

**Special Report
Sales Tax Study**

February 2001

City Auditor's Office

City of Kansas City, Missouri

February 7, 2001

Honorable Mayor and Members of the City Council:

We conducted this study to identify factors contributing to lower than expected and erratic growth in sales tax revenue. The city manager and budget officer were concerned that sales tax revenue was not growing as expected and was difficult to forecast. We tested five possible explanations of lower than expected revenues:

- Refunds and other adjustments on individual returns
- Loss of sales to other jurisdictions
- Increased shopping on the Internet
- Forecasting methods
- Misallocation between sales and use tax revenues or among jurisdictions at the state level

We conclude that the first two of these affect the city's sales tax revenues, while the others have not been significant.

Sales and use tax refunds and other adjustments amounted to about \$73 million between 1995 and 1999, contributing to lack of growth in the city's sales tax revenue during this period. Refunds create a windfall for vendors because state law does not require vendors to return the tax to the original purchaser. According to the state auditor, six surrounding states have laws, policies or regulations requiring vendors to return credits and refunds to the original purchaser. Similar legislation was introduced in Missouri in 1997, but not approved by the General Assembly. We recommend the city support legislation to require vendors to return sales and use tax refunds and credits to the original purchaser.

Loss of sales to other jurisdictions also helps to explain slow growth in sales tax revenue. The city's pull factor – a measure of the extent to which the city attracts retail business – fell between 1995 and 1999. The city's rank among metropolitan area cities declined from 3rd to 5th as Leawood and Olathe, where new shopping centers opened, moved ahead of Kansas City.

The other possible explanations we tested do not appear to be major factors in lower than expected sales tax revenue. Internet sales are unlikely to have affected revenues to date, although they could have an impact in the future. While revenue forecasting is made difficult by the unpredictability of refunds and the length of the budget cycle, the Office of Management and Budget's forecasting methods are reasonable. To assist in identifying factors that may affect forecasts, we recommend that the budget officer annually request and review sales and use tax filing detail available from the state.

While the state has controls to prevent misallocation of local sales and use tax revenue, neither the state nor the city verifies business location information provided by taxpayers. If a business location is incorrect, it could be paying sales taxes to the wrong city. Our site visits to 42 city businesses identified one that is not properly registered with a Kansas City address. We recommend the Finance director work with the state to develop a procedure to verify that businesses within the city have proper state sales tax licenses.

The draft report was sent to the city manager, Finance director, and budget officer on January 19, 2001. Written responses are included as an appendix. We worked closely with the Office of Management and Budget in preparing this report. We appreciate the assistance of Darrel Woodward, Jacob Cowan, and David Hunker. We also appreciate the courtesy and cooperation of the Missouri and Kansas departments of Revenue and staff from the city's Revenue Division and Information Technology Department. The audit team for this project was Douglas Jones and Amanda Noble.

Mark Funkhouser
City Auditor

Special Report: Sales Tax Study

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Introduction

Objectives

We conducted this study pursuant to Article II, Section 13 of the Charter of Kansas City, Missouri, which establishes the Office of the City Auditor and outlines the city auditor's primary duties.

The purpose of the study is to identify factors that have contributed to the city's lower than expected and erratic growth in sales and use tax revenues. In fiscal year 2000, sales tax revenues were about 5 percent less than estimated, while use tax revenues were about 35 percent higher than estimated. The Office of Management and Budget is concerned that the erratic growth makes it difficult to accurately forecast revenues. Accurate revenue estimates are important for the city's annual budget process and capital improvements planning.

Scope and Methodology

We tested five possible explanations for lower than expected sales tax revenues:

- Refunds and other adjustments on individual returns
- Loss of sales to other jurisdictions
- Increased shopping on the Internet
- Forecasting methods
- Misallocation between sales and use tax revenues or among jurisdictions at the state level

We conducted our work in accordance with applicable government auditing standards, with the exception of the completion of an external quality control review of the City Auditor's Office within the last three years.¹ Our methods included:

- Interviewing city and state staff.
- Reviewing state statutes and regulations related to sales and use tax.

¹ The last review was performed in April 1995. A peer review is scheduled for March 2001.

- Analyzing a database of sales and use tax returns filed by Kansas City taxpayers between July 1994 and April 2000, provided by the Missouri Department of Revenue, under RSMo. 32.057.
- Comparing city per capita sales tax collections to other jurisdictions in the metropolitan area.
- Reviewing reports and work programs prepared by the State Auditor's Office.
- Reviewing the Office of Management and Budget's method of forecasting sales tax revenue.
- Matching state sales tax license information to city occupational license information for selected zip codes.
- Conducting 42 site visits to verify state sales tax license information.

In accordance with state law, confidential taxpayer information is not included in this report. No other information is omitted from this report because it was deemed privileged or confidential.

Background

Legislative Authority

The city has no inherent power to tax. The state constitution and statutes give cities the authority to impose sales and use taxes. Voter approval is required to institute new taxes or tax increases.

Sales and Use Taxes

The city assesses sales and use taxes on retail activity. Merchants 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 merchants who are not required to collect the sales tax. For example, a Missouri resident who made untaxed catalog purchases totaling more than \$2,000 in a calendar year is required to file a use tax return with the state.

The city's current sales tax rate is 1.5 percent. Three one-half cent sales taxes support capital improvements, debt service, and public mass transportation. An additional one-half cent sales tax to renovate Liberty

Memorial was in effect from April 1, 1999, through September 30, 2000. The city began to recognize use tax revenue in fiscal year 1998. Use tax revenues have generally been used to fund deferred maintenance and capital projects. The use tax rate is the same as the city's sales tax rate.

The state administers sales and use tax collections. Merchants submit returns and sales tax collections to the state on a schedule (four times a month, monthly, quarterly, or annually) based on sales volume. Businesses and individuals also submit use tax returns and payments to the state on a schedule based on sales volume. Businesses are allowed to keep two percent from the total sales or use tax remitted on or before the due date to cover their collection costs.² The state distributes sales and use taxes to the city each month. The state retains one percent of all local sales/use taxes to cover collection costs.³

Sales tax growth has been flat when adjusted for rate increase.

Excluding the Liberty Memorial sales tax, average annual growth in sales tax revenue has been 1.2 percent over the past five fiscal years with sales taxes declining in fiscal year 2000. Although sales tax growth has been sluggish, use tax revenues increased 25 percent in fiscal year 2000 after adjusting for the change in rates due to the Liberty Memorial tax. Since fiscal year 1996, total sales and use tax revenues have increased. (See Exhibit 1.)

Exhibit 1. Sales and Use Tax Revenue (\$ millions)

| Fund | FY96 | FY97 | FY98 | FY99 | FY00 |
|-----------------------|--------|--------|--------|---------|---------|
| Sales Tax | \$80.9 | \$81.7 | \$84.3 | \$86.2 | \$84.8 |
| Liberty Memorial | 0 | 0 | 0 | 0 | 27.2 |
| Total Sales Tax | \$80.9 | \$81.7 | \$84.3 | \$86.2 | \$112.0 |
| Use Tax | 0 | 0 | 12.2 | 17.6 | 29.3 |
| Total Sales & Use Tax | \$80.9 | \$81.7 | \$96.5 | \$103.8 | \$141.2 |

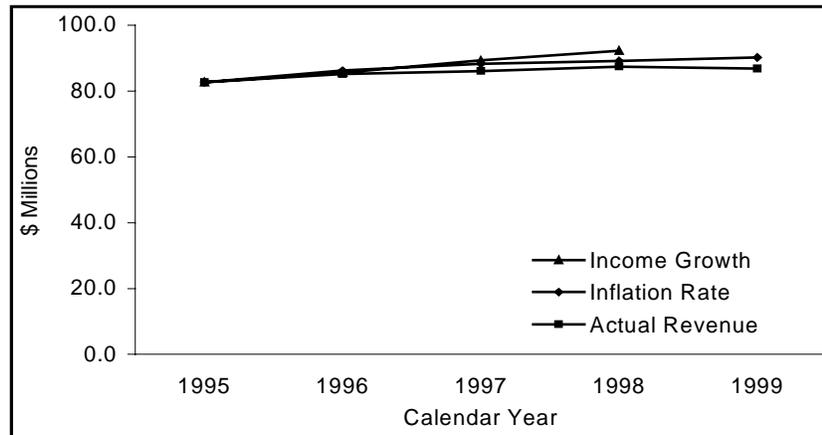
Source: City's financial management system.

Sales tax growth lags economic indicators. Sales tax distributions have not kept pace with inflation, with the biggest differences in 1997 and 1999. Nor have sales tax distributions kept pace with area income growth between 1995 and 1998 (personal income data are not yet available for 1999). (See Exhibit 2.)

² RSMo §144.140 and RSMo §144.710.

³ RSMo §92.421.1, RSMo §94.550.1, and RSMo 144.759.1.

Exhibit 2. City Sales Tax Revenue Compared to Inflation and Income Growth



Sources: Missouri Department of Revenue, Bureau of Economic Analysis, and Bureau of Labor Statistics.

Findings and Recommendations

Summary

Refunds and other adjustments to sales tax returns help explain why the city's sales tax revenues have been flat. Kansas City taxpayers submitted sales and use tax returns for adjustments amounting to about \$73 million between 1995 and 1999. About two-thirds of this amount occurred in 1997 and 1999, when growth in the city's sales tax revenue was lowest. The percentage of Kansas City taxpayers submitting returns for refunds or credits has increased from about 20 percent in 1995 to about 25 percent in 1999.

Refunds create a windfall for vendors because state law does not require vendors to return the tax to the original purchaser. According to the state auditor, six surrounding states have laws, policies or regulations requiring vendors to return credits and refunds to the original purchaser. Similar legislation was introduced in 1997, but not approved by the General Assembly. We recommend the city support legislation to require vendors to return sales and use tax refunds and credits to the original purchaser.

Loss of sales to other jurisdictions also helps to explain slow growth in sales tax revenue. The city's pull factor – a measure of the extent to which the city attracts retail business – fell between 1995 and 1999. The city's rank among metropolitan area cities declined from 3rd to 5th as Leawood and Olathe, where new shopping centers opened, moved ahead of Kansas City.

The other possible explanations we tested do not appear to be significant factors in lower than expected sales tax revenue. Internet sales are unlikely to have affected revenues to date, although they could have an impact in the future. The Office of Management and Budget's forecasting methods appear reasonable. Ongoing review of filing detail available from the state could provide additional information that could be useful.

While the state has controls to prevent misallocation of local sales and use tax revenue, neither the state nor the city verifies business location information provided by taxpayers. If a business location is incorrect, it could be paying sales taxes to the wrong city. Our site visits to 42 city businesses identified one that is not properly registered with a Kansas City address. We recommend the Finance director work with the state to

develop a procedure to verify that businesses within the city have proper state sales tax licenses.

Refunds Contribute to Lower Than Expected Sales Tax Revenues

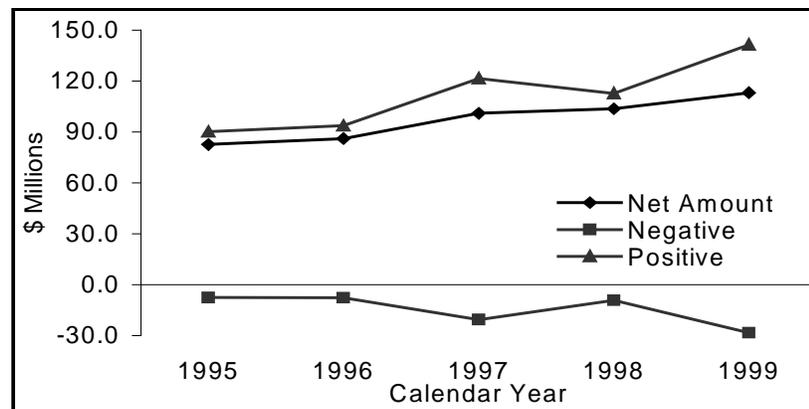
Refunds and other adjustments to tax returns help explain why the city's sales tax revenues have been flat. Kansas City taxpayers submitted sales and use tax returns for refunds or credits amounting to about \$73 million between 1995 and 1999. The percentage of taxpayers submitting returns for refunds or credits has increased from about 20 percent in 1995 to about 25 percent in 1999.

State law allows vendors to treat sales and use tax refunds as a windfall because vendors are not required to return the tax to the original purchaser. The city should support state legislation requiring vendors to do so.

Refunds and Other Adjustments Totaled \$73 Million over the Last Five Years

Refunds and other adjustments to sales and use tax returns filed by Kansas City taxpayers amounted to about \$73 million between calendar years 1995 and 1999. (See Exhibit 3.) About two-thirds of this amount occurred in 1997 and 1999, when growth in the city's sales tax revenue was lowest. The proportion of negative adjustments to positive sales tax filings was about 8 percent in 1995, 1996, and 1998; but was about 19 percent in 1997 and 22 percent in 1999. Negative adjustments were a smaller proportion of use taxes.

Exhibit 3. Sales and Use Tax Distributions 1995 – 1999 (excluding Liberty Memorial Tax)



Source: Missouri Department of Revenue.

Amended or audited returns can result in negative adjustments. For example, a return amended to claim an exemption results in a refund or credit to the taxpayer. In some cases, the adjustment is offset by another transaction, such as amending a return to submit use tax instead of sales or to change tax ID numbers.

Reasons Taxpayers Amend Sales Tax Returns

- To claim an exemption for nontaxable sales (farmers, resale, manufacturer)
- To claim an exemption for sales to purchasers such as non-profit organizations
- To correct an invalid location (inside city changed to outside city or to another city)
- To make corrections based on an audit
- To pay use tax instead of sales tax

Source: Missouri Department of Revenue.

The number of Kansas City taxpayers submitting negative returns has grown. About 1,900 taxpayers submitted approximately 30,000 returns for refunds or other adjustments in 1995. In 1999 about 3,500 taxpayers submitted almost 77,000 of these returns. The proportion of taxpayers submitting returns for refunds or credits has increased from about 20 percent in 1995 to about 25 percent in 1999.

However, a small number of taxpayers account for most of the adjustment amounts. Between 1995 and 1999, about 1 percent of the taxpayers who submitted returns for refunds or other adjustments received 75 percent of the total amount refunded or credited.

Reasons varied for large adjustments. We identified 15 taxpayers each with negative adjustments totaling \$500,000 or more between 1995 and 1999, and asked the Missouri Department of Revenue to explain the reasons for the adjustments. Of the 15 taxpayers we asked about:

- 6 were issued refunds based on court rulings that certain sales were exempt;
- 4 were issued refunds following audits;
- 3 submitted amended returns to change tax ID numbers; and
- 2 submitted amended returns due to overpayment

In two of the cases, the adjustments moved sales tax to use tax. However, most of the adjustments do not appear to be related to use tax filings.

Sales and use tax refunds have grown. The state auditor reported that sales and use tax refunds increased more than 400 percent (\$9 million to \$47.6 million) between 1990 and 1999.⁴ The state auditor cited state Administrative Hearing Commission decisions and changes to state law as reasons for many of the refund applications. Much of the increase in refunds during fiscal year 1999 was related to exemptions affecting country club membership dues, athletic club fees, and tax rate changes affecting food sales.

Sales Tax Refunds Create Windfalls for Vendors

Missouri law does not require vendors to return sales and use tax refunds to the original purchasers. Because vendors may treat refunds as a windfall there is an incentive to seek refunds.

The state auditor reported that vendors might be receiving a windfall because refunds are not always passed on to the original purchaser. The state auditors found that approximately \$20.9 million in sales and use tax refunds were issued in 1999 without an indication that the vendor would be returning the tax to the original purchaser.⁵ State auditors also found that consultants were involved in filing 76 of 266 refunds reviewed, totaling about \$14 million.

The state auditor reported that six surrounding states require refunds be passed on to the original purchaser and recommended similar legislation in Missouri.⁶ Legislation was introduced in 1997 that would have prohibited a refund or credit unless it was demonstrated that the amount would be returned to the original purchaser. However, the General Assembly did not approve the legislation. To encourage the correct collection of sales and use taxes, the city should support legislation that would require vendors to return sales and use tax refunds to the original purchaser.

Loss of Sales to Other Jurisdictions Also Slows Revenue Growth

The city's share of sales tax revenue is declining relative to other cities in the metropolitan area, suggesting that the city is losing sales to other jurisdictions. It is unlikely that Internet sales have affected city revenues, but they could have an impact in the future.

⁴ *Review of Department of Revenue Division of Taxation and Collection: Sales and Use Tax Refunds*, Office of the Missouri State Auditor, May 12, 2000, p. 6.

⁵ *Review of Department of Revenue Division of Taxation and Collection: Sales and Use Tax Refunds*, p. 7.

⁶ The State Auditor previously addressed this issue in two prior financial statement audits of sales and use tax funds issued in 1995 and 1999.

Kansas City Appears to Be Losing Sales to Other Metro Area Cities

Kansas City's estimated share of retail sales has declined relative to other metro area cities in the last five years. The city's rank among area cities declined from 3rd in 1995 to 5th in 1999, suggesting that the city is losing sales to other cities. Leawood and Olathe moved ahead of Kansas City, as new shopping centers opened in each of these cities since 1995.

We calculated a pull factor to measure how well the city is attracting retail business.⁷ A ratio greater than 1 indicates that the city is attracting business relative to the rest of the cities in the metro area and a ratio less than 1 indicates that the city is losing business relative to other cities. Kansas City's ratio, while above 1, is less than it was 5 years ago.

Exhibit 4. Pull Factor Analysis: 1995 and 1999

| City | Pull Factor 1995 | Pull Factor 1999 | Rank 1995 | Rank 1999 |
|------------------------|---------------------|---------------------|--------------|--------------|
| Lenexa, KS | 3.1 | 2.9 | 1 | 1 |
| Overland Park, KS | 2.6 | 2.5 | 2 | 2 |
| Olathe, KS | 1.6 | 2.1 | 4 | 3 |
| Leawood, KS | 0.9 | 1.7 | 16 | 4 |
| Kansas City, MO | 1.7 | 1.5 | 3 | 5 |
| Shawnee, KS | 1.3 | 1.5 | 7 | 6 |
| Independence, MO | 1.3 | 1.4 | 6 | 7 |
| Blue Springs, MO | 1.3 | 1.4 | 8 | 8 |
| Gladstone, MO | 1.2 | 1.3 | 10 | 9 |
| Liberty, MO | 1.4 | 1.3 | 5 | 10 |
| Grandview, MO | 1.3 | 1.3 | 9 | 11 |
| Lee's Summit, MO | 1.0 | 1.2 | 13 | 12 |
| Raytown, MO | 1.1 | 1.2 | 12 | 13 |
| Kansas City, KS | 1.1 | 1.1 | 11 | 14 |
| Prairie Village, KS | 1.0 | 1.0 | 14 | 15 |
| Leavenworth, KS | 0.9 | 0.9 | 15 | 16 |
| Belton, MO | 0.8 | 0.8 | 17 | 17 |

Sources: Missouri and Kansas Departments of Revenue, Census Bureau.

Internet Sales Have Had Little Effect on Sales Tax Revenues, But This Could Change

Internet sales have had little impact on state and local government sales tax revenue according to a recent report by the United States General

⁷ The pull factor is the ratio of city per capita sales tax collections to state per capita sales tax collections, adjusted for differences in sales tax rates. Because the city's metropolitan area straddles the state line, we constructed a bi-state pull factor with per capita sales taxes in Missouri and Kansas combined as the base. We selected cities in the metro area with populations greater than 20,000 for comparison.

Accounting Office (GAO).⁸ GAO estimated that the size of tax loss from Internet sales, not replacing other remote sales, for 2000 is less than two percent of general sales tax revenues.⁹ However, GAO's estimate for sales tax losses in 2003 ranged from less than one percent to about five percent. There is much uncertainty about the major factors that determine the tax loss created by Internet and other remote sales, and current economic data are not well suited to tracking rapidly evolving Internet activity.

GAO reported that continued growth in Internet sales is likely to present compliance challenges for sales and use tax administrators. Tax liabilities for Internet sales are generally the same as for other sales, however, collection and remittance responsibilities may differ. Vendors with a substantial presence in a taxing jurisdiction are responsible for collecting and remitting sales taxes. When the vendor does not, purchasers are responsible for remitting use taxes. Although reliable national estimates of sales and use tax compliance do not exist, state officials and other experts told GAO that compliance is highest for in-store sales and lowest for remote sales (including Internet) when vendors do not have a substantial presence in the taxing jurisdiction.

City's Forecasting Methods Are Reasonable

The Office of Management and Budget's method of estimating sales and use tax revenues seems reasonable. Other statistical models we tested produced no more accurate results than current methods. The variability in refunds and amount of lead-time required make it difficult to forecast sales tax revenues. The short history of local use tax collections makes it difficult to accurately forecast use taxes.

Revenue Estimates Are Based on Analysis and Judgment

The Office of Management and Budget uses trend analysis and judgment to estimate annual growth. The trend analysis is based on five years of monthly data and annual data going back to the beginning of the sale tax in the 1980s. Judgments are based on data from several sources, including local economic projections and state revenue forecasts.

⁸ *Sales Taxes: Electronic Commerce Growth Presents Challenges; Revenue Losses Are Uncertain*, United States General Accounting Office, June 30, 2000.

⁹ Remote sales are purchase orders that are placed by mail, phone, or electronically and do not require the purchaser to visit the seller's premises or the seller to visit the purchaser's premises.

The Office of Management and Budget monitors forecast accuracy throughout the year. The Office of Management and Budget compares actual revenues to projections each month and prepares quarterly analyses comparing actual revenues to estimates.

Refunds and Lead Time Make Forecasting Difficult

Not knowing how refunds will affect revenues makes it difficult to accurately forecast sales tax revenue. The amount of lead time required also makes it difficult to forecast revenues. The Office of Management and Budget needs to prepare annual revenue estimates about 22 months in advance to accommodate the budget cycle. The short history of local use tax collections makes it difficult to accurately forecast use taxes.

We tested two forecasting models; neither produced better results overall. The first model we tested was more accurate than the Office of Management and Budget's method (an error of 0.1% compared to 4.4%) for the fiscal year 2000 estimate. However, our projection for fiscal year 2001 (through November) was less accurate (an error of 3.7% compared to 0.6%). The second model we used produced an error of nearly 20 percent. We did not test models to estimate use tax.

While the Office of Management and Budget's forecasting methods are reasonable, ongoing review of the sales and use tax filing detail available from the state could provide additional information that could be useful in preparing forecasts or explaining why actual collections are above or below forecasts. We recommend the budget officer annually request and review the reports available from the state.

Procedures in Place to Identify Misallocated Taxes, But Business Locations Are Not Verified

The state auditor's review of the Missouri Department of Revenue's internal controls over local sales and use tax collections and disbursements found no material weaknesses. However, neither the state nor the city verifies business location information provided by taxpayers. It is possible that some businesses in Kansas City are paying sales tax to the wrong jurisdiction.

Controls Appear to Be in Place to Identify Misallocated Sales and Use Tax Revenues

The state auditor found no material weaknesses regarding the state Department of Revenue's internal controls over financial reporting in the

most recent audit of sales and use tax collections.¹⁰ The state auditor performs tests that should be adequate to identify misallocated sales and use taxes.

State law requires the state auditor to conduct financial audits of local sales and use tax distributions every year.¹¹ We did not independently review management controls over the state's collection and disbursement of local sales and use taxes. We reviewed state audit reports and audit procedures used in conducting the last three audits.

Business Location Information Is Not Verified

Neither the state nor the city verifies accuracy of business location information provided by taxpayers. If business locations are not correctly reported, sales and use tax revenue could be disbursed to the wrong city. The state recommends that cities ensure a business is properly coded by requiring a business to provide a copy of its retail sales tax license to obtain an occupational license. However, under state statute, the state director of revenue is responsible for administering, collecting, and enforcing sales taxes, including collecting local taxes authorized under statute.¹² The city's commissioner of revenue believes, therefore, that the state should verify business locations as part of its tax administration and enforcement duties.

Site visits point to problems. Half of the 42 businesses we visited either could not produce a state sales tax license or had incorrect information on their license. Each business location should publicly display a state sales tax license showing the address of that location. Four of the businesses we visited had an incorrect address listed. Missouri Department of Revenue staff confirmed that one of these business locations was not registered in their database. This business showed us a photocopy of a sales tax license from an Independence store, with the Kansas City address written in. It is possible that this business is paying sales taxes to Independence. Seventeen locations we visited were unable to show us their state sales tax license.

The city and state should work together. Although the state is responsible for local sales tax administration for which it receives a fee, it is in the city's interest to ensure that businesses within Kansas City are correctly registered and paying taxes to Kansas City. We recommend

¹⁰ *Department of Revenue Division of Taxation and Collection: Sales and Use Tax Two Years Ended June 30, 1998*, Office of the Missouri State Auditor, July 19, 1999.

¹¹ RSMo §32.087.15.

¹² RSMo §32.087.6.

that the Finance director work with the state to develop a procedure to verify that businesses within the city are properly registered with the state.

Recommendations

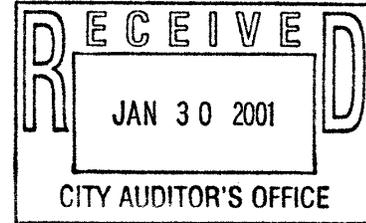
1. The city manager should submit for mayor and Council consideration a resolution to support state legislation that would require vendors to return credits, refunds, and associated interest to the original purchaser.
2. The budget officer should annually obtain and review sales and use tax filing detail and registration data available from the Missouri Department of Revenue.
3. The Finance director should work with the Missouri Department of Revenue to develop and implement a procedure to verify that businesses within the city have proper state sales tax licenses.

Appendix A

Management's Response



Office of the City Manager



DATE: January 30, 2001
TO: Mark Funkhouser, City Auditor
FROM: Robert L. Collins, City Manager *RLC*
SUBJECT: Response to Sales Tax Study Recommendations

Staff have reviewed the draft of your special report on sales tax in Kansas City, Missouri and concur with your conclusions and recommendations. We share your concern with the rising number of refunds and other adjustments that have impacted Kansas City's sales tax revenues and the associated capital improvements program. Following is our response to recommendations one and two. Please refer to the attached response from the Director of Finance regarding the third recommendation.

1. The city manager should submit for mayor and council consideration a resolution to support state legislation that would require vendors to return credits, refunds, and associated interest to the original purchaser.

The city manager will work with the mayor and council to reach consensus regarding support of such legislation.

2. The budget officer should annually obtain and review sales and use tax filing detail and registration data available from the Missouri Department of Revenue.

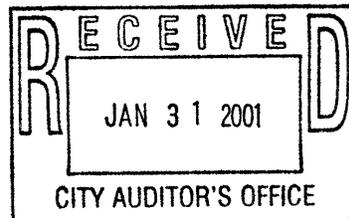
In the summer of 2000, the Office of Management and Budget (OMB) obtained sales and use tax filing detail for the calendar years 1995-1999. This data was provided to the Auditor's Office for analysis in its study. OMB staff also traveled to Jefferson City twice in recent months to discuss concerns about sales tax revenues with State officials. OMB will analyze sales and use tax detail at least annually, if not more often. We will also request that the State notify the city of significant refunds and adjustments before monthly revenue distribution to aid us in short term planning.

Thank you for the opportunity to review and comment on this draft report. OMB has appreciated working with your office on this important report.

cc: Larry Plaisted, Budget Officer



Interdepartmental Communication



DATE: January 30, 2001
TO: Mark Funkhouser, City Auditor
FROM: ^{KR}Kevin Riper, Director of Finance
SUBJECT: Sales Tax Study

I appreciate the opportunity to review and respond to the draft of the Special Report; Sales Tax Study prepared by the City Auditor's Office. The report contains one recommendation directed to the Finance Department. The Finance Department's response to that recommendation is set forth below.

Recommendation Number 3 –The finance director should work with the Missouri Department of Revenue to develop and implement a procedure to verify that businesses within the city have proper state sales tax licenses.

Agree in part

The Finance Department agrees with the City Auditor's conclusion that although the state is responsible for local sales tax administration, it is in the city's interest to ensure that businesses within Kansas City are correctly registered and paying taxes to Kansas City. Therefore, the Finance Department is willing to work with the Missouri Department of Revenue to identify information that the Finance Department can provide to assist the Missouri Department of Revenue to verify that businesses within the city have proper state sales tax licenses.

However, the auditor's recommendation that the Finance Department work with the Missouri Department of Revenue to develop and implement a procedure to verify that businesses within the city have proper state sales tax licenses goes further than providing assistance. This recommendation shifts part of the responsibility for administering local sales tax to the city. The state is currently responsible, and is compensated by the city, for administration of local sales taxes. Therefore, while the Finance Department is also willing to work with the Missouri Department of Revenue toward this goal, the Finance Department believes that the cost to the city of implementing the recommendation should be assessed and that the impact that increasing the resources devoted to sales tax administration will have on the taxes the Finance Department is directly charged with collecting should be taken into account as part of that assessment.

cc: Wanda Gunter, Deputy Director of Finance
Tracy Smedley, Commissioner of Revenue
James Brady, Assistant City Attorney