's progress in addressing the audit's recommendations, Finance staff reported the Legislative Committee Chair, the city's Legislative Liaison and lobbyist all believed the city would not be successful in getting this recommendation approved by the state legislature. In response, I told the committee the Missouri State Auditor had identified six states surrounding Missouri with similar legislation. In response, you had asked for copies of other states' legislative language. This memorandum provides the requested information.

SUMMARY

Our January 2007 *Sales Tax Study Follow-up* determined that about \$246 million in Kansas City's sales and use tax revenues was refunded between 2002 and 2005. Missouri law, unlike six surrounding states, does not require vendors receiving sales and use tax refunds to return them to the original purchaser. Both my office and the Missouri State Auditor's Office believe that the absence of similar legislation in Missouri allows a questionable windfall for businesses and a disincentive to charge customers the correct tax amount. Arkansas, Illinois, Iowa, Kansas, Nebraska, and Oklahoma have regulations or state laws that require returning the sales and use tax refunds to the original customer. Attached is the legislative language from these states.

WORK PERFORMED

We contacted the Missouri's State Auditor's Office to identify the surrounding states that have regulations requiring sales and tax refunds be returned to the original customer. We

contacted government staff in each state to identify the state statutes and/or administrative rules that govern sales and use tax refunds. We also reviewed the Missouri State Auditor's May 2000 *Review of Department of Revenue Division of Taxation and Collection Sales and Use Tax Refunds*; June 2003 *Department of Revenue Division of Taxation and Collection Sales and Use Tax Two Years Ended June 30, 2002*; and January 2010 Report, *Revenue: Sales and Use Tax*; and our January 2007 Performance Audit, *Sales Tax Study Follow-up*.

BACKGROUND

The city assesses sales and use taxes on retail activity. Vendors collect sales taxes at the time of purchase. Businesses and individuals are required to pay use tax for taxable purchases made from out-of-state vendors who are not required to collect sales tax.¹ Vendors collect sales and use taxes from their customers and remit the taxes to the Missouri Department of Revenue. The Missouri Revised Statutes authorize sales and use tax refunds:

If any tax, penalty or interest has been paid more than once, or has been erroneously or illegally collected, or has been erroneously or illegally computed, such sum shall be credited on any taxes then due from the person legally obligated to remit the tax. . . . and the balance, with interest shall be refunded to the person legally obligated to remit the tax. . . .²

The Missouri State Auditor's May 2000 audit³ identified approximately \$47.6 million in sales and use tax refunds disbursed in fiscal year 1999. The files for \$20.8 million of these refunds did not indicate the vendor was going to return the tax or interest to the original customer. Missouri statutes do not require vendors seeking refunds to return them to their customers. The only requirements are that the claim for refund must be in writing and signed by the applicant, and must state the specific grounds upon which the claim is founded.⁴

Failure to return refunds to the original purchaser results in a windfall for the vendor. In addition, because the statutes also require the refund to be credited on any taxes the vendor owes, it could provide a disincentive to charge taxpayers the correct tax amount.

The Missouri State Auditor contacted six contiguous states regarding their refund policies. All have regulations, state laws, or policies that require refunds be returned to the original customer. According to the state audits we reviewed, legislation was introduced in Missouri's 1997, 2002, and 2003 legislative session, that would have prohibited the refund or credit of sales or use tax erroneously collected by a retailer, unless it was demonstrated that all erroneously collected amounts would be refunded to

¹ *Sales Tax Study Follow-up*, Office of the City Auditor, Kansas City, Missouri, January 2007.

² RSMo. 144.190(2).

³ *Review of Department of Revenue Division of Taxation and Collection Sales and Use Tax Refunds*, Office of the State Auditor of Missouri, May 2000.

⁴ RSMo. 144.190(3).

the person who originally paid the tax. This provision, however, was not approved by the General Assembly. The Missouri State Auditor recommended pursuing legislation requiring sales tax refunds and related interest be returned to the original customer. The Missouri Department of Revenue agreed with the recommendation and pledged to support the legislation.

Our January 2007 *Sales Tax Study Follow-up* determined that refunds and adjustments offset more than a quarter of Kansas City's sales and use tax revenues between 2002 and 2005, or about \$246 million during the four-year period. We recommended legislation requiring vendors to return refunds, adjustments, and associated interest to the original purchaser be part of the city's state legislative agenda. In addition, we recommended that in situations in which it is not practical or possible to identify the original purchaser, the monies be retained by the state, county, or city jurisdictions to be used for the benefit of the general public.

The December 2, 2009 meeting of the Finance and Audit Committee included a presentation by the Finance Department on their progress in addressing the recommendations of our January 2007 Sales Tax Follow-up. For the recommendation concerning the state legislation for refunds, Finance staff reported that the Chair of the Legislative Committee, the city's Legislative Liaison, and the city's lobbyist all believed that the city would not be successful in getting this recommendation approved by the state legislature.⁵

My office was asked to obtain legislation from the surrounding states that require sales and use tax refunds be returned to customers: Arkansas, Illinois, Iowa, Kansas, Nebraska, and Oklahoma. The state statutes and/or administrative rules that govern sales and use tax refunds are attached.

If you have any questions, please contact me at 513-3320.

cc: Members of the Legislative Committee
Honorable Mayor and Members of the City Council
Troy Schulte, Interim City Manager
Randall J. Landes, Director of Finance

⁵ Audit Report Tracking System Report Form for Sales Tax Study Follow-up, completed by Finance Department staff, September 23, 2009.

Legislation Requiring Sales and Use Tax Refunds be Returned to Original Purchaser

State	Source	Language
Arkansas	State statute 26-18-507(d)	Notwithstanding any provisions of the law to the contrary, a taxpayer who acts only as an agent of the state in the collection of any state tax shall be entitled to claim a credit or refund of such tax only if the taxpayer establishes that he or she has: (1) Borne the tax in question; (2) Repaid the amount of the tax to the person from whom he or she collected it; or (3) Obtained the consent of the person to the allowance of the credit or refund.
Illinois	State statute 35 ILCS 105/3-45	If a seller collects use tax measured by receipts that are not subject to use tax, or if a seller, in collecting use tax measured by receipts that are subject to tax under this Act, collects more from the purchaser than the required amount of the use tax on the transaction, the purchaser shall have a legal right to claim a refund of that amount from the seller. If, however, that amount is not refunded to the purchaser for any reason, the seller is liable to pay that amount to the Department.
Iowa	State Code 423.47	If it shall appear that, as a result of mistake, an amount of tax, penalty, or interest has been paid which was not due under the provisions of this chapter, such amount shall be credited against any tax due, or to become due, on the books of the department from the person who made the erroneous payment, or such amount shall be refunded to such person by the department.
Kansas	Administrative Regulation KAR 92-19- 61a(e)	Taxes collected by retailers shall be deemed to be held in trust until paid to the department. In addition, all funds paid by a customer to a retailer as taxes that exceed the taxes that are actually due shall be refunded to the consumer or, if the funds cannot be refunded, treated as public money that is held in trust for and payable to the state of Kansas.
Nebraska	State statute 77-2708(2)(a)	If the Tax Commissioner determines that any sales or use tax amount, penalty, or interest has been paid more than once, has been erroneously or illegally collected or computed, or has been paid and the purchaser qualifies for a refund under section 77-2708.01, the Tax Commissioner shall set forth that fact in his or her records and the excess amount collected or paid may be credited on any sales, use, or income tax amounts then due and payable from the person under the Nebraska Revenue Act of 1967. Any balance may be refunded to the person by whom it was paid or his or her successors, administrators, or executors.
Oklahoma	Tax Commission Rule 710:65- 11-1(b)	Credit/refund requests should be documented with the following information (if applicable):... (6) Copies of the credit invoices or checks showing the tax collected or charged in error has been refunded to your customer.