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February 28, 2017

DIANNE E. RAY, CPA
STATE AUDITOR

DEPARTMENT OF REVENUE – LOCAL SALES TAXES (NOVEMBER 2015) – STATUS REPORT

Members of the Legislative Audit Committee:

Attached is the status report from the Department of Revenue (Department) on the implementation of recommendations contained in the Office of the State Auditor's (OSA) *Department of Revenue – Local Sales Taxes* performance audit.

OSA REVIEW OF DOCUMENTATION

As part of the status report process, we requested and received supporting documentation for each recommendation that the Department reported as having been implemented. Specifically, we reviewed the following documentation:

- Local sales tax look-up and mapping software provided by vendors certified by the Department and available to the public online.
- Notices sent by the Department to a sample of businesses, found to be incorrectly registered during the audit, informing the businesses that their registration information had been corrected.
- A sample of emails the Department sent to home rule jurisdiction administrators notifying them of businesses potentially registered in error as identified in the audit.

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- Updated Department tax forms on local sales taxes and a new electronic crosswalk showing the relations between jurisdictions and location codes.
- A December 2016 report (attached) prepared by the Department describing its evaluation of options for providing improved resources for businesses to use to determine their sales tax liabilities.
- Draft rules related to ensuring the accuracy of vendors certified by the Department to provide local sales tax information to businesses.
- A local government contacts tracking spreadsheet created by the Department to record information related to inquiries, complaints, and requests handled by its local government liaison office.

Based on our review, the supporting documentation substantiates the Department's reported implementation status.



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February 23, 2017

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

Dear Auditor Ray:

In response to your request, we have prepared an updated status report regarding the implementation of audit recommendations contained in the 2015 Local Sales Taxes Performance Audit. The attached report provides a brief explanation of the actions taken by the Department of Revenue to implement each recommendation.

If you have any questions, please do not hesitate to contact me at (303) 866-2344 or by email at Matthew.Scott@state.co.us.

Sincerely,

Matthew Scott
Senior Director of Taxation
Colorado Department of Revenue

AUDIT RECOMMENDATION STATUS REPORT

AUDIT NAME: Local Sales Taxes

AUDIT NUMBER: 1422P

DEPARTMENT: Department of Revenue

DATE OF STATUS REPORT: 2/23/2017

SUMMARY INFORMATION

Rec. Number	Agency's Response	Original Implementation Date	Implementation Status	Revised Implementation Date (If applicable)
1A	Agree	November 2016	Implemented	
1B	Agree	July 2019	Partially Implemented	July 2017
1C	Agree	July 2019	Partially Implemented	July 2017
1D	Agree	July 2016	Implemented	
1E	Agree	December 2016	Implemented	
2A	Agree	July 2019	Partially Implemented	July 2017
2B	Agree	July 2019	Partially Implemented	July 2017
2C	Agree	May 2016	Implemented	
2D	Agree	July 2016	Implemented and Ongoing	
3A	Agree	November 2016	Implemented	
3B	Agree	November 2016	Implemented	
4A	Agree	December 2016	Partially Implemented	July 2017
4B	Agree	January 2017	Partially Implemented	July 2017
5A	Agree	February 2016	Implemented and Ongoing	
5B	Agree	February 2016	Implemented and Ongoing	
5C	Agree	February 2016	Implemented and Ongoing	
5D	Agree	August 2016	Implemented and Ongoing	

DETAIL OF IMPLEMENTATION STATUS

Note: The Department agreed with all of the audit recommendations.

Recommendation No. 1:

The Department of Revenue should improve the accuracy of local sales tax collections and license registrations by:

- A. Identifying and estimating the cost of options for obtaining a geographic-information-system (GIS)-based mapping application, or a system that uses similar mapping technology, that is capable of plotting business site addresses and determining applicable sales tax jurisdictions and corresponding GenTax location codes. Among the options to consider, the Department should evaluate the feasibility of collaborating with the Office of Information Technology (OIT) and the Department of Local Affairs (DOLA) to develop an in-house system. Based on the cost estimates, the Department should then choose a cost-effective option to pursue.

Current Implementation Status for Rec. 1, part a: Implemented.

Agency's Update:

The Department considered several options for this recommendation. Based on the analysis submitted to the Legislative Audit Committee pursuant to Recommendation 3, we chose to partner with vendors that are a part of the streamlined sales tax consortium to deliver a mapping application capable of plotting addresses, determining applicable jurisdictions and their tax rates, and returning GenTax location codes. No budget action is needed for this alternative.

- B. Pursuing to obtain the mapping application chosen in response to PART A—either through procurement or by collaborating with OIT and DOLA for development—and using the application to register all new business sites for sales tax licenses.

Current Implementation Status for Rec. 1, part b: Partially Implemented

Agency's Update:

Based on our decision to partner with the private sector, the Department of Revenue does not need to work with other state agencies to deliver the application described in the recommendation. However, we are writing procedures to utilize the application we chose to register new businesses. We anticipate this recommendation to be fully implemented by July 2017.

- C. Implementing a process to conduct periodic reviews of the registrations for physical business sites with active sales tax accounts in GenTax using the mapping application acquired in PART B.

Current Implementation Status for Rec. 1, part c: Partially Implemented

Agency's Update:

The Department is writing procedures to not only review businesses currently registered with the Department, but also to use when registering new businesses as discussed in 1B. Once implemented, these procedures will define DOR's process for using the vendor provided mapping application for reviewing and registering businesses. We anticipate this recommendation to be fully implemented by July 2017.

- D. Reviewing the sales tax licenses we found to be probably in error and, for those business sites the Department confirms are registered incorrectly, correcting registrations. For those businesses that the Department determines did not collect the proper amount of sales taxes, the Department should follow the appropriate process as defined in statutes.

Current Implementation Status for Rec. 1, part d: Implemented

Agency's Update:

The Department implemented this recommendation in July, 2016. We verified the list of exception registrations provided by the Office of the State Auditor staff by searching through the applicable county assessor's website. This verification allowed the department to submit a list of businesses that required new registrations to our system for an automated update. New licenses were printed during the first week of July.

- E. Notifying home-rule municipalities that collect their own sales taxes about each of the businesses we identified that appear to be misregistered with respect to their jurisdictions, including those that are located inside but are registered as being outside and vice versa.

Current Implementation Status for Rec. 1, part e: Implemented

Agency's Update:

The Department emailed each home-rule jurisdiction the list of businesses identified in the audit as potentially misregistered to assist us in the verification process. As we hear back from these jurisdictions, we will update our system as necessary.

Recommendation No. 2:

The Department of Revenue (Department) should ensure that its location code system is complete, understandable, and accurately communicated to Department staff, local governments, and the public by:

- A. Developing and regularly updating a map of local sales tax jurisdictions that shows the boundaries of each jurisdiction using the mapping application recommended in RECOMMENDATION 1 and working with local governments to validate the map.

Current Implementation Status for Rec. 2, part a: Partially Implemented

Agency's Update:

The Department has chosen to partner with vendors to deliver a mapping application capable of plotting addresses, determining applicable jurisdictions and their tax rates, and returning GenTax location codes at no cost to the State as detailed in our response to recommendation 1A. As a result of this approach, the Department does not control the mapping capabilities of the vendor provided solution. However, the Department will publish updated certification rules as detailed in recommendation 4A which will serve as the basis for ongoing evaluations of the accuracy of certified vendors. We anticipate this recommendation to be fully implemented by July 2017.

- B. Periodically reviewing the results of the process for mapping business addresses and assigning location codes using the mapping application recommended in RECOMMENDATION 1 to determine whether all geographic regions and jurisdictional combinations are accounted for in the location code system.

Current Implementation Status for Rec. 2, part b: Partially Implemented

Agency's Update:

We recently completed a review of location codes in Douglas County, a particularly troublesome area identified in the audit. By working with county staff, we refined the coding system and eliminated unnecessary codes from GenTax. We plan on using this process developed as a way to move forward with other jurisdictions while we explore how we can use the application to assist us in this process. Additionally, rate and location code updates are provided to the certified database vendors on a semi-annual basis. We anticipate this recommendation to be fully implemented by July 2017.

- C. Creating a new form to serve as a crosswalk for Forms DR 0800 and DR 1002 that shows the relations between jurisdictions and location codes.

Current Implementation Status for Rec. 2, part c: Implemented

Agency's Update:

The Department created a crosswalk between the DR 1002 and DR 800. This form is located on our website: <https://www.colorado.gov/pacific/tax/sales-and-use-tax-rates-lookup>. We designed

this form to be a downloadable spreadsheet that businesses and software vendors can use to their benefit. It is updated twice a year for tax rate or law changes that can occur in either January or July.

- D. Implementing a regular process for systematically comparing the list of location codes and descriptions published in Form DR 0800 against the corresponding tables in GenTax and resolving any discrepancies.

Current Implementation Status for Rec. 2, part d: Implemented and Ongoing

Agency's Update:

As indicated in the update to Recommendation 2C, the department updates this form twice a year to coincide with changes to local tax rates and laws. The Department utilizes the DR 0800 to identify and resolve any discrepancies identified during the update process. Currently, the two most recent versions of the crosswalk are available (July – December 2016 and January – June 2017).

Recommendation No. 3:

The Department of Revenue should ensure that businesses have access to adequate resources for determining applicable sales tax jurisdictions and rates for sales occurring at customers' locations by:

- A. Evaluating whether it should develop a state-managed, certified database that businesses could use free of charge to determine their sales tax liabilities. The evaluation should include an assessment of (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 to develop a state-managed database; (3) the ability of such state-managed database to satisfy the requirements of House Bill 13-1295, pending enactment of the federal Marketplace Fairness Act; and (4) whether legislative changes are necessary to provide a state-managed database in lieu of the current process of certifying private database providers.

Current Implementation Status for Rec. 3, part a: Implemented

Agency's Update:

The Department evaluated several options: developing a state-owned and –managed database; engaging a vendor to database; and partnering with vendors that are certified as hold-harmless databases to provide rate look-up information and a mapping application. We determined that partnering with vendors certified as hold-harmless databases is the best option, and we submitted a report to the Legislative Audit Committee in December, 2016.

- B. Reporting the results of the evaluation for PART A to the Legislative Audit Committee.

Current Implementation Status for Rec. 3, part b: Implemented

Agency's Update:

As mentioned above, the Department submitted its report to the Legislative Audit Committee in December, 2016.

Recommendation No. 4:

As necessary based on the results of its evaluation in RECOMMENDATION 3, the Department of Revenue should ensure that businesses have access to accurate databases for determining applicable sales tax jurisdictions and rates for sales occurring at customers' locations by:

- A. Revising the Department's rules for certifying database providers to (1) give specific direction to verifiers regarding the source or quality of data they should use to check the accuracy of databases; (2) establish sound techniques for calculating accuracy; (3) require certifications to expire every three years, as required by statute; and (4) outline procedures for re-certifying providers after certifications have expired. If, based on RECOMMENDATION 3, the Department develops a state-managed database, it should revise its rules to establish similar requirements for ensuring the accuracy of the database.

Current Implementation Status for Rec. 4, part a: Partially Implemented

Agency's Update:

The Department has revised the rules for certifying database providers as outlines in the recommendation. The Department's process for rule changes and updates requires us to hold stakeholder meetings prior to publishing a draft rule for comment. The stakeholder meeting for this rule was held on September 7, 2016. The draft rule was updated to reflect statements made in that meeting. Feedback was solicited and received on January 6, 2017. A formal hearing at the Secretary of State is scheduled for March. That time frame will result in a final rule being published by the end of July. Therefore, we anticipate this recommendation to be fully implemented by July 2017.

- B. Requiring currently certified providers to re-apply for certification under the rules developed for PART A

Current Implementation Status for Rec. 4, part b: Partially Implemented

Agency's Update:

Based on the direction the Department chose for a GIS system and the expressed desire of software companies representing the streamlined sales tax consortium to become certified, the Department decertified one vendor and certified three vendors during 2016 using the existing certification criteria. While this does not align with how this recommendation is written, a business need

existed to certify databases while the Department updated the certification criteria through the rule-making process. The certified databases will be recertified using standards created in the new rule upon their expiry date. We anticipate this recommendation to be fully implemented by July 2017.

Recommendation No. 5:

The Department should improve the efficiency and effectiveness of its services for local governments related to sales tax administration by:

- A. Instituting a system for recording local government inquiries, requests, and complaints in an electronic format, such as a searchable database or spreadsheet, that can be systematically measured and analyzed.

Current Implementation Status for Rec. 5, part a: Implemented and Ongoing.

Agency's Update:

The Department created a spreadsheet to track inquiries, requests, and complaints in February, 2016. We summarize inquiries by jurisdiction and by issues.

- B. Monitoring the timeliness of responses to local government inquiries, requests, and complaints

Current Implementation Status for Rec. 5, part b: Implemented and Ongoing.

Agency's Update:

Our tracking system identifies both the inquiry date and resolution date. The spreadsheet is analyzed to monitor the timeliness of responding to inquiries, requests, and complaints.

- C. Regularly analyzing local government contacts by type to identify and address possible systemic problems and inefficiencies and to target outreach and trainings to issues and areas that are most in need.

Current Implementation Status for Rec. 5, part c: Implemented and Ongoing.

Agency's Update:

The Department regularly analyzes the tracking spreadsheet to characterize issues as they arise; however, our experience shows that most inquiries are not systemic in nature. Rather, they are based on isolated issues. Additionally, the Department continues to provide training and outreach to local jurisdictions, and incorporates areas of improvement identified by the local government contacts as they arise.

- D. Setting benchmarks and goals for reducing the number of inquiries, requests, and complaints received from local governments that are either commonly occurring or can be better addressed through more proactive measures.

Current Implementation Status for Rec. 5, part d: Implemented and Ongoing

Agency's Update:

The Department establishes goals for our local government liaison section. Those goals include performing training and outreach to local governments both in-person and through training materials available to local government staff. Feedback provided by local government contacts is incorporated into training and outreach materials updates as it is identified. Based on our review of the feedback received to date, we found that training is the most pressing need for the local government contacts. We also identified some revenue reporting enhancements based on feedback from local jurisdictions and will incorporate that feedback into the next update the reports.



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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: