



COLORADO
Department of Revenue

Executive Director's Office

Physical Address:
1375 Sherman Street
Denver, CO 80203

Mailing Address:
P.O. Box 17087
Denver, CO 80217-0087

Dianne E. Ray, CPA, MPA
Colorado Office of the State Auditor
State Services Building
1525 Sherman St., 7th Floor
Denver, CO 80203

Introduction

The Office of the State Auditor completed a performance audit of the Department of Revenue's local sales tax administration in November, 2015. The audit's primary recommendation was to have the Department of Revenue (Department) explore the feasibility of creating a state-owned and -managed geographic-information system (GIS)-based mapping application capable of plotting business site addresses, determining applicable sales tax jurisdictions, and determining corresponding GenTax location codes. The audit also requested the Department evaluate:

1. The effectiveness of the currently available certified databases in mitigating the risk of businesses incorrectly determining local sales tax liabilities given the databases' actual rate of use, costs, and the needs of businesses;
2. The feasibility and cost of using the mapping application the Department develops in response to recommendation 1 (of the audit) to develop a state-managed database;
3. The ability of such state-managed database to satisfy the requirements of HB 13-1295; and
4. Whether legislative changes are necessary to provide a state-managed database in lieu of the current process of certifying private database providers.

In response to [Quill v North Dakota](#), a United States Supreme Court decision from 1992 that limits a state's ability to collect sales tax on tangible personal property sold from vendors that do not have a physical presence, or nexus, in the state, the United States Congress is considering legislation commonly known as the Marketplace Fairness Act. This legislation addresses the key conclusion in the Supreme Court's Quill decision - that Congress can overturn the decision with explicit action - and will allow states to collect sales tax on tangible personal property sold by businesses with no nexus in the state.

In order to enact the provisions of the federal legislation, states need to act independently, either: (1) as a member of the streamlined sales and use tax agreement, or (2) with an alternative. Colorado is not a party to the streamlined sales and use tax agreement, and the General Assembly, acting in the alternative, prepared the state for the passage of the Marketplace Fairness Act with HB 13-1295. The bill requires the Department to "provide information to remote sellers that indicates the taxability of products and services along with any product and service exemptions from sales tax in the state. The Department of Revenue shall also provide to remote sellers a sales tax rate database and a database of local taxing jurisdiction boundaries."¹

Additionally, the bill allows the Department to contract with one or more certified software providers to:

- Make available, free of charge, software that calculates sales tax due on each transaction at the time the transaction is complete;

¹ HB 13-1295, page 10.

- Files sales tax returns, and,
- Updates to reflect any tax rate changes for the state or any local taxing jurisdiction.

This report summarizes the Department's actions to satisfy the audit recommendations and provides an update on the outcome the Department is moving toward.

Effectiveness of Currently Available Databases

The Department certified two databases, beginning in 2007, for citizen and business community use to determine the correct tax rate by address. These databases were recertified in two-year increments until 2016, at which point, the Department asked them to recertify with updated statistical testing methodology. Concurrently, the Department developed an anonymous survey for the historical database providers to circulate among their clients, since the Department does not have a way to independently track business utilization of these products. The survey was developed to assess the effectiveness of the currently available certified databases in mitigating the risk of businesses incorrectly determining local sales tax liabilities given the databases' actual rate of use, costs, and the needs of businesses, as directed in recommendation 3 of the audit.

The Department sent the survey to the two certified databases in August. One, Core Logic, responded that they were no longer interested in participating as a hold harmless database. Since receiving that notification, the Department has decertified their product and removed them from our list of databases. The other, Pitney Bowes, responded that they could not participate in the survey for business reasons. As a result, the Department is unable to determine the effectiveness of these databases as suggested by the audit.

Attached to this report, as Appendix 1, is the survey intended for Pitney Bowes and their clients.

Feasibility and Cost of a State Managed Database

The Department explored two alternatives for a database capable of plotting address: (1) a state-managed and owned GIS system developed and maintained with assistance from the Office of Information Technology (OIT); and (2) a system capable of returning map-based information developed by a third party.

It is the department's view that developing and allocating resources to a state-owned GIS system is not a preferred alternative. We come to this conclusion for several reasons. First, the General Assembly previously established its desire to utilize the private sector's technology expertise with plotting and mapping addresses to determine the correct tax rates for businesses and consumers. In 2004, the Department was directed to certify private databases capable of identifying the correct tax rate by address. As previously mentioned, the Department certified two companies to provide hold harmless databases beginning in 2007. Building on this model is more efficient and takes advantage of the strengths of the Department, via a strong statistical sampling method, and that of the private sector, via years of developing databases that can meet the requirements of the Streamlined Sales Tax Agreement and the Marketplace Fairness Act.

Second, a state-owned database will only replicate, at this point, what the private sector can offer at a cost to the state that is minimal compared to the development and maintenance costs that the state would incur. Moreover, the address data covered by OIT's system does not include information for 14 counties, or an estimated 5-10% of addresses. Thus, time and resources must be devoted to getting a state-managed database to the point where the private sector already is, and it is our view that state resources can be deployed to greater effect elsewhere.

A state owned and operated database requires resources to maintain, whereas a solution offered by the private sector will not. The Office of Information Technology (OIT) estimates that it will cost

approximately \$210,000 and 2.5 FTE. Additionally, the Department will need to increase its support staff at the call center in order to offer technical support to businesses. The Department estimates that this will cost approximately \$198,000 and 6.0 FTE. With a private sector solution, the Department will certify databases as accurate and leverage some of these companies to develop mapping applications for the public to use.

Finally, there are seven databases that are currently certified by the Streamlined Sales and Use Tax Agreement. Certification from SSUTA means that a database is accurate for tax rate and jurisdiction boundaries. By certifying them in Colorado, the Department is leveraging the work done by the consortium of streamlined sales tax vendors. These providers, in some cases, have powerful mapping tools available to the public. Since July, the Department certified four databases as hold harmless vendors. In order to be certified, the databases must be at least 95% accurate. This threshold for accuracy exceeds the state database of addresses because of the missing addresses in 14 counties.

During discussions with one of the most recent companies to be certified, the Department mentioned its goals for a system that can plot addresses, determine applicable sales tax jurisdictions, and determine location codes from GenTax. After certification, the company built a web utility capable of determining applicable taxing jurisdictions, their corresponding rates, and the GenTax location code for the address. The Department is working with this company to get a mapping application, which will satisfy the last piece of the audit's recommendation.

Solutions are present in the marketplace. By proceeding in this direction and certifying the databases as accurate, the Department can leverage their solutions for a public purpose.

State Managed Database and HB 13-1295

HB 13-1295 essentially compels the Department to certify those companies that are the certified software providers of the Streamlined Sales and Use Tax Agreement, of which the State of Colorado is not a party to. Audit recommendation 3A asks the Department to consider the ability of a state-managed database to satisfy the requirements identified in the introduction. Any state developed and managed database will be able to identify the tax rate database and local taxing jurisdiction boundaries. However, such a database will not be able to perform the other three functions delineated in the bill and bulleted above.

The Department believes that devoting state resources to address a portion of the requirements in HB 13-1295 will not result in the best solution.

Need for Legislative Changes

As currently written, the Department feels that HB 13-1295 is sufficient to allow out-of-state vendors with no nexus in Colorado the best opportunity to collect and remit Colorado sales tax. It does not recommend any changes to the law and believes that the private sector software packages currently available offer the best products at the lowest cost to create and maintain.

Address Lookup Survey from Colorado Department of Revenue

This short survey is being sent on behalf of the Colorado Department of Revenue. It should take you less than 10 minutes to complete. Your answers will remain anonymous and your contact information is not being collected.

1. How much do you pay per month to use the Address Lookup Service? *

- Do not pay
- \$1 - \$500
- \$501 - \$1,000
- \$1,001 - \$5,000
- \$5,001 - \$10,000
- more than \$10,000
- Unsure of exact amount
- Other: _____

2. How many times per month do you use the Address Lookup system to look up an address in Colorado? *

- Never
- 1-25
- 26-100
- 101-250
- 251-750
- 751-1,000
- Over 1,000
- Other: _____

3. On a scale of 1-5 (1=very unsatisfied and 5=very satisfied), how would you rate your overall satisfaction level with the Address Lookup service? *

1 2 3 4 5

Very Unsatisfied ● ● ● ● ● Very Satisfied

4. On a scale of 1-5 (1=very difficult and 5=very easy), how would you rate the ease of use of the Address Lookup system? *

1 2 3 4 5

Very Difficult ● ● ● ● ● Very Easy

5. How often does a customer dispute with you the sales taxes you collect based on the Address Lookup system rates? *

- Never
- Once
- Rarely
- Sometimes
- Often
- Always

6. Please tell us about your experience, if any, when audited by the State of Colorado or a Colorado home-rule city in the past three years. *

Please check all that apply. If you mark "Other" option, please specify.

- Not audited in the last three years
- Audited, but do NOT regularly use the Address Lookup System.
- Audited, regularly use the Address Lookup System and all transactions were taxed correctly.
- Audited, some transactions taxed incorrectly, but use of the Address Lookup System protected us from owing additional tax.
- Audited, some transactions taxed incorrectly, but the city does not allow waivers for using the Address Lookup System.
- Other: