**Opinion Letter**

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| **Letter Number:** | **O-2000-007** |

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| **Tax Type:** | **Kansas Retailers' Sales Tax** |
| **Brief Description:** | **Franchise fees imposed by a city.** |
| **Keywords:** |  |
| **Approval Date:** | **04/07/2000** |

**Body:**

Office of Policy & Research  
  
  
April 7, 2000

XXXX  
XXXX  
XXXX

RE: Your letter request of April 7, 2000

Dear Mr. XXXX:  
  
I have been asked to respond to your letter that we received today. You ask whether the tax base for Kansas sales tax on your gas billing to customers should include the franchise fee imposed by the City of Spencer.  
  
The department recently litigated whether franchise fees should be included in the tax base under the City of Atchison’s cable franchise agreement. The Kansas Supreme Court upheld our argument that the sales tax base should include the franchise fees. The case is *In re the Tax Appeal of Atchison Cablevision, L.P.*, 262 Kan. 223, 936 P.2d 721 (1997). The outcome of each case that raises these issues will depend on the terms of the municipality’s franchise agreement. While each case depends on the terms of the franchise, our experience suggests that the way most Kansas franchise agreements are written requires the franchise fee to be included in the tax base on which Kansas sales tax is computed.  
  
Whether the tax base for state sales tax includes other excise taxes has been the subject of frequent Constitutional litigation over the perceived tax on a tax. This has led to a straightforward test for analyzing whether fees like the franchise fee should be included in the tax base for sales tax. The test asks the following questions: (1) Does the legal incidence of the Kansas retailer’s sale tax fall upon the retailer or the consumer?, (2) Does the legal incidence of the franchise fee fall upon the retailer or the consumer?, and (3) Does the sales tax act allow the franchise fee to be deducted from the tax base for sales tax? If the retailers’ sales tax act does not specifically exclude franchise fees from the tax base and if the franchise fee falls on the retailer and the sales tax on the consumer, then the franchise fee may properly be included in the sales tax base for sales tax.  
  
United States Supreme Court decisions provide the test for determining where the legal incidence of a tax falls. The location of the economic impact for the tax does not fix the legal incidence of a tax. It is only if the state imposes a legal obligation on the purchaser either to pay the tax, or to reimburse the vendor for the tax payment, that the legal incidence of the tax fall on the purchaser. In Gurley v. Rhoden, 421 US 200, 204-5 (1975), the United States Supreme Court explained:

The economic burden of taxes incident to the sale of merchandise is traditionally passed on to the purchasers of the merchandise. Therefore, the decision as to where the legal incidence of either tax falls is not determined by the fact that petitioner, by increasing his pump prices in the amounts of the taxes, shifted the economic burden of the taxes from himself to purchaser-consumer. The court has laid to rest doubts on that score raised by such decisions as Panhandle Oil Co. v. Mississippi ex rel. Knox, 277 US 218 (1928); Indian Motorcycle Co. v. United States, 283 US 570 (1931); and Kern-Limerick, Inc. v. Scurlock, 347 US 110 (1954), at least under taxing schemes, as here, where neither the statutes required petitioner to pass the tax on to the purchaser-consumer. See Alabama v. King & Boozer, 314 US 1 (1941); Lash’s Products Co. v. Lumber Co. v. United States, 281 US 572 (1930); Agricultural Nat. Bank v. Tax Comm’n, 392 US 339 (1968); American Oil Co. v. Neill, 380 US 451 (1965).

Gurley v. Rhoden, id. instructs that the legal incidence of the tax falls on the consumer if: (1) the state has imposed a legal obligation on the consumer to pay the tax or; (2) the state has required the consumer to reimburse the retailer for the tax paid. As the Supreme Court stated in United States v. Mississippi Tax Comm’n., 421 US 599, 608 (1975):”[T]he controlling significance of First Agricultural Bank for our purposes is the test formulated by that decision for the determination where the legal incidence of the tax falls, namely, that where a State requires that its sales tax be passed on to the purchaser and be collected by the vendor from him this establishes as a matter of law that the legal incidence of the tax fall upon the purchaser.” (Emphasis supplied).  
  
The Kansas retailers’ sales tax requires that the tax “shall be paid by the consumer” and “shall be a debt from the consumer or user to the retailer.” K.S.A. 79-3604. The act requires “every retailer in the state to collect from the consumer or user, the full amount of the tax.” K.S.A. 79-3604. The act makes it unlawful for the retailer to state that the tax will be assumed or absorbed by the retailer. K.S.A. 79-3605. The act does not allow the franchise fee to be deducted from the tax base. See K.S.A. 79-3606(a). The Kansas retailers’ sales tax act requires that the tax be passed on to the purchaser and be collected by the vendor. Thus, as a matter of law, the legal incidence of the Kansas retailers’ sales tax fall on the purchaser/ consumer.  
  
Determining where the legal incidence of the franchise fee falls requires the same type of analysis that was applied to the retailers’ sales tax act. In your case, the wording of the ordinance in question will establish whether the legal incidence of the gas fee falls upon them your company or on the consumer. As noted in the first paragraph, the department of revenue has reviewed many of municipal franchise agreements from different Kansas communities. Our nearly universal findings are that these fees are not imposed on the consumer but are simply a cost imposed on the franchise provider that the franchise provider passes on to the customer as a line item on the customer billing. This makes these fees subject to sales tax. Since we issued a specific ruling to you in the past, I assume that the ruling was based on the wording of the Spencer ordinance that grants the franchise to your business. You can easily confirm this by reviewing the ordinance itself. The ordinance probably requires Greenley Gas to pay the fee, and probably does not provide a cause of action for Greenley to collect the fee from the customer. Greenley cause of action for collecting the fee is simply that the customer billing has not been paid in full. Similarly, the City of Spencer has recourse only against your business for the fee and not against the final consumer.  
  
Please feel free to contact me at (785) 296-3081 if you need to discuss this matter further.

Sincerely,  
  
  
  
Thomas E. Hatten  
Attorney/Policy & Research

**Date Composed: 04/19/2000 Date Modified: 10/10/2001**