

# COLORADO OFFICE OF THE STATE AUDITOR



DEPARTMENT OF REVENUE

## LOCAL SALES TAXES



NOVEMBER 2015

PERFORMANCE AUDIT

THE MISSION OF THE OFFICE OF THE STATE AUDITOR  
IS TO IMPROVE GOVERNMENT  
FOR THE PEOPLE OF COLORADO

## LEGISLATIVE AUDIT COMMITTEE

Senator Lucia Guzman – Chair      Representative Dan Nordberg – Vice-Chair

Senator Chris Holbert  
Senator Cheri Jahn  
Senator Tim Neville

Representative Dianne Primavera  
Representative Su Ryden  
Representative Lori Saine

## OFFICE OF THE STATE AUDITOR

Dianne E. Ray      State Auditor

Monica Bowers      Deputy State Auditor

Trey Standley      Audit Manager  
Christopher Harless      Team Leader  
Heidi Wagner      Staff Auditors  
Torry van Slyke

AN ELECTRONIC VERSION OF THIS REPORT IS AVAILABLE AT  
[WWW.STATE.CO.US/AUDITOR](http://WWW.STATE.CO.US/AUDITOR)

A BOUND REPORT MAY BE OBTAINED BY CALLING THE  
OFFICE OF THE STATE AUDITOR  
303.869.2800

PLEASE REFER TO REPORT NUMBER 1422P WHEN REQUESTING THIS REPORT



# OFFICE OF THE STATE AUDITOR



November 20, 2015

DIANNE E. RAY, CPA  
—  
STATE AUDITOR

Members of the Legislative Audit Committee:

This report contains the results of a performance audit of the Department of Revenue's administration of local sales taxes for counties, municipalities, special districts, and combined authorities. The audit was conducted pursuant to Section 2-3-103, C.R.S., which authorizes the State Auditor to conduct audits of all departments, institutions, and agencies of state government. The report presents our findings, conclusions, and recommendations, and the responses of the Department of Revenue.

OFFICE OF THE STATE AUDITOR  
1525 SHERMAN STREET  
7TH FLOOR  
DENVER, COLORADO  
80203

303.869.2800





# CONTENTS



Report Highlights	1
CHAPTER 1	
OVERVIEW OF LOCAL SALES TAX	3
Local Sales Tax Administration	4
Local Sales Tax Process	7
Program Funding and Expenditures	8
Audit Purpose, Scope and Methodology	9
CHAPTER 2	
LOCAL SALES TAX ADMINISTRATION	13
Sales Tax License Registrations	14
RECOMMENDATION 1	31
Design and Management of the Location Code System	34
RECOMMENDATION 2	47
Assistance for Businesses	49
RECOMMENDATION 3	59
RECOMMENDATION 4	61
Local Government Services	63
RECOMMENDATION 5	69
APPENDIX A	
ESTIMATED ERRORS IN SALES TAXES— CALENDAR YEAR 2014	A-1
APPENDIX B	
SUMMARY OF FINDINGS RELATED TO THE SMART GOVERNMENT ACT	B-1



# REPORT HIGHLIGHTS



## LOCAL SALES TAXES PERFORMANCE AUDIT, NOVEMBER 2015

DEPARTMENT OF REVENUE

### CONCERN

The Department of Revenue (Department) can improve its administration of local sales taxes by developing geographic-information-system (GIS) resources to ensure that businesses are properly registered to the applicable local tax jurisdictions and to assist businesses in determining the amount of sales taxes that should be applied to sales in each location.

### KEY FACTS AND FINDINGS

- The Department likely did not register 11,070 of the 103,836 retail business sites we reviewed (11 percent) to the proper local jurisdictions based on addresses provided to the Department on their sales tax license applications. Of these, about 3,750 sites were likely misregistered for jurisdictions where the Department collects sales taxes, which we estimate resulted in about \$3.3 million in over-collections and \$3.8 million in under-collections during Calendar Year 2014.
- The Department's system for coding and tracking tax jurisdictions was not complete for nine geographic areas in the state and uses place names that can be difficult to understand. Further, the Department's published forms providing information on taxing jurisdictions were not complete and accurate.
- The Department has not developed a map or other GIS-based tools to determine whether businesses are properly registered to the applicable taxation districts, which is essential for ensuring that they remit the appropriate amount of sales taxes.
- Database providers certified by the Department to provide businesses with tax jurisdiction look-up services based on addresses may not be fulfilling the General Assembly's intent under Section 39-26-105.3, C.R.S., to provide a means for businesses to accurately determine their sales tax liabilities. Specifically, the Department has not verified the databases' accuracy every 3 years as required, and lacked a reliable method for verifying their accuracy. In addition, the providers may be costly for some businesses, and according to the Department, some businesses are using non-certified providers.
- In our survey of local government administrators, 91 percent of respondents reported satisfaction with the Department's outreach efforts. However, we found that the Department receives a high volume of contacts from local governments and could improve the system it uses to track contacts and ensure timely responses.

### BACKGROUND

- The Department is responsible for collecting and administering sales taxes for 223 local governments and combined authorities, such as counties, cities, and special districts.
- The Department uses the same process for local sales taxes as it does for the state sales tax and maintains a coding system to track the sales taxes that apply to each business location.
- Home-rule jurisdictions collect and administer their own sales taxes unless they have requested that the Department do so.
- During Calendar Year 2014 the Department collected \$1.3 billion in net sales taxes on behalf of local governments.
- The Department collected sales taxes from 91,303 businesses in Calendar Year 2014.

### KEY RECOMMENDATIONS

The Department should:

- Develop GIS tools to assist its staff in registering businesses to the correct local tax jurisdictions, correct the registrations of businesses we identified to be registered in error, and conduct periodic reviews of registrations.
- Using GIS tools, ensure that its system for tracking local jurisdictions' boundaries and tax rates is complete, understandable, and accurately communicated to the public.
- Ensure that businesses have access to adequate resources for determining applicable sales taxes by evaluating the potential to create a state-managed database that would provide this information and ensuring that the process it uses to certify databases is reliable and conducted in accordance with statute.
- Develop an electronic tracking system for local government contacts to better analyze contacts and monitor its timeliness.

The Department of Revenue agreed with these recommendations.



# CHAPTER 1

## OVERVIEW OF LOCAL SALES TAXES

In Colorado, local governmental entities, such as cities, counties, special districts, local improvement districts (LIDs), and regional transportation authorities (RTAs), can institute local sales taxes on retail sales within their boundaries. Local sales taxes are applied in addition to the State's sales tax, and state law allows local governments to set their own tax rates, subject to approval by the voters within their boundaries. Currently, local sales taxes are levied in a complex nexus of 297 overlapping tax jurisdictions, each with its own sales tax rate and set of allowable exemptions.



According to statute [Section 29-2-106(1), C.R.S.], the Department of Revenue (Department) is responsible for collecting, distributing, and enforcing local sales taxes for most local governments in the state. During Fiscal Year 2014, the Department collected about \$1.3 billion in net local sales taxes and (for some special districts) use taxes.

## LOCAL SALES TAX ADMINISTRATION

The Department, businesses, and local governments share responsibility for administering the state's local sales taxes. Coordination between each of these entities is critical for ensuring the accurate collection and distribution of sales taxes.

THE DEPARTMENT plays a central role in administering local sales taxes and ensuring that local governments receive the correct amount of sales tax revenue. One of the Department's primary responsibilities is registering businesses through the issuance of sales tax licenses. Through the registration process, the Department determines the local sales tax rates applicable to each business based on its address, and establishes a sales tax account for the business within its tax processing system, GenTax. To facilitate the determination of applicable local sales tax rates, the Department has implemented a system of about 1,100 location codes that represent geographic regions of the state and the local sales taxes associated with each region. The Department assigns each business site with a location code at the time of registration, which the Department can then use to ensure the business collects and remits the appropriate amount based on its address and taxable sales revenues. Further, to assist businesses in determining the applicable sales tax jurisdictions and associated rates for sales in each location of the state, the Department has certified two database providers in accordance with House Bill 04-1237 to provide this information to businesses.

The Department is responsible for collecting and distributing sales taxes for all counties; statutory municipalities incorporated under Sections 31-1-203 and 31-4-101, et seq., C.R.S.; special districts; and combined authorities composed of counties, municipalities, and/or special districts that have instituted a sales tax. Home-rule

municipalities that operate under Article XX of the Colorado State Constitution and are incorporated under Sections 31-1-202 or 31-2-201, et seq., C.R.S., administer their own sales taxes unless they have requested that the Department administer their sales taxes in accordance with Section 29-2-106(4)(a)(I), C.R.S. Home-rule municipalities that collect their own sales taxes are responsible for licensing businesses separately from the state licensing process, and for the collection, processing, and enforcement of local sales taxes within their jurisdictions. As of June 2015, pursuant to statute the Department administered local sales taxes for the following jurisdictions:

- 152 municipalities, of which 27 are home-rule [Section 29-2-102, C.R.S.]
- 50 counties [Section 29-2-103, C.R.S.], including three that have county-wide mass transportation taxes, 28 that have county lodging taxes, and one that has a public safety improvement tax [Sections 29-2-103.5(1), 30-11-107.5(1), 30-11-107.9(2), C.R.S.]
- 5 county local improvement districts [Section 30-20-604.5, C.R.S.]
- The Regional Transportation District [Section 32-9-119(2), C.R.S.]
- The Scientific and Cultural Facilities District [Section 32-13-110, C.R.S.]
- 3 metropolitan special districts [Section 32-1-1106, C.R.S.]
- 5 regional transportation authorities [Section 43-4-604(1)(j)(I), C.R.S.]
- 5 local marketing districts [Section 29-25-112(1), C.R.S.]
- 1 multi-jurisdictional housing authority [Section 29-1-204.5(3)(f.1), C.R.S.]

The Department also provides training and support to businesses, responds to local government inquiries and complaints, and conducts enforcement activities, such as field audits and follow-up with delinquent taxpayers.

**BUSINESSES** that make retail sales or provide services that are subject to sales tax must obtain a sales tax license from the Department [Section 39-26-103, C.R.S.]. Such businesses are responsible for collecting all applicable sales taxes from customers, completing sales tax return

forms, and remitting sales taxes to the Department and to any applicable home-rule jurisdictions. In addition to collecting the state sales tax, businesses are required to collect all local sales taxes that apply to each sales transaction, which depends on where the customer takes receipt of the purchased property and whether the business has established a physical presence in that area. Because local government boundaries often overlap, many locations are subject to multiple local sales taxes. For example, a retailer operating in Lyons would be required to collect the 3 percent city tax, the 0.985 percent county tax for Boulder County, the 1 percent Regional Transportation District tax, and the .01 percent tax for the Scientific and Cultural Facilities special district, in addition to the 2.9 percent State sales tax, for a total of 7.985 percent in sales taxes on the total selling price. In addition to their responsibilities related to Department-administered sales taxes, businesses located in home-rule municipalities that collect their own sales taxes must obtain a separate license from those municipalities and remit the applicable sales taxes directly to them. For many taxing jurisdictions, businesses are allowed to hold back a small percentage of sales taxes they have collected as a service fee.

**LOCAL GOVERNMENTS** are required to report to the Department any changes in local tax laws or rates at least 45 days prior to their effective date and must send the Department copies of any new annexation ordinances and maps [Sections 29-2-106(2) and 31-12-113(3), C.R.S.]. Local governments are also responsible for informing businesses in their jurisdiction of these changes. In addition, local governments share responsibility with the Department for identifying businesses within their jurisdictions that are not collecting and remitting sales taxes as required. Specifically, Section 29-2-106(4)(b) and (c), C.R.S., requires the Department to provide local governments with reports showing the businesses registered within each local government and the sales revenues and taxes remitted by each business. If local governments identify businesses that are not properly registered within their jurisdiction, or are not properly remitting sales taxes, the local governments are required to report the businesses to the Department within 180 days of receiving the Department's reports. Further, according to Department policy local governments

can request that the Department audit businesses within their jurisdiction to ensure the businesses are properly reporting revenue and remitting sales taxes.

## LOCAL SALES TAX PROCESS

Section 29-2-106(1), C.R.S., provides that the Department’s “collection, administration, and enforcement [of local sales taxes]...shall be performed...in the same manner as the collection, administration, and enforcement of the Colorado state sales tax.” Accordingly, the Department processes local sales taxes using the same procedures, forms, information system, and staff as the state sales tax.

First, businesses are required to collect and remit applicable state and local sales taxes when making taxable sales. According to Department rules, most businesses must file a tax return on a monthly basis to report sales revenue and remit sales taxes. Most businesses file online using Revenue Online, the Department’s website for tax filing that interfaces with GenTax, the Department’s tax database and processing system. However, some smaller businesses file using hardcopy return forms, in which case the Department contracts with the Department of Personnel and Administration to scan and digitize the returns and load the information into GenTax.

Second, the Department processes and reviews sales tax returns provided by businesses. Almost all of the Department’s sales tax processing is automated in GenTax. Upon receiving the sales tax return, GenTax performs mathematical checks to ensure the calculations on the return are accurate. If an error is found, GenTax “flags” the return and routes it to Department staff for manual error resolution. Error resolution can range from correction of the math to contacting the business to resolve more complicated errors.

Third, the Department is required by Section 29-2-106(3)(a), C.R.S., to make monthly distributions of sales tax revenue to local governments with state-administered sales taxes. Each month, GenTax processes and accounts for sales tax revenues for each of the local tax jurisdictions that are administered by the Department. After the last

day of the month, Department staff reconcile the revenue amounts posted on GenTax with the local governments' account balances for any credits or debits from previous months' distributions, which can occur when businesses file for refunds or remit taxes due from previous months. Department staff then processes payments to the local governments.

The Department conducts audits of businesses to ensure that they accurately reported sales revenues and remitted the appropriate amount of sales taxes. Generally, such audits review all of a business' tax liabilities, including both state and local sales taxes paid by the business. Businesses may be selected for an audit based on risk factors developed by the Department, such as size, inconsistent revenue patterns, or problems identified on returns. In addition, the Department may conduct audits based on requests and tips received from local governments. If the Department finds that a business did not remit the correct amount of sales taxes, it collects the additional taxes due from the business and may assess penalties and interest.

## PROGRAM FUNDING AND EXPENDITURES

According to statute [Sections 29-2-106(3)(a) and 32-9-119(2)(c)(II), C.R.S.], the Department must administer countywide sales taxes and city and town sales taxes at no cost to local governments, but it can withhold the cost of administration for certain other state-administered local sales taxes, such as the Regional Transportation District. Because the Department uses the same resources within its Taxpayer Service Division to collect both state and local sales taxes, it does not receive a separate appropriation to administer local sales taxes. For Fiscal Year 2016, the Department was appropriated \$7.3 million for staffing and operating expenses within its Taxpayer Service Division.



## AUDIT PURPOSE, SCOPE AND METHODOLOGY

This report includes the results of our performance audit of local sales tax administration at the Department of Revenue. We conducted this audit pursuant to statute [Section 2-3-103, C.R.S.], which authorizes the State Auditor to conduct audits of all departments, institutions and agencies of state government. This audit was prompted by a legislative audit request that, given the complexity of Colorado's local tax laws, sought to determine whether the Department has adequate controls to ensure that local governments for which the Department administers sales taxes accurately receive the sales taxes due. Audit work was performed from March 2015 to October 2015.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The key objectives of the audit were to assess the Department's:

- Processes for maintaining accurate and comprehensive information on local jurisdictional boundaries and assigning businesses to the correct local taxing jurisdictions.
- Controls to ensure that businesses report and pay the correct amount of local sales taxes and that the Department distributes the correct amount to local governments.
- Customer service and support for local tax administrators, including its responsiveness to requests, concerns, and complaints it receives from local governments.

To accomplish our audit objectives, we:

- Reviewed statutes and Department rules related to the administration of local sales taxes.
- Interviewed Department staff to gain an understanding of the procedures they use for registering and issuing sales tax licenses to retail businesses.
- Analyzed Department forms including sales tax license applications, sales tax returns, and published guidance on local jurisdiction tax rates.
- Tested the accuracy of the jurisdictions assigned by the Department to businesses for all 103,836 business locations that have valid physical addresses capable of being mapped using geographic-information-system software and that filed a tax return and submitted a payment in Calendar Year 2014.
- Compared the list of jurisdictions included in GenTax with local jurisdiction boundaries to determine if each location is included in the Department's system.
- Reviewed the Department's policies and procedures for processing sales tax returns, identifying problems, and following up with businesses.
- Reviewed the Department's rules and procedures for verifying the accuracy of data available from the tax-rate database providers certified by the Department.
- Interviewed staff in the Department's Local Government Liaison Office to gain an understanding of the procedures staff use to provide support and guidance to local tax administrators.
- Reviewed the Department's procedures for addressing local governments' complaints, questions, and requests for audits.

- Reviewed written guidance the Department provides to local governments and the memorandum of understanding that the Department requires local tax administrators to sign in order to receive confidential taxpayer information.
- Conducted a survey of all 220 tax administrators for local governments in the state for which the Department collects sales taxes and interviewed a subset of them to gain an understanding of the procedures local governments use to ensure businesses in their jurisdictions are properly remitting sales taxes and to assess local governments' satisfaction with the service and support they receive from the Department.

We planned our audit work to assess the effectiveness of those internal controls that were significant to our audit objectives. Our conclusions on the effectiveness of those controls are described in the audit findings and recommendations. Because the objectives of our audit were focused on the Department's administration of local sales taxes, we did not analyze local use taxes in this audit, which the Department only administers for some special districts and regional transportation authorities using a separate process. We also did not include the additional excise taxes that are due on the sales of some select items such as cigarettes, alcohol, spirits, and marijuana.



# CHAPTER 2

## LOCAL SALES TAX ADMINISTRATION

Colorado's local sales tax laws provide local governments and their constituents with the flexibility to establish sales taxes in accordance with local preferences and revenue needs. However, this local control across the state's counties, municipalities, special districts, and combined authorities has created a complex and often overlapping network of 297 sales tax jurisdictions with varying tax rates that the Department of Revenue (Department), businesses, and local governments must work together to administer.



Because of the complexity of this network, each responsible party must have access to accurate, up-to-date information to ensure that local sales taxes are properly collected and distributed in accordance with local tax laws.

During the audit we assessed the Department's controls to ensure that its staff, businesses, and local governments have access to accurate information to administer local sales taxes in the state. We reviewed the Department's administration in four key areas which included: (1) registering businesses within their applicable tax jurisdictions, (2) maintaining accurate information on the boundaries of local tax jurisdictions, (3) providing information on applicable local sales taxes to businesses, and (4) providing information and assistance to local governments. Overall, as discussed in the following sections, we found that the Department could improve its administration of local sales taxes by developing geographic-information-system (GIS) tools and processes to ensure businesses are registered correctly to collect and remit sales taxes for their local jurisdictions, improving the quality of information and resources provided to the public, and developing a system for tracking and managing inquiries and complaints from local governments.

## SALES TAX LICENSE REGISTRATIONS

Any business owner who wants to sell retail goods in the state must first obtain a sales tax license from the Department [Section 39-26-103(1), C.R.S.]. Businesses that operate from multiple locations must obtain separate sales tax licenses for each physical site. Given the complexity of Colorado's local sales tax system, in which rates vary depending on applicable jurisdictions (e.g., cities, counties, and special districts), a key step in the Department's process for issuing a sales tax license is determining which local taxing jurisdictions apply to the business' location. To facilitate this step, the Department has created a system of location code numbers that identifies tax liabilities for

various geographic regions of the state, based on the taxing jurisdictions that apply. When a business registers for a sales tax license, the Department assigns one of these location codes to the business site and prints it on the sales tax license to represent the business' liability for collecting local sales taxes. There are three ways by which retailers can apply for a sales tax license, and the process of assigning location codes is similar in each.

- **MAIL IN APPLICATION.** With this method, a retail business site owner submits a completed Colorado Sales Tax Withholding Account Application (Form CR 0100AP), fee payment, and copies of required photo identification to the Department through the mail. After processing the application, the Department mails the sales tax license to the business.
- **APPLY IN PERSON.** The business owner brings two copies of the completed Form CR 0100AP, fee payment, and copies of required photo identification to one of the Department's five walk-in centers located around the state. A Department employee registers the business site in real-time, and the business owner leaves the walk-in center with a temporary sales tax license. The business owner then receives the official sales tax license in the mail.
- **APPLY ONLINE VIA COLORADO BUSINESS EXPRESS (CBE).** CBE allows businesses to simultaneously register for Unemployment Insurance with the Colorado Department of Labor and Employment and for wage withholding and sales tax accounts with the Department of Revenue. Upon processing the CBE application, the Department mails the sales tax license to the business. Business owners looking to add retail business sites to an existing sales tax account cannot use this service; they must submit an application by mail or in-person.

For both mailed-in and in-person applications, a Department employee determines the business' local sales tax liability and assigns a location code based on information supplied by the business owner on the application form, which includes the site's street address, city, county, and ZIP code. The form also asks, "If business is within limits

of a city, what city?” A Department employee manually enters the information collected on this form into GenTax, the Department’s tax database, which then verifies the business address against the United States Postal Service’s (USPS) address database to confirm that the address is known to USPS and that its format conforms to USPS standards. Next, GenTax presents a drop-down list of location codes and descriptions (typically names of cities or counties that are associated with the site’s ZIP code) and the Department employee selects the appropriate code. If the employee is unsure which location code to choose, he or she may seek additional information from the business owner or may use an online lookup tool offered by one of the electronic database providers that the Department has certified pursuant to Section 39-26-105.3, C.R.S. This tool identifies which local sales tax jurisdictions cover a particular address. Department staff report that in some cases they may also use a web mapping service, such as Google Maps, or consult a map or guide that the Department has created for certain areas.

For applications submitted through CBE, the CBE online portal gathers the same information from business owners as the hard-copy application (Form CR 0100AP) and, according to the Department, automatically assigns a location code based on the business’ ZIP code. If CBE encounters an error, or if for some reason it cannot assign a location code, the system emails the incomplete registration to the Department’s Registration Control Section, where a Department employee will complete the registration as if it were a mail-in application.

Once registered, the business is liable to collect and remit state and local sales taxes to the Department at the end of each filing period for each retail site.

## WHAT WAS THE PURPOSE OF THE AUDIT WORK, AND WHAT WORK WAS PERFORMED?

Our objective was to determine whether the Department accurately registers retail businesses with correct location codes. We tested the accuracy of the location codes assigned to businesses in GenTax using GIS mapping software and data on address locations that was developed by the Governor's Office of Information Technology (OIT) using information from local governments' Enhanced 911 databases and county assessor records, along with jurisdictional boundary data supplied by local governments, the Department of Local Affairs (DOLA), and the Department of Transportation.

First, we plotted on a map the addresses for 103,836 of the 115,857 retail business sites (90 percent) with physical locations that filed returns and submitted payments for sales taxes during Calendar Year 2014. The 12,021 business sites that we did not review either (1) had irregularly formatted addresses that do not comply with USPS standards; (2) had addresses that did not match to any known addresses in OIT's location data and, therefore, could not be mapped; or (3) did not have addresses recorded in GenTax at all—many of these were mobile vendors that do not receive mail at the business site. Since a single company or business owner can operate multiple sites, the 103,836 sites we reviewed correspond to 83,241 of the 91,303 business accounts (91 percent) that remitted sales taxes during 2014.

Second, we determined the sales tax jurisdictions covering each business plotted on the map. We were able to perform testing for 346 of the 351 local governmental entities that have authority to impose sales taxes in the state—excluding local marketing districts and county lodging taxes, both of which only apply to lodging services, hotel rooms, and accommodations. Specifically, we were able to test for:

- **COUNTIES**—all 64 (including the two consolidated city-counties), of which 50 have state-collected local sales taxes. Our county-level testing also covered the mass transportation taxes for Eagle, Pitkin,

and Summit Counties and the public safety improvement tax for Montrose County. We also tested boundaries for county taxes that are earmarked for cities through intergovernmental agreements in Moffat, Rio Blanco, and Summit Counties.

- **COUNTY LOCAL IMPROVEMENT DISTRICTS (LIDs)**—three of seven. The three we tested, which are within Boulder, Douglas, and Jefferson Counties, are state-collected. Two of the four that we did not test are also state-collected.
- **INCORPORATED MUNICIPALITIES**—all 271 (including the two consolidated city-counties), of which 153 had state-collected local sales taxes in 2014.
- **SPECIAL DISTRICTS**—four of five, including the following:
  - ▶ The Regional Transportation District (RTD)
  - ▶ The Science and Cultural Facilities District (SCFD)
  - ▶ Two of three metropolitan districts. The one we did not test levied a new sales tax in January 2015, which was after our review period.
- **REGIONAL TRANSPORTATION AUTHORITIES (RTAs)**—all five with a minor exception in an area of Eagle County.
- **MULTI-JURISDICTIONAL HOUSING AUTHORITY**—the Summit Combined Housing Authority.

We then compared the results of our GIS analysis with the jurisdictions associated with each business' location code in GenTax to determine whether the businesses were properly registered with the Department. For the businesses we found to be improperly registered, we performed a manual quality review to ensure that the addresses we mapped using location data from OIT matched the businesses' addresses as listed in GenTax. We also compared our results for a statistically valid sample of these businesses with results we obtained from a publicly available, online resource to assess the reliability of our methodology and results. As a result, with 95 percent confidence,



we estimate that between 89 and 93 percent of the business sites we identified as having incorrect registrations would be corroborated by the publicly available resource, which allows users to search for addresses one at a time.

Additionally, we reviewed statutes and rules related to the Department's duties for local sales tax collection. We interviewed Department staff and management to understand the Department's policies and procedures for assigning location codes to businesses. We reviewed the taxation forms and documents the Department publishes for public use, including forms that list local sales tax jurisdictions, rates, and location codes; the application and instructions for acquiring a sales tax license; the form and instructions for filing sales tax returns; and general sales tax reference and informational materials.

## HOW WERE THE RESULTS OF THE AUDIT WORK MEASURED?

The Department is responsible for correctly identifying which local sales taxes apply to business locations. While statute holds retail business owners liable for collecting and paying the appropriate amount of state and applicable local sales taxes, statute holds the Department responsible for issuing sales tax licenses to businesses, collecting taxes in accordance with local tax laws, and enforcing local tax laws "in the same manner as Colorado state sales tax" [Sections 39-26-105(1), 39-26-103(1), and 29-2-106(1), C.R.S.]. Thus, to properly collect and enforce local sales taxes and hold businesses who fail to collect taxes liable, the Department needs to ensure that it accurately assigns tax liabilities to businesses based on the local tax jurisdictions that apply to their locations.

## WHAT PROBLEM DID THE AUDIT WORK IDENTIFY?

We found that the Department does not sufficiently ensure it assigns location codes to business sites that accurately reflect the sales tax jurisdictions that apply to their locations. Specifically, 11,070 of the 103,836 business-site licenses we reviewed (11 percent) appear to be incorrectly registered with location codes that do not accurately reflect the totality of those taxing jurisdictions they are located within. Many businesses operate multiple sites, and our results showed that almost 1 out of every 8 businesses we reviewed (12 percent) had at least one site that was probably registered in error.

It is important to note that our testing in this area was dependent upon the accuracy of the GIS maps and address location data we used, as described earlier. To assess the reliability of our testing, we compared our results for a statistically valid sample of businesses to the results provided by an address database provider that the Department has certified to provide tax-jurisdiction information to businesses. Based on this review, with a 95 percent confidence level, we estimate that 91 percent (plus or minus 2 percent) of the exceptions we identified would be independently confirmed by the database provider. Therefore, our results are reliable for the purpose of identifying weaknesses in the Department's system for registering businesses, but they should be regarded as estimates. The Department will need to confirm our results before taking action related to specific businesses' registration status. EXHIBIT 2.1 shows how many of the 103,836 sites we reviewed are located within various jurisdiction types and how many we estimate the Department registered in error. See APPENDIX A for details for each jurisdiction.

EXHIBIT 2.1. PROBABLE REGISTRATION ERRORS FOR BUSINESS SITES WITH PHYSICAL LOCATIONS CALENDAR YEAR 2014					
	JURISDICTION TYPE	SITES ACTUALLY INSIDE THE JURISDICTIONS	SITES INSIDE THAT ARE REGISTERED AS BEING OUTSIDE <sup>1</sup>	SITES OUTSIDE THAT ARE REGISTERED AS BEING INSIDE <sup>1</sup>	ERROR RATE <sup>2</sup>
<b>STATE-ADMINISTERED JURISDICTIONS</b>					
COUNTIES & MUNICIPALITIES	Counties (50)	82,270	805	577	2%
	Municipalities	9,664	335	947	12%
	County Taxes Distributed to Municipalities <sup>3</sup>	1,907	78	231	14%
	County LIDs	1,398	120	75	13%
	<hr/>				
SPECIAL DISTRICTS & AUTHORITIES	RTD	51,147	206	310	1%
	SCFD	52,153	158	93	0%
	Metropolitan Districts	34	15	6	53%
	RTAs	12,908	158	167	2%
	Summit Combined Housing Authority	2,219	1	1	0%
<b>NON-STATE-ADMINISTERED JURISDICTIONS</b>					
COUNTIES & MUNICIPALITIES	Counties Without Sales Taxes (12) <sup>4</sup>	6,278	45	86	2%
	Home-Rule Municipalities that Self-Collect	71,690	3,120	6,358	12%
	Municipalities Without Sales Taxes	717	127	214	37%
TOTAL SITES REVIEWED: 103,836					
TOTAL SITES MISREGISTERED: 11,070 <sup>5</sup>					
TOTAL SITES MISREGISTERED FOR STATE-ADMINISTERED JURISDICTIONS: 3,746 <sup>5</sup>					
SOURCE: Office of the State Auditor analysis of taxpayer records from GenTax using GIS mapping software.					
<sup>1</sup> Includes Sites that are incorrectly registered for another jurisdiction of the same type.					
<sup>2</sup> Error rate equals the sum of sites misregistered for the jurisdictions divided by the sum of sites misregistered and sites that are correctly registered as being inside.					
<sup>3</sup> Moffat, Rio Blanco, and Summit Counties have inter-governmental agreements with certain cities to distribute to them county sales taxes that are collected within their boundaries.					
<sup>4</sup> Excludes the City and Counties of Denver and Broomfield, which are home-rule municipalities that self-collect and so are included in the next row.					
<sup>5</sup> Sites can be misregistered for multiple jurisdictions.					

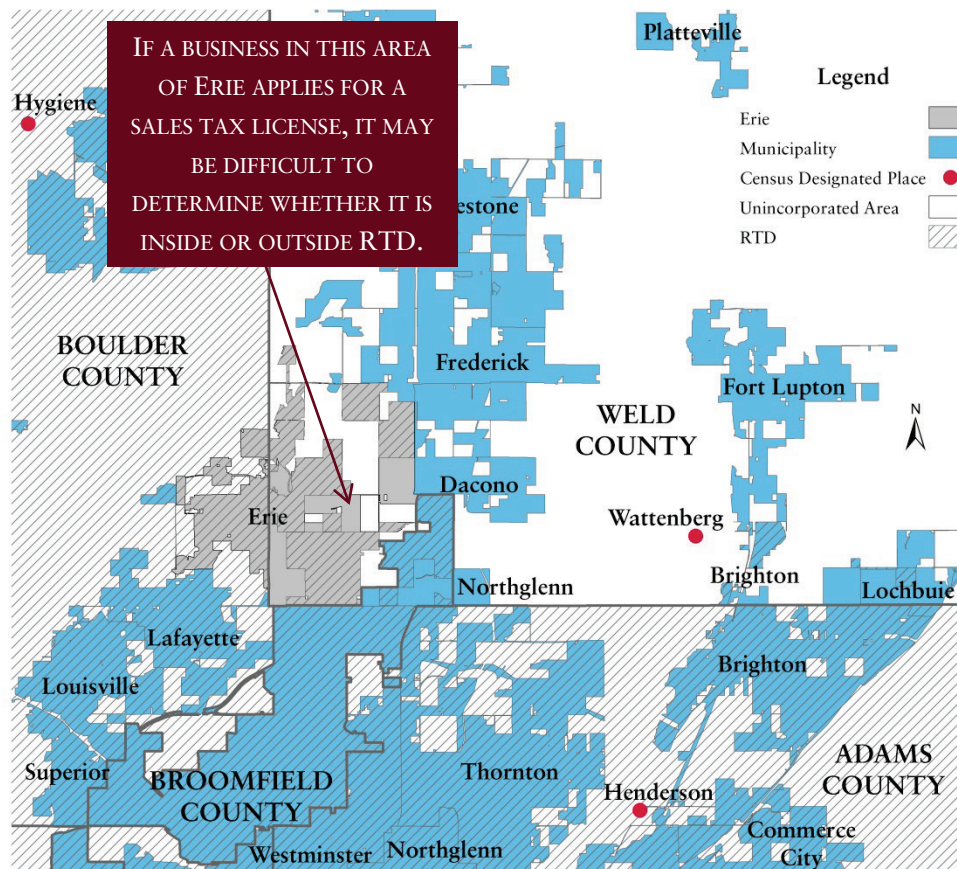
As shown in EXHIBIT 2.1, many of the probable errors we found centered on businesses that were improperly registered as being either inside or outside of municipal boundaries. Although most of the errors we identified concerned businesses that appear to be improperly registered in relation to home-rule municipalities for which the Department does not administer sales taxes, we found the same error rate of 12 percent applied to municipalities for which the Department does administer sales taxes. In total, we identified 3,746 business sites that appear to be misregistered in relation to at least one jurisdiction with a state-administered sales tax.

## WHY DID THE PROBLEM OCCUR?

Overall, we found that the Department lacks adequate tools to ensure that businesses are properly assigned to the applicable tax jurisdictions. Although the Department does not maintain information that would be necessary to determine the specific reasons why particular businesses were not assigned the correct location codes at the time of registration, the Department's lack of GIS tools is a factor that makes it more difficult for staff to register businesses properly. In addition, local governments do not always review the lists of businesses sent to them by the Department, and the Department lacks a method to perform its own comprehensive reviews to ensure previously registered businesses continue to be assigned to the correct location codes.

**NO MAPPING TOOL USED FOR SALES-TAX-LICENSE REGISTRATIONS.** When registering a business for a sales tax license, the Department relies mostly on address information supplied by the business owner on its application form and the ZIP-code-based system employed by GenTax for selecting location codes. The Department's current registration process, which does not employ a mapping tool, is problematic for three reasons, as described below. To illustrate these reasons, we reference EXHIBIT 2.2, which shows the northern Denver Metro area around the intersections of Weld, Adams, Broomfield, and Boulder counties—a complex patchwork of county boundaries, incorporated municipalities, unincorporated areas, and RTD.

## EXHIBIT 2.2. NORTH DENVER METRO AREA



SOURCE: Office of the State Auditor analysis of GIS data obtained from OIT and RTD.

- **APPLICATION FORMS COLLECT INSUFFICIENT INFORMATION.** We found that without tools such as GIS mapping, the overlay of taxing jurisdictions is too complex in some areas to accurately determine the tax jurisdiction(s) a business would fall under based solely on the information collected on the application alone (i.e., city, county, and ZIP code of a site's physical address), especially for local improvement districts (LIDs), metropolitan districts, RTD, and regional transportation authorities (RTAs). For example, there are portions of Erie within Weld County, as indicated by the red arrow in EXHIBIT 2.2, that are within RTD and portions that are outside RTD. Thus, there are two location codes for Erie in Weld County. With a GIS mapping tool, Department staff would be able to determine more accurately whether a business in Erie should be assigned the location code that carries the RTD tax or the one that does not.

- **APPLICANTS FOR SALES TAX LICENSES MAY PROVIDE MISTAKEN INFORMATION ON CITIES.** The Department’s sales tax application form attempts to ascertain the applicability of city sales taxes by asking the question, “If business is within limits of a city, what city?” However, this question can be misinterpreted, because neither the form nor the instructions provide context for why the question is asked or how applicants should answer in specific situations. For example, in reference to EXHIBIT 2.2, it is unclear whether one should enter the names of places that are not technically cities, such as statutory towns like Erie or unincorporated, census-designated places like Wattenberg or Hygiene. It is also unclear what applicants should enter for a site that is technically outside of a city’s boundaries but have the city’s name in its address, or whether the form should simply be left blank in such cases. If an applicant mistakenly indicates that they are within a city, the site may be registered to collect sales taxes for a jurisdiction that does not apply.

This kind of mistake is a particular risk in areas where mailing addresses have not been updated to reflect recent incorporations or annexations. For example, in our GIS analysis, we identified 617 business sites that had mailing addresses showing Henderson—an unincorporated community in Adams County—as the “city.” These sites were assigned location codes labeled for Henderson. However, our GIS analysis showed that 537 of these 617 sites are actually located inside the city limits of either Commerce City or Brighton and were therefore incorrectly registered by the Department. We found similar errors in areas beyond those shown in EXHIBIT 2.2, specifically sites with Englewood addresses that are in Centennial, sites with Arvada addresses that are in Westminster, and sites with Littleton addresses that are in Lone Tree, Centennial, or Greenwood Village. Given the recent population growth in these areas, it would not be surprising for business owners to be mistaken about whether their sites lie within the limits of these cities. Thus, the Department needs an independent method of verifying business sites’ sales tax liabilities based on their street addresses instead of relying on the city information supplied on the application forms.

- **REGISTRATION STAFF LACK ADEQUATE TOOLS FOR DETERMINING SALES TAX JURISDICTIONS BASED ON ADDRESSES.** Department staff report that if the information supplied by a sales tax-license applicant is insufficient to determine sales tax liabilities, staff sometimes rely on publicly available mapping tools, such as Google Maps, or one of the electronic database providers that are available online and certified pursuant to Section 39-26-105.3, C.R.S. However, such tools may not always be accurate or provide enough information to determine sales tax liabilities. For example, we discovered three municipalities for which Google Maps had incorrect or outdated boundary lines when compared to official zoning maps and the GIS data maintained by DOLA. Online mapping tools also typically only show city or county boundaries when requested by the user and generally do not show the boundaries of LIDs, metropolitan districts, or other special districts. In addition, the free services of the online database provider may not always be available, because the Department does not have a contract or written agreement with the provider to ensure ongoing accessibility.

The Department could procure a GIS system from a vendor, or it could leverage resources already present within the State—in particular, resources and expertise within OIT and DOLA—to create a system that Department staff could use for creating maps and registering business sites. Specifically, OIT, which the General Assembly has vested with “all duties and responsibilities for statewide geographic information system [GIS] coordination” [Section 24-37.5-111, C.R.S], has developed a repository of GIS data, including local government jurisdictional boundaries, which is accessible online through the Colorado Information Marketplace ([data.colorado.gov](http://data.colorado.gov)). In addition, DOLA is currently working on a comprehensive GIS map of all special districts around the state—including local and special district sales tax jurisdictions—compiled from data supplied by local governments. Moreover, local governments are required to maintain accurate jurisdiction-boundary ordinances and maps with both DOLA and the Department, as changes such as annexations cannot become effective until these agencies receive updated local ordinances and

maps [Section 31-12-113(2)(a)(II)(B), C.R.S.]. Thus, such collaboration with DOLA could also act as a control to ensure that the Department receives timely and accurate information from local governments regarding changes to jurisdictional boundaries.

**NO SYSTEMATIC CHECKS POST-REGISTRATION.** After registration, the Department does not conduct systematic reviews of sales tax licenses to ensure the accuracy of assigned location codes in GenTax. Rather, to detect possible errors, the Department relies on (1) periodic audits it conducts of individual businesses and (2) oversight by local governments. However, these two activities alone are not sufficient to ensure the accuracy of sales tax registrations. First, the Department reports that it has conducted about 1,500 audits of businesses in the past 3 years, which represents less than 2 percent of the total number of businesses that collected sales taxes in Calendar Year 2014.

Second, although statute establishes a process for information sharing between the Department and local governments to ensure that businesses are properly registered for the correct jurisdictions, our survey indicates that many local governments do not review the information provided by the Department. Thus, oversight by local governments provides minimal assurance that assigned location codes are accurate. Specifically, in accordance with statute [Section 29-2-106(4)(b), C.R.S.], the Department provides local governments with monthly reports that show all the business sites registered within their jurisdiction(s) and the revenue amounts they can expect to receive. The local governments then have 180 days to review these reports and notify the Department of any retailers they believe have been omitted. If local governments regularly review reports and independently track the businesses located inside their jurisdictions, either by instituting their own registration process or by performing visual assessments, they can serve as an additional control to ensure businesses are properly registered with the Department and are remitting sales taxes. However, in our survey of sales tax administrators for local jurisdictions, 49 of the 77 survey respondents (64 percent) said they do not verify the accuracy of information in the Department's reports, and 34 respondents (44 percent) said they do not independently track



which businesses are within their jurisdictions. Although the reasons local governments gave for not performing these activities varied, some respondents reported that they lack the resources and staff to perform the reviews. Therefore, the Department could improve the accuracy of businesses' registrations by developing its own processes for regularly reviewing the accuracy of sales tax registrations vis-à-vis jurisdictional boundaries.

**CORRECTING ACCOUNTS FOR MISREGISTERED SITES.** The Department needs to review the accounts for the 11,070 business sites we identified as being probably registered with incorrect location codes in GenTax and correct the accounts for those it confirms as being misregistered. Due to its statutory obligations, this process may require the Department to issue new assessments of unpaid taxes to businesses that did not remit the correct amount in local sales taxes, which could increase revenues for some jurisdictions. Specifically, according to statute, if a business fails to collect and remit sales taxes for a local jurisdiction, the Department is responsible for assessing the amount of underpayment and any applicable penalties and interest within 3 years of the filing date on the business' sales tax return [Sections 39-21-103 and 107, C.R.S.]. Conversely, if, within 3 years of the due date for a return, a business can show that it has over-collected and overpaid sales taxes for a jurisdiction and that it has refunded or will refund the tax to its customers, the Department is required to make a refund to the business in accordance with Section 39-26-703(2.5), C.R.S. Further, the Department has provided a process by which customers can request a refund directly from the Department if they are unable to obtain a refund from the business. In these situations the Department would then balance the jurisdiction's account by reducing future sales tax distributions to offset the amount of the refund. If a business requests a refund but lacks proof that it has refunded the money to customers, the Department would not be authorized to refund the overcollections.

Some of the problematic business sites we identified appear both to have incorrectly collected sales taxes for one jurisdiction and to have incorrectly *not* collected sales taxes for another. In such a situation,

the Department reports that it may be able to adjust future distributions to both jurisdictions so that the improperly collected taxes can be diverted from the first jurisdiction to the second. For example, if a business in Douglas County has been collecting and remitting sales taxes for Arapahoe County due to a registration error, the Department may be able to reduce future distributions to Arapahoe County and increase distributions to Douglas County by the amount that was paid in error.

As discussed, the 11,070 business sites we identified may have relied on the location code provided by the Department at the time of registration and collected and remitted taxes based on this location code. If the Department assesses a business up to 3 years' worth of past sales taxes for a jurisdiction the business site should have been collecting for, the business has no opportunity to collect the tax from the customer and will have to pay the tax from its own revenues. The jurisdiction would receive the taxes and recognize an unexpected windfall. According to our calculations, the net amounts to be assessed could range from a few dollars to more than \$100,000 for 1 year. Conversely, if the business site collected for the wrong jurisdiction, the business is only refunded the incorrect sales taxes if it can pass those refunds on to the customers who paid the taxes. Because the jurisdictions that previously received the taxes to be refunded will likely have already used these funds to support operations, any requested refunds could create a hardship for local governments in backfilling those funds. Our calculations show that net refunds to businesses could range from a few dollars to over \$60,000 for a single year.

Based on our review of statute, the Department can hold a business harmless and waive the sales taxes owed if the business can show that its miscollection was due to an error on the part of a database provider certified under Section 39-26-105.3, C.R.S. Additionally, a business may protest a tax assessment and request a hearing in accordance with the procedures outlined in Section 39-21-103 et seq., C.R.S. If the case is then brought to district court, statute grants the Executive Director authority to compromise with the business on the

amount to be taxed or charged in penalties and interest [Section 39-21-106, C.R.S.]. The Department reports that it may be able to apply this authority for some misregistered businesses identified in this audit.

## WHY DOES THIS PROBLEM MATTER?

When business sites are registered with incorrect location codes, some local governments may receive more sales tax revenues than they should, while others less. Whether a business submits a paper return or files its sales taxes through Revenue Online, only the jurisdictions that are associated with the business' location code will ultimately receive sales tax revenue. As EXHIBIT 2.3 illustrates, we estimate that in Calendar Year 2014 the Department potentially over-collected about \$3.3 million and under-collected up to \$3.8 million on behalf of local governments due to inaccurately assigned location codes. We estimated over-collections based on the actual amount of taxes that businesses reported for local jurisdictions on their tax returns (Form DR 0100). However, businesses that are not registered for a particular jurisdiction would not have reported actual taxes for those jurisdictions. Therefore, we estimated uncollected local sales taxes by applying the appropriate rates to the businesses' reported net taxable sales. Thus, the under-collected amounts are estimates and may not incorporate differences in exemptions the businesses might have been able to claim or deductions due to sales that were completed outside of their jurisdictions.

EXHIBIT 2.3. ESTIMATED EFFECT OF PROBABLE ERRORS IN LOCATION CODE ASSIGNMENTS CALENDAR YEAR 2014			
	JURISDICTION TYPE	POTENTIALLY OVER- COLLECTED <sup>1</sup>	POTENTIALLY UNDER- COLLECTED <sup>2</sup>
COUNTIES & MUNICIPALITIES	Counties <sup>3</sup>	\$473,000	\$1,384,000
	Municipalities with State- Administered Sales Taxes	\$1,305,000	\$1,194,000
	Home-Rule Municipalities that Self-Collect	N/A <sup>4</sup>	N/A <sup>4</sup>
	County Taxes Distributed to Municipalities	\$667,000	\$654,000
	County LIDs	\$20,000	\$51,000
SPECIAL DISTRICTS & AUTHORITIES	RTD	\$482,000	\$354,000
	SCFD	\$15,000	\$50,000
	Metropolitan Districts	\$163,000	\$21,000
	RTAs	\$156,000	\$92,000
	Summit Combined Housing Authority	<\$500	<\$500
TOTALS		\$3,281,000	\$3,800,000
SOURCE: Auditor analysis of sales tax filings in GenTax for 3,746 business sites that appear to be misregistered in relation to jurisdictions with state-administered sales taxes.			
<sup>1</sup> Estimated based on total taxes reported by businesses for jurisdictions.			
<sup>2</sup> Estimated based on businesses' reported net taxable sales and does not necessarily incorporate jurisdiction-specific exemptions or deductions.			
<sup>3</sup> Includes county taxes for mass transportation and public safety improvements.			
<sup>4</sup> The Department does not collect sales taxes for home-rule cities that have opted to administer their own sales taxes.			

As shown in EXHIBIT 2.3, there is no direct monetary effect of incorrect registrations for home-rule cities and towns that collect their own sales taxes since the Department does not collect or distribute sales tax revenues for them. However, businesses within home-rule municipalities that self-collect are responsible for registering with those municipalities so that they can collect and remit sales taxes directly to them. If businesses are misregistered with the Department, they may mistakenly conclude that the location code assigned by the Department and provided on their sales tax license confirms the business' location as either being inside or outside the home-rule municipality. Thus, given the risk of misregistrations at the municipal level, the Department should notify the home-rule cities and towns that self-collect about all the businesses we identified that appear to be misregistered at the state level with respect to their jurisdictions.

# RECOMMENDATION 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.
- 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.
- 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.
- 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.
- 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.

# RESPONSE

## DEPARTMENT OF REVENUE

### A AGREE. IMPLEMENTATION DATE: NOVEMBER 2016.

The Department will work with the Governor's Office of Information Technology and private industry to determine the best solution for local governments, businesses, and the Department of Revenue. The Department does not have the budget to develop a solution, nor to maintain it; thus, any solution will require an appropriation from the General Assembly.

### B AGREE. IMPLEMENTATION DATE: JULY 2019.

The Department will identify a solution and ask for resources by November 1, 2016, for inclusion in the FY 2017-18 budget request. While the Department does not yet know the specifics of the solution, it will likely include one-time capital costs and funding for annual maintenance and support, including FTE. In addition, it is possible that our support and maintenance agreement with the contractors responsible for GenTax and Colorado Business Express will need additional funding to implement this recommendation. Development and implementation are dependent on inclusion of funding in the FY 2017-18 budget. Once the Department obtains funding to implement the application chosen for RECOMMENDATION 1A, it will develop the process to register all new business sites using the preferred application. As the audit suggests, the Department, the business community, and local jurisdictions will benefit from this system compared to our current, manual registration process, which relies on zip-code-based, rather than address-based, jurisdiction codes.

C AGREE. IMPLEMENTATION DATE: JULY 2019.

Once the Department obtains funding to implement RECOMMENDATION 1B, it will develop the process to conduct a regular review of business registrations using the preferred application. This review may be based on samples, or a different approach, and a final approach will not be developed until the system referenced in RECOMMENDATION 1B is funded.

D AGREE. IMPLEMENTATION DATE: JULY 2016.

The Department will review the list of potential exceptions identified by the Office of the State Auditor to confirm whether they are registered in error and correct any improperly registered accounts. We will work with the local jurisdictions and their respective county assessors to verify addresses are properly accounted for and their location codes are accurate. If required, we will send a new sales tax license to an affected business. For any tax issues that arise as part of this review, we will evaluate each business individually, and we will work with the business to get it into compliance.

E AGREE. IMPLEMENTATION DATE: DECEMBER 2016.

In accordance with Section 29-2-106(6), C.R.S., the Department will provide a list of business names to the home rule jurisdictions so those jurisdictions can review their sales tax license records to ensure proper registration with the home rule jurisdiction. For any businesses that are registered in the wrong jurisdiction, we will issue a corrected sales tax license.

# DESIGN AND MANAGEMENT OF THE LOCATION CODE SYSTEM

Currently, the Department administers sales taxes for a complex, often overlapping nexus of 223 tax jurisdictions (not counting the self-collecting jurisdictions), each with its own sales tax rate and set of allowable exemptions. To facilitate its administration of local sales taxes, the Department has implemented a system of about 1,100 location codes, each of which represents a geographic region of the state and is labeled with a place name and linked within GenTax to all the individual tax jurisdictions and rates that apply to businesses in that region. As discussed in RECOMMENDATION 1, registering businesses with location codes that accurately reflect their location and sales tax liabilities is an essential control to ensure that the Department properly collects and distributes local sales taxes. The Department publishes its location codes, truncated to six digits and organized by county, on its Form DR 0800, which serves as the official list of active location codes, according to the Department. The Department also publishes Form DR 1002, which contains all sales and use tax rates, and allowable service/vendor fees and exemptions, for the various local sales and use taxes in effect around the state. The Department updates these forms regularly and makes them available for free to taxpayers on its website.

## WHAT WAS THE PURPOSE OF THE AUDIT WORK, AND WHAT WORK WAS PERFORMED?

The purpose of our work was to determine whether the Department's system for associating geographic areas with location codes and sales tax jurisdictions adequately captures the complexity of Colorado's



local sales tax structure and facilitates accurate registrations of retail business sites. We reviewed statutes and rules related to the Department's duties for local sales tax collection. We interviewed Department staff and management to understand the Department's policies and procedures for creating, editing, and managing location codes in GenTax. We reviewed the taxation forms and documents the Department publishes for public use, including forms listing local sales tax jurisdictions, rates, and location codes (Forms DR 1002 and DR 0800); the application and instructions for acquiring a sales tax license (CR 0100AP); the form and instructions for filing sales tax returns (DR 0100); and general sales tax reference and informational materials. We then compared the information available on these forms to information stored in GenTax. Our audit work also consisted of analyzing how well the Department's location code system captures the appropriate taxing jurisdictions for 11,070 business site addresses that, as explained in RECOMMENDATION 1, we determined appear to be registered in error.

## HOW WERE THE RESULTS OF THE AUDIT WORK MEASURED?

Statute requires the Department to “collect, administer, and enforce local sales taxes in the same manner as Colorado state sales tax” [Section 29-2-106(1), C.R.S.]. Further, statute permits municipalities, counties, and some special districts to levy a sales tax and to allow for any or all of the exemptions that apply to the statewide sales tax [Sections 29-2-102(1), 29-2-103(1), 29-2-105(1)(d)(I), and 32-9-119(2)(a), C.R.S.]. We evaluated the following aspects of the Department's location code system for identifying sales tax liabilities for particular locations:

- **COMPLETENESS.** The system should include every sales tax jurisdiction and should define location codes to account for every geographic region of the state that has a unique combination of taxing jurisdictions.

- **CLARITY.** For any given geographic location, it should be clear to system users which location code should be used, and each code should be clearly intended for a specific geographic region. The system should minimize the potential for incorrect registrations by providing unambiguous, clearly distinguished names and descriptions for all available location codes.
- **COMMUNICATION.** All users of the system, including Department employees, local government staff, and businesses, should have access to accurate information on location codes, the local sales tax jurisdictions and rates associated with each location code, and how to determine the sales tax jurisdictions applicable to a business site.

## WHAT PROBLEMS DID THE AUDIT WORK IDENTIFY?

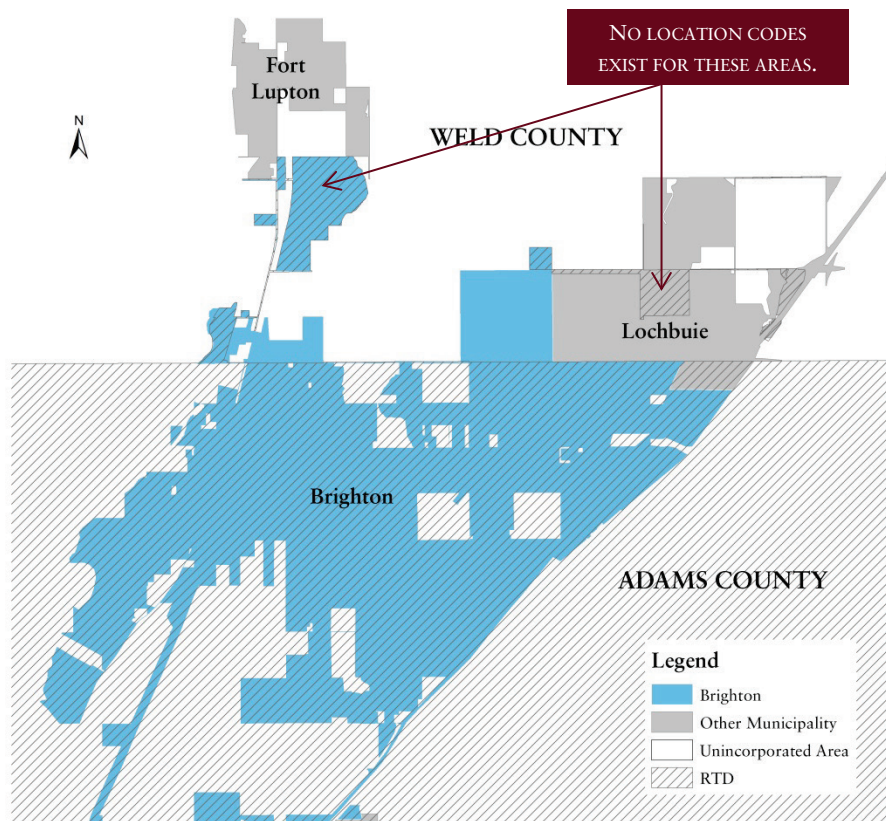
On the whole, the Department has created a usable system of location codes that, in most cases, accurately reflects the inherent complexity of Colorado's sales tax structure. However, we found that this system is not always complete, understandable, and accurately communicated to system users or the public.

**THE DEPARTMENT'S LOCATION CODE SYSTEM IS NOT COMPLETE.** We found that the Department's system does not account for all jurisdictional combinations that exist in the state. Although the system uses about 1,100 location codes to define such combinations, we identified nine areas for which the Department either has not created location codes or has created location codes that do not include all applicable taxing jurisdictions. As a result, businesses located within these areas either cannot be registered to collect and remit the sales taxes for all applicable jurisdictions or must use a location code intended for another region. Following are descriptions and maps of these nine areas:

- **PORTIONS OF THE CITIES OF BRIGHTON AND LOCHBUIE IN WELD COUNTY THAT ARE WITHIN RTD.**

Our analysis showed that there are currently five business sites located within the portion of Brighton indicated in EXHIBIT 2.4, which, as a result of the lack of a location code for the area, are not collecting and remitting RTD sales taxes. Similarly, we identified a portion of Lochbuie within RTD that lacks a location code.

#### EXHIBIT 2.4. BRIGHTON-LOCHBUIE

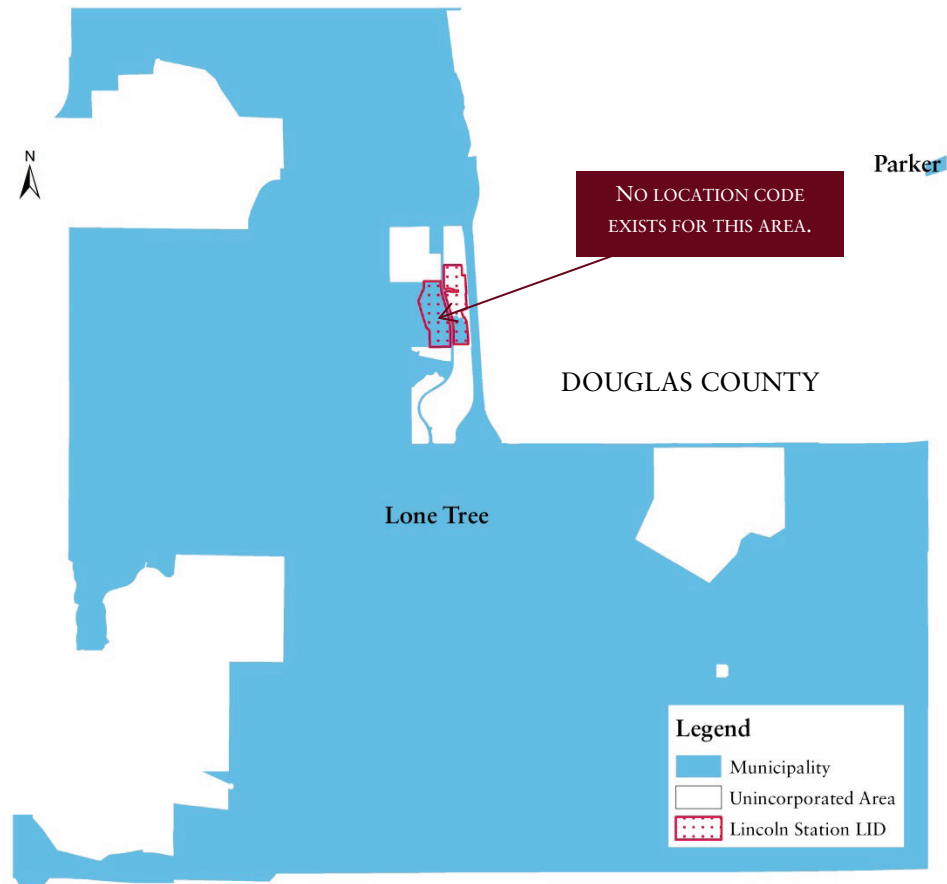


SOURCE: Office of the State Auditor analysis of GIS data obtained from OIT and RTD.

- **PORTIONS OF THE TOWN OF LONE TREE THAT ARE WITHIN THE LINCOLN STATION LOCAL IMPROVEMENT DISTRICT (LID).**

The area of Lone Tree indicated in EXHIBIT 2.5 contains one business site, which was assigned a location code that includes Lone Tree but not the Lincoln Station LID. The Department has a location code that includes the LID, but only for areas that are in unincorporated Douglas County.

## EXHIBIT 2.5. LONE TREE

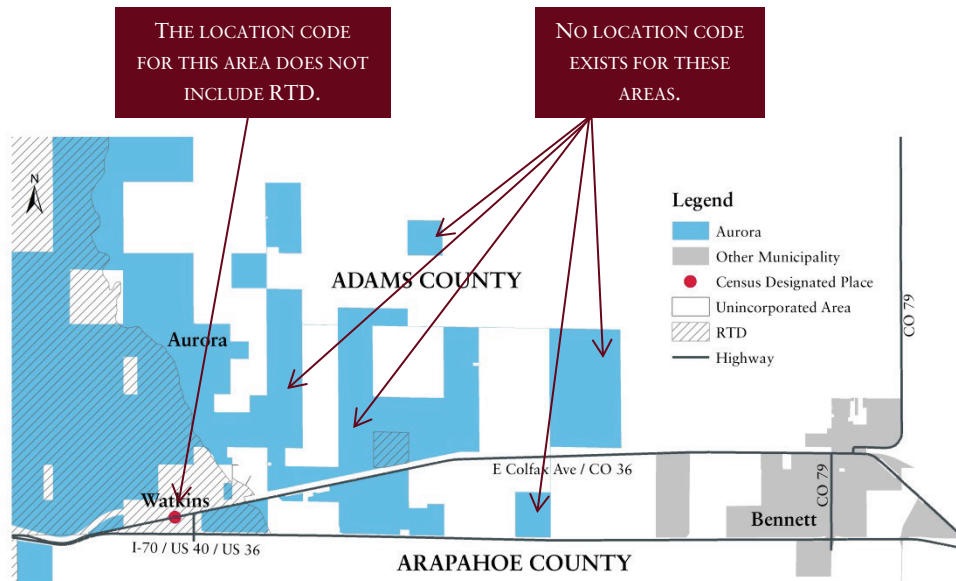


SOURCE: Office of the State Auditor analysis of GIS data obtained from OIT.

- **AREAS NEAR THE COMMUNITY OF WATKINS WITHIN RTD**

The unincorporated community of Watkins is located within RTD (SEE EXHIBIT 2.6), but the Department's two location codes for this area do not include RTD. We found that there are 18 businesses in the Watkins area of Adams County that were assigned Watkins location codes. Seven of these businesses are within RTD, but due to the location codes assigned, they are not collecting and remitting RTD sales taxes.

## EXHIBIT 2.6. AURORA AND WATKINS



SOURCE: Office of the State Auditor analysis of GIS data obtained from OIT and RTD.

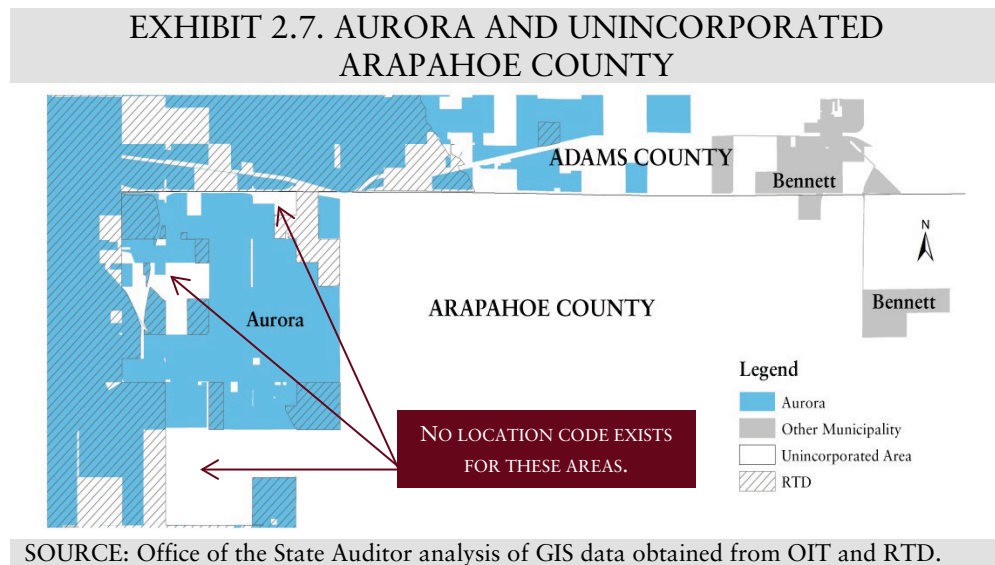
- **PORTIONS OF ADAMS COUNTY NEAR AURORA OUTSIDE RTD**

There are portions of Aurora within Adams County that are not within RTD (SEE EXHIBIT 2.6). While there are currently no business sites registered in these areas, any future businesses will not be registered correctly as no location code exists to represent these areas.

- **AREAS OF UNINCORPORATED ARAPAHOE COUNTY NEAR AURORA THAT ARE OUTSIDE RTD**

We found 12 business sites that are located within the areas indicated in EXHIBIT 2.7, of which 10 are incorrectly registered to collect and remit RTD sales taxes. The boundaries for RTD include portions of Aurora and Arapahoe County. We found that the Department's system includes a location code within Arapahoe County for the portion of Aurora that is outside RTD, but it lacks a similar code specifically labeled for the unincorporated areas outside RTD that are near Aurora. There are eight location codes that one could use for these areas to capture the applicable

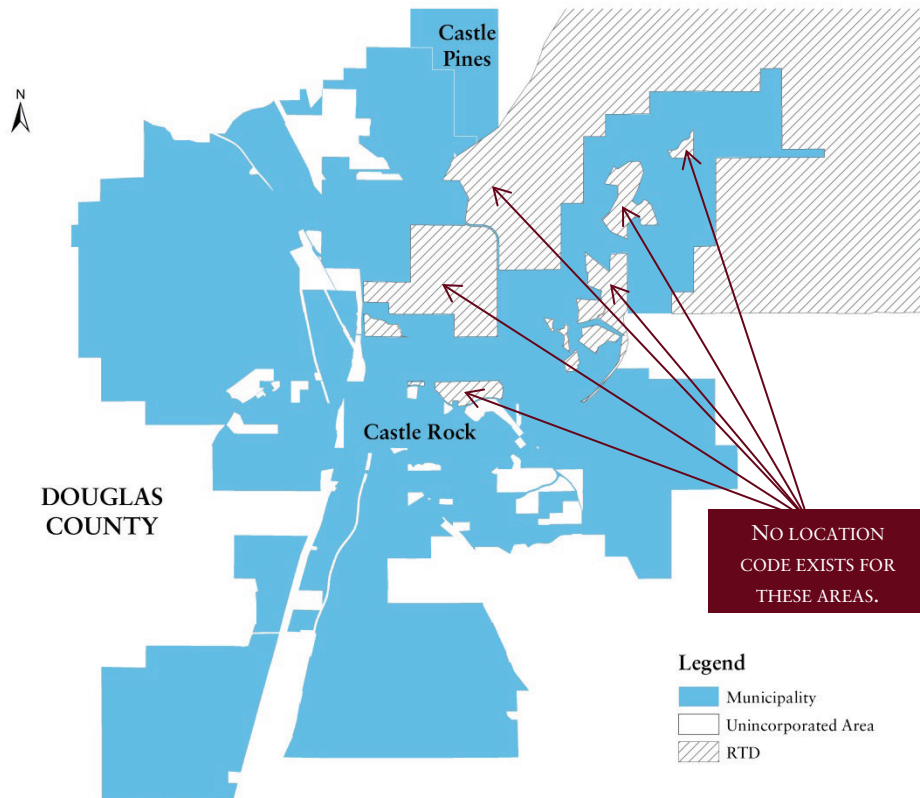
jurisdictions, but all of them are labeled for other communities to the east of Aurora, such as Bennett.



- **AREAS OF UNINCORPORATED DOUGLAS COUNTY SURROUNDED BY OR ADJACENT TO CASTLE ROCK THAT ARE WITHIN RTD**

Our analysis showed there are six businesses located in some of the unincorporated areas of Douglas County indicated in EXHIBIT 2.8. Two are incorrectly registered for incorporated Castle Rock, which is a home-rule city that collects its own sales taxes. Four of the sites are registered with location codes for unincorporated Douglas County that do not include RTD, and therefore the sites are not collecting and remitting RTD sales taxes. There are 10 location codes for unincorporated Douglas County that capture all the applicable jurisdictions, including RTD, but they are labeled for other communities, such as Franktown, Highlands Ranch, and Parker.

## EXHIBIT 2.8. CASTLE ROCK AND RTD



SOURCE: Office of the State Auditor analysis of GIS data obtained from OIT and RTD.

- **UNINCORPORATED GUNNISON AND PITKIN COUNTIES WITHIN RTAs**

We found that one of the Department's location codes for unincorporated Gunnison County does not include the Gunnison Valley RTA, and another location code for unincorporated Pitkin County does not include the Roaring Fork RTA. As a result, four businesses that were assigned these location codes are not collecting and remitting sales taxes for the RTAs, though they should be.

THE DEPARTMENT'S LOCATION CODE SYSTEM DOES NOT ALWAYS CLEARLY INDICATE WHICH LOCATION CODES APPLY TO PARTICULAR REGIONS. We found that it is not always obvious which location code a user should select for certain areas based on the names and descriptions of the codes. There are two main reasons for this lack of clarity. First, there are many sets of location codes that have similar names, and it is not always clear whether the choice of one over

another makes a difference with respect to the sales taxes a business will collect. For example, a business in the unincorporated town of Evergreen is only subject to state and county sales taxes and, therefore, could be assigned any one of the following location codes, the choice of which makes no practical difference in the local sales taxes the business collects:

- 11-0035007—Evergreen-Jefferson
- 11-0206036—Evergreen-Jefferson (0206)
- 11-0206048—Jefferson County (0206)

In contrast, based on the above naming conventions, it would appear that a business in the unincorporated community of El Jebel would have the following location codes available:

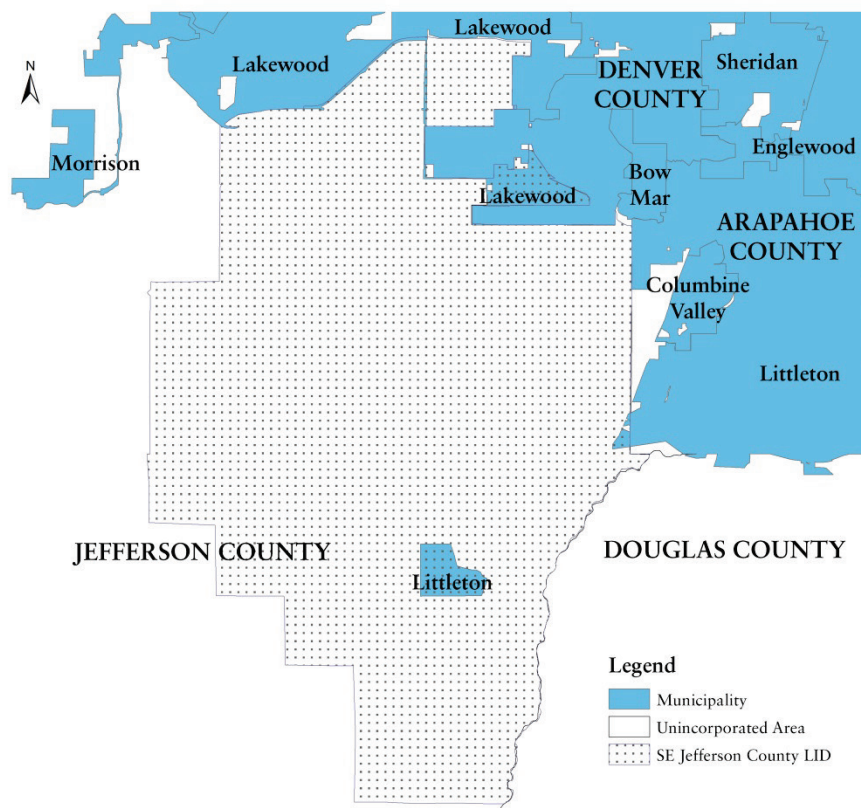
- 44-0062015—El Jebel-Eagle
- 44-0206023—El Jebel-Eagle (0206)
- 44-0206028—Eagle County (0206)

However, the last option would be incorrect, even though, according to Form DR 0800, the “0206” codes are intended for unincorporated areas and El Jebel is in unincorporated Eagle County. This is because the last option does not include all of the applicable taxing jurisdictions in the El Jebel area—namely, the Roaring Fork RTA. Similarly, whereas the choice between the first and second option makes no difference in the two examples above, since these communities do not have a municipal sales tax, the choice would make a difference for any incorporated municipality that has a state-administered sales tax, since “0206” codes do not include sales taxes for such municipalities. For example, the town of Olathe has a 4 percent sales tax; thus, it matters whether a business is assigned the location code labeled “Olathe-Montrose,” which carries the 4 percent tax, as opposed to the one labeled “Olathe-Montrose (0206),” which does not.



Second, the Department’s labels for location codes do not always clearly indicate the scope of the area for which they are intended. For example, the South-East Jefferson County Local Improvement District (LID) covers a sizeable portion of Jefferson County, as shown by the dotted area in EXHIBIT 2.9. The Department has assigned one location code for the entire area covered by the LID, labeled “Littleton-Jefferson (0206).” However, there are areas within the LID that are outside of Littleton and inside of or nearer to other communities, such as Lakewood. Thus, the label may make it unclear that this code should be used for areas near other communities or municipalities. For example, we identified 63 business sites that are located within the LID but do not have Littleton addresses. All but one of these were incorrectly registered with location codes for neighboring communities, such as Morrison, Lakewood, or Denver, and therefore are not collecting and remitting sales taxes for the South-East Jefferson County LID.

EXHIBIT 2.9. SE JEFFERSON COUNTY LID  
AND SURROUNDING CITIES



SOURCE: Office of the State Auditor analysis of GIS data obtained from OIT.

**THE DEPARTMENT DOES NOT ALWAYS COMMUNICATE TO THE PUBLIC COMPLETE AND FULLY ACCURATE INFORMATION ABOUT ITS LOCATION CODE SYSTEM.** We found three discrepancies between the location codes in GenTax and the January 2015 version of Form DR 0800. Specifically, Form DR 0800 omitted codes that are used in GenTax for the community of Parlin, which is in Gunnison County, and the portion of Highlands Ranch that is not within RTD. The form also omitted a location code for Littleton and showed incorrect codes for other areas of Douglas County. After we presented these issues to the Department during our audit, the Department released an updated version of Form DR 0800 in May 2015 that corrects the omissions and errors we identified.

## WHY DID THE PROBLEMS OCCUR?

Given the complexity of Colorado’s local sales tax laws, we found that the Department lacks adequate tools to ensure that its location code system is complete, that it provides clear descriptions of locations and the tax jurisdiction that apply to them, and that this information is communicated to the public.

**THE DEPARTMENT HAS NOT CREATED A MAP OF LOCAL SALES TAX JURISDICTIONS.** As described earlier, a business site’s sales tax liabilities are directly tied to its physical location. However, the system the Department has established to collect, administer, and enforce local sales taxes does not include a visual, geographic representation of such tax jurisdictions and instead relies only on text-based descriptions of local sales tax jurisdictions and lists of location codes. With a map displaying county, city, and special-district boundaries in relation to each other—possibly supplemented with reference points such as major roads—Department employees, local government staff, and businesses would be better able to determine a business’ tax liabilities based on location. Such a map could be based on the GIS application the Department develops in implementing RECOMMENDATION 1. Some states currently publish such maps on their tax agency websites. For example, the Ohio Department of Taxation’s website contains a map of the state’s 88 counties, color-coded with their local sales tax rates.

The Oklahoma Tax Commission publishes on its website the ordinances and maps of local tax jurisdictions, which include counties, cities, and some special districts, and links to GIS maps of municipalities and special districts. Additionally, the Washington Department of Revenue provides a “Tax Rate Lookup Tool” on its website that allows users to view tax jurisdiction boundaries, plot address points within these boundaries, and view the sales tax rates of plotted addresses.

**THE DEPARTMENT LACKS PROCEDURES AND TOOLS TO REVIEW ITS LOCATION CODE SYSTEM FOR COMPLETENESS AND ACCURACY.** As the maps provided earlier demonstrate, the jurisdictional boundaries are highly complex and are difficult to review manually. Currently, the Department relies on staff to update the location codes when changes to jurisdictional boundaries occur, but lacks a process to perform comprehensive reviews to ensure that all geographic regions are appropriately assigned to location codes. With a GIS mapping solution, as we describe in RECOMMENDATION 1, the Department would be able to perform reviews that compare its location code system to a complete, up-to-date map of sales tax jurisdictions in order to determine where new location codes may be required to represent new or changed combinations of sales tax jurisdictions.

**THE DEPARTMENT DOES NOT PUBLISH A SINGLE FORM THAT CLEARLY SHOWS WHICH JURISDICTIONS CORRESPOND TO WHICH LOCATION CODES.** Rather, the Department publishes two forms, one for location codes and one for taxing jurisdictions, and does not provide a crosswalk linking the two. Specifically, Form DR 1002 lists all sales and use taxes in effect, their tax rates, and their general boundaries (for example, the Baptist Road RTA is described as “a portion of the city of Monument”). Form DR 0800 lists all of the location codes available in GenTax (simplified to six-digits), organized by county. However, neither form explains the relationship between location codes and jurisdictions. The Department could publish a crosswalk form that would provide all system users a breakdown of the local sales tax jurisdictions and rates that are connected to each location code. Such information would provide more sales tax information to

system users and better allow them to accurately determine which location code is applicable to a particular business site.

**THE DEPARTMENT DID NOT ADEQUATELY REVIEW ITS LOCATION CODE FORM (DR 0800).** Department management reported that any changes the Business Tax Section wants to make to its forms must be submitted to the Department's graphic designers, who produce the changes and release the final form. However, the Department's process to update and review this form did not include a direct comparison with the appropriate location code tables in GenTax, resulting in the omissions and errors we explained earlier.

## WHY DO THESE PROBLEMS MATTER?

The problems we identified increase the risk that Department staff will assign businesses the wrong location code upon registration for sales tax licenses. Because the Department's local sales tax system relies on accurate assignment of location codes to determine businesses' tax liability, if it assigns businesses to the wrong location code or lacks a location code that includes all applicable tax jurisdictions for businesses, businesses will collect improper amounts. For example, a total of 33 business sites are located in the nine areas described earlier for which no applicable location codes exist, meaning that the Department cannot properly assign these businesses to all of their local tax jurisdictions and that the businesses are not collecting and remitting the proper sales taxes. Further, we found that 11,070 of the 103,836 active business sites (11 percent) that we reviewed had the wrong location code in GenTax (SEE RECOMMENDATION 1). Although there could be other reasons why these businesses are assigned to the wrong location code, such as businesses making mistakes on their registration forms, the problems we identified related to the Department's location coding system make misregistrations more likely. In addition, if the system is not clearly and accurately communicated to the public, businesses may have difficulty understanding their local sales tax requirements and incur increased time and costs navigating the system.

## RECOMMENDATION 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.
- 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.
- 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.
- 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.

## RESPONSE

### DEPARTMENT OF REVENUE

- A AGREE. IMPLEMENTATION DATE: JULY 2019.

Once the Department obtains funding to implement RECOMMENDATION 1B, it will develop a process in coordination

with local governments to regularly update its map of local sales tax jurisdictions.

B AGREE. IMPLEMENTATION DATE: JULY 2019.

Once the Department obtains funding to implement RECOMMENDATION 1B, it will periodically review the results of its process for mapping business addresses and location code assignment. If any additional location codes are required, then the Department will develop those and work with affected businesses and local jurisdictions to get businesses registered correctly.

C AGREE. IMPLEMENTATION DATE: MAY 2016.

The Department will develop a new crosswalk form that compares tax rates for local jurisdictions, location codes, and jurisdiction codes used in the registration process.

D AGREE. IMPLEMENTATION DATE: JULY 2016.

Tax rate changes and annexations occur at six month intervals. The Department will implement this recommendation in July 2016, which aligns with the next period during which rates and annexations can change. The Department will develop and implement a process for the regular review of the codes and descriptions identified on the DR 800 with the information in GenTax for each jurisdiction. We will update either the form or the system if needed and communicate any changes to the local jurisdictions and any affected businesses.

# ASSISTANCE FOR BUSINESSES

In previous sections, we discussed the challenges faced by the Department and business owners in determining which taxing entities have jurisdiction over a business's physical site and, correspondingly, which of the Department's location codes they should use when registering the site for a sales tax license. In this section, we discuss similar challenges associated with determining applicable taxing jurisdictions and rates when the point of sale occurs at the customer's location, as opposed to a physical site owned by the business, such as a store front. Generally, a jurisdiction's sales taxes apply to a transaction if (1) the buyer is within the jurisdiction when taking receipt of the purchased property (or service, in the case of utilities and telecommunications) and (2) the seller has established what federal courts call a business "nexus" within the jurisdiction. A business can establish a nexus if it has some form of physical presence within the jurisdiction (not necessarily a retail store), such as a warehouse, storage space, or office, or if it employs sales representatives that frequent the area and engage in regular, purposeful sales activities directed at customers within the jurisdiction. Thus, businesses that ship or deliver products directly to their customers must determine whether the customers are inside or outside of any of the jurisdictions in which they have a nexus. The following are examples of businesses that collect sales taxes based on their customers' locations:

- Providers of natural gas, electrical, telephone, and cellular services
- Retailers, such as furniture and appliance stores, that deliver goods using their own vehicles
- Online and mail-order retailers that ship products to customers using common carriers

- Mobile vendors, such as food trucks, that sell directly from a vehicle
- Companies with traveling sales agents
- Multi-level marketing firms that have networks of representatives selling products in people’s homes

The Department requires retail businesses to obtain sales tax licenses for every physical site from which they conduct sales. However, if a licensed business establishes a nexus within another jurisdiction by conducting sales at customers’ locations but does not have a “brick-and-mortar” retail site there, the Department requires it to register for a “non-physical” site, which will be linked to its account in GenTax and to the appropriate location code and jurisdictions. If a business has customers and a nexus in multiple jurisdictions, then it must register as many non-physical sites as necessary to cover all the jurisdictions in which it conducts sales. When filing sales tax returns, such businesses combine all the taxable sales that occurred within each area defined by their non-physical sites and report them in separate, site-specific filings.

The General Assembly has recognized the difficulty retail businesses sometimes have in identifying applicable taxing jurisdictions and passed legislation in 2004 designed to help. In the legislative declaration for House Bill 04-1237, the General Assembly stated that retailers “are often penalized for collecting the incorrect amount of tax from a purchaser due to inaccurate information regarding the entities that have jurisdiction to impose a tax on the purchase.” The General Assembly further stated, “Therefore, it would be beneficial for the state to authorize retailers to use an electronic database of addresses, certified for accuracy by the state, to determine the jurisdictions to which sales and use tax is owed and to hold retailers harmless for errors in collection when relying on a certified database to determine the jurisdictions.” The rest of this bill, which was codified in Section 39-26-105.3, C.R.S., establishes parameters for the Department to certify providers of such electronic databases and sets minimum criteria for certification to help ensure accuracy. In particular, the law



requires the databases to be at least 95 percent accurate and gives authority to the Department to designate a third party to verify their accuracy. Currently, there are two database providers certified by the Department that have been verified for accuracy by such a third party.

## WHAT WAS THE PURPOSE OF OUR AUDIT WORK AND WHAT WORK WAS PERFORMED?

The purpose of our audit work was to determine whether the Department's process for certifying database providers pursuant to Section 39-26-105.3, C.R.S., effectively achieves the General Assembly's intent of providing a means for businesses to accurately determine their sales tax liabilities.

We reviewed the guidance that the Department provides on its website related to filing sales tax returns for non-physical sites, how to determine what jurisdictions apply to sales transactions, and how to determine whether a business has established a nexus within local jurisdictions. We examined the Department's forms and instructions related to applying for sales tax licenses and filing sales tax returns. We also interviewed Department staff in the Registration Control and Field Audit sections to understand the processes by which the Department issues sales tax licenses for businesses needing to use non-physical sites and how it checks the accuracy of their sales tax filings during audits. In addition, we reviewed the Department's rules for certifying private database providers and documents from the most recent certifications in 2007. We also interviewed representatives from the two database providers that are currently certified by the Department.

## HOW WERE THE RESULTS OF THE AUDIT WORK MEASURED?

We expected the Department's certification process established in Section 39-26-105.3, C.R.S., to provide businesses with an accurate

and practical method for determining sales tax liabilities. As a condition for certification, Subsection 3 of this statute requires that providers' databases include all addresses in the state and that they be "at least ninety-five percent accurate based on a statistically valid sample of addresses from the database." The statute assigns responsibility to the Department for testing the accuracy [Section 39-26-105.3(3), C.R.S.].

Further, to support the legislative intent that retail businesses be able to use certified databases to reduce the possibility of collecting the incorrect amount of tax due to inaccurate information regarding the applicability of local taxing jurisdictions, certified databases need to be practically usable and viable options for retailers.

## WHAT PROBLEMS DID THE AUDIT WORK IDENTIFY AND WHY DID THEY OCCUR?

Based on our audit work, it is not clear that the use of private database providers is the most effective and economical method of making resources available to businesses for determining the jurisdictions to which sales taxes are owed, especially when businesses must make such determinations at the level of individual transactions. This is because the current certification process does not ensure that accurate data are readily available to businesses.

**THE CERTIFICATION PROCESS PROVIDED BY DEPARTMENT RULES DOES NOT ENSURE 95 PERCENT ACCURACY, AS REQUIRED BY STATUTE.** Specifically, the Department's rules [1 CCR 201-4, Regulation 39-26-105.3] state that the third-party verifier shall use a random sample of 2,000 Colorado addresses to test the accuracy of a database. The rules state that the verifier shall provide the sample to each "municipality, county, and special district that may reasonably claim that one or more of the addresses are within their respective jurisdiction" and allow them 30 days to verify whether the addresses are correctly listed as being inside or outside of their jurisdictions. The rules further state, "If the local taxing authority does not accept or reject the accuracy of

an address within the 30-day period, the addresses shall be deemed correct for the purposes of verifying the accuracy of databases.” For calculating the accuracy of a tested database, the rules state that each address evaluated counts for four distinct jurisdictional determinations—one each for determinations of applicable state, county, city, and special districts. Thus, for example, the accuracy rate of 2,000 addresses would be calculated on the basis of 8,000 jurisdictional determinations. We identified two basic problems with the approach outlined in the Department’s rules, as explained below.

- **LACK OF RELIABLE SOURCE DATA.** The provision in rules that if a local taxing authority does not verify the addresses sent to it the sample data will be assumed to be correct assumes the sample source is inherently accurate. In 2007, which is the last time a database was tested for accuracy, the third-party verifier pulled the sample of business addresses from the Department’s own registration system. However, as we demonstrated in RECOMMENDATION 1, the registration records in GenTax are *not* entirely accurate. Additionally, the method of verifying the data—asking local jurisdictions to report if the sample data are accurate or inaccurate—is problematic as we found when we surveyed local sales tax administrators. In our survey, 34 of the 77 respondents (44 percent) reported they do not independently track businesses located within their jurisdictions outside of the information they receive from the Department. As a result, these local jurisdictions would not be a reliable source to verify the addresses sent to them. As an alternative approach, the Department could use the GIS-based application suggested in RECOMMENDATION 1 as a reference for verifying the accuracy of databases from private providers.
- **FLAWED METHOD FOR CALCULATING ACCURACY.** The method outlined in the Department’s rules for calculating accuracy is flawed for two reasons. First, it assigns one-fourth of the accuracy calculation to whether the database correctly identifies addresses that are within Colorado. Since presumably all of the tested addresses are within Colorado, including the state as a factor diminishes the importance of errors related to local jurisdictions.

Second, this method does not ensure that 95 percent of the tested addresses will be error free, because it assumes every address involves four distinct jurisdictional determinations. In fact, this method allows up to 20 percent of the tested addresses to have errors. For example, if 2,000 addresses are tested, 400 of them (20 percent) could have one error each and the database would be deemed 95 percent accurate. Consequently, according to the third-party verifier's reports from 2007, both of the providers that were certified scored less than 95 percent accuracy for identifying applicable city tax jurisdictions, yet they were deemed at least 95 percent accurate overall. This outcome does not seem to be consistent with the intent of statute. A better method would be to calculate the percentage of addresses for which the database correctly determined *all* applicable jurisdictions.

**THE DEPARTMENT HAS EXTENDED CERTIFICATIONS WITHOUT RE-VERIFYING ACCURACY.** According to the Department, since 2007 it has extended the expiration dates for the two providers' certifications over the last 8 years without verifying that they still meet the criteria outlined in statute, including that their databases are at least 95 percent accurate. This practice is in violation of statute, which states that "such certification shall be valid for three years" [Section 39-26-105.3(3), C.R.S.]. The practice also violates the Department's own rule, which is more restrictive than statute and states, "The certification shall be effective for two years, beginning with the date that the Department issues notice of certification. The certification shall expire automatically upon the expiration of two years from the effective date," [1 CCR 201-4, Regulation 39-26-105.3].

**CERTIFICATION OF PRIVATE PROVIDERS MAY NOT PROVIDE AN ECONOMICAL SOURCE OF DATA FOR ALL BUSINESSES.** We contacted both database providers that are currently certified, and neither were willing to tell us how many businesses use their databases in Colorado. The Department also was unable to estimate usage. Although we were unable to determine if the use of certified database providers is widespread in Colorado, we found that cost considerations could disincline businesses from using them, despite the

benefits of the “hold harmless” provision in statute. Specifically, we found:

- **THE DATABASES ARE COSTLY.** Although one database provider offers an online lookup tool that businesses can use free of charge, this tool only allows a user to look up one site address at a time, which would be impractical for businesses that make hundreds or thousands of sales at customers’ locations each month. Both of the currently certified providers offer customizable software solutions that businesses can purchase to determine applicable sales taxes. We asked both providers how much their solutions cost, and neither were able to tell us in the absence of a bid request with specific requirements. However, both providers said that they would charge between 5 and 15 cents per address to process them in batches on their own servers, which could be costly for some businesses, depending on their sales volume and average invoice totals. Further, businesses that need custom software integrated into their existing accounting systems would incur additional costs.
- **SOME BUSINESSES ARE USING OTHER OPTIONS.** Department staff report that some businesses use software applications from non-certified providers to determine the applicable taxing jurisdictions and rates for their transactions. This is problematic because such applications have not been tested for accuracy by the Department. According to staff, some of these applications identify applicable tax rates based on the customer’s ZIP code. However, we found that ZIP codes are an imprecise indicator of taxing jurisdictions, because they do not necessarily correspond to the boundaries of any particular taxing jurisdiction. Thus, there is significant risk that businesses using applications from non-certified providers may be misreporting taxable sales for local jurisdictions.

We also found that although statute gives the Department authority to establish criteria for certification, the Department does not require providers to report the number of companies in Colorado that use their software. The Department could require such reporting to allow it to collect metrics on the penetration of these solutions within the

business community and thereby evaluate whether use of the databases is practical in real-life situations.

**IMPROVING DATA AVAILABILITY FOR BUSINESSES.** Given the problems with the current method of certifying private providers to make tax data available to businesses, the optimal solution may be for the Department to develop and provide a free database service to businesses. Taking this approach would both address the problems we identified and position the Department to meet requirements that may be imposed by pending legislation at the federal level. Specifically, in 2013 a bill known as the “Marketplace Fairness Act of 2013” was introduced in both houses of Congress, which would have allowed states implementing certain tax simplification requirements to collect sales and use taxes from remote retailers, such as online stores, that ship products to customers within their jurisdictions but that do not have a physical presence there. The bill was passed by the Senate, but failed to pass in the House of Representatives. Nevertheless, in anticipation of the bill’s possible enactment, Colorado’s General Assembly passed House Bill 13-1295, which included provisions implementing some of the necessary simplifications, but only upon passage of the federal law. Specifically, Colorado’s bill, codified in Section 39-26-105.3(8)(a), C.R.S., states, “The Department of Revenue shall make available free of charge software to retailers that calculates sales taxes due on each transaction at the time the transaction is completed, files tax returns, and updates to reflect any tax rate changes for the state or any local taxing jurisdiction.” House Bill 13-1295 also contained provisions allowing the Department to contract with a private provider to make such software available to retailers free of charge and would have appropriated about \$363,000 to the Department for Fiscal Year 2014 to cover development and service costs. The state bill was written such that the free software provision and the associated appropriation only become effective upon enactment of the federal Marketplace Fairness Act of 2013. Although the federal bill did not pass, similar legislation was introduced in 2015 into the current Congress [S. 698 and H. R. 2775, 114th Cong. (2015)] that would require states to meet similar simplification requirements before collecting sales taxes from remote retailers. If

such legislation were to pass and the General Assembly were to update the State's law accordingly, the Department could be required to provide free software to retailers for looking up sales tax jurisdictions and rates.

Regardless of whether Congress enacts legislation similar to the Marketplace Fairness Act of 2013, there already seems to be a need for software that businesses can use to accurately determine the local sales taxes they should be collecting. In addition, the Department reports that at least one online retailer has already begun voluntarily collecting and remitting local sales taxes to the State, even though it is not yet technically required to do so. If the Department develops the GIS tools discussed in RECOMMENDATION 1, it would be well-positioned to develop a free software solution for businesses that is capable of accurately determining taxing jurisdictions and GenTax location codes. The Department could then verify the accuracy of the system and certify itself as a database provider under Section 39-26-105.3, C.R.S., to extend the hold harmless provision to any business that uses the Department's software.

## WHY DO THESE PROBLEMS MATTER?

Due to the complex geographical relationships of sales tax jurisdictions in this state, which we describe in previous sections, the lack of tools to accurately determine applicable local sales taxes, such as GIS mapping tools, creates a risk that businesses will incorrectly identify the jurisdictions for which they owe sales taxes and miscollect sales taxes for those jurisdictions. Because thousands of businesses in the state make sales at their customers' locations, this risk is substantial. Although the Department was unable to provide precise figures on the total amount of sales taxes collected by businesses at customer locations, we summarized sales tax data from GenTax and estimated that in Calendar Year 2014 at least 8,300 businesses decided whether they should collect local sales taxes based on their customers' locations. Neither we nor the Department has information necessary to confirm that these businesses correctly determined applicability of local sales taxes for such sales. While businesses may

have reported these sales correctly, any errors could result in mis-collections. Specifically, we found the following:

- **TAXES COLLECTED FOR NON-PHYSICAL SITES.** About 5,600 businesses collected about \$152 million in local sales taxes that they reported on sales tax returns for approximately 125,000 non-physical sites. This represents about 14 percent of the total \$1.1 billion that businesses collected for both physical and non-physical sites combined. About 820 of these 5,600 businesses (15 percent) also had licenses for physical sites that we determined were registered in error, as discussed in RECOMMENDATION 1. Thus, it appears that many of these businesses may not have adequate methods for determining the tax jurisdictions that apply to specific addresses.
- **UNTAXED SALES THAT OCCUR OUTSIDE THE JURISDICTIONS OF A BUSINESS' PHYSICAL SITE.** About 3,200 business sites with licenses for physical locations reported more taxable sales for the State than they did for their municipalities during at least one reporting period in 2014, indicating that they conducted some sales outside of their municipalities' jurisdictions. In total, we estimate at least \$1.1 billion in sales were untaxed by municipalities because retailers deemed them to have occurred outside of the municipalities' boundaries. While these sales may have been correctly reported, there is a possibility of error because a retailer might make an incorrect judgment as to whether a sale occurred inside or outside of the municipality. Thus, for some sales, municipalities may not have received all of the sales tax revenue that is due.



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

## RESPONSE

### DEPARTMENT OF REVENUE

- A AGREE. IMPLEMENTATION DATE: NOVEMBER 2016.

As part of its research into implementing RECOMMENDATION 1A, the Department will evaluate offering the solution it develops, if funded, to the public in a manner that meets the requirements of the certified databases currently available. Included in this evaluation will be an assessment of the effectiveness of the current process; the feasibility of offering the solution in lieu of the

certified databases; how such a solution can satisfy the requirements of H.B. 13-1295; and a discussion of any necessary legislative changes.

B AGREE. IMPLEMENTATION DATE: NOVEMBER 2016.

The Department will update the Legislative Audit Committee after the evaluation identified in RECOMMENDATION 3A is complete.

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

## RESPONSE

### DEPARTMENT OF REVENUE

- A AGREE. IMPLEMENTATION DATE: DECEMBER 2016.

The Department will update its rules with regard to the certified database providers that will properly reflect the statutory requirements associated with certifying the third-party database providers. We will review and update the method used to calculate the accuracy of the database providers and develop guidance regarding the source or quality of data that verifiers should use as a reference. We will also delineate the process for re-certification and develop procedures for the certification to end after three

years, or be extended through the provisions of Section 39-26-105.3(5), C.R.S. Additionally, if the results of the evaluation described in Recommendation 3A results in a state owned or operated system, we will update our regulations accordingly.

**B AGREE. IMPLEMENTATION DATE: JANUARY 2017.**

Once rules are finalized pursuant to RECOMMENDATION 4A, we will notify the current database providers that they will need to re-apply for recertification.

# LOCAL GOVERNMENT SERVICES

To provide local governments with a single point of contact and to make sure their issues are addressed in a professional and timely way, the Department created a local government liaison office in late 2009. This office is staffed by two full-time equivalent staff, responsible for providing local government tax administrators with the monthly sales tax reports required by Section 29-2-106(4)(c)(I), C.R.S.; training local government staff on how to use and review the monthly reports; responding to local governments' questions, concerns and requests for audits of businesses; and handling other requests for information and support. These employees also ensure that each local government designates a single point of contact on its end who will annually sign a memorandum of understanding with the Department pledging to protect the confidentiality of taxpayer information. Through these activities, the Department seeks to strengthen local governments' ability to ensure businesses are registered in the correct jurisdiction and that they are collecting and remitting the correct amount of taxes.

## WHAT WAS THE PURPOSE OF THE AUDIT WORK AND WHAT WORK WAS PERFORMED?

The purpose of the audit work was to determine whether the Department provides required reports to local governments and whether the local government liaison office efficiently and effectively responds to and resolves their concerns and requests. We conducted a survey of all 220 sales tax administrators from jurisdictions for which the Department collects sales taxes and who have signed memoranda of understanding with the Department regarding their satisfaction with services and resources from the Department and reviewed the answers from the 77 (35 percent) that responded. We interviewed the local government liaison staff and business tax management staff at

the Department to understand their processes for managing incoming local government questions and requests. We also reviewed the Department's electronic records used to track local government audit requests and hardcopy logs maintained by Department staff to track other contacts and requests from local governments. In addition, we reviewed the local jurisdiction reference guide that was created by the Department's local government liaison office. We also reviewed examples of standard reports that the Department provided to local tax administrators showing the businesses registered in their jurisdictions and the net sales tax revenue the Department received from each during January 2015.

## HOW WERE THE RESULTS OF THE AUDIT WORK MEASURED?

We evaluated the two primary service functions of the Department's local government liaison office:

- **PROVIDING TAX REPORTS TO LOCAL GOVERNMENTS.** Statute [Section 29-2-106(4)(b) and (c), C.R.S.] requires the Department to provide monthly reports to municipalities and counties with information about the retail businesses licensed within their jurisdiction and the sales tax returns filed by those businesses. For municipal and county officials that have signed a memorandum of understanding with the Department to protect confidential information, statute further requires the Department to provide monthly reports on the status of each business' account, and the amount of sales tax the business has collected and paid on behalf of the municipality or county.
- **PROVIDING TAX SUPPORT TO LOCAL GOVERNMENTS.** According to interviews with the Department and information in the job descriptions of the local government liaison office staff, the Department expects its local government liaison office to respond proactively to issues raised by local governments with the aim of reducing the possibility of their occurrence in the future. Toward this aim, the local government liaison office needs to have a good

system for tracking the approximately 180 calls it receives per month so that Department management can ensure issues are being resolved efficiently and effectively. Therefore, we evaluated the Department's system for managing inquiries and complaints according to how well it allows management to monitor the timeliness of responses provided by the local government liaison office and to track and analyze concerns by type.

## WHAT PROBLEM DID THE AUDIT WORK IDENTIFY AND WHY DID IT OCCUR?

We found that the Department provides the monthly reports to local governments that are required by statute and adequately responds to requests for audits. We also found that most local governments were satisfied with the outreach and timeliness of information provided by the Department. Specifically, 90 percent of local government survey responses reported satisfaction with the Department's outreach efforts, and 87 percent of the tax administrators who said they had contacted the Department in the last year reported being satisfied with the timeliness of the information provided by the Department. Nevertheless, we found that there are some ways the Department can achieve greater efficiencies in its management of inquiries, complaints, and requests for assistance from local governments.

The Department receives a high volume of contacts from local governments. In addition to formal audit requests, which the Department tracks separately, based on staff tallies, the local government liaison office receives an average of about 180 contacts per month from local governments with inquires, complaints, and other requests for information or assistance. Currently, to record these types of contacts, staff use handwritten notes on paper logs, which typically include the name of the jurisdiction, the date of initial contact, the date of any resolution, and sometimes—though not always—the reason for the contact. Because the contacts are recorded on paper and the information is not collected in a consistent or comprehensive manner, we found the following deficiencies in the Department's system:

- **NO MONITORING OF RESPONSE TIMES.** Management does not measure or review response timeliness. Given the call volume, any analysis of timeliness based on the information collected by staff on paper notes and logs would require a significant amount of manual calculation. Although most of the local governments that completed our survey reported being satisfied with the timeliness of information they receive from the Department, the Department cannot demonstrate its overall level of timeliness, nor can management easily analyze complaints received to determine which types of issues take the most time to resolve and why. For example, management does not have sufficient data to analyze potential problem areas that could explain why 13 percent of the tax administrators who reported having contacted the Department in our survey expressed dissatisfaction with the Department's timeliness in responding to issues.
- **NO TRACKING OR ANALYSIS OF CONTACTS BY TYPE.** Department staff do not categorize contacts made with local governments by type for tracking or analysis purposes. For example, staff cannot generate reports to show the number of contacts that had to do with delinquent taxpayer accounts as opposed to more basic questions, such as how to login to RevenueOnline, the Department's web-based interface for GenTax that local governments use to access reports.
- **NO GOALS FOR MANAGING THE HIGH VOLUME OF CONTACTS.** Because the Department does not track contacts by type, it does not know what drives the volume or whether the volume could be reduced. Thus, the Department has not set goals for reducing complaints or the general call volume through proactive solutions, such as providing targeted trainings on common issues for local-government sales tax administrators.

According to the Department, it has not implemented an electronic system to track its contacts with local governments due to limited resources and staff time constraints. We recognize that the volume of calls and emails the Department receives from local sales tax administrators, though significant, may not be high enough to warrant



investment in a state-of-the-art customer resource management solution. Nevertheless, the Department could use common desktop software to create a system for better monitoring of these contacts without a large expenditure of resources. For example, DOLA handles a similar volume of contacts from local government officials, county assessors, and the general public using a simple electronic database. DOLA uses this database to help control the consistency of answers provided for similar questions, to measure the volume of calls to understand how local government officials and the general public are using them as a resource, and to ensure that all requests are being addressed in a timely manner.

## WHY DOES THIS PROBLEM MATTER?

Because the Department's local government liaison office does not systematically track and monitor inquiries and requests from local governments, it may not be operating as efficiently as possible. Specifically:

**THE DEPARTMENT IS LESS EQUIPPED TO IDENTIFY SYSTEMIC PROBLEMS AND INEFFICIENCIES.** Common or recurring issues presented by local governments could indicate a need for systemic changes to the Department's policies or procedures. For example, Department staff report that there are a few local sales tax administrators who frequently call with issues that take up a large amount of staff time to research and resolve. According to the Department, one of the issues these administrators often call to discuss is the accounts of individual taxpayers who are delinquent in their payments. Such calls may require liaison staff to research business accounts in GenTax or to review the historical revenue trends for a jurisdiction and correlate changes with businesses that opened or closed. Without more data on the reasons for such calls, where they are coming from, and how they are being resolved, it is difficult to determine whether there may be a more efficient way to address the concerns being raised and target outreach to the areas with the most need. For example, if the data showed that administrators often call the Department when taxpayers in their jurisdictions have been delinquent for a certain number of

days, the Department could use this information to build processes for sending automatic status updates when accounts are delinquent or to consider adjusting the thresholds for when various enforcement actions are taken. Similarly, the Department may identify a need to provide more guidance or to change the format or content of its monthly reports to better assist the local governments' monitoring. By adjusting its processes in this way, the Department could potentially improve its overall administration of sales taxes and reduce the volume of inquiries it receives. However, the information needed for this kind of analysis cannot easily be gleaned from the local government liaison's paper logs.

**THE DEPARTMENT MAY NOT BE USING STAFF RESOURCES EFFICIENTLY.** Department staff in the local government liaison office reported that a significant amount of their time is spent responding to the large volume of phone calls and emails the office receives from local sales tax administrators. Consequently, staff have less time to spend on outreach and training, which, if provided, could be a more efficient way of addressing the concerns of local governments and could result in less call volume. Additionally, due to the constant interruptions, staff have less time to work on tasks that require more focus, such as researching problem accounts, creating training materials, and updating the reference guide. Staff report working after normal business hours to complete such tasks when local government officials are less likely to call.

**THE DEPARTMENT IS LESS PREPARED FOR STAFF TURNOVER.** Currently, the Department relies on the handwritten log notes and knowledge of two staff members to ensure that it responds to local government inquiries and problems in a timely manner and to identify potential areas for improvement. If either or both persons were to leave the Department, much of this information would be lost, thereby limiting the Department's ability to efficiently address the volume of phone calls and emails from local governments going forward.

## RECOMMENDATION 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.
- B Monitoring the timeliness of responses to local government 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.
- 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.

## RESPONSE

### DEPARTMENT OF REVENUE

- A AGREE. IMPLEMENTATION DATE: FEBRUARY 2016.

The Department will develop a spreadsheet that tracks inquiries, requests, and complaints to replace the manual system of tracking these items currently in use.

- B AGREE. IMPLEMENTATION DATE: FEBRUARY 2016.

The Department notes that according to the audit, 87 percent of local government survey respondents who said they contacted the Department in the last year reported being satisfied with the

timeliness of our responses to them. Nonetheless, it is useful to benchmark the response rates for future use and for management to make improvements in customer service.

C AGREE. IMPLEMENTATION DATE: FEBRUARY 2016.

Analysis of the local government contacts by type will begin with the implementation of the tracking system required by RECOMMENDATION 5A. The Department will start this in February, 2016.

D AGREE. IMPLEMENTATION DATE: AUGUST 2016.

We will analyze data obtained by implementing RECOMMENDATION 5A, B, and C for six months and begin benchmarking these for performance and customer service improvement.

# APPENDIX A



# ESTIMATED ERRORS IN SALES TAX REGISTRATIONS

## – CALENDAR YEAR 2014

	SALES TAX TYPE	SITES ACTUALLY INSIDE THE JURISDICTIONS	SITES INSIDE THAT ARE REGISTERED AS BEING OUTSIDE	SITES OUTSIDE THAT ARE REGISTERED AS BEING INSIDE	ERROR RATE <sup>1</sup>
<ul style="list-style-type: none"> <li>● = Has a state-administered sales tax</li> <li>⦿ = Has a self-collected sales tax</li> <li>■ = Receives county sales taxes through an inter-governmental agreement</li> <li>Blank = Does not have a sales tax</li> </ul>					
<b>COUNTIES</b>					
Adams	●	6,898	245	106	5%
Alamosa	●	373	3	0	1%
Arapahoe	●	9,986	177	241	4%
Archuleta	●	486	3	0	1%
Baca		100	0	0	0%
Bent	●	48	0	0	0%
Boulder	●	6,859	22	33	1%
Broomfield	⦿	1,183	25	38	5%
Chaffee	●	841	0	0	0%
Cheyenne		45	0	0	0%
Clear Creek	●	322	7	2	3%
Conejos		108	0	1	1%
Costilla	●	39	0	0	0%
Crowley	●	34	1	0	3%
Custer	●	180	2	1	2%
Delta	●	859	3	2	1%
Denver	⦿	14,105	85	259	2%
Dolores		32	0	2	6%
Douglas	●	4,752	75	12	2%
Eagle	●	2,064	13	12	1%
El Paso	●	10,156	15	2	0%
Elbert	●	360	8	8	4%
Fremont	●	835	2	0	0%
Garfield	●	1,480	7	9	1%
Gilpin		129	0	30	19%
Grand	●	915	1	0	0%
Gunnison	●	855	0	1	0%
Hinsdale	●	90	0	0	0%
Huerfano	●	189	1	0	1%
Jackson	●	57	0	0	0%
Jefferson	●	9,323	167	79	3%
Kiowa		25	0	0	0%
Kit Carson		245	0	0	0%

	SALES TAX TYPE	SITES ACTUALLY INSIDE THE JURISDICTIONS	SITES INSIDE THAT ARE REGISTERED AS BEING OUTSIDE	SITES OUTSIDE THAT ARE REGISTERED AS BEING INSIDE	ERROR RATE <sup>1</sup>
<p>● = Has a state-administered sales tax            ● = Has a self-collected sales tax            ■ = Receives county sales taxes through an inter-governmental agreement            Blank = Does not have a sales tax</p>					
La Plata	●	1,596	1	9	1%
Lake	●	235	0	0	0%
Larimer	●	6,812	11	18	0%
Las Animas		352	0	0	0%
Lincoln	●	125	0	1	1%
Logan	●	506	1	0	0%
Mesa	●	3,074	0	1	0%
Mineral	●	65	1	0	2%
Moffat	●	381	0	0	0%
Montezuma		620	1	1	0%
Montrose	●	1,043	5	5	1%
Morgan		539	0	5	1%
Otero	●	356	0	1	0%
Ouray	●	303	2	1	1%
Park	●	359	3	1	1%
Phillips	●	143	0	0	0%
Pitkin	●	1,030	11	11	2%
Prowers	●	289	0	0	0%
Pueblo	●	2,559	0	4	0%
Rio Blanco	●	213	1	0	0%
Rio Grande	●	342	2	6	2%
Routt	●	1,153	1	0	0%
Saguache	●	122	3	1	3%
San Juan	●	115	6	0	5%
San Miguel	●	519	1	2	1%
Sedgwick	●	78	0	0	0%
Summit	●	2,219	1	1	0%
Teller	●	535	1	7	1%
Washington	●	97	2	0	2%
Weld		3,782	44	45	2%
Yuma		301	0	2	1%
<b>MUNICIPALITIES</b>					
Aguilar	●	9	0	2	18%
Akron	●	52	3	5	14%
Alamosa	●	266	6	63	21%
Alma	●	26	2	1	11%
Antonito	●	22	2	3	20%
Arriba		3	0	2	40%



	SALES TAX TYPE	SITES ACTUALLY INSIDE THE JURISDICTIONS	SITES INSIDE THAT ARE REGISTERED AS BEING OUTSIDE	SITES OUTSIDE THAT ARE REGISTERED AS BEING INSIDE	ERROR RATE <sup>1</sup>
<ul style="list-style-type: none"> <li>● = Has a state-administered sales tax</li> <li>⦿ = Has a self-collected sales tax</li> <li>■ = Receives county sales taxes through an inter-governmental agreement</li> <li>Blank = Does not have a sales tax</li> </ul>					
Arvada	⦿	1,496	41	184	13%
Aspen	⦿	685	16	77	12%
Ault	●	35	1	3	11%
Aurora	⦿	4,259	142	117	6%
Avon	⦿	221	20	116	40%
Basalt	●	207	12	14	12%
Bayfield	●	64	4	31	37%
Bennett	●	28	1	18	41%
Berthoud	●	123	0	26	17%
Bethune		3	0	4	57%
Black Hawk	⦿	20	1	38	67%
Blanca	●	6	0	0	0%
Blue River	●■	47	17	4	41%
Bonanza		0	0	0	0%
Boone		3	0	1	25%
Boulder	⦿	3,019	82	352	13%
Bow Mar		8	8	0	100%
Branson		1	0	1	50%
Breckenridge	⦿■	860	40	89	14%
Brighton	⦿	530	50	98	24%
Brookside		4	4	0	100%
Broomfield	⦿	1,183	25	38	5%
Brush	●	119	0	3	2%
Buena Vista	●	173	2	31	16%
Burlington	●	130	6	8	10%
Calhan	●	27	0	4	13%
Campo		0	0	3	100%
Cañon City	⦿	435	16	66	16%
Carbondale	⦿	249	12	30	15%
Castle Pines	●	111	10	0	9%
Castle Rock	⦿	937	47	63	11%
Cedaredge	●	70	1	11	15%
Centennial	⦿	1,947	124	40	8%
Center	●	21	0	6	22%
Central City	⦿	24	2	2	15%
Cheraw		6	1	0	17%
Cherry Hills Village	⦿	98	74	0	76%
Cheyenne Wells	●	22	1	5	22%

	SALES TAX TYPE	SITES ACTUALLY INSIDE THE JURISDICTIONS	SITES INSIDE THAT ARE REGISTERED AS BEING OUTSIDE	SITES OUTSIDE THAT ARE REGISTERED AS BEING INSIDE	ERROR RATE <sup>1</sup>
<p>● = Has a state-administered sales tax            ○ = Has a self-collected sales tax            ■ = Receives county sales taxes through an inter-governmental agreement            Blank = Does not have a sales tax</p>					
Coal Creek		1	0	0	0%
Cokedale		1	0	0	0%
Collbran	●	16	1	7	35%
Colorado Springs	○	7,724	165	635	10%
Columbine Valley	●	15	7	0	47%
Commerce City	○	1,283	611	51	50%
Cortez	○	286	4	59	18%
Craig	●■	295	2	22	8%
Crawford	●	8	0	11	58%
Creede	●	38	0	5	12%
Crested Butte	○	270	4	48	16%
Crestone	●	18	0	4	18%
Cripple Creek	●	60	1	5	9%
Crook		5	0	1	17%
Crowley		1	0	0	0%
Dacono <sup>2</sup>	●	50	3	0	6%
De Beque	●	10	0	5	33%
Deer Trail		11	3	3	43%
Del Norte	●	42	0	4	9%
Delta	○	299	17	28	14%
Denver	○	14,105	85	259	2%
Dillon	●■	125	3	41	27%
Dinosaur	●■	7	0	0	0%
Dolores	●	47	1	11	21%
Dove Creek	●	16	2	0	13%
Durango	○	877	42	182	21%
Eads	●	22	2	0	9%
Eagle	●	192	4	6	5%
Eaton	●	87	2	4	7%
Eckley		1	0	4	80%
Edgewater	○	98	1	0	1%
Elizabeth	●	61	0	24	28%
Empire	●	17	0	0	0%
Englewood	○	1,050	31	540	36%
Erie	●	240	16	8	10%
Estes Park	●	534	7	41	8%
Evans	○	171	6	1	4%
Fairplay	●	68	1	6	9%

	SALES TAX TYPE	SITES ACTUALLY INSIDE THE JURISDICTIONS	SITES INSIDE THAT ARE REGISTERED AS BEING OUTSIDE	SITES OUTSIDE THAT ARE REGISTERED AS BEING INSIDE	ERROR RATE <sup>1</sup>
<p>● = Has a state-administered sales tax            ○ = Has a self-collected sales tax            ■ = Receives county sales taxes through an inter-governmental agreement            Blank = Does not have a sales tax</p>					
Federal Heights	○	138	20	1	15%
Firestone	●	105	2	3	5%
Flagler	●	21	1	3	17%
Fleming	●	4	0	2	33%
Florence	●	105	0	5	5%
Fort Lupton	●	137	7	12	13%
Fort Morgan	●	281	6	15	7%
Fountain	●	216	9	5	6%
Fowler	●	31	0	0	0%
Foxfield	●	13	2	0	15%
Fraser	●	75	2	22	25%
Frederick	●	169	15	0	9%
Frisco	○■	272	3	23	9%
Fruita	●	166	7	7	8%
Ft Collins	○	2,885	82	443	16%
Garden City	●	54	3	0	6%
Genoa		0	0	1	100%
Georgetown	●	66	1	0	2%
Gilcrest	●	8	0	0	0%
Glendale	○	184	54	1	30%
Glenwood Springs	○	463	11	42	10%
Golden	○	572	31	366	42%
Granada	●	9	0	0	0%
Granby	●	143	6	10	10%
Grand Junction	○	1,985	98	195	13%
Grand Lake	●	94	2	8	10%
Greeley	○	1,423	49	84	9%
Green Mountain Falls	●	29	3	0	10%
Greenwood Village	○	821	95	4	12%
Grover		2	0	0	0%
Gunnison	○	221	3	32	14%
Gypsum	○	132	2	14	11%
Hartman		0	0	0	0%
Haswell		0	0	1	100%
Haxtun	●	36	0	2	5%
Hayden	●	32	0	4	11%
Hillrose		2	0	1	33%
Holly	●	27	0	2	7%

	SALES TAX TYPE	SITES ACTUALLY INSIDE THE JURISDICTIONS	SITES INSIDE THAT ARE REGISTERED AS BEING OUTSIDE	SITES OUTSIDE THAT ARE REGISTERED AS BEING INSIDE	ERROR RATE <sup>1</sup>
<p>● = Has a state-administered sales tax            ○ = Has a self-collected sales tax            ■ = Receives county sales taxes through an inter-governmental agreement            Blank = Does not have a sales tax</p>					
Holyoke	●	83	2	5	8%
Hooper	●	0	0	0	0%
Hot Sulphur Springs	●	19	1	1	10%
Hotchkiss	●	55	1	10	17%
Hudson	●	30	1	2	9%
Hugo	●	21	0	0	0%
Idaho Springs	●	112	0	10	8%
Ignacio	●	33	1	11	27%
Iliff		5	1	0	20%
Jamestown		3	1	3	67%
Johnstown	●	169	16	4	12%
Julesburg	●	56	0	2	3%
Keenesburg	●	41	2	4	13%
Kersey	●	17	0	0	0%
Kim		2	0	4	67%
Kiowa	●	22	0	8	27%
Kit Carson	●	8	0	1	11%
Kremmling	●	61	1	4	8%
La Jara	●	20	1	4	21%
La Junta	○	171	2	25	14%
La Salle	●	43	3	4	15%
La Veta	●	49	2	6	15%
Lafayette	○	437	4	52	11%
Lake City		64	5	10	20%
Lakeside	●	16	2	0	13%
Lakewood	○	2,807	173	80	9%
Lamar	○	206	4	16	9%
Larkspur	○	16	1	22	61%
Las Animas	●	32	0	2	6%
Leadville		146	8	14	14%
Limon	●	87	1	2	3%
Littleton	○	1,045	53	743	45%
Lochbuie	●	17	0	0	0%
Log Lane Village	●	6	0	0	0%
Lone Tree	○	612	15	17	5%
Longmont	○	1,563	52	136	11%
Louisville	○	479	12	1	3%
Loveland	○	1,454	75	133	13%

	SALES TAX TYPE	SITES ACTUALLY INSIDE THE JURISDICTIONS	SITES INSIDE THAT ARE REGISTERED AS BEING OUTSIDE	SITES OUTSIDE THAT ARE REGISTERED AS BEING INSIDE	ERROR RATE <sup>1</sup>
<p>● = Has a state-administered sales tax            ● = Has a self-collected sales tax            ■ = Receives county sales taxes through an inter-governmental agreement            Blank = Does not have a sales tax</p>					
Lyons	●	84	4	7	12%
Manassa	●	9	0	0	0%
Mancos	●	50	0	13	21%
Manitou Springs	●	242	1	1	1%
Manzanola	●	5	0	0	0%
Marble	●	13	1	6	37%
Mead	●	70	18	4	30%
Meeker	■	82	5	2	8%
Merino		3	0	6	67%
Milliken	●	42	0	0	0%
Minturn	●	72	4	0	6%
Moffat	●	4	0	2	33%
Monte Vista	●	106	3	10	11%
Montezuma	●■	1	0	0	0%
Montrose	●	652	27	108	18%
Monument	●	188	13	70	32%
Morrison	●	37	4	52	63%
Mountain View	●	19	0	0	0%
Mountain Village	●	118	22	2	20%
Mt Crested Butte	●	125	11	1	10%
Naturita	●	18	1	2	15%
Nederland	●	81	1	4	6%
New Castle	●	74	4	7	14%
Northglenn	●	480	23	7	6%
Norwood	●	27	1	12	33%
Nucla	●	30	1	1	6%
Nunn	●	6	0	2	25%
Oak Creek	●	24	0	8	25%
Olathe	●	36	1	6	17%
Olney Springs		0	0	4	100%
Ophir		3	0	0	0%
Orchard City		56	55	0	98%
Ordway	●	18	0	0	0%
Otis	●	9	0	2	18%
Ouray	●	126	0	1	1%
Ovid	●	7	0	1	13%
Pagosa Springs		189	28	129	49%
Palisade	●	68	2	11	16%

	SALES TAX TYPE	SITES ACTUALLY INSIDE THE JURISDICTIONS	SITES INSIDE THAT ARE REGISTERED AS BEING OUTSIDE	SITES OUTSIDE THAT ARE REGISTERED AS BEING INSIDE	ERROR RATE <sup>1</sup>
<p>● = Has a state-administered sales tax            ● = Has a self-collected sales tax            ■ = Receives county sales taxes through an inter-governmental agreement            Blank = Does not have a sales tax</p>					
Palmer Lake	●	71	4	0	6%
Paoli		0	0	0	0%
Paonia	●	64	0	15	19%
Parachute	●	42	0	9	18%
Parker	●	833	53	166	22%
Peetz		6	0	2	25%
Pierce	●	15	0	2	12%
Pitkin	●	9	0	0	0%
Platteville	●	47	3	2	10%
Poncha Springs	●	8	0	1	11%
Pritchett		2	0	2	50%
Pueblo	●	1,838	18	21	2%
Ramah		0	0	2	100%
Rangely	■	67	1	0	1%
Raymer		2	2	0	100%
Red Cliff	●	9	0	1	10%
Rico	●	8	0	0	0%
Ridgway	●	106	1	27	21%
Rifle	●	248	16	30	17%
Rockvale		2	1	0	50%
Rocky Ford	●	69	0	4	5%
Romeo	●	2	0	0	0%
Rye		5	1	6	64%
Saguache	●	21	1	1	9%
Salida	●	387	5	31	9%
San Luis	●	14	0	1	7%
Sanford		10	2	2	33%
Sawpit	●	1	0	0	0%
Sedgwick	●	5	0	1	17%
Seibert	●	5	0	0	0%
Severance	●	28	4	0	14%
Sheridan	●	352	99	11	30%
Sheridan Lake		0	0	1	100%
Silt	●	52	2	9	18%
Silver Cliff	●	20	2	6	31%
Silver Plume	●	10	0	0	0%
Silverthorne	● ■	151	7	50	28%
Silverton	●	108	1	0	1%

	SALES TAX TYPE	SITES ACTUALLY INSIDE THE JURISDICTIONS	SITES INSIDE THAT ARE REGISTERED AS BEING OUTSIDE	SITES OUTSIDE THAT ARE REGISTERED AS BEING INSIDE	ERROR RATE <sup>1</sup>
<p>● = Has a state-administered sales tax            ○ = Has a self-collected sales tax            ■ = Receives county sales taxes through an inter-governmental agreement            Blank = Does not have a sales tax</p>					
Simla	●	19	0	4	17%
Snowmass Village	○	105	14	0	13%
South Fork	●	72	1	14	17%
Springfield	●	58	3	3	10%
Starkville		0	0	0	0%
Steamboat Springs	○	936	27	55	8%
Sterling	○	352	5	46	13%
Stratton	●	27	1	3	13%
Sugar City		2	0	1	33%
Superior	●	83	7	0	8%
Swink		7	0	0	0%
Telluride	○	262	4	56	19%
Thornton	○	1,035	52	39	8%
Timnath	○	20	1	0	5%
Trinidad	●	259	2	9	4%
Two Buttes		0	0	0	0%
Vail	○	600	19	6	4%
Victor	●	27	0	0	0%
Vilas		1	0	0	0%
Vona		0	0	1	100%
Walden	●	42	3	2	11%
Walsenburg	●	88	0	8	8%
Walsh	●	11	0	2	15%
Ward	●	5	0	3	38%
Wellington	●	86	3	6	10%
Westcliffe	●	81	6	16	23%
Westminster	○	1,446	118	40	11%
Wheat Ridge	○	868	59	34	10%
Wiggins	●	27	1	2	10%
Wiley		7	0	3	30%
Williamsburg		1	1	0	100%
Windsor	○	431	26	4	7%
Winter Park	○	219	5	10	7%
Woodland Park	○	235	10	39	18%
Wray	●	102	9	3	11%
Yampa	●	17	0	2	11%
Yuma	●	121	4	6	8%

	SALES TAX TYPE	SITES ACTUALLY INSIDE THE JURISDICTIONS	SITES INSIDE THAT ARE REGISTERED AS BEING OUTSIDE	SITES OUTSIDE THAT ARE REGISTERED AS BEING INSIDE	ERROR RATE <sup>1</sup>
<p>● = Has a state-administered sales tax            ○ = Has a self-collected sales tax            ■ = Receives county sales taxes through an inter-governmental agreement            Blank = Does not have a sales tax</p>					
<b>SPECIAL DISTRICTS, AUTHORITIES, AND LIDS</b>					
Aspen Park Metro District	●	14	6	3	53%
Bachelor Gulch Metro District	●	20	9	3	52%
Baptist Road RTA	●	65	28	1	44%
Boulder County - Niwot LID	●	47	1	31	41%
Broomfield - Arista LID <sup>3</sup>	○	N/A	N/A	N/A	N/A
Broomfield - Flatirons LID <sup>3</sup>	○	N/A	N/A	N/A	N/A
Douglas County - Lincoln Station LID	●	7	6	1	88%
Gunnison Valley RTA	●	829	6	2	1%
Jefferson County - Southeast LID	●	1,333	113	43	11%
Mesa County - Gateway LID <sup>3</sup>	●	N/A	N/A	N/A	N/A
Mesa County - Whitewater LID <sup>3</sup>	●	N/A	N/A	N/A	N/A
Pikes Peak RTA	●	9,648	87	28	1%
Roaring Fork RTA	●	2,014	32	90	6%
RTD	●	51,147	206	310	1%
SCFD	●	52,153	158	93	0%
South Platte Valley RTA	●	352	5	46	13%
Summit Combined Housing Authority	●	2,219	1	1	0%
Two Rivers Metro District <sup>4</sup>	●	N/A	N/A	N/A	N/A
SOURCE: Office of the State Auditor analysis of taxpayer records from GenTax using GIS mapping software.					
<sup>1</sup> Error rate equals the sum of sites misregistered for the jurisdictions divided by the sum of sites misregistered and sites that are correctly registered as being inside.					
<sup>2</sup> Dacono had a state-administered sales tax during our review period but began self-collecting on July 1, 2015.					
<sup>3</sup> We did not test for the Flatirons or Arista LIDs in the city and county of Broomfield or for the Gateway or Whitewater LIDs in Mesa County.					
<sup>4</sup> The Two Rivers Metropolitan District became effective January 1, 2015, which was after our review period.					



# APPENDIX B



SUMMARY OF FINDINGS RELATED TO  
THE SMART GOVERNMENT ACT  
LOCAL SALES TAXES  
DEPARTMENT OF REVENUE  
NOVEMBER 2015

The SMART Government Act [Section 2-7-204(5), C.R.S.] requires the State Auditor to annually conduct performance audits of one or more specific programs or services in at least two departments. These audits may include, but are not limited to, the review of:

- The integrity of the department's performance measures audited.
- The accuracy and validity of the department's reported results.
- The overall cost and effectiveness of the audited programs or services in achieving legislative intent and the department's goals.

The performance audit relating to the administration of local sales taxes by the Department of Revenue (Department) was selected for focused audit work related to the SMART Government Act. We have presented our findings as responses to three key questions that can assist legislators and the general public in assessing the value received for the public funds spent by the Department.

*What is the purpose of this function of the Department and what is its fiscal impact?*

According to statute [Sections 39-26-105(1), 39-26-103(1), and 29-2-106(1), C.R.S.] the Department is required to administer, enforce, and distribute sales taxes instituted by local governments using the same process it uses to collect the State's sales tax. During Fiscal Year 2014, the Department collected about \$1.3 billion in net local sales taxes and (for some special districts) use taxes.

*What key improvements did the audit recommend related to the Department's measurement and reporting of its performance for this function?*

As discussed in RECOMMENDATION 5, we found that the Department uses hardcopy logs to track its contacts with local governments and does not systematically track or report the type and reasons for

contacts and the timeliness of its responses. We recommended that the Department develop an electronic tracking system and use the system to analyze trends, set goals, and monitor its timeliness.

*What other key improvements did the audit recommend related to the effectiveness of the Department related to this function?*

Overall, we found that the Department could improve its administration of local sales taxes by developing geographic-information-system (GIS) resources. Specifically, we recommended the following improvements:

- **RECOMMENDATION 1** – We found that the Department did not accurately register about 11,070 of the 103,836 business locations (11 percent) we reviewed to their appropriate local tax jurisdictions and recommended that it implement GIS tools to ensure that businesses are properly registered and to perform periodic reviews of registrations.
- **RECOMMENDATION 2** – Based on our review of business locations, we identified nine areas of the state for which the Department’s system does not capture each applicable local taxing jurisdiction and recommended that it develop and regularly update a GIS-based map of local tax jurisdictions to ensure that its system captures all areas of the state.
- **RECOMMENDATIONS 3 AND 4** – We found that the Department’s current process for certifying database service providers under the requirements of Section 39-26-105.3, C.R.S., may not be providing businesses with a cost-effective and accurate resource for determining their sales tax liabilities and recommended that the Department evaluate whether it should implement a state-managed database and improve the process it uses to verify the accuracy of the databases.



