AUDIT REPORT
Department of Finance
Municipal Sales Tax Collection Practices
August 2016

Office of the Auditor
Audit Services Division
City and County of Denver

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Denver Auditor
The Auditor of the City and County of Denver is independently elected by the citizens of Denver. He is responsible for examining and evaluating the operations of City agencies for the purpose of ensuring the proper and efficient use of City resources and providing other audit services and information to City Council, the Mayor, and the public to improve all aspects of Denver's government. He also chairs the City's Audit Committee.

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Report number: A2016-004
We have completed an audit of the City and County of Denver's (City's) Municipal Sales Tax Collection Practices. The purpose of the audit was to assess the City's processes and controls for the collection and distribution of sales and use tax and the collection of and response to stakeholder feedback. In addition, the audit assessed the City's efforts to increase online registration, filing, and payment and to enforce the collection and remittance of sales tax on internet sales.

As described in the attached report, our audit revealed that the Treasury Division's Tax Compliance Section has established a process that facilitates the proper collection of sales and use tax monies. However, we identified five areas where improvement to the Tax Compliance Section's operations could be made. The audit also revealed that the City is not receiving sales tax revenues from all remote sellers who sell to City residents.

By enhancing tax adjustment policy and related procedures and sales tax return guidance, conducting a periodic revenue impact analysis of the City's sales and use tax exemptions, streamlining the delinquent payment process, and increasing coordination with the Colorado Department of Revenue, the Tax Compliance Section will further strengthen its operations. Our report lists several related recommendations. Furthermore, by continuing to engage in work efforts to standardize local home rule municipalities' sales and use tax definitions and monitor ongoing legal challenges and pending regulatory developments, the Tax Compliance Section can help the City expedite solutions and position itself to fully enforce the collection of remote online sales tax.

This performance audit is authorized pursuant to the City and County of Denver Charter, Article V, Part 2, Section 1, General Powers and Duties of Auditor, and was conducted 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.
We extend appreciation to the Treasury Division Director and the Tax Compliance Section personnel who assisted and cooperated with us during the audit.

Denver Auditor’s Office

Timothy M. O’Brien, CPA
Auditor
Municipal Sales Tax Collection Practices August 2016

Scope
The audit assessed the City and County of Denver’s (City’s) processes and controls for the collection and distribution of sales and use tax and the collection of and response to stakeholder feedback. In addition, the audit assessed the City’s efforts to increase online registration, filing, and payment and to enforce the collection and remittance of sales tax on internet sales.

Background
Denver’s authority to administer its own local sales and use tax is established by the Colorado Constitution through the concept of home rule, and the City uses the Denver Revised Municipal Code to set tax rates and establish any exemptions from these taxes. The Department of Finance, Treasury Division’s Tax Compliance Section is responsible for billing, collecting, payment-processing, recording, and reconciling all collected taxes, including sales and use tax.

Purpose
The purpose of the audit was to determine whether effective controls, processes, and practices exist to ensure that sales and use tax is collected and distributed properly; to collect and respond to stakeholder feedback; and to increase online registration, filing, and payment. The audit also assessed what action the City has taken to enforce the collection and remittance of sales tax on internet sales and whether additional actions can be taken.

Highlights
The Treasury Division’s Tax Compliance Section has established a process that facilitates the proper collection of sales and use tax. We found that the Tax Compliance Section has established policies and procedures that support the collection process and serve as a training tool and reference guide for employees. The Tax Compliance Section has also developed a customer feedback process that adequately tracks questions and complaints and facilitates proper follow-up. Finally, we found that the City’s online sales and use tax services and their use by taxpayers are similar to those of other comparable municipalities. However, we identified five areas where improvement would further strengthen the Tax Compliance Section’s operations. We also discuss the actions the City has taken to collect sales tax on internet sales and additional actions that could be taken.

Finding 1 discusses the five areas where enhancements can be made to the Tax Compliance Section’s operations. First, tax adjustment approval policy and processes are not sufficiently detailed or formalized. Second, the Treasury Division does not periodically analyze or report on the financial impact of specific product exemptions. Third, instructional guidance on the Denver Sales Tax Form is not detailed enough to help ensure that vendors conducting sales from a physical store-front location in Denver also report online sales. Fourth, the handling of mail-in delinquent tax payments has an unnecessary step that results in a process inefficiency. Finally, there is minimal cooperation between the Treasury Division and the state Department of Revenue to share taxpayer registration and taxable sales information to help improve the City’s tax collection rates.

The audit also assessed what action the City has taken to enforce the collection and remittance of sales tax on internet sales and whether additional actions can be taken. Vendors that conduct business from a location outside of Denver that do not have a physical presence in the City are not lawfully required to collect the City’s sales tax from Denver customers. Finding 2 discusses the complexity of this issue as well as the ongoing legal efforts and challenges to enforce the collection of sales tax on all remote sales. Specifically, the audit found that the City is not receiving sales tax revenues from all remote sellers who sell to its residents, and that a change in purchasing practices and ongoing issues associated with remote-sales federal legislation has directly impacted the City’s ability to anticipate, collect, and rely on revenues from taxes associated with these transactions.
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INTRODUCTION & BACKGROUND

Local Sales Tax Authority in Colorado

In accordance with the Colorado Constitution, Colorado’s local governmental entities have the power to establish local sales tax rates, subject to voter approval, within their jurisdictions. These entities include cities, counties, special districts, local improvement districts, and regional transportation authorities. Retailers are responsible for collecting and remitting sales tax from purchasers on a government’s behalf.

Denver’s Taxing Authority and Legal Framework

Denver’s authority to set and collect sales and use tax is established by the Colorado Constitution through the concept of home rule. The City and County of Denver (City) acts on this authority by using the Denver Revised Municipal Code (D.R.M.C.) to set the tax rates and establish any exemptions from these taxes.

Municipal Home Rule

Article XX of the Colorado State Constitution provides municipal citizens the right to adopt a home rule charter, which provides for municipal control over the structure and operation of a local government’s activities by its citizens rather than by state government. Municipal home rule enables municipalities to self-govern in matters that are local and municipal in nature without the need for state enabling legislation or other state involvement.1

Pursuant to state law, the Colorado Department of Revenue (DOR) is generally responsible for collecting, distributing, and enforcing local sales taxes for the state’s local governments, but DOR does not administer or collect city or county use tax. Local use tax is paid directly to the taxing authority to which it is owed.2, 3 Although DOR administers many local government sales taxes, Colorado Revised Statutes (C.R.S.) § 29-2-106 (4)(a)(I) provides that home rule municipalities administer their own sales taxes unless they request DOR do so for them. Denver is a home rule municipality that administers, collects, processes, and enforces its own local sales and use tax. Further, the City is responsible for issuing tax licenses to businesses in its jurisdiction.

Sales Tax

D.R.M.C. Article II imposes a sales tax on the purchase price paid or charged on retail sales and purchases of tangible personal property, and on certain services. Taxable services include, but are not limited to, the sale or furnishing of telephone and certain telecommunication services; electricity, steam, and natural gas for energy producing purposes; and entertainment services. The purpose of this tax is to help meet the expenses of City operations, improvements, and bond payments.4 Specifically, D.R.M.C. § 53-25 levies sales tax on the following items:

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2 Colorado Revised Statutes § 29-2-106 (1).
4 D.R.M.C. § 53-22.
- Retail sales and purchases of tangible personal property
- Telephone and certain telecommunications services
- Coal, petroleum, liquid petroleum, electric, steam, and natural gas services, and any other products used for energy-producing purposes
- Food or drink served or furnished in or by restaurants, cafes, lunch counters, cafeterias, hotels, drugstores, social clubs, nightclubs, cabarets, resorts, snack bars, caterers, boardinghouses, carryout shops and other places at which prepared food or drink is regularly sold, including sales from pushcarts, motor vehicles, and other mobile facilities
- Informational or entertainment service, including, but not limited to, pay television and television, cinema, or similar programming provided at a theater or similar place open to the public
- Data processing equipment and data processing programs

Pursuant to D.R.M.C. § 53-27, the City’s general sales tax rate is currently set at 3.65 percent, of which 3.5 percent is distributed to the General Fund and the remainder is distributed to the Denver Preschool Program.\(^5\) To determine a local government’s combined sales tax rate, one must calculate the total of any local sales tax rates and the state’s sales tax rate. The City’s combined general sales tax rate is 7.65 percent, which comprises the 3.65 percent City sales tax rate and an additional 4 percent in state (2.9 percent), Regional Transportation District (1 percent), and Cultural Facilities District (0.1 percent) sales tax rates.

The D.R.M.C. also imposes special City sales tax rates on the following sales at retail:

- **Food and Beverage**—A 4-percent sales tax rate is imposed on the sale of food and beverages not exempt by ordinance, which includes the sale of food for domestic household use.\(^6\) Some examples of taxable sales include prepared food and beverages sold by restaurants and grocery stores, catered food, coffee services, and liquor purchases. This tax is distributed to two funds: 3.5 percent to the General Fund and 0.5 percent to the Excise Tax Pledged Revenue Fund for the payment of the Colorado Convention Center bonds. The combined sales tax rate is 8 percent.

- **Aviation and Railway Fuel**—A 4-cents-per-gallon sales tax is imposed on the sale of aviation and railway fuel with 50 percent of the proceeds going to the General Fund and 50 percent going to the Airport Gross Revenue Fund.\(^7\) The combined sales tax rate is 4 percent (state, Regional Transportation District, and Cultural Facilities District taxes) plus 4 cents per gallon.

- **Car Rentals**—A 7.25-percent sales tax is imposed on short-term car rentals, which include vehicles that are hired, rented, or leased for thirty days or less.\(^8\) The tax rate is distributed to three funds: 3.5 percent to the General Fund; 2 percent to the Excise Tax Pledged Revenue Fund for the payment of the Colorado Convention Center bonds; and 1.75 percent to the

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\(^5\) This rate was previously set at 3.62 percent between 2007 and 2014. In 2014, voters approved to raise the general sales and use tax rate, effective January 1, 2015, by .03 percent to expand programming, reach more preschool students, and reduce costs for families in the Denver Preschool Program.

\(^6\) D.R.M.C. § 53.27.

\(^7\) Ibid.

\(^8\) Ibid.
Convention Center Expansion Fund for the expansion of the Convention Center. The combined sales tax rate is 11.25 percent.

- **Retail Marijuana**—A 3.5-percent special sales tax rate is imposed on all sales of retail marijuana and retail marijuana products. The special rate is in addition to the general sales tax rate of 3.65 percent, for a total City tax rate of 7.15 percent. The purpose of the tax levy is to raise funds for the payment of direct and indirect expenses related to the licensing and regulation of the retail marijuana industry, enforcement of marijuana laws in general, educational and public health programs to mitigate any negative consequences associated with the consumption of marijuana and marijuana products, programs to prevent the illegal diversion of retail marijuana and retail marijuana products to persons under the age of twenty-one, and to otherwise pay the expenses of operating and improving the City and its facilities. Because Colorado also imposes a special state sales tax of 10 percent on sales of retail marijuana and retail marijuana products, the combined sales tax rate is 21.15 percent.

### Use Tax

D.R.M.C. Article III establishes the City’s use tax, which is charged at and distributed in the same manner as the general and special City’s sales taxes. D.R.M.C. § 53-92 imposes use tax upon the privilege of using, storing, distributing, or consuming within the City tangible personal property and certain services purchased at retail, when sales or use tax equal to or greater than the City’s rate has not previously been paid. The purpose of the use tax is to raise funds for the payment of expenses of operating and improving the City and its facilities and for the payment of principal and interest due on bonds.

There are two types of use tax: consumer use tax and retailer’s use tax.

- **Consumer Use Tax**—Consumer use tax is a counterpart to sales tax and is due when Denver sales tax was not collected on a retail purchase of tangible personal property and taxable services that are used, stored, or consumed within Denver. Tangible personal property is generally defined as furniture, fixtures, equipment, and supplies—not inventory. For example, consumer use tax would be due when a Denver company buys a machine from a manufacturer in Chicago, and the machine will be used by the Denver company to make belts in Denver. The machine is shipped to Denver from Chicago, and the Chicago manufacturer does not collect sales tax because the machine was not sold to a buyer in a City where the manufacturer has a physical presence, such as a storefront business or warehouse. The Denver company is required instead to pay the City the 3.65 percent consumer use tax. The rationale behind this is that Denver lost out on sales tax that would have been generated if the Denver company would have purchased the machine from a Denver-based company.

- **Retailer’s Use Tax**—Retailer’s use tax is the same as sales tax, but it generally results from a sale delivered into Denver by a vendor located outside the City. For example, retailer’s use tax would be due when a licensed Denver business, physically located outside of Denver’s jurisdiction, makes a retail sale of an appliance to a buyer located in Denver.

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9 D.R.M.C. § 53-86.
10 Medical marijuana is taxed at the regular City and state sales tax rates.
11 D.R.M.C. § 53-98.
12 D.R.M.C. § 53-93.
Since the business does not have a Denver location, it collects 3.65 percent retailer’s use tax on the purchase price of the appliance, reports the tax on its Denver sales tax return, and remits the tax to the City.

**Sales and Use Tax Revenues**

The City’s main operating fund is the General Fund, which finances the operations of approximately forty City departments, agencies, and offices.\(^{13}\) The majority of the City’s sales and use tax revenues are distributed to the General Fund, and these revenues comprise the fund’s major revenue source. As depicted in Figure 1, actual sales and use tax revenues distributed to the General Fund increased 50 percent from 2009 to 2015 and comprised between 47 percent and 49 percent of General Fund revenues during these years.

**FIGURE 1.** General Fund Sales and Use Tax Revenues, 2009 – 2015 (in millions)

![Graph showing General Fund Sales and Use Tax Revenues, 2009 – 2015](source)

*Source:* Developed by auditors using the City and County of Denver’s First Quarter General Fund Revenue Report—A Profile of the General Fund’s 22 Largest Revenue Accounts.

*Note:* Included in this revenue figure are general sales and use tax, aviation fuel tax, short-term car rental tax, and prepared food and beverage tax.

In 2016, sales and use tax is projected to comprise almost 50 percent, or $603 million, of the General Fund’s $1.2 billion estimated revenues. Figure 2 depicts the General Fund’s 2016 estimated financial revenue sources and the City’s dependence on the collection of sales and use tax to pay City operating expenses, improvements, and bond payments.

\(^{13}\) City and County of Denver Mayor’s 2016 Budget
**FIGURE 2.** General Fund Estimated Financial Revenue Sources – 2016

<table>
<thead>
<tr>
<th>Source</th>
<th>Developed by auditors from the City and County of Denver Mayor’s 2016 Budget, General Fund Summary – Estimated Revenues, Schedule 100A.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sales and Use Tax</strong></td>
<td>49.8%</td>
</tr>
<tr>
<td><strong>Other General Government</strong></td>
<td>12.2%</td>
</tr>
<tr>
<td><strong>Property Tax</strong></td>
<td>9.7%</td>
</tr>
<tr>
<td><strong>Fees</strong></td>
<td>5.4%</td>
</tr>
<tr>
<td><strong>Fines and Forfeits</strong></td>
<td>4.8%</td>
</tr>
<tr>
<td><strong>All Other Taxes</strong></td>
<td>4.3%</td>
</tr>
<tr>
<td><strong>Occupational Privilege Tax</strong></td>
<td>4.0%</td>
</tr>
<tr>
<td><strong>Licenses and Permits</strong></td>
<td>3.7%</td>
</tr>
<tr>
<td><strong>Transfers</strong></td>
<td>3.4%</td>
</tr>
<tr>
<td><strong>Intergovernmental Revenues</strong></td>
<td>2.7%</td>
</tr>
</tbody>
</table>

**Sales and Use Tax Exemptions**

All retail sales in the City are deemed taxable unless they have been explicitly exempted from taxation by the D.R.M.C. Examples of items exempted include sales to governments when purchases are made in their official capacities and sales made to religious or charitable organizations when used for their regular functions and activities. A complete listing of sales and use tax exemptions allowed pursuant to D.R.M.C. is provided in the Appendix.14

**The Treasury Division Is Responsible for Overseeing Tax Collection and Compliance**

The Treasury Division (Treasury) within the City’s Department of Finance collects, records, deposits, and enforces compliance with all City taxes and other revenues. Treasury is overseen by the Treasurer under the direction of the Chief Financial Officer. It is made up of two sections: Tax Compliance and Motor Vehicle.

- **Tax Compliance**—The Tax Compliance Section is responsible for billing, collecting, payment-processing, recording, and reconciling all collected taxes. Additionally, it deposits all City taxes and other revenues into City bank accounts. The Tax Compliance Section’s goal is to “effectively oversee the tax collection and compliance process.”15

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14 D.R.M.C. § 53-26 and § 53-97.
15 City and County of Denver Mayor’s 2016 Budget.
• **Motor Vehicle**—The Motor Vehicle Section acts as an authorized agent of the State of Colorado for titling, registering, and licensing of vehicles for residents and businesses located in the City.

**Strategies and Performance Measures**

Treasury has established various strategies to help achieve its goals. According to the City and County of Denver Mayor’s 2016 Budget, these strategies include proactive outreach to all City business taxpayers regarding the City’s online filing program for excise taxes to increase online transactions; utilizing eBiz technology to improve taxpayer education and usage; and employing best practices in working delinquent accounts and providing educational efforts to delinquent taxpayers to obtain future voluntary compliance.16

Treasury maintains data on its performance in several areas related to tax collection and compliance. First, Treasury tracks the use of online tax filing and payment options because it has determined that this method is more efficient, accurate, and allows for more timely collection, the elimination of paper returns, and a reduction in postage costs to both the City and taxpayers. To provide additional context related to this performance measure, Treasury also tracks the percentage of mail-in renewals, online renewals, and manual renewals to show increases and decreases in methods used over time. Second, Treasury tracks the number of tax compliance audits completed because it has determined that these audits recover previously unremitted revenues, encourage voluntary compliance with the City’s tax laws, and create educational opportunities for future voluntary compliance. Finally, Treasury tracks sales tax delinquency rates because it has determined that these performance measures indicate the level of timely filing of tax returns and remittance of tax revenue and aid Treasury in its voluntary compliance/non-compliance deterrent and collection efforts. Treasury regularly reports on these performance measures in the annual City and County of Denver Mayor’s Budgets.

**Tax Compliance Section Structure and Responsibilities**

The Tax Compliance Section’s activities are carried out by three groups: Operations, Tax Collection, and Tax Audit. Each group carries out its responsibilities through smaller work units that handle payment processing, return corrections, taxpayer services, collections, asset recovery, and audit. Figure 3 provides a simplified graphical representation of the Tax Compliance Section’s organizational structure.

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16 The eBiz application provides sales and use tax businesses the opportunity to register and manage accounts, file tax returns, make payments, and claim and view the status of tax refunds online.
An explanation of the duties and functions of each work unit that has sales and use tax responsibilities follows.\textsuperscript{17}

- **Payment Processing and Return Correction**—This unit reports to the Operations Manager and processes, reconciles, and researches tax payments. The unit identifies mathematical errors on tax returns and determines any interest and penalties due on delinquent returns. The unit processes between 25,000 and 35,000 tax returns (for all tax types) per month that result in the collection of approximately $30 to $50 million in taxes.\textsuperscript{18}

- **Taxpayer Services**—This unit reports to the Tax Collections Manager and registers excise tax accounts, issues tax licenses, mails property tax bills and excise tax returns, and responds to taxpayer inquiries. Sales and use tax licenses are issued for a two-year period, renewable on a biennial basis by January 1. New and renewing businesses can apply for a Denver sales or use tax license through the mail, in person, or online through the City’s eBiz Tax Center application. License fees are $50 when a business begins operating prior to June 30 of the first year. If the business begins operating after this date, the license fees are prorated accordingly. The City requires the following different types of tax licenses, based on business type:

\textsuperscript{17} The Special Accounts unit collects property tax related to local improvement and special assessment charges, delinquent real property tax, and sewer and storm drain liens. Additionally, this unit conducts the annual tax lien auction, processes property tax deed applications, and administers the City’s Payment to the Elderly and Disabled Program.

\textsuperscript{18} Tax Return and Payment Processing General Overview, last revised on July 29, 2015, accessed June 20, 2016.
○ A sales tax license authorizing the collection and remittance of sales tax is required if a business is a City vendor.

○ A consumer use tax license is required if a business buys tangible personal property for use in the business and the vendor does not collect City sales tax on the invoice.

○ A retailer’s use tax license is required for a business located outside of the City if the business is required to collect tax on deliveries into the City.

Taxpayer inquiries are routed through the Denver 311 help center. Denver 311 operators have access to and can answer most general tax information questions. When questions arise that cannot be addressed by Denver 311 operators, the calls are forwarded to Treasury’s Taxpayer Services unit.

- **Collections and Audit**—These two units collect delinquent and unremitted taxes from businesses within the City, provide education regarding Denver’s tax laws to the public, and ensure compliance with all applicable tax laws. The Collections unit reports to the Tax Collections Manager and enforces business tax compliance, collects delinquent taxes, and monitors any business movement into and out of the City. The Audit unit reports to the Tax Audit Manager and conducts tax audits of various businesses that are selected based on sampling methods or various risk factors identified by Audit Unit management and Audit staff members.

- **Asset Recovery**—This unit reports to the Operations Manager and is responsible for collection efforts on debts and monies owed to other City agencies.

Treasury’s operating budget is provided through the City’s General Fund. For 2016, Treasury received annual general fund appropriations of over $17 million to carry out its duties.

**Sales and Use Tax Return Filing Frequency**

Sales and use taxes are self-reported taxes, meaning taxpayers file their tax returns and remit taxes due at the frequency required and determined in accordance with the D.R.M.C. Generally sales and use taxpayers use monthly, quarterly, or annual filing frequencies depending on their average monthly tax liability for the previous six months. Monthly returns are due on the 20th day of the month following the taxable month and are required if the average monthly tax liability for the previous six months exceeds $300. Quarterly returns are due on April 20, July 20, October 20, and January 20 for the first, second, third, and fourth quarters, respectively, and are allowed if the monthly tax liability for the previous six months is $300 or less. Annual returns are due on January 20 following the taxable year and are allowed if the monthly tax liability for the previous six months averages $15 or less. Sales and use tax returns can be filed and paid through the mail, in person, or online through the City’s eBiz Tax Center application.

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19 The Denver 311 provides residents with an accessible way to navigate City services.

20 All marijuana businesses, bars, liquor stores, restaurants, caterers, and street vendors are required to file monthly tax returns regardless of the average monthly tax liability for the previous six months.
Controls and Tools Used by the Tax Compliance Section

The Tax Compliance Section uses various controls and tools for tax collection, enforcement, and education of all businesses and industries regardless of the type. The controls and tools used that are relevant to this audit include systems to process all returns and payments received; establishing more detailed tax rules; and developing resources for taxpayers.

Tax Return Remittance Systems—Using a software system called GenTax, the Tax Compliance Section prints tax returns and mails the returns and self-addressed return envelopes to taxpayers for their use in remitting returns and taxes to the City through one of two locations: a local post office box in Denver and a bank lockbox in Dallas, Texas.\(^{21}\) Personnel at the Dallas location open the item, deposit the check, and then scan the return, envelope, and any enclosed documentation or correspondence into GenTax.

Tax Rules—Treasury, under the authority granted to the Manager of Finance by the D.R.M.C., has developed multiple Tax Rules. These rules provide more detailed explanations of various sections of the D.R.M.C. and are used in the administration and enforcement of related D.R.M.C. provisions. As of June 2016, there were six Tax Rules pertaining to the collection of sales and use tax. The rules expand on the sales and use of tangible personal property acquired by construction companies, the exemption of certain types of food and drink, the sales and use of newspapers and other publications, the frequency of tax returns, hearings before the Manager of Finance, and previously paid sales or use taxes.

Taxpayer Resources—Treasury has also developed a number of tax guides to serve as quick references written in layman’s terms. Tax guides generally contain a brief description of the applicable law and may provide one or more examples of taxable or exempt transactions within that industry, and references to the relevant D.R.M.C. provisions. Finally, Treasury developed the City and County of Denver: General Tax Information Booklet. The purpose of this booklet is to provide general tax information to individuals and businesses conducting business in the City, and it includes information regarding the collection and filing of City taxes.

Collection of Sales Tax from Remote Vendors

Retail businesses located within the City must receive a license to collect and remit the Denver sales tax. In addition, businesses located outside the City must also receive a license to collect and remit Retailer’s Use Tax on taxable retail sales to City purchasers if they have a physical presence within the City’s jurisdiction. However, vendors that conduct business from a location outside of Denver that do not have a physical presence in the City are not lawfully required to collect the City’s sales tax from Denver customers. The complexity of this issue, as well as the ongoing legal efforts and challenges to enforce the collection of sales tax on all remote sales is discussed in detail in Finding 2.

\(^{21}\) GenTax is an integrated tax processing software package designed to support an agency implementing multiple taxes.
SCOPE

The audit assessed City processes and controls for the collection and distribution of sales and use tax and the collection of and response to stakeholder feedback. In addition, the audit assessed the City’s efforts to increase online registration, filing, and payment and to enforce the collection and remittance of sales tax on internet sales.

The audit focused on retail sales and purchases levied at the general sales and use tax rate and excluded those related to the various special tax rates such as retail marijuana and retail marijuana products.

OBJECTIVE

The audit had the following three objectives:

1. To determine whether effective controls and practices exist to ensure that sales and use tax is being collected and distributed properly
2. To determine whether effective processes exist for collecting and responding to stakeholder feedback and to increase online registration, filing, and payment
3. To assess what action the City has taken to enforce the collection and remittance of sales tax on internet sales and whether there are additional actions that could be taken

METHODOLOGY

The methodologies used to achieve the audit objectives included, but were not limited to:

- Reviewing Colorado Revised Statutes, City Charter, Denver Revised Municipal Code, Executive Orders, Fiscal Accountability Rules, and other City agency administrative guidance including Tax Rules and Tax Topic Guides
- Interviewing Department of Finance personnel regarding processes in place to collect and distribute sales and use tax
- Reviewing the Treasury Division’s internal sales and use tax policies and procedures and conducting walkthroughs of various processes to identify efficiency and effectiveness concerns
- Selecting for testing a sample of 2014 and 2015 sales and use tax business registrations and return filing and payment transactions from the Treasury Division’s GenTax system. To select the sample, auditors considered timely, late, and out-of-City tax registrations; timely filed and paid returns of all filing frequencies; and delinquent filed and paid returns.
- Reviewing source documents maintained within the GenTax system
• Interviewing Colorado Department of Revenue and Treasury Division personnel regarding coordination efforts between the state and the City on sales and use tax registered businesses and identified tax concerns

• Reviewing taxpayer inquiries received by Denver 311 and the process for follow-up and tracking of Tax Compliance Section-related inquiries

• Conducting benchmarking of other Colorado and U.S. cities that have established a home rule charter to compare Denver’s online registration, return filing, and payment rates

• Reviewing efforts considered and implemented by the Treasury Division’s Tax Compliance Section to increase businesses’ usage of eBiz for business registrations, return filings, and tax payments

• Interviewing personnel from the Colorado Department of Revenue, the Treasury Division, and the Colorado Municipal League regarding current efforts to collect sales tax on internet/e-commerce retail sales by businesses located outside of the City

• Researching legal and regulatory efforts and decisions regarding internet/e-commerce retail sales tax collection and payment requirements

• Calculating an estimated sales tax loss to the City on internet/e-commerce retail sales where no sales tax is being collected and consumer use tax may not be paid
FINDING 1

The City Has Sound Sales and Use Tax Collection and Customer Feedback Practices, but Some Improvements Could Further Enhance Effectiveness and Efficiency

The Treasury Division's (Treasury's) Tax Compliance Section has established a process that facilitates the proper collection of City sales and use tax. However, we identified five areas where improvement would further strengthen the Tax Compliance Section's operations. These improvements include enhancing the procedures for making tax adjustments to sales and use tax penalties and interest; developing and performing an impact analysis on sales and use tax exemptions; enhancing sales tax return guidance; streamlining the delinquent payment process; and increasing coordination with the Colorado Department of Revenue (DOR).

The Tax Compliance Section Has an Effective System in Place for Collecting Sales and Use Tax

We found that the Tax Compliance Section has established an effective system that helps provide for the proper collection of City sales and use tax. This system includes formal policies and procedures to support the collection process and serve as a training tool and reference guide for employees. The Tax Compliance Section has also developed a customer feedback process to track questions and complaints that facilitates proper follow-up. Finally, we found that the City's online sales and use tax services and their use by taxpayers are similar to those of other comparable municipalities.

Sales and Use Tax Collection Policies, Procedures, and Processes Are Effective

The audit team reviewed the registration, return and payment processing, and collections processes by performing walkthroughs and testing procedures on transactions processed by the Tax Compliance Section. We determined that the processes observed during our walkthroughs followed the steps established in the section's Tax Return and Payment Processing Overview policy and procedure document as well as the Tax Revenue Agent Training Manual. Further, we determined that these processes were well designed for collecting and recording tax revenue timely and accurately. The transactions tested for these three processes also revealed no significant exceptions, indicating that these processes are generally operating effectively.

Customer Feedback System Is Operating As Intended

In addition to establishing sound sales and use tax collection processes, the Tax Compliance Section has established and implemented an effective system to respond to stakeholder feedback. Taxpayer and citizen questions, concerns, and feedback calls are first received through the Denver 311 help center (Denver 311) and subsequently logged into a system called Salesforce, which is a customer relationship management software product. If the Denver 311 operator does not have sufficient information to resolve the caller's issue, the call is forwarded to the Tax Compliance Section's Taxpayer Services (TPS) unit, which is primarily responsible for addressing taxpayer questions, concerns, and feedback. According to Salesforce, TPS has thus far in 2016 received between 2,000 and 3,000 calls per month.
After reviewing TPS’s process for receiving and reviewing taxpayer feedback, we identified no significant issues. Furthermore, TPS monitors instances of complaints and call volume and has a specific handling process upon receiving a fraud tip, which involves notifying the management of the Tax Collection unit. Overall, TPS has demonstrated that despite the large call volume received, they consistently monitor complaints, note pervasive issues, and take appropriate action to resolve validated issues raised by concerned citizens.

Denver Is Generally Aligned with Similar Municipalities for Online Taxpayer Services

In addition to calling Denver 311 with tax-related concerns, taxpayers can also go online to Treasury’s eBiz Tax Center to find information, download tax forms, and perform common sales tax services. The City began offering online tax services to taxpayers in 2012. This online option provides taxpayers the ability to remotely register for a sales or use tax license, file a tax return, and make a tax payment.

To determine whether Denver is generally aligned with the type and degree of online taxpayer services that are being offered by other comparable municipalities, we obtained benchmarking data from the Colorado cities of Aurora, Colorado Springs, Fort Collins, Lakewood, and Thornton, as well as the City of Phoenix, Arizona. We asked participating benchmark cities the following questions to gauge the extent to which they offer online tax services and the extent of their use in 2015:

- What percent of all (new) sales and use tax business registrations (licenses) during the year were performed by taxpayers online?
- What percent of sales and use tax returns filed during the year were done so online?
- What percent of payments made during the year were submitted online?

Figure 4 shows the results of these survey questions. The five Colorado municipalities were averaged together to compare to Denver’s and Phoenix’s results. The results show that although Denver had less new businesses using online services to register for a sales and use tax license in 2015 than the benchmark cities, Denver taxpayers utilized the City’s online services for sales and use tax return filings and payments on par with or more than taxpayers in the benchmark cities.
In order to add context to the survey results, auditors also requested that the benchmark cities provide their total number of registered sales and use taxpayers as of the end of 2015. The average registered taxpayers for the other Colorado cities benchmarked was over 9,600, while Denver and Phoenix were approximately 28,000 and 56,000, respectively. The results of the benchmarking survey showed that Denver had the lowest rate of new online registrations out of all of the Colorado cities that responded. However, Denver tied Thornton for the highest online return filing rate and had the median online tax payment rate when compared to the other Colorado cities.22

Even though the rate of new online tax registrations is much lower than the average of the other Colorado cities, the Tax Compliance Section recently worked with Denver’s Peak Academy to enact improvements to communication methods with taxpayers in an effort to further improve the online registration rate and return filing rate.23

In 2013, Treasury established a goal of increased use of online tax filing and payment as a performance measure. The annual City and County of Denver Mayor’s Budget for the years 2013 through 2016 report both the agency’s goal for increased use of online options and the actual increase for this measure. The increase is measured as a percentage of returns filed online for all tax types regardless of how payment was submitted. Figure 5 provides a trend history of the performance measure goal compared to the actual measure from 2013 through 2015. The figure shows an increasing upward trend since 2013 indicating Treasury’s success in getting more taxpayers to utilize online tax return filing through outreach, technology, and education.

22 Auditors note that this benchmarking survey was not conducted as a scientific or statistically sound study and its results should not be represented as such. Variances in online tax service usage may differ between cities due to several factors including, but not limited to, differences in size, tax policy and procedure, and demographics.

23 The Peak Academy initiative was created in 2012 to provide City employees with techniques and training to help identify process improvements. Peak Academy trains City employees in Lean principles, which focus on the identification and elimination of waste within a process and encourages staff-driven improvements.
Policy and Process Improvements Could Further Strengthen Operations

Although the Tax Compliance Section has developed and implemented processes that facilitate the proper collection of sales and use tax, we identified five areas where enhancements can be made to further strengthen the section’s operations. First, tax adjustment approval policy and processes are not sufficiently detailed or formalized. Second, Treasury does not analyze the financial impact of existing exemptions and report the findings to City decision makers for them to review the efficacy of the exemptions. Third, instructional guidance on the Denver Sales Tax Form is not detailed enough to help ensure that vendors conducting sales from a physical storefront location in Denver also report online sales. Fourth, the handling of mail-in delinquent tax payments has an unnecessary step in which received mail is bundled together and sent on to the location in Texas where all other payments are directly mailed. Finally, there is minimal cooperation between Treasury and the state DOR to share taxpayer registration and taxable sales information to help improve the City’s tax collection rates.

The Tax Compliance Section’s Operational Policies and Procedures Do Not Include Complete and Descriptive Tax Adjustment Guidance

The Tax Compliance Section’s Collections unit is responsible for collecting delinquent and unremitted taxes from businesses within the City. The Collections unit includes eleven TRA employees (TRA-1s) who report to four higher level TRAs (TRA-2s), who in turn report to two TRA Supervisors. A TRA-1 is primarily responsible for the collection of delinquent sales and other taxes.
A TRA-2 has similar responsibilities, in addition to team leadership tasks that include monitoring team performance efforts and training.

The unit uses the GenTax system to collect, record, deposit, and enforce compliance of all City administered taxes. Additionally, the unit has established procedures for Tax Revenue Agents (TRAs) to oversee the tax collection and compliance processes. Although we found these controls and procedures generally to be sufficient, we identified opportunities to further strengthen operations through the establishment of more descriptive tax adjustment approval policies and procedures and by ensuring that approval authority is clearly defined in the GenTax system’s security features. Adjustments in the GenTax system include both waivers and write-offs. Waivers are used to relinquish a legitimate tax liability under certain conditions. For example, a liability may be waived if it is a taxpayer’s first late payment. In contrast, write-offs are adjustments that are used when a debt owed is not collectible.

Tax returns can be deficient for one reason or another, resulting in an underpayment. The most common cause of an underpayment is that the tax return and associated payment were filed after the due date. GenTax automatically assesses penalty and interest when this occurs. However, a taxpayer may request an adjustment, including waiving penalty and interest, when there are extenuating circumstances. We evaluated the policy, procedures, and practices for requesting tax adjustments and approving them.

As noted, the Collections unit has established practices that are documented in a manual, and this manual is used to train and guide all TRA personnel on how to monitor and manage taxpayer registration, payment processing, and delinquency collections. Although this manual provides guidance on most areas of the unit’s practices, it does not include guidance outlining the tax adjustment process. In 2010, the Tax Compliance Section’s management issued an email outlining waiver procedures for underpayments, and these procedures have not been updated since that time. Although the waiver procedures provide some guidance on required justification and documentation, they are incomplete because they do not provide approval thresholds or distinguish approval responsibility and authority between a TRA-2 and a Supervisor. The establishment of complete and descriptive guidance on tax adjustments is necessary to demonstrate uniformity and equity in the application of TRA tax adjustment determinations.

During audit testing of twenty GenTax transactions, we identified three cases in which the GenTax system records indicated that the tax adjustment requestor and approver were the same person, either a TRA-2 or a TRA Supervisor. However, we found no intentional wrongdoing in these instances because the system documentation also suggests that the TRAs who both requested and approved their own tax adjustments discussed some of the adjustments with TRA-2s or TRA Supervisors prior to approval. Regardless, these instances indicate that there is a system control weakness in that GenTax allows adjustments to be requested and approved by the same person.

We recognize that individual circumstances vary such that all-encompassing guidance is not a reasonable expectation. However, it is important to provide sufficient guidance to address the most common circumstances. In addition, guidance should establish an appropriate staff...
hierarchy for approval of tax adjustments that includes upper dollar thresholds. As a result of discussions between auditors and Tax Compliance Section personnel during and at completion of the fieldwork phase of our audit engagement, management from the Tax Collections unit proactively established a Policy Regarding Waivers and Write-Offs (Adjustments) in order to establish stronger internal controls. Because audit fieldwork was already completed at the time of the new policy’s release, we did not assess the policy as part of the audit. However, we noted that the policy standards highlight the importance of strong internal controls and adequate separation of duties over approving adjustments. This separation of duties should also be extended to GenTax approval authority controls. Therefore, we recommend that the Tax Collections unit periodically review and reassess the new Policy Regarding Waivers and Write-Offs (Adjustments) to ensure that it provides TRA personnel with sufficient guidance. In addition, the Tax Collections unit should periodically assess GenTax security controls and other features as appropriate to ensure that the system enforces appropriate separation of duties in approval responsibilities.

### The Impact of Sales and Use Tax Exemptions Is Not Currently Assessed and Reported to City Leadership

In addition to the establishment of more descriptive formal tax adjustment approval policies and procedures, the Tax Compliance Section can further strengthen operations by conducting an analysis of the revenue loss impact of the City’s sales and use tax exemptions. All retail sales in the City are taxable unless they have been explicitly exempted from taxation by the D.R.M.C. The City has exempted many items from sales and use tax as identified in the Appendix. However, the Tax Compliance Section does not periodically assess the ongoing fiscal impact of these exemptions and report the results to City leadership.

Historically, exemptions approved by City Council have not included an expiration date and therefore remain in effect permanently unless specifically repealed. Many of these exemptions were established over thirty years ago. For example, City Ordinance No. 638-84, passed in December 1984, established a sales tax exemption on the sales of tangible personal property to a natural gas and electric utility or a telephone utility for use in its business operations outside the City. However, the most recently passed exemption—exempting the sales of aircraft parts, aircraft simulator parts, and rail carrier parts—including an expiration date. The Departments of Aviation and Finance analyzed this exemption and estimated a revenue loss of $3 million per year from 2015 until expiration. Although the Tax Compliance Section has performed past analysis on the impact of expanding the definition of a tax exempt organization, they have not taken measurable action to routinely assess the ongoing impact of existing specific product category exemptions on the City’s revenue stream and future revenue projections.

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24 D.R.M.C. § 53-2 (14).
25 D.R.M.C. § 53-97.2 was passed in 2013 and is set to be repealed effective December 31, 2040.
Although performing this type of assessment would be a new practice for the City, there is state and federal precedent for such an analysis and reporting of the impact of existing exemptions. In Colorado, the Governor signed House Bill 13-1288 into law on May 28, 2013. The intent of this legislation was to reduce the complexity of Colorado’s tax structure while respecting the needs of local taxing jurisdictions. The bill directed Colorado’s DOR to recommend ways to achieve a uniform sales and use tax base. DOR proposed its recommendations premised on revenue neutrality, and in order to do so, they recommended the repeal of certain exemptions based on their current revenue loss impact. At the federal level, the U.S. Department of the Treasury estimates the cost of tax exemptions through its Office of Tax Analysis, which is responsible for analyzing the effects of existing tax law, but they are currently not included in federal annual financial reports. However, the Federal Accounting Standards Advisory Board proposed a change to federal exemption reporting requirements to include exemption impacts in annual financial reports.26, 27

City leadership could benefit from having an estimation of specific product exemption impact on the City’s tax revenue. Therefore, we recommend that the Tax Compliance Section develop an estimation methodology to form estimates of the ongoing revenue impact of product category tax exemptions and provide that information periodically to decision makers to help ensure that existing exemptions, some of which were enacted many years ago, continue to make business sense in the City’s economic climate.

Sales Tax Return Guidance Does Not Help Ensure that Gross Online Sales Are Reported

In addition to developing a periodic analysis of tax exemption impact, additional information on the Sales Tax Return form would help clarify that taxpayers must report all taxable sales. In the absence of such clarification, the City may not be as well positioned as it could be to ensure that all tax revenue due is received.

Many retailers doing business in Denver have a physical presence through a storefront location in the City. Some of these retailers also conduct online, or e-commerce, sales to Denver businesses and residents. While some of the businesses that conduct both storefront and online sales report these two types of gross sales separately on their sales tax return by utilizing multiple tax accounts with the City, others have only one sales tax account and report storefront and online gross sales together on the same form. Although the current Sales Tax Return instructions specify that the taxpayer must “Enter total receipts from all sales and services both taxable and non-taxable,” which implies that both storefront and online sales should be reported, Treasury’s Sales Tax Return form does not include instructions specifying that explicitly.

Management in the Tax Compliance Section’s Tax Audit unit indicated that, when conducting tax audits, they have occasionally identified businesses that have not accurately reported online sales in the overall gross sales receipts figure. Treasury’s sales tax website does have a frequently asked questions section that addresses many common questions about the sales tax return filing process. However, the content does not answer the specific question of what type of sales the taxpayer should be reporting. Although including additional instruction on the Sales Tax Return


The Delinquent Tax Payment Mail-In Process Is Inefficient

In addition to updating the Sales Tax Return form to provide taxpayers additional guidance on gross sales reporting, we found that simplifying the steps to submit a delinquent tax payment will improve the efficiency and speed with which sales tax payments are processed. The current process of receiving delinquent tax payments by mail involves unnecessary handling that delays the timely deposit of funds. The primary mail receiving location for the processing and depositing of sales tax payments is a bank lockbox located in Dallas, Texas. However, delinquent payments are first mailed to a Denver post office (PO) box and then forwarded to the Dallas lockbox by the Collections unit (Collections). Taxpayer submissions may include tax returns, delinquency notices, letters, and payments. In 2015, taxpayers submitted over 5,500 delinquent tax notices and payments exceeding $1.5 million to the Denver PO box.

Prior to the implementation of the GenTax system, Collections received delinquent tax payments in Denver. Collections continued this practice after the GenTax system was effected due to some system concerns that required Collections personnel to review certain delinquent tax payment submissions. Although Collections has since discontinued this review, the unit continues to receive delinquent tax payments at the Denver PO box, forwarding a batch of unopened envelopes each evening to the Dallas bank lockbox for processing. The Dallas bank lockbox personnel then process the delinquent tax returns and payments, including depositing of funds, in a similar manner as a timely tax return and payment submission.

The use of lockbox processing allows for timely handling of returns and prompt deposit of funds. However, the current practice of directing delinquent returns and payments to a Denver PO box prior to being routed to their ultimate destination results in handling inefficiencies, delays in payment processing, and unnecessary costs of processing returns and payments. Therefore, we recommend that the Tax Compliance Section direct delinquent returns and payments to the City’s Dallas lockbox by revising the return address on notices, envelopes, and its website.

Opportunities Exist To Enhance Practices through Increased Coordination with the Colorado Department of Revenue

In addition to implementing procedural and informational improvements, we identified two ways in which the Tax Compliance Section can help provide for greater accuracy of tax license registrations and related collections by increasing coordination with DOR. First, the Tax Compliance Section could use a 2015 Colorado state audit report to investigate businesses that are possibly incorrectly registered by the DOR. Second, the Tax Compliance Section could compare the sales and use tax businesses registered with the City to the DOR’s sales and use tax business registration records to identify any discrepancies.

State of Colorado Audit Report on Local Sales Tax—In November 2015, the Colorado Office of the State Auditor (OSA) released a performance audit of the DOR’s administration of local sales taxes for counties, municipalities, special districts, and combined authorities. The audit found that DOR could improve its administration of local sales taxes to ensure that businesses are properly
registered to the applicable local tax jurisdictions. Specifically, auditors identified that DOR may not have registered 11 percent of retail business sites reviewed to the proper local jurisdiction. Of those potentially incorrectly registered sites, OSA found more than 340 business sites that are related to the City: 85 sites appeared to be inside the City but were registered as being outside the City, and 259 sites appeared to be outside the City but were registered as being inside the City.

According to the OSA audit report, one factor contributing to the potential errors was the use by vendors of electronic address databases that may not have provided them with accurate jurisdictional information. Tax jurisdictions are complex; for example, municipal boundaries change frequently, a postal city may not be the same as the taxing city, and ZIP codes may cross both municipal and county boundaries. Therefore, many businesses use third-party databases with extensive parcel and municipal boundary data to help them determine all the different tax jurisdictions to which they are subject. Accordingly, the DOR website provided links to several of these databases, which had been certified by DOR as reliable. However, OSA auditors found that DOR’s certification practices did not ensure that the databases were accurately determining sales tax liabilities. OSA recommended that DOR evaluate the best course of action for making sure vendors have the information they need to make accurate tax payments, whether through a third-party database or through a database provided by the state. OSA also recommended that DOR notify home-rule municipalities that collect their own sales taxes—such as Denver—about each of the possible incorrectly registered businesses identified in the audit.

Upon conclusion of our audit report writing in July 2016, the Tax Compliance Section had not yet received a listing of possible DOR incorrect registrations related to its jurisdiction that were identified by the OSA. Therefore, Tax Compliance Section personnel have not yet investigated and reviewed the possible DOR registration errors to identify whether there are similar concerns within the City’s tax system for these businesses. When asked about the state of this recommendation, DOR management stated that their current focus is on addressing system concerns identified by the OSA in its audit report, with plans to provide the City with its business listing later in the year. Although the potential registration errors identified in the OSA audit relate to DOR’s business registration practices and not the City’s, it is important for the City to investigate the potential errors related to its jurisdiction in the event that these businesses relied upon the inaccurate databases.

Comparison of City Sales and Use Tax Business Registrations with DOR Records—The Tax Compliance Section does not perform a routine or periodic review of businesses registered for sales and use tax licenses in the City with DOR’s business registration records. According to Tax Compliance Section management, they conducted routine reviews in the 1990s comparing City and DOR records. However, the practice was short-lived because the results of these reviews regularly indicated that the City’s registration practices were more robust and its registration records more accurate than those of the state. The possibility of conducting such a review has not been reevaluated since.

While the 2015 OSA audit report identified concerns with DOR’s sales tax business registration practices, efforts being conducted by DOR to increase the reliability of its registration information presents the opportunity for the City to reassess the feasibility of conducting these types of reviews again in the future. In addition, utilizing new methods to help ensure the accuracy of sales and use tax business license registrations can help enhance the collection of related taxes as it

provides the City with additional opportunities to detect taxpayers that may not have registered for a sales and/or use tax license with the City, but are licensed with the state.

**Legal Authority Provides for Exchange of Licensed Vendor Information between DOR and the City**—Colorado Revised Statutes § 29-2-106 (6) authorizes DOR’s Executive Director to exchange information with the proper official of any home rule city concerning licensed vendors within the jurisdiction of the home rule city. DOR and the City have entered into an agreement to provide for the exchange of this type of information and to agree to safeguard the confidentiality of any information provided. As such, we recommend that the Tax Compliance Section obtain the listing of possible incorrectly registered business sites identified in OSA’s Local Sales Tax audit and investigate whether the possible errors have any local impact. In addition, we recommend that the Tax Compliance Section reassess the feasibility of conducting a routine or periodic comparison of the sales and use tax businesses registered by the City with DOR’s sales and use tax business registration records.
RECOMMENDATIONS

To enhance sales and use tax collection practices, we make the following recommendations.

1.1 The Treasury Division’s Tax Collections unit should periodically review and reassess the new Policy Regarding Waivers and Write-Offs (Adjustments) to ensure that it provides Tax Revenue Agent personnel with sufficient guidance.

**Auditee Response: Agree, Implementation Date - Annually in the 2nd Quarter of Each Year (Next review - 2017)**

Treasury agrees with this recommendation. After the Audit Team identified and communicated to us during the course of the audit, some concerns regarding the existing policy, we undertook immediately to update our policy. Consequently a new policy regarding waivers and write-offs (adjustments) was documented and issued to Tax Collection staff on June 9, 2016 (a copy was sent to the Audit Team) strengthening internal controls, separation of duties and approval authority. We will do an annual review of this policy to ensure it provides Tax Collection personnel with sufficient guidance and is meeting our current needs and addressing any issues.

1.2 The Treasury Division’s Tax Collections unit should periodically assess GenTax security controls and other features as appropriate to ensure that the system enforces appropriate separation of duties in approval responsibilities.

**Auditee Response: Agree, Implementation Date - Annually in the 2nd Quarter of Each Year (Next review - 2017)**

As with Recommendation 1.1, when the Audit Team communicated concerns with GenTax security controls, we immediately undertook a review of those controls (including appropriate separation of duties in approval responsibilities) and modified the system such that no Tax Revenue Agents (or any user) can approve their own adjustment requests, and that only supervisors can approve adjustments of more than $2,000. Treasury will now conduct an annual review of these areas in GenTax.

1.3 The Treasury Division’s Tax Compliance Section should develop an estimation methodology to form estimates of the ongoing revenue impact of product category tax exemptions and provide that information periodically to decision makers to help ensure that existing exemptions continue to make business sense in the City’s economic climate.

**Auditee Response: Agree, Implementation Date - October 31, 2016**

The Tax Compliance Section will work diligently to develop an estimation methodology to project estimates on the revenue impact of product category tax exemptions and provide that information periodically to decision makers.

1.4 The Treasury Division should provide additional instruction on the Sales Tax Return form to make clear the requirement that taxpayers must include both storefront and online sales in their gross sales reporting.
Treasury implemented this shortly after the Audit Team identified and communicated it during the course of the audit. Additional language was added to the sales tax returns instructing taxpayers to include any Denver related online sales (updated sales tax returns can be viewed on Treasury’s website).

1.5 The Treasury Division’s Tax Compliance Section should direct delinquent returns and payments to the City’s Dallas bank lockbox by revising the return address on notices, envelopes, and its website.

Auditee Response: Agree, Implementation Date - December 31, 2016
Treasury will work with our printing vendor, our bank/lockbox vendor, and our Technology Services Division to make this change.

1.6 The Treasury Division’s Tax Compliance Section should obtain the listing of possible incorrectly registered business sites identified in the Colorado Office of State Auditor’s Local Sales Tax audit and investigate whether the possible errors have any local impact.

Auditee Response: Agree, Implementation Date - December 31, 2016
Treasury will contact the Colorado State Auditor and/or the Colorado Department of Revenue to obtain this list.

1.7 The Treasury Division’s Tax Compliance Section should reassess the feasibility of conducting a routine or periodic comparison of the sales and use tax businesses registered by the City with DOR’s sales and use tax business registration records.

Auditee Response: Agree, Implementation Date - December 31, 2016
Treasury will contact the Colorado Department of Revenue to obtain a list of sales and use tax business registrations, and compare them to our records to determine their usefulness, and evaluate setting up a periodic review.
FINDING 2

The City Should Continue To Position Itself To Act upon Pending Legal and Regulatory Developments Related to the Collection of Remote Online Sales Tax

The City and County of Denver (City) is not receiving sales tax revenues from all remote sellers who sell to City residents. As noted, the City’s primary source of revenue for the General Fund is sales and use tax, which made up 48 percent of total General Fund revenues in 2015. According to the 2016 City and County of Denver Mayor’s Budget:

Sales and use tax revenue is viewed as a volatile source of revenue due to its correlation with business cycles, and in periods of strong growth the City has experienced sales and use tax revenue increases of over 10 percent. Conversely, during periods of economic recession, sales and use tax revenues have decreased from prior periods causing a retraction in the City’s General Fund.

One of the avenues from which the City’s General Fund receives sales tax is from collections associated with remote sales, which primarily include e-commerce transactions. E-commerce transactions are defined by the U.S. Department of Commerce as “the sales of goods and services where the buyer places an order, or the price and terms of the sale are negotiated over an Internet, mobile device, extranet, Electronic Data Interchange network, electronic mail, or other comparable online system in which payment may or may not be made online.”

Remote e-commerce sales can generally be broken down into two major types of transactions: business-to-consumer (B2C) sales in which a business sells a finished product directly to a consumer, and business-to-business (B2B) sales in which a business sells a finished good or product to another business. These different types of transactions, coupled with the continuous expansion of the world’s online infrastructure and development of online business markets, has radically altered the landscape of how and where consumers purchase goods and services. This change in purchasing practices has complicated the City’s ability to anticipate, collect, and rely on revenues from taxes associated with these transactions.

Federal Rulings Have Created Roadblocks Impacting Collections of Remote Online Sales Tax

The growing practice of online selling and shopping has caused rapid expansion in e-commerce transactions nationwide and has created a complex problem for the City when one analyzes the long-standing history surrounding taxation of remote online e-commerce sales. The effect of this has resulted in a potential loss of revenue.

Foremost, the City is adversely impacted because it lacks the ability to enforce sales tax collection requirements associated with remote sellers. This issue stems from a 1967 Supreme Court case formally known as National Bellas Hess v. Illinois Department of Revenue, which set the stage for the ruling on taxing online remote sales. The court ruled that “the many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle

30 https://supreme.justia.com/cases/federal/us/386/753/case.html
interstate business in a ‘virtual welter of complicated obligations to local jurisdictions.’ 31 In other words, the court ruled that out-of-state remote retailers do not have the responsibility to collect and remit sales tax, based purely on the notion that it would place too much of a burden on their businesses.

Furthermore, in 1992, the matter of sales tax on remote sales was revisited by the Supreme Court again in *Quill Corp. v. North Dakota*. 32 The court ultimately decided to uphold the decision from *National Bellas Hess v. Illinois Department of Revenue* and further ruled that Congress may be better qualified to resolve the overall issue. This case also brought forward the concept that businesses must have a physical presence, or nexus, in a state in order to be responsible for the collection and remittance of sales tax for purchases made by in-state customers. Physical presence was defined as offices, branches, warehouses, employees, etc., and the existence of customers (i.e., economic presence) does not create sufficient nexus for a state to impose sales tax collection and remittance burdens on a business. The Supreme Court’s reasoning was further supported by the fact that there were thousands of separate sales tax jurisdictions in the United States, and imposing collection obligations on retailers would burden interstate commerce and once again burden businesses.

Despite the Supreme Court’s decisions, the City has imposed the liability of collecting and remitting sales tax on every retailer in accordance with the provisions of the Denver Revised Municipal Code (D.R.M.C.) § 52-28, as follows:

> Every retailer shall be liable and responsible for the payment of an amount equivalent to 3.65 percent of the retailer’s gross taxable sales of commodities and services except for aviation and railway fuel, automotive vehicle rentals, and food and beverage not already exempted from taxation under subsection 53-26(8) of the Code.

However, while the City’s code requires retailers to collect and remit taxes regardless of physical location, and even though the City has recently begun receiving significant revenues from a major online retailer, the City is still not receiving sales tax remittances related to all remote e-commerce transactions.

The City Is Potentially Losing Millions in Tax Revenue

Since the City is not receiving sales tax revenues from all remote e-commerce transactions, the City is potentially experiencing losses of revenue estimated to be in the millions. For example, a report titled “Impact of ‘Marketplace Fairness’ on Select Jurisdictions – Update,” released in May 2013 by IHS Global Insights for the National League of Cities, estimated that the City and County

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31 Ibid.
32 https://www.law.cornell.edu/supct/html/91-0194.ZO.html
of Denver lost between $7.8 million and $19.3 million dollars associated with remote e-commerce collections from 2011 through 2013.\(^{33}\)

In addition, during audit work, we developed estimated revenue losses that were largely based on a more conservative starting point outlined in the City’s 2012 Structural Financial Task Force Report, which estimated losses of between $2 million and $4 million.\(^{34}\) The report covered a broad range of topics including the City’s revenues, expenditures, and tax burdens. In addition, the report brought forth recommendations directed to the City that aimed to solve the structural budget gap. For example, one recommendation suggested imposing a sales tax on internet purchases, which was contingent upon state and federal legal changes. Our methodology for creating a revenue loss estimate was largely based off the average growth of national e-commerce sales and personal net income. After averaging these statistics, the projected revenue losses were predicted to grow by approximately 5 percent annually. Furthermore, as mentioned above, we used the estimated $2 million to $4 million brought forth in the 2012 Structural Financial Task Report as a base amount of revenue loss to apply our growth rate on a forward basis. Considering these factors, we projected that for the years 2013 through 2015, the City may have experienced revenue losses of approximately $2.2 million to $5.5 million. While our estimates differ widely from the IHS Global Insights Report, it is important to note that there does not appear to be a consistent measure by which to estimate revenue loss associated with remote e-commerce transactions.

The City Has Spearheaded Efforts Recommending Change

It is important to recognize that, while the City is potentially losing revenue, the Treasury Division has taken steps to address tax collection hurdles and improve taxation complexities facing the City and the state. For example, in 2013, the Colorado General Assembly issued Senate Joint Resolution 14-038, which directed home rule municipalities to begin adopting and utilizing a system of standardized tax definitions to help address the issues brought forward in the Supreme Court Decisions of Hess and Quill. The resolution also suggests collaboration between home rule municipalities and the Colorado Municipal League (CML) along with members of the business community, Colorado Department of Revenue (DOR), Colorado Association of Commerce and Industry, and Colorado Retail Council, with the goal of developing tax definitions that do not have significant fiscal impact, do not require voter approval, and have no impact on TABOR restrictions.\(^{35}\)

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\(^{33}\) The National League of Cities, also known as NLC, is a U.S. advocacy organization that represents 19,000 cities, towns, and villages and encompasses 49 state municipal leagues. NLC provides training to municipal officials and provides assistance to cities on educational issues.


\(^{35}\) TABOR, or the Taxpayer Bill of Rights, is a constitutional amendment designed to restrain expenditure growth in government. TABOR applies to all levels of government in Colorado and is viewed as a very restrictive tax spending limitation.
As a response to this resolution, Treasury helped spearhead and participated in a CML Sales Tax Simplification Committee that developed a Sales Tax Simplification Model Ordinance for CML’s review.\(^{36}\) The model is currently being reviewed for finalization by CML officials.\(^{37}\)

In addition, Treasury, via additional CML working committees, has encouraged Congress to support two pieces of pending legislation: the Marketplace Fairness Act of 2015 (S.698) and the Remote Transactions Parity Act of 2015 (H.R.2775). Treasury supports the notion that both bills would give Colorado and its local governments the flexibility to collect taxes owed to them from remote online purchases. For example, the Marketplace Fairness Act would grant states authority to compel remote sellers, regardless of physical location, to collect sales tax during transactions. However, this authority would only be granted to states upon simplification of their tax laws.

Similar to the ideas in the Marketplace Fairness Act, the state’s DOR embarked on an effort to provide recommendations for establishing a revenue-neutral uniform sales and use tax base to the General Assembly, as prescribed by House Bill 13-1288. The bill’s purpose was to reduce the complexity of Colorado’s existing tax structure and to recommend specific ways to achieve a uniform sales and use tax base while maintaining no impact on the revenues throughout the state. The findings of this effort identified that, as of December 2013, Colorado had nearly 300 taxing authorities with differing sales and use tax bases, which places a heavy burden on businesses operating in the state and further complicates any efforts remote sellers may make to correctly collect and remit taxes.

The issues identified by DOR as a result of this House Bill support the City’s reasoning for pursuing support of legislation, such as the Marketplace Fairness Act, and would ultimately require a joint effort by both the City and state to resolve.

Current Legislation May Help Curb Revenue Loss

Regulatory efforts at the state level in both Colorado and South Dakota could prove useful to the City in its efforts to collect sales tax from all online remote retailers. First, a Colorado state law may be able to provide the City with crucial information needed to capture potential revenue losses associated with remote online sales. Specifically, a recent Supreme Court case, Direct Marketing Association v. Brohl, Executive Director, Colorado Department of Revenue, challenged Colorado Revised Statutes (C.R.S.) § 39-21-112 (3.5)(d), which became law in 2010 and imposes three obligations on remote retailers that do not collect sales tax. Specifically, a retailer must send the following:

- A transactional notice to purchasers informing them that they may be subject to Colorado’s use tax.
- An annual purchase summary to Colorado purchasers who buy goods from a retailer totaling more than $500, including the dates, categories, and amounts of purchase, to remind them of their obligation to pay use taxes on those purchases.

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\(^{36}\) The Colorado Municipal League is a nonprofit organization that provides services to municipal officials in managing the cities and towns of Colorado.

\(^{37}\) As of June 2016, this ordinance was still undergoing review.
An annual customer information report to DOR by March 1 of each year listing customers’ names, addresses, and total amounts spent on purchases for which sales tax was not paid.

Although the information collected from this law could potentially aid the Treasury Division’s Audit unit in its risk assessment process and allow for a greater amount of use tax collection from City businesses, this law has not been fully enacted by the DOR due to the ongoing court case. Specifically, this law has been challenged by the Direct Marketing Association; accordingly, as of June 2016, no information has been obtained as outlined by the statute.38

In addition to the requirements outlined in C.R.S. § 39-21-112 (3.5)(d), a current lawsuit regarding a law recently enacted in South Dakota may pave the way for the City to fully enforce sales tax collections from online remote retailers.39 The South Dakota law adopts the concept of economic presence rather than physical presence as the catalyst in determining which remote retailers must collect and remit South Dakota sales tax.40 Enacted in March 2016, the law states that any seller selling tangible personal property, products transferred electronically, or services for delivery into South Dakota, who does not have a physical presence in the state, is required to remit sales tax if the seller, in the prior or current year, meets either of two alternative criteria: (a) the seller’s gross revenue from sales delivered into South Dakota exceeds $100,000; or (b) the seller made sales for delivery into South Dakota in two hundred (200) or more separate transactions.

In other words, any remote seller of taxable goods or services exceeding these thresholds is subject to sales tax, regardless of whether or not the seller has a physical presence as defined by the U.S. Supreme Court in Quill Corp. v. North Dakota. This law could potentially pave the way for the City to fully enforce the requirements set forth in the D.R.M.C. regarding the collection and remittance of sales tax as it relates to remote sellers who currently do not remit, thus capturing lost revenues for the City.

After the passage of Senate Bill 106, two lawsuits were filed in the following months, one by the State of South Dakota and one jointly by the American Catalog Mailers Association (ACMA) and NetChoice.41 42 South Dakota’s lawsuit targets four large online retailers, seeking to force them to comply with Senate Bill 106, while ACMA and NetChoice are challenging the constitutionality of the state’s law.43 These lawsuits act as examples of the ongoing questions associated with the 1992

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38 The Direct Marketing Association (DMA) is a group of global trade organizations that advocate for the ability to advertise directly to customers through various media outlets such as email, websites, catalogs, etc.
39 South Dakota Senate Bill 106, an Act to provide for the collection of sales tax from certain remote sellers, to establish certain Legislative findings, and to declare an emergency.
40 Economic presence is not based on a retailer’s physical location in a city or state but rather it is based on if that retailer conducts economic activities or receives income from sales to customers in a city or state.
41 The American Catalog Mailers Association (ACMA) acts as a leading voice in the catalog market and represents members of the industry on issues such as postal rates, tax laws, environmental issues, and innovation in the business.
42 NetChoice is a trade association of eCommerce businesses and online consumers with the goal of promoting convenience, choice, and commerce on the internet. Members of NetChoice include eBay, Lyft, Living Social, PayPal, 21st Century Fox, AOL, Overstock.com, and others.
43 The state sued Newegg Inc., Overstock.com Inc., Systemax Inc., and Wayfair LLC. In a circuit court in Hughes County, where the state capital of Pierre is located.
Supreme Court decision and highlight the front-line leaders attempting to reach a solution to the issue of remote sales tax collections.

The City Should Continue Efforts To Standardize Definitions and Work With DOR To Assess Reported Information

While the Treasury Department is an active participant in efforts to solve the issue of remote sales tax collection, continued efforts and partnerships can help the City expedite solutions. Therefore, we recommend that Treasury’s Tax Compliance Section continue to monitor the legal challenge to C.R.S. § 39-21-112 (3.5)(d), which requires retailers that do not collect Colorado sales tax to file an annual report for each purchaser by March 1 of each year to notify Colorado tax authorities of the total amount paid for Colorado purchases when sales tax was not imposed. If DOR is legally able to pursue collection of the annual reporting requirements outlined in this statute, the City should work with DOR to assess the information reported and determine the usefulness of the information to help inform the Treasury Division’s audit risk assessment function. Furthermore, the Treasury’s Tax Compliance section should continue to engage in work efforts to standardize local home rule municipalities’ sales and use tax definitions and monitor ongoing legal challenges that could impact the collection of sales tax from remote online sellers.
RECOMMENDATIONS

To decrease the potential revenue losses associated with remote online sales tax collection, we make the following recommendations.

2.1 The Treasury Division’s Tax Compliance Section should continue to monitor the legal challenge to C.R.S. § 39-21-112 (3.5)(d), which requires retailers that do not collect Colorado sales tax to file an annual report for each purchaser by March 1 of each year to notify Colorado tax authorities of the total amount paid for Colorado purchases when sales tax was not imposed. If the Colorado Department of Revenue (DOR) is legally able to pursue collection of the annual reporting requirements outlined in this statute, the City should work with DOR to assess the information reported and determine the usefulness of the information to help inform the Treasury Division’s audit risk assessment function.

**Auditee Response: Agree, Implementation Date - Ongoing**

Treasury will continue to monitor this situation, and if the Colorado Department of Revenue can ultimately legally pursue vendors for this report, we will work with them to obtain the information and evaluate its usefulness.

2.2 The Treasury Division’s Tax Compliance Section should continue to engage in work efforts to standardize local home rule municipalities’ sales and use tax definitions and monitor ongoing legal challenges that could impact the collection of sales tax from remote online sellers.

**Auditee Response: Agree, Implementation Date - Ongoing**

Treasury will continue with our efforts in these areas.
## APPENDIX

### Denver Revised Municipal Code Sales and Use Tax Exemptions

<table>
<thead>
<tr>
<th>D.R.M.C. References</th>
<th>Sales and Use Tax Exemptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>§ 53-26(1) § 53-97(1)</td>
<td>Sales to the U.S. government, to the state, its departments and institutions, and the political subdivisions thereof when purchased in their governmental capacities.</td>
</tr>
<tr>
<td>§ 53-26(2) § 53-97(2)</td>
<td>Sales made to religious or charitable corporations when purchased for their regular religious or charitable functions and activities.</td>
</tr>
<tr>
<td>§ 53-26(3) § 53-97(3)</td>
<td>Sales of cigarettes.</td>
</tr>
<tr>
<td>§ 53-26(4) § 53-97(4)</td>
<td>Sales of motor fuel and special fuel.</td>
</tr>
<tr>
<td>§ 53-26(5) § 53-97(5)</td>
<td>Sales and purchases of meat, cattle, sheep, lambs, swine and goats; all sales of mares and stallions for breeding purposes.</td>
</tr>
<tr>
<td>§ 53-26(6) § 53-97(6)</td>
<td>Sales and purchases of feed for livestock or poultry and all sales of seeds to farmers, ranchers, truck farmers, florists and horticulturists who sell the crops resulting from the propagation of such seeds or use such crops as feed for livestock or poultry.</td>
</tr>
<tr>
<td>§ 53-26(7) § 53-97(7)</td>
<td>Sales and purchases of medical supplies.</td>
</tr>
<tr>
<td>§ 53-26(8) § 53-97(8)</td>
<td>Sales and purchases of food.</td>
</tr>
<tr>
<td>§ 53-26(9) – sales tax only</td>
<td>Sales of tangible personal property to a purchaser residing or doing business outside the City, where delivery is made to the purchaser's residence or business address outside the City by the vendor; on the vendor's vehicle; by common, contract, or commercial carrier that is hired by the vendor, or by mail.</td>
</tr>
<tr>
<td>§ 53-26(10) § 53-97(11)</td>
<td>Sales which the City is prohibited from taxing under the Constitution or laws of the U.S. or the Constitution of the state.</td>
</tr>
<tr>
<td>§ 53-26(11) § 53-97(12)</td>
<td>Sale of automotive vehicles that are registered and required by state law to be registered outside the City.</td>
</tr>
<tr>
<td>§ 53-26(12) § 53-97(13)</td>
<td>Sales of farm machinery.</td>
</tr>
<tr>
<td>§ 53-26(13) – sales tax only</td>
<td>Sales of tangible personal property for use in improving real property outside the City only in the amount and to the extent that a use tax has been or will be paid in respect to the proposed use of such property to a municipal corporation organized and existing under the authority of the laws or the constitution of any state, if the purchaser presents to the retailer a building permit or other documentation acceptable to the manager showing that a use tax has been or will be paid to the municipality in which the real property is located.</td>
</tr>
<tr>
<td>§ 53-26(14) § 53-97(10)</td>
<td>Sales of tangible personal property to a natural gas and electric utility or a telephone utility for use in its business operations outside the City, even though the property is delivered and temporarily stored within the City.</td>
</tr>
<tr>
<td>D.R.M.C. References</td>
<td>Sales and Use Tax Exemptions</td>
</tr>
<tr>
<td>--------------------</td>
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</tr>
<tr>
<td>§ 53-26(15)</td>
<td>Sales of machinery, tools, and equipment, including replacement parts, to a transportation utility to be used by the utility in the operation of an equipment maintenance facility and at an industrial building.</td>
</tr>
<tr>
<td>§ 53-97(16)</td>
<td>Sales of construction and building materials for use in the construction, reconstruction, or remodeling of a new industrial building of a transportation utility to be used by the utility for an equipment maintenance facility.</td>
</tr>
<tr>
<td>§ 53-26(16)</td>
<td>Sales of prepress preparation materials.</td>
</tr>
<tr>
<td>§ 53-97(17)</td>
<td>Sales made to, billed directly to, and paid for directly by, qualified hospital organizations, provided that the property or service purchased by the qualified hospital organization is employed in furtherance of an exempt function.</td>
</tr>
<tr>
<td>§ 53-26(17)</td>
<td>Sale of aircraft to an airline company that is used in interstate commerce by the airline company.</td>
</tr>
<tr>
<td>§ 53-97(18)</td>
<td>Sales of aircraft parts, aircraft simulator parts, and rail carrier parts.</td>
</tr>
<tr>
<td>§ 53-26(18)</td>
<td>Sales of construction and building materials for their storage in the City; but any use, consumption or distribution beyond storage of the construction and building materials in the City shall be taxable.</td>
</tr>
<tr>
<td>§ 53-97(19)</td>
<td>Sales of tangible personal property purchased outside the City for use, storage, distribution or consumption outside the City by a nonresident of the City while the property is temporarily within the City for the purchaser's own personal use, storage, or consumption.</td>
</tr>
<tr>
<td>§ 53-97(20)</td>
<td>Sales of tangible personal property and services taxable under the City retail sales tax article upon which a sales tax has been paid to the City.</td>
</tr>
<tr>
<td>§ 53-26.2</td>
<td>The sale of construction and building materials for their storage in the City; but any use, consumption or distribution beyond storage of the construction and building materials in the City shall be taxable.</td>
</tr>
<tr>
<td>§ 53-97.2</td>
<td>Sales of tangible personal property (excepting (a) construction equipment, tools and machinery; (b) construction and building materials as defined in this article; and (c) vehicles that are capable of moving themselves, or of being moved from place to place upon wheels or endless tracks, excluding bicycles and other devices moved by human power and excluding &quot;farm machinery&quot;) that are first used, stored, consumed or distributed within the City more than one year after the most recent sale of the property if, within the year following such sale, the property has been used in a significant way outside the City for the principal purpose for which it was most recently purchased.</td>
</tr>
<tr>
<td>§ 53-97(21)</td>
<td>The use of tangible personal property which was originally purchased at wholesale and which is subsequently removed from inventory or taken out of a manufacturing or compounding process and donated without consideration to the U.S. government, to the state, its departments and institutions and the political subdivisions thereof or any organization which has been certified as a not-for-profit organization under Internal Revenue Code and which is also operated as a Colorado nonprofit corporation.</td>
</tr>
</tbody>
</table>

**Source:** Table developed by auditors from Denver Revised Municipal Code § 53-26 and § 53-97.

**Notes:** D.R.M.C. § 53-26 (15) and (16) and D.R.M.C. § 53-97 (16) and (17) are contingent upon the equipment maintenance facility and industrial building meeting several requirements, as defined in parts a through d of those subsections.

D.R.M.C. § 53-26 (18)(a) and (b) and D.R.M.C. § 53-97 (20)(a) and (b) provide further guidance explaining significant wording used in this section, including, but not limited to “qualified hospital organization”.

Only the exemption on the sales of aircraft parts, aircraft simulator parts, and rail carrier parts pursuant to D.R.M.C § 53-26.2 and § 53-97.2 include a provision for repeal.
July 26, 2016

Auditor Timothy M. O’Brien, CPA
Office of the Auditor
City and County of Denver
201 West Colfax Avenue, Dept. 705
Denver, Colorado 80202

Dear Mr. O’Brien,

The Office of the Auditor has conducted an audit of Municipal Sales Tax Collection Practices.

This memorandum provides a written response for each reportable condition noted in the Auditor’s Report final draft that was sent to us on July 15, 2016. This response complies with Section 20-276 (c) of the Denver Revised Municipal Code (D.R.M.C.).

AUDIT FINDING 1
The City Has Sound Sales and Use Tax Collection and Customer Feedback Practices, but some improvements could further enhance effectiveness and efficiency.

RECOMMENDATION 1.1
The Treasury Division’s Tax Collections unit should periodically review and reassess the new Policy Regarding Waivers and Write-Offs (Adjustments) to ensure that it provides Tax Revenue Agent personnel with sufficient guidance.

<table>
<thead>
<tr>
<th>Agree or Disagree with Recommendation</th>
<th>Target date to complete implementation activities (Generally expected within 60 to 90 days)</th>
<th>Name and phone number of specific point of contact for implementation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agree</td>
<td>Annually in the 2nd Quarter of Each Year (Next review – 2017)</td>
<td>Bob Dent, Tax Collections Manager 720-913-9413</td>
</tr>
</tbody>
</table>

Narrative for Recommendation 1.1
Treasury agrees with this recommendation. After the Audit Team identified and communicated to us, during the course of the audit, some concerns regarding the existing policy, we undertook immediately to update our policy. Consequently a new policy regarding waivers and write-offs (adjustments) was documented and issued to Tax Collection staff on June 9, 2016 (a copy was sent to the Audit Team) strengthening internal controls, separation of duties and approval authority. We will do an annual review of this policy to ensure it provides Tax Collection personnel with sufficient guidance and is meeting our current needs and addressing any issues.
### RECOMMENDATION 1.2
The Treasury Division’s Tax Collections unit should periodically assess GenTax security controls and other features as appropriate to ensure that the system enforces appropriate separation of duties in approval responsibilities.

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**Narrative for Recommendation 1.2**

As with Recommendation 1.1, when the Audit Team communicated concerns with GenTax security controls, we immediately undertook a review of those controls (including appropriate separation of duties in approval responsibilities) and modified the system such that no Tax Revenue Agents (or any user) can approve their own adjustment requests, and that only supervisors can approve adjustments of more than $2,000. Treasury will now conduct an annual review of these areas in GenTax.

### RECOMMENDATION 1.3
The Treasury Division’s Tax Compliance Section should develop an estimation methodology to form estimates of the ongoing revenue impact of product category tax exemptions and provide that information periodically to decision makers to help ensure that existing exemptions continue to make business sense in the City’s economic climate.

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<tbody>
<tr>
<td>Agree</td>
<td>10/31/2016</td>
<td>Bruce Moore, Director of Tax Compliance 720-913-9421</td>
</tr>
</tbody>
</table>

**Narrative for Recommendation 1.3**

The Tax Compliance Section will work diligently to develop an estimation methodology to project estimates on the revenue impact of product category tax exemptions and provide that information periodically to decision makers.

### RECOMMENDATION 1.4
The Treasury Division should provide additional instruction on the Sales Tax Return form to make clear the requirement that taxpayers must include both storefront and online sales in their gross sales reporting.

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<tr>
<td>Agree</td>
<td>06/15/2016</td>
<td>Bob Dent, Tax Collections Manager 720-913-9413</td>
</tr>
</tbody>
</table>
Narrative for Recommendation 1.4
Treasury implemented this shortly after the Audit Team identified and communicated it during the course of the audit. Additional language was added to the sales tax returns instructing taxpayers to include any Denver related online sales (updated sales tax returns can be viewed on Treasury’s website).

RECOMMENDATION 1.5
The Treasury Division’s Tax Compliance Section should direct delinquent returns and payments to the City’s Dallas bank lockbox by revising the return address on notices, envelopes, and its website.

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<tr>
<td>Agree</td>
<td>12/31/2016</td>
<td>Bob Dent, Tax Collections Manager 720-913-9413</td>
</tr>
</tbody>
</table>

Narrative for Recommendation 1.5
Treasury will work with our printing vendor, our bank/lockbox vendor, and our Technology Services Division to make this change.

RECOMMENDATION 1.6
The Treasury Division’s Tax Compliance Section should obtain the listing of possible incorrectly registered business sites identified in the Colorado Office of State Auditor’s Local Sales Tax audit and investigate whether the possible errors have any local impact.

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<tr>
<td>Agree</td>
<td>12/31/2016</td>
<td>Bruce Moore, Director of Tax Compliance 720-913-9421</td>
</tr>
</tbody>
</table>

Narrative for Recommendation 1.6
Treasury will contact the Colorado State Auditor and/or the Colorado Department of Revenue to obtain this list.

RECOMMENDATION 1.7
The Treasury Division’s Tax Compliance Section should reassess the feasibility of conducting a routine or periodic comparison of the sales and use tax businesses registered by the City with DOR’s sales and use tax business registration records.

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<tr>
<td>Agree</td>
<td>12/31/2016</td>
<td>Bruce Moore, Director of Tax Compliance 720-913-9421</td>
</tr>
</tbody>
</table>
Narrative for Recommendation 1.7
Treasury will contact the Colorado Department of Revenue to obtain a list of sales and use tax business registrations, and compare them to our records to determine their usefulness, and evaluate setting up a periodic review.

AUDIT FINDING 2
The City Should Continue To Position Itself to Act upon Pending Legal and Regulatory Developments Related to the Collection of Remote Online Sales Tax

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<tr>
<td>Agree</td>
<td>Ongoing</td>
<td>Bruce Moore, Director of Tax Compliance 720-913-9421</td>
</tr>
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</table>

Narrative for Recommendation 2.1
Treasury will continue to monitor this situation, and if the Colorado Department of Revenue can ultimately legally pursue vendors for this report, we will work with them to obtain the information and evaluate its usefulness.

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<td>Ongoing</td>
<td>Bruce Moore, Director of Tax Compliance 720-913-9421</td>
</tr>
</tbody>
</table>

Narrative for Recommendation 2.2
Treasury will continue with our efforts in these areas.
The Department of Finance and the Treasury Division would like to thank the Auditor's Office and the Audit Team for their professional, timely work and recommendations, we sincerely appreciate their help.

Please contact Steve Ellington at 720-913-9384 or Bruce Moore at 720-913-8421 with any questions.

Sincerely,

Brendan J. Hanlon
Chief Financial Officer
City and County of Denver

cc: Kip R. Memmott, MA, CGAP, CRMA, Director of Audit Services
    Cody Schulte, Lead Internal Auditor
    Steve Ellington, Treasurer
    Bruce Moore, Director of Tax Compliance
    Bob Dent, Tax Collections Manager