FEEDBACK TO WASHINGTON STATE “CLEARINGHOUSE” PROPOSAL TO SSTGB

PUBLIC DOCUMENT

PREPARED FOR

STREAMLINED SALES TAX GOVERNING BOARD EXECUTIVE COMMITTEE

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THE FEDERAL TAX AUTHORITY (Fed-Tax.net)

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1 SUMMARY

This response to the paper recently submitted to the executive committee of Streamlined Sales Tax Governing Board (SSTGB) by the Washington Department of Revenue, informally titled “Role of Technology for SST Clearinghouse from State of Washington”1 is intended to provide guidance to SSTGB that will increase the likelihood of success in making information technology (IT) investments.

The ultimate goal of this effort is the creation and reliable operation of a nationwide, interstate and intrastate sales tax collection structure and systems that can cost effectively and reliably scale to apply to all US commerce. Demonstrating feasibility and minimal cost for this structure, particularly for small merchants is a critical political and operational pre-requisite for achieving national legislation to remove the commonly termed “Quill Protection” currently impeding nationwide implementation of the Streamlined Sales and Use Tax Agreement (SSUTA).

In addition to cost and implementation, given the potential scale and critical dependency of the economic activity of the United States on this structure, it is critical that SSTGB consider reliability, redundancy, and system security with the rigor appropriate for a very large scale business-critical system with significant privacy and security risks as it considers IT investments.

In summary, Fed-Tax.net’s feedback to the Washington document suggests that SSTGB engage in a transparent, rigorous process to clarify goals, mitigate implementation, deployment and operational risk, and reduce costs to business and government.

Such a process would include:

1) Creation of a prioritized pain-point analysis of the current situation. This document provides a straw-man version of such an analysis, based on Fed-Tax.net’s problem analysis and implementation experience in creating the TaxCloud Sales-tax-as-a-service.2 A second step in this analysis includes descriptions of scenarios (i.e. features) that address those pain points and how they reduce costs and simplify collection.

2) Construction of a step-wise implementation and operational plan to address those pain points that assesses and mitigates technology and commercial risk in light of potential nationwide implementation of SSUTA.

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1 The paper can be found among the meeting materials provided from the Executive Committee’s meeting of January 28, 2010 at this link on the Streamlined Sales Tax Governing Board web site.
2 Currently undergoing certification as a CSA/CSP, offered free of charge to any merchant.
2 CLARIFYING GOALS AND SOLUTION SCENARIOS

In designing TaxCloud, Fed-Tax.net performed a rigorous gap analysis to understand potential regulatory and operational risks. This document ranks criticality of these pain points in light of potential nationwide implementation of SSUTA per the table below:

<table>
<thead>
<tr>
<th>Critical Impact</th>
<th>Issue has a potential impact to flow of national commerce or is a critical accuracy, reliability or security exposure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Significant Impact</td>
<td>Issue could provide significant additional tax revenue, improve operational efficiency or reduce costs of collection</td>
</tr>
<tr>
<td>Minimal Impact</td>
<td>Provides incremental improvements, may be currently addressed by commercial vendors or CSPs</td>
</tr>
</tbody>
</table>

Solution scenarios include a discussion of operational availability requirements per the examples in the following table:

<table>
<thead>
<tr>
<th>Ultra High availability (99.999% uptime)</th>
<th>Must scale to provide near-real time integration with all web-based or physical points of sale in the US, provide multiple points of redundancy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very High availability (99.9% uptime)</td>
<td>Needs to be available to sellers, CSPs or consumers in offline mode, not integrated into transactions</td>
</tr>
<tr>
<td>Moderate Availability (99% uptime)</td>
<td>Typical commercial website availability</td>
</tr>
</tbody>
</table>

2.1 PAIN POINT: TAX INFORMATION AND PUBLISHING AUTOMATION GAP – ERRORS AND INCONSISTENCIES

**Critical Impact** – affects state government, sellers, consumers and CSPs. Current data has multiple errors, current system creates and propagates opportunities for human error.

The current framework for publishing rate and boundary and taxability matrix information is incomplete and lacks the level of accuracy and robustness required to support national commerce (i.e. tens of thousands of sellers, millions of buyers). Calculating interstate sales tax requires multiple transcriptions from human-readable to machine-readable data representations, by sellers, states, SSTGB staff and CSPs. This automation gap creates additional costs and workload for all participants and introduces the potential for clerical and interpretation errors.

**Solution Scenario:** Provide an authoritative, up to the minute source of tax data for States, Sellers and CSPs. All tax collecting and receiving entities reference and maintain the same, authoritative data source. This system is described in Fed-Tax.net’s CSDPub³ proposal provided to the Streamlined Board. It benefits states, sellers and CSPs by increasing accuracy and reducing costs of research and tax calculation. This system could be effectively used if deployed with Moderate Availability.

³ The CSDPub proposal can be found at [http://fed-tax.net/revised.CSDPub_proposal.pdf](http://fed-tax.net/revised.CSDPub_proposal.pdf)
2.2 PAIN POINT: INCONSISTENT, MANUAL APPLICATION OF ENTITY BASED EXEMPTIONS

**Significant Impact:** -- affects state government, sellers, consumers and CSPs, creates significant additional costs of collection

Each exempt entity must register separately with each state in which it might purchase, with no cross-state information sharing. The burden of validating exempt sales and maintaining proof of exemptions falls on merchants and CSPs. Lost opportunity for fraud detection, increased risk of lost revenue.

**Solution Scenario:** Provide a nationally accessible registration and lookup service for entity-based exemptions, per the laws of all affected states. Exempt purchasers (including direct pay permit holders) apply and register with a national online service, providing identifying details and the nature of exemption claimed. Once granted, exempt purchasers would be given an exempted purchaser number, which is then presented to all US merchants at the point of sale. Upon receipt from a merchant of a valid exempted purchaser number associated with a particular transaction, the service will deliver all valid exemptions associated with that exempted purchaser number to that transaction process, allowing vendor and CSP systems to apply valid exemptions at the point of sale. The service logs exempted transactions and associated exempted purchaser numbers to enable automated fraud detection and facilitate auditing. In the case of temporary service outage, the service automatically approves exemption requests and logs them in a pre-process cache for future processing, thus all exempted transactions create a logged record for future examination. Enabling this scenario provides a significant reduction in costs of research, administration, enforcement and auditing for all sellers.

This system could be effectively used if deployed with *Very High availability*.

2.3 PAIN POINT: COST OF CSP SERVICES TO SMALL SELLERS

**Indeterminate Impact:** CSPs currently have announced no-fee collection services for smaller sellers

**Solution Scenario:** The Washington discussion document suggests creation of a “public option” to compete with existing CSPs. Provisions included in proposed national legislation reportedly include compensation for interstate and intrastate sales for CSPs and seller. This change should thus address cost issues for CSPs supporting small sellers and suggests this pain point can be addressed without an IT investment by SSTGB.

If a “public option” is provided, this system would need to be provided at *Ultra-High availability* to scale to millions of small sellers in the US.

2.4 PAIN POINT: DEFINITIVE ADDRESS VERIFICATION

**Significant Impact:** Currently all sellers and CSPs must create or license an address verification system (AVS) to determine correct tax rates at significant expense

**Solution Scenario:** SSTGB contracts with USPS or a third party provider (perhaps providing aggregate transaction data as compensation) to provide an authoritative AVS to all sellers and state government. Currently USPS is prohibited from providing AVS services for any purposes other than supporting mail delivery (although this prohibition is widely ignored by third party licensors of USPS data). A prerequisite to using USPS AVS capabilities would be removal of this prohibition (perhaps as part of upcoming federal legislation). This system would need to provided at *Ultra-High availability* to support all points of sale in the US.
3 Technical Risk Mitigation Strategies

There are a number of existing investments that SSTGB, sellers and CSPs have made that could be preserved and enhanced by proceeding in a stepwise manner and addressing the known pain points in the existing framework. This approach allows SSTGB to evaluate progress at each point and take on greater technical challenges as systems are deployed and stabilized. This stepwise approach also mitigates costs and technical risk, and allows SSTGB to focus on known gaps in the current system. For example, SSTGB could begin with offline systems (see moderate availability systems above) that present lower technical risk, and over time move to “online” systems (see very high availability and ultra-high availability above) that scale readily to integrate with commercial websites or retail points of sale on a nation-wide basis. In contrast, “offline” systems can be queried on a periodic basis.

The chart below summarizes technical and operational risk of some of the scenarios mentioned in this document.
4 CONCLUSIONS

1) SSTGB should evaluate and prioritize the pain points and technology gaps it is attempting to address with any prospective IT investments in a transparent forum.

2) SSTGB should consider an accretive, step-wise technology strategy that takes into account implementation and operational risks in light of prospective nation-wide implementation of SSUTA.

3) SSTGB should consider commercial offerings that may already address perceived gaps and the positive and negative impacts of potential IT investments on the competitive dynamics of the CSP/CSA market.