



ACCELERATED SALES TAX FEASIBILITY STUDY

Report to Commissioner Christopher C. Harding
Massachusetts Department of Revenue
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Origin of the Study

Section 94 and Section 95 of Chapter 47 of the Acts of 2017 (Section 94 and Section 95), which are appended to this document, addressed the remittance of sales tax by vendors to the Department of Revenue (DOR). In brief, Section 94 directed the Commissioner of Revenue “to implement methods to effectuate accelerated sales tax remittance,” and included a set of instructions and considerations to be reflected in the resulting regulations. Section 95 provided for an alternative course of action “...if the commissioner of revenue certifies that the method under said section 94 is not cost-effective to implement before June 1, 2018..”

At the direction of Commissioner Christopher C. Harding, management and functional leaders in the Department of Revenue have solicited public comment, conducted an internal analysis, and completed an assessment of the impact and feasibility of accelerated sales tax remittance (ASTR). The information-gathering process supports both the requirements for implementation provided in Section 94 and the certification process described in Section 95.

Finding in Brief

Given the scale and complexity of the effort required, the development and implementation of ASTR before June 1, 2018 within acceptable levels of cost and risk mitigation is not feasible.

As directed, this document focuses on the June 2018 deadline. It should be noted, however, that DOR did not identify any long-term logical or technological barriers to implementing ASTR. Further study in collaboration with industry participants would be required to create a timeline, but for discussion purposes, implementation within three years would be an appropriate starting point.



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PUBLISHED SEPARATELY: COMPILATION OF STAKEHOLDER INPUT



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Context: the current sales tax remittance process

In brief, the current sales tax¹ remittance process works as follows:

- Sales and meals taxes are collected at the time that the purchase, rental, or other transaction is completed between the buyer (whether an individual or a business) and the seller.
- Generally, the seller is required to collect, hold, and then remit the tax to the Commonwealth, generally on the twentieth calendar day of the following month, or on the next business day if a weekend or holiday falls on the twentieth.
- For sales tax, most vendors are required to file and remit monthly, but small businesses may have a quarterly or annual requirement instead. Meals tax filing and remittance is required on a monthly basis.
- In statutory and regulatory language, the seller is called the “vendor,” and is required to register with DOR and perform the collection and remittance function.
- Because of this process, sales and meals taxes are often referred to as trustee taxes. The tax is borne in economic terms by the purchaser, but collected and remitted by the vendor.
- Sales tax dollars paid by the buyer may take over 50 days to reach the Department of Revenue, from the first day of one month to the twentieth day (or slightly later) of the following month.
- A brief review of other states showed that while the timing of payment and filing may vary, other U.S. tax jurisdictions also use a trustee tax process. We did not discover any states that either currently use or were in the process of implementing an ASTR process.

Internal (DOR) Analysis

Approach

The Department of Revenue conducted the study for each segment of possible implementation: Development, Testing, Implementation (Stand-Up Cost), Deployment and Maintenance (Recurring Cost), the associated challenges and risks, and consideration of feedback from the taxpayers and affected industry groups. The DOR analysis was done mainly by the Tax division and led by Dustin Botta.

The DOR system would be at the receiving end of data from vendors and their processors. This would entail the development and acceptance of data protocols and standards by vendors and the service providers (point-of-sales system providers, transaction processors, and others) that support them. Analogous methods are in use in other tax areas (such as withholding). Without underestimating the work required to design and implement the protocol, this section assumes it can be achieved, in order to focus on the core system functionality required to process the data.

¹ For the purpose of this report, the term “sales tax” is used broadly to include the various trustee taxes on purchase or rental of goods, certain telecommunication services, and meals, the room occupancy tax, and all taxes specified in Section 94.



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Cost effectiveness: comparison of costs and benefits to DOR

Generally, cost-effectiveness is the comparison of potential or expected benefits with potential or expected costs. DOR does not normally assess cost-effectiveness after policy has been set through legislation. Rather, after legislation is passed, DOR is focused on achieving cost-effective implementation. During the policy-making process, DOR may be engaged by policymakers to provide input on legislation that impacts revenue or revenue operations. This occurred in the case of ASTR, and the resulting work is the basis for assessing the impact.

Potential benefits. Because the ASTR concept was raised in the budget process, the revenue impact was estimated by DOR's Office of Tax Policy Analysis (OTPA) and delivered to policymakers earlier in 2017. According to the OTPA study of the original proposal², the benefit in the first fiscal year was estimated to be \$125 million dollars. Acceleration itself is a one-time phenomenon, because a single year experiences 13 months of revenue collections, but the following years return to the normal 12-month figure. However, there is a benefit in succeeding fiscal years. First, given that in most years the total amount of sales tax revenue shows an increase over the prior year, the 12 months should yield revenue slightly larger than the former 12-month period. In addition, the ASTR technology could yield benefits in shrinking the gap between taxes paid by purchasers and the amount received by the state. For example, a business that fails and closes before remitting the tax could potentially create an unrecoverable loss for DOR. In addition, the illicit practice of understating sales and diverting funds would potentially be made more difficult.

DOR did not undertake a study of potential operating efficiency benefits related to ASTR. Rather, the focus for DOR would be on efficiency in building, implementing, and operating under the new approach.

Even excluding any potential cost-efficiency impacts to DOR, the scale of the revenue benefit of the acceleration is very substantial.

Potential costs. Given the large scale of the potential revenue benefit, it is unlikely that the cost of building, implementing, and operating the ASTR process would be prohibitive. Therefore, we took the approach of creating a conservative (high cost) estimate for comparison.

The figures below assume a project timeline of 9 to 18 months, which we felt was appropriate baseline for a major systems and operations project that includes true new functionality and processes. While recognizing that legislation requires completion by June 2018, we felt that the cost discussion should assume the likely total time required under normal circumstances.

² The original proposal applied to electronic transactions and applied to businesses above a threshold count of employees.



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- To be conservative, we structured an estimate based on design and implementation requiring 20 professional FTEs (full time equivalents) for a period of one year. Over the period, the type of resource would shift from systems development and testing, to implementation and training, to administration and maintenance. In order to create a high-cost estimate, we associated cost of \$200,000 per year per FTE, all of it incremental. The total cost would therefore be \$4 million. While this is a considerable figure, it is relatively small in proportion to the benefit.
- Similarly, to be conservative in the sense of attributing more costs to implementation, we posited that 2 additional FTEs would be required on an ongoing basis. These resources could address ongoing needs in both the systems and the tax administration functions.

Given those figures, our conclusion is that ASTR would provide substantial net financial benefits to the state. The question is whether it can be implemented cost-effectively by the deadline of June 1, 2018.

Feasibility assessment

To effectuate the technical components required for implementation of ASTR, DOR explored two options with its in-house developers, tax area experts, auditors, and project management leaders to evaluate the feasibility of implementing either option by the June 1 deadline. The work focused on two areas: technical feasibility (the implementation of the systems and methods) and compliance feasibility (the creation of a system to allow accurate attribution of payments and the ability to monitor and audit the process).

The two options are shown below. The key difference between them is the mechanism by which the remittance record is matched to the registered vendor (whether it is a “push” or “pull” action in the process). Option A requires the transmitter to provide granular details in the data to facilitate the application of the payment to multiple registered vendors. This option appears close to the statutory language. Option B requires less data in the transmitted file, but places greater burden on DOR to reconcile the credits claimed and adds complexity to the monthly return filed by the taxpayers.



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OPTION A

Option A is the baseline approach, reflecting most directly the mechanism envisioned in the legislation and earlier analyses. Option A requires a mechanism to receive electronic deposit files from transaction processors³ including identifying vendor information (IDs, names, addresses, sales tax amount, filing period, etc.). Option A leverages the existing processes in GeniSys to process the payment files daily, and to post the payments to vendor accounts. The vendors would then file returns and claim these prepayments on their sales tax returns.

Implementation steps:

- Design file schema, develop & test with processors and vendors
- Employ payment allocation rules
 - Ensure multiple payments from multiple processors correctly post to each registered vendor's account/period
 - Develop error handling rules for misapplied payments or unregistered accounts
- Create verification rules in order to properly reconcile payments
- Modify each affected return layout and schema including forms ST-9, ST-MAB-4, RO-2, and STS

OPTION B

Option B is an alternative that functions somewhat like the cigarette excise process. In the Option B approach, the vendor files a return that excludes remittances processed under ASTR, but includes cash sales or other transactions not captured by the ASTR technology. The return and audit process would employ data from the transaction processors for the ASTR portion of sales tax due.

Files from the transaction processors would be accepted and processed by DOR each day. Vendors would file returns that exclude sales on which tax was previously remitted by their processors. Vendors would only report net taxable sales (those sales on which a tax was not previously collected and remitted through ASTR). After the return was filed, DOR would run matching programs against the data submitted by processors and verify those aggregated amounts against the vendor returns.

On a net basis, these options were not found to have materially different outlooks for cost or feasibility.

³ In this report, the terms "transaction processors" and "processors" are intended to cover the variety of businesses that may serve the vendors in the transaction process. This would include credit card companies, transaction processors, other financial institutions, point-of-sale systems vendors, and others.



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Each of the major steps and focus areas has been assessed and rated as low, medium, or high risk to completion of the effort by the required date. The assessment is focused on feasibility of the implementation by DOR, not by vendors, except in those areas where the process would require DOR/vendor collaboration.

Technical Feasibility

Development, Testing, and Implementation

- Development Challenges and Risks **MEDIUM**
 - requires 10 developers and 10 subject matter experts from January 1 – August 31
- Integrated development and testing with vendor participation **HIGH**
 - requires 3-5 pilot participants, January 1 - March 30
 - requires test schema files by March 31
 - requires test plan successful completion by May 1

Deployment and Maintenance

- Technical Challenges and Risks **MEDIUM**
 - requires reconciliation jobs and error reports
 - requires work-item creation for unapplied payments
 - requires work-item creation for unregistered accounts
 - education for 1,015 taxpayers on how this custom-build operates

Resource constraints

- Technical and business resource (FTEs) constraints **HIGH**
 - 10 developers
 - 5 business resources
 - Expert resources are committed to competing priorities

Compliance Feasibility

Compliance Challenges and Risks

- Reconciliation issues across multiple processors
 - **MEDIUM:** *the ASTR process is conceptually simple at the level of the daily remittance, but more complexity arises in monthly filing and compliance testing.*
 - *Data from processors must identify the taxpayer at the Genisys Account ID level, to create a reconciliation*



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report for monthly sales, which enables the vendor to file the monthly return.

- *Returned Items (resulting a return of tax paid to a customer) currently create a reconciliation issue mainly when the purchase and return break across a month-end. In ASTR, returns done “intra-month” would also require reconciliation.*
 - *Sales on weekend days (and other non-banking days) would require a solution for processing and reconciling payments. Occasions when the payment was pushed into the following month would pose additional issues for reconciliation and compliance.*
 - *Sales tax returns, whether filed on paper or through MassTaxConnect, would be updated to include new fields to reflect the remittances through ASTR. The process for “truing up” would be different for online versus paper filers. While not a major problem, this would drive some additional complexity in the audit selection and testing process.*
- Regional reporting/accounting complexities for processors. With remittance through ASTR, the locality at which a transaction takes place is relevant not only to identify sales subject to the Commonwealth’s ASTR requirement, but at the local level to determine the presence of any local option taxes.
 - Local Option complexities for disbursement of municipal funds
 - **LOW:** *Confined to meals and rooms Taxes. Adjustments for refunds or other credits to sales transactions may result in the need to adjust or reconcile distributions to municipalities by the Division of Local Services.*

Audit Challenges and Risks

- Reconciliations and verification complexities
 - **LOW:** *The implementation of ASTR will require the design and implementation of new processes for verification and reconciliation. Given the daily processing and periodic reconciliation under ASTR, these will be more complex, but are within DOR capabilities to design and implement.*
- Introduces some risk to audit data
 - **LOW:** *The audit process will not be affected other than requesting transaction payment information specific to the audit period; all other data reviewed does not change. Audit*



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would have to ensure that all taxes were remitted properly and timely from each processor.

Summary assessment

The costs to DOR of developing and implementing ASTR should be relatively small in comparison to the revenue benefit to the state, both in year one and in subsequent periods. Therefore, the concern shifts to the feasibility of implementation by June 2018.

The two outstanding areas of feasibility concern are (1) integrated development and testing with vendors and (2) technical and business resource (i.e., expert people) constraints.

Integrated development and testing requires intense participation from vendors and the transaction processors that serve them. Therefore, the DOR deliverable is one-half of the equation, because vendors must be ready to participate. The **HIGH RISK** score in the feasibility section is based on the judgment that completing the fundamental programming work, achieving the interoperability of DOR and vendor systems, and fully testing to mitigate risk, would be extremely difficult. Given that millions of dollars and hundreds of millions of datapoints will be in motion, extensive testing and extremely high confidence levels are an absolute necessity.

Technical and business resource constraints are the result of the scarcity of expert people. The available resources are constrained because both IT resources and tax administration resources face peak demand from December through April, as DOR prepares for and then manages a new tax filing season. This leads to the question: *could DOR invest in additional resources, whether on an employee or contractor/consulting basis, to make the date more achievable with less risk?*

In this case, the project team requires not generic systems experience, but specific expertise in the GeniSys tax system, in the programming that has been done to customize it for Massachusetts, in trustee taxes, and in financial processing and banking. Given that virtually no individual will be fully capable in all of those areas, the team will need to engage a fairly large number of people, and those individuals will need time to collaborate and share their expertise effectively with each other. It also means that the option to hire or contract with additional resources is of limited utility, because expertise and familiarity with DOR systems and tax administration is critical.

We believe that the scarcity of expert resources means that DOR would struggle either in achieving an effective, low-risk implementation of ASTR, or in successfully administering other core projects and tasks required for a successful 2018 filing season, or both.

Therefore, from the DOR perspective, the obstacle to achieving the June 2018 deadline is not cost per se, but the high risk created by attempting to achieve the goal. On that basis, we believe that seeking to implement by June 2018 would not be prudent and feasible.



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External Stakeholder Input

Context

The Department of Revenue cannot build or operate an ASTR system without the active collaboration of the vendors who collect and remit trustee taxes, and the service providers (transaction processors, credit card companies, financial institutions, etc.) that support them. We have collectively labeled these organizations as “stakeholders” in the matter of ASTR.

As authorized by legislation, DOR can mandate that these stakeholders participate in an ASTR system. A very close analogy exists in withholding. Employers are required by both federal and state tax authorities to collect income, Social Security, and Medicare taxes from paychecks, and in most cases to remit them through the electronic transfer of both the funds and the data required for the tax authority to process them.

The legislative language directs DOR to regulate in a manner that recognizes (among other things), established industry practices, technological feasibility, and financial impacts on consumers and businesses. To achieve that goal, DOR issued a “request for input” notice on the topic, focused on cost-effectiveness and feasibility. We found that many stakeholders were aware of the legislation and prepared to provide information.

The input from stakeholders has been collected for this report. Because of the amount of material received, it will be delivered as a separate document.

In addition, DOR responded to requests for meetings on the topic. Meeting participants were reminded that written submissions would constitute the official input and be included as part of the materials. Generally speaking, DOR officials were “in listening mode” during the meetings, seeking to understand the stakeholder viewpoints as discussed.

Recapping stakeholder input

DOR did not seek to challenge or validate the input from stakeholders. Rather, the input was reviewed from a commonsense viewpoint for relevance on the topic. In reviewing the submissions, DOR took the following approach:

- Focus on input about cost-effectiveness and feasibility.
- Ignore input on topics that are out of scope. Example: we received commentary on whether a one-time acceleration represents a meaningful benefit to the state.
- Look for patterns among the input. The stakeholders submitting input were a varied group, delivering multiple viewpoints, reflecting different areas of concern, and using different language even when addressing common topics. DOR attempted to understand common themes and concerns.



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The following page shows a table summarizing our interpretation of a sampling of the stakeholder input, with a focus on submissions received in a timely way with substantial input on the key issues. DOR created this table on a “best effort” basis, but makes no representation that it is comprehensive or the only interpretation of the input. Please note that original materials from the stakeholders constitute the key resource.

DOR sampling of input (not comprehensive)

NAME	OVERALL	CAPABILITY	COST	TIMELINE	COMPLEXITY	MAJOR RISK
Stakeholder 1	●	●	●	●	●	compliance
Stakeholder 2	●	●	●	●	●	cost
Stakeholder 3	●	●	●	●	●	compliance
Stakeholder 4	●	●	●	●	●	reconciliation
Stakeholder 5	●	●	●	●	●	compliance
Stakeholder 6	●	●	●	●	●	compliance
Stakeholder 7	●	●	●	●	●	compliance
Stakeholder 8	●	●	●	●	●	none cited
Stakeholder 9	●	●	●	●	●	reconciliation
Stakeholder 10	●	●	●	●	●	reconciliation
<i>Compilation</i>	●	●	●	●	●	<i>compliance</i>
DOR	●	●	●	●	●	timeline

Among the stakeholder submissions, the majority of organizations that are currently in the processor space had negative opinions of the cost-effectiveness and feasibility of ASTR, with varying reasons and varying levels of analysis provided. In addition, however, DOR received an extensive set of materials in support of ASTR from one technology firm in the space, and positive support submissions from vendors.

Because ASTR is a change to the status quo and places significant costs on organizations, we expected negative opinions from some stakeholders. In reviewing the input, the question is not whether the stakeholders would choose to move to ASTR if not required by legislation. The question is whether stakeholders can make a serious case about the feasibility and cost-effectiveness of implementation by June 2018.

Based on our reading of the submitted materials, we drew the following conclusions about the pro and con input:

The “con” input:

- Makes a plausible case that the total cost to industry (and therefore ultimately to taxpayers) would be very substantial. The cost estimates included in the submission varied widely in focus, from statements from individual firms to white papers that sought to reflect the entire state



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economy and all market participants. As a result, those cost estimates ranged from several million to more than \$1 billion dollars.

- Makes a strong case that the June 2018 deadline is too short to allow for the development and rigorous testing required to implement this system, given the number of transactions, amount of money, and number of systems and vendors that are inherently at risk in any change.
- Fails to make an irrefutable case that ASTR is not technologically feasible given adequate time for implementation.

The “pro” input:

- Makes a strong case that modern information technology allows ASTR to be built and implemented.
- Fails to make an irrefutable case that implementation is straightforward enough to allow for low-risk, cost-effective implementation by June 2018.

Conclusion of the report

Given the scale and complexity of the effort required, the development and implementation of ASTR by June 1, 2018 within acceptable levels of cost and risk mitigation is not feasible.

In adherence to the Section 95 language, the report focuses on cost-effective implementation by June 2018. It is important to note that neither the internal DOR work nor submissions from stakeholders would indicate that ASTR is technologically impossible. The timetable and potential cost remain as subjects for debate and for research, but ASTR should be regarded as an achievable modernization goal using current technology.



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Appendix: Section 94 and Section 95 of Chapter 47 of the Acts of 2017

SECTION 94.

(a) As used in this section, the following words shall, have the following meanings unless the context clearly requires otherwise:-

“Third party payment processor”, any person or entity engaged in the business of remitting payments to vendors or operators under chapters 64G, 64H, 64I or 64L of the General Laws, in association with credit card, debit card, or similar payment arrangements that compensate the vendor or operator in transactions subject to the excise under said chapters.

"Vendor or operator", a business, with a number of employees to be determined by the commissioner, that is required to file a return under section 16 of chapter 62C of the General Laws.

(b) The commissioner of revenue shall promulgate regulations in accordance with section 2 of chapter 30A, including the requirements that a public hearing be held and that a small business impact statement be filed, to implement methods to effectuate accelerated sales tax remittance, identify noncompliant vendors, operators, and third party payment processors, and to ensure that the excise under chapter 64G, 64H, 64I or 64L of the General Laws is collected and remitted. The regulations shall ensure, at a minimum, that: (i) any vendor or operator, when seeking payments from or through a third party payment processor, separately identifies tax amounts charged in association with the excise under said chapter 64G, 64H, 64I or 64L and non-tax amounts for which payment is sought; (ii) any third party payment processor, upon receiving a request for payment from a vendor or operator, shall directly pay the identified tax portion of such request to the commissioner, at substantially the same time that any non-tax balance is paid to the vendor or operator, the frequency of which shall be determined by the commissioner; (iii) third party payment processors report total payments made to the commissioner on a monthly return, which shall identify each vendor or operator to whom payments were made during the month as well as the amount of tax paid to the commissioner during the month in association with transactions with each such vendor or operator; and (iv) third party payment processors report, on a monthly basis, to each vendor or operator with whom they conduct business, the total tax remitted to the commissioner with respect to transactions of the particular vendor or operator during the monthly period. In developing the regulations, the commissioner shall consider the impact of the implementation of the methods described in this subsection, including, but not limited to, consideration of the following: (i) established industry practices; (ii) technological feasibility; (iii) financial impacts on consumers and businesses; (iv) the fiscal impact on the commonwealth; (v) relevant federal or state laws and regulations; and (vi) limitations on applicability to mobile telecommunications services, as defined by section 1 of chapter 64H, and telecommunications services, as defined by said section 1 of said chapter 64H.

(c) Tax amounts paid to the commissioner by a third party payment processor in association with the processing of transactions of a particular vendor or operator during the month shall be available as a credit to the vendor or operator in the filing of returns showing tax due under chapter 64G, 64H, 64I or 64L, as applicable.

SECTION 95. Notwithstanding section 94, if the commissioner of revenue certifies that the method under said section 94 is not cost-effective to implement before June 1, 2018, the department of revenue shall record as revenue in fiscal year 2018 sales tax revenue collected by vendors and operators required to file a return under section 16 of chapter 62C on account of June 2018 sales but remitted to and received by the department in July 2018, in the amount that otherwise would have been collected in fiscal year 2018 under said section 94. Notwithstanding any general or special law, rule, regulation or accounts receivable policy to the contrary, the comptroller shall record in fiscal year 2018 such revenue in the state accounting system and in the statutory basis financial report required by section 12 of chapter 7A of the General Laws. If the commissioner so certifies, no further action shall be taken to implement the method under section 94. The commissioner shall submit its determination under this section to the clerks of the senate and house of representatives, the senate and house chairs of the joint committee on revenue and the chairs of the senate and house committees on ways and means not later than November 1, 2017.