

2009 Innovations Awards Program APPLICATION

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ID # (assigned by CSG): 09-W-14WA

Please provide the following information, adding space as necessary:

State: **Washington State**

Assign Program Category (applicant): **Government Operations** (Use list at end of application)

- 1. Program Name**
Destination-based Sales Tax
- 2. Administering Agency**
Washington State Department of Revenue
- 3. Contact Person (Name and Title)**
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- 9. Please provide a two-sentence description of the program.**

This program used a unique, user-centered approach to develop tools necessary for Washington businesses to successfully transition to a new method for collecting sales tax. The success can be directly attributed to involving customers throughout the implementation process.

- 10. How long has this program been operational (month and year)? Note: the program must be between 9 months and 5 years old on March 1, 2008 to be considered.**

Legislation was signed in March 2007 that conformed Washington's tax structure to the national Streamlined Sales and Use Tax Agreement. This required Washington to change its method for collecting sales tax.

On July 1, 2008, Washington businesses began collecting sales tax based on the rate in effect *where their customers take possession* of the goods – the “destination” of the sale. Before the new legislation, businesses collected sales tax at the rate in effect *where the goods were shipped from*. This change – from origin-based to destination-based sales tax – significantly impacted retailers that shipped or delivered their goods.

11. Why was the program created? What problem[s] or issue[s] was it designed to address?

Complex tax administration

Retailers that operate in multiple states are required to submit separate tax returns for each state. Not only is it burdensome to file multiple returns, but these businesses are faced with varying tax structures and definitions.

The national Streamlined Sales and Use Tax Agreement (SSUTA) is a cooperative effort of 44 states, the District of Columbia, local governments and the business community to simplify and make more uniform sales and use tax collection and administration by retailers and states. It is intended to reduce the cost and administrative burdens on retailers that collect the sales tax.

Unfair competition

Washington businesses that collect sales tax are losing sales to out-of-state retailers that don't charge sales tax. These retailers have a competitive advantage over traditional brick-and-mortar businesses located in Washington. The brick-and-mortar businesses often serve as showrooms for online and mail order sellers. People may look at big ticket items in a local store, but order elsewhere to avoid paying sales tax.

According to Pat Gilmore from Dunbar Jewelers in Yakima, Washington, “They get an education on what to look for in a diamond, but then don't buy,” Gilmore said. “They even come in with pictures of diamonds for sale on the Internet to ask me what I think.”

The national Streamlined Sales and Use Tax Agreement simplifies and standardizes the way each state taxes goods so it's easier for online and mail order retailers to collect sales tax. The hope of states belonging to the Agreement organization is that the United States Congress will pass legislation allowing member states to require remote sellers (those without a physical presence in the state) to collect tax on sales into their respective states. A 1992 United States Supreme Court decision, *Quill v. North Dakota*, prohibits states from doing this. The Court said that Congress has the power to remove the prohibition.

Loss of tax revenue

Estimates show that Washington has been losing about \$260 million a year in state and local sales and use tax revenue. This represents the tax revenue on \$3 billion in sales lost from in-state retailers to out-of-state retailers that don't collect Washington taxes. This hurts Washington businesses and it dramatically erodes Washington's tax base.

Washington is particularly vulnerable to the effects of lost sales tax because, with no income tax, the state relies heavily on sales tax.

12. Describe the specific activities and operations of the program in chronological order.

In March 2007, the Washington State Legislature passed legislation to conform Washington's tax structure to the national Streamlined Sales and Use Tax Agreement. This included the shift from origin to destination-based sales tax.

From the time the legislation was signed, the Department had one year to build the infrastructure, implement the change, and prepare taxpayers. The Destination-based Sales Tax Initiative required the most intensive outreach and education effort the Department of Revenue had ever embarked upon.

The challenge was monumental.

The challenge not only came in the form of reaching out and educating the estimated 40,000 affected businesses about the major changes they must make, but also managing their resistance to the change.

With 360 tax jurisdictions – each with its own tax rate and code – in-state businesses would be dealt *increased* complexity in their collection and remittance of sales tax.

To further complicate the matter, the 360 tax jurisdictions do not match with 5-digit ZIP Code boundaries. This means businesses would have to find a way to determine the correct sales tax rate to charge based on exact street address.

These retailers, many of whom previously only had to collect one sales tax rate – their own – were now also required to *code* their delivery sales to the appropriate jurisdictions when filing their tax returns.

The Department prides itself on a 97.5 percent voluntary compliance rate among registered businesses. The Agency's compliance studies have identified lack of understanding as the number-one reason for noncompliance.

Washington Revenue was looking at a year of intensive education and outreach efforts. To continue its successful compliance rate, the Department had to arm taxpayers with the information and tools they needed to comply with the new complexity. It had to accomplish this, *while at the same time*, developing a public relations strategy to overcome resistance to the change by some businesses.

Washington met this challenge head on, putting taxpayers at the center of its effort to develop solutions. The agency involved customers from the start, asking them what they needed to make this change. This innovative user-centered, data-based decision making continues to be the key to the program's success.

The following details specific activities involved in each phase of the process:

Phase 1: Notification/Research (June 2007 - December 2007)

- Mailed letter to more than 200,000 retailers and tax practitioners
- Wrote articles and provided flyers for association newsletters and city mailings
- Created online tutorial
- Wrote news releases and Op Ed pieces that resulted in numerous news stories
- Gathered feedback at more than 70 statewide workshops and speaking engagements with 1,500 businesses
- Surveyed more than 1,000 businesses with online survey
- Held facilitated discussions with 24 retailers
- Developed web page with links to provide feedback

Phase 2: Tool Development (November 2007 – March 2008)

- Shifted internal resources
- Created tools ranging from low-tech to high-tech: online tax rate lookup, city and county tax rates in multiple formats, downloadable databases, Excel worksheet, customer database conversion service, paper maps, language source code

Phase 3: Communication/Education (April 2008 – December 2008)

- Presented information and tools at more than 50 workshops and speaking engagements
- Answered more than 10,000 phone calls and responded to e-mails related to destination-based sales tax
- Responded to more than 850 letter ruling requests
- Met individually with more than 20 businesses to find solutions
- Sent updates to more than 1,000 stakeholders through Listserv e-mail service
- Translated multiple documents into Spanish, Chinese, Korean, Tagalog, and Vietnamese
- Sent information with every tax return and in *Tax Facts* newsletter
- Developed online video workshop
- Continued media efforts and launched consumer awareness campaign

Phase 4: Ongoing communication and assistance/tool refinement (December 2008 forward)

- Continue communication/education efforts
- Refine tools as businesses put them to use
- Update tools quarterly as rates change
- Assist businesses with reporting

13. Why is the program a new and creative approach or method?

With a successful history in data-driven decision making and user-centered design (the practice of building a good or service around the actual needs of real users), Washington Revenue began its work by going straight to the heart of the matter – the taxpayers themselves.

Initial notification letter

The Department made first contact with taxpayers by sending out a letter, in June 2007, to all 204,000 registered retailers and 5,500 tax practitioners. While the Department estimated that only 40,000 retailers would be affected by the change, it needed to cast the net widely, ensuring no one was overlooked.

The letter, written in plain language:

- Notified businesses of the change occurring on July 1, 2008
- Explained how to register for a workshop
- Informed businesses of the reasons for the change and the Streamlined Sales and Use Tax Agreement
- Provided a mechanism for gathering information and feedback from affected businesses

The first survey

The letter directed businesses to visit the Department's web site to complete a short survey. Agency staff needed data to assess the impact of the change and develop a strategy that would serve the taxpayers and the Department.

The survey helped Agency staff identify:

- Industries that would be affected
- Volume of taxpayers' deliveries made outside their tax jurisdictions
- Software businesses used to record customer orders and sales
- Whether businesses' processes were manual or automated.
- What businesses felt they needed from the Agency to transition

In addition to gathering valuable data, the survey had another purpose. The Agency knew many businesses would be unhappy about the change because of the additional burden it placed on them. This feedback channel gave taxpayers a place to vent their frustration directly with the Agency, rather than to the Governor's Office or state legislators. Of course, elected officials still received some complaints during the course of the year, but many were averted because the Agency provided this initial feedback and resolution mechanism.

This early data gave the Agency a better understanding of *who* the affected retailers were, *what* they were currently doing to determine sales tax rates, and *how many* of their sales were delivered to another tax jurisdiction.

With this information, the Agency's communication professionals began to get a better picture of the target audience and their needs. This helped refine the information on the Department's web site and develop a more focused question-and-answer section. It also made it clear that additional discussions were needed to better understand these businesses and their individual challenges.

Communications consulting firm

The success of this project was of high importance to the Governor, the Revenue director, counties, cities, and Washington retailers. To assist with strategic communication, the Agency hired a communications consulting firm to focus the initial efforts. This firm scheduled, recruited, and facilitated discussions with 24 retailers.

These discussions quickly confirmed what some Agency staff suspected – that the word *streamlined* (which the Agency had used to this point) was a hot issue for retailers affected by the change. With the help of the consulting firm, the Agency settled on *destination-based sales tax* to describe the move from origin- to destination-based sales tax. It was more descriptive and demonstrated the Agency's understanding of the additional burden placed on retailers who saw this change as anything but *streamlined*. This simple name

change would avoid inflaming an already skeptical crowd during future workshops and speaking engagements.

Among other informative findings from these facilitated discussions, one in particular flagged a serious and unforeseen flashpoint. A gentleman from an office furniture business who made deliveries throughout the state had implemented the change to destination-based sales tax prematurely. Once he did, he received letters from several local taxing jurisdictions directing him to purchase a city business license and pay city business and occupation tax because he was now “doing business” in their jurisdictions. (The Department of Revenue is required to give local jurisdictions a list of businesses that report local sales tax in their jurisdictions.) This news that a seller simply mailing an item to a buyer in another taxing jurisdiction would be asked to purchase additional licenses and pay additional taxes quickly put the crowd in an uproar.

This revelation enabled the Agency to start working early with the Association of Washington Cities and business associations to clarify each city’s licensing requirements. Together, they were able to establish that simply shipping a product to another city through common carriers did not, in itself, make a business liable for a city’s licenses or taxes.

Hosting these facilitated discussions also helped the Agency better anticipate issues and taxpayer attitudes associated with the implementation of this change.

Stakeholder group

Early in the implementation effort, Agency leadership and communications staff began holding regular meetings with key stakeholders. These meetings included representatives from the Association of Washington Business, Washington Retail Association, National Federation of Independent Business, Independent Business Association, Association of Washington Cities, and Washington Association of Counties. The ability to check in with this group at key decision points and test communication pieces with them was extremely valuable to the overall success of this effort.

Fall 2007 workshops and speaking engagements

Shortly after the June 2007 notification letter was mailed, the three scheduled workshops began quickly filling up. Additional sessions were scheduled for a total of 18 workshops in 14 cities across the state.

A mailing to all Washington chambers of commerce, as well as informational articles placed in association newsletters and city mailings, generated additional requests for speaking engagements.

To prepare for the workshops and speaking engagements, the Department held a train-the-trainer session to ensure all of the Agency’s speakers were well informed and communicated the same message. The goal of the fall workshops was to educate businesses about the change and to hear their ideas about what the Agency could do to help.

Comprehensive online information

Throughout the implementation effort, the Agency leveraged its web site as a primary communication tool. With 87 percent of the Agency's customers having access to the Internet, it was a clear choice.

Every educational piece that went out in print referenced *destinationtax.dor.wa.gov*. This simple URL took visitors directly to the DOR web site that communications staff continued to expand and update throughout the implementation process.

An e-mail distribution list was created for business owners who wanted to receive regular updates on new workshops and information. In fall 2007, the Agency created an online destination-based sales tax tutorial that walked taxpayers through the changes and how those changes would affect them.

The Agency posted materials on its web site translated into Spanish, Chinese, Korean, Tagalog, and Vietnamese languages.

The tools the Department would eventually develop for taxpayers were also placed online for ready access.

14. What were the program's start-up costs? (Provide details about specific purchases for this program, staffing needs and other financial expenditures, as well as existing materials, technology and staff already in place.)

The initial start-up costs included:

- \$150,000 for printing and postage, workshops, business advisory visits
- \$70,000 for the consulting firm and facilitated discussions they hosted
- \$130,000 for an upgrade to the agency's online tax rate lookup tool
- \$428,000 for staffing needs
- \$52,000 over and above existing office equipment

15. What are the program's annual operational costs?

The annual operating costs for this program are \$362,000. This includes staff time for:

- quarterly enhancements to the tools
- determining the amount of mitigation dollars local governments receive
- account administration

16. How is the program funded?

The program is funded through the Washington State General Fund.

17. Did this program require the passage of legislation, executive order or regulations? If YES, please indicate the citation number.

Yes, [SSB5089](#) was passed during Washington's 2007 legislative session.

18. What equipment, technology and software are used to operate and administer this program?

The results of the first survey, coupled with data from the facilitated discussions and feedback from the first round of fall workshops, led the Agency to valuable conclusions regarding the specific types of tools taxpayers would find most useful.

The majority of taxpayers wanted a simple 5-digit ZIP Code lookup. Unfortunately, Washington's tax jurisdictions do not follow 5-digit ZIP Code boundaries. Allowing this would compromise the accuracy that city and county governments were counting on – their future tax revenues were dependent on businesses accurately making the shift to destination-based sales tax.

The Agency already had an online tax rate lookup tool that allows someone to find a rate by entering a street address or selecting a location on a map. This was, and continues to be, a widely used tool, but is not convenient for businesses with high sales volumes.

Other businesses favored solutions that ranged from paper maps to real-time automated lookup programs.

The overwhelming interest in a 5-digit ZIP Code lookup prompted the Agency to explore the accuracy of ZIP+4. It discovered ZIP+4 was more than 99 percent accurate. The Department readily expanded its tools to include this type of lookup.

At the Washington Department of Revenue, as with other agencies, information technology resources are scarce. It was critical that the Agency carefully prioritize the requests for IT hours spent developing the tools businesses were requesting.

To gather additional data to support this careful prioritization, the Agency created a second online survey that asked specific questions about a number of potential tools. The Agency used the survey feedback and IT estimates on development time for each tool to identify and prioritize its projects.

It was already fall 2007 and destination-based sales tax would begin July 1, 2008. The Agency needed time to develop its tools and educate businesses. The businesses then needed time to transition to using the tools.

The Department set a deadline to have all tools developed and ready for use by March 31, 2008. This would coincide with the Department's spring workshops that would run from mid-April through June.

The Department identified and developed the following tools:

- **Paper maps** – maps of counties that show location code boundaries and tax rates
- **City and county tax rates in downloadable formats** – Excel, QuickBooks, and pdf versions
- **Excel workbook** – a downloadable tax calculator using Excel that displays tax rates and location codes, calculates totals, and summarizes sales by city and county without an online connection
- **Customer database conversion service** – allows businesses to submit their customer address database and receive the location code and sales tax rate for each address
- **Improved online tax rate lookup tool** – allows tax rate lookups by street address, ZIP+4, map, or latitude/longitude; includes a tax calculator function that provides the tax amount, total, and confirmation code
- **Downloadable databases** – addresses and tax jurisdictions that businesses can integrate into accounting systems (by county, state, or ZIP+4)
- **Real-time automated lookup** – a URL interface that provides direct access to the DOR address-based rate lookup technology platform
- **Washington sales tax rate library** – source code that provides a sales tax rate lookup using the Department’s address and rate download files

The tools proved to be incredibly popular, visited frequently by taxpayers. The following table shows the number of visits some of the tools have received since March 2008.

Tool	Number of visits*
Paper maps	5,759
City and county tax rates in downloadable formats	352,172
Excel workbook	4,167
Customer database conversion service	3,931
Real-time automated lookup	9,383
WA sales tax rate library	6,350

*Page visits may not reflect exact number of tools used, as some users may visit a page without using the tool.

19. To the best of your knowledge, did this program originate in your state? If YES, please indicate the innovator's name, present address, telephone number and e-mail address.

While this program did not originate in our state, Washington's approach was unique and by far the most successful implementation of destination-based sales tax.

20. Are you aware of similar programs in other states? If YES, which ones and how does this program differ?

Yes, the states of Kansas, North Carolina, Iowa, Arkansas, and Oklahoma all moved from origin-based to destination-based sales tax. None of these states embarked on a comprehensive customer-driven approach to implementing this change like Washington State.

SSUTA full-member states, with dates of entry, include:

Arkansas - 1/1/2008
Indiana - 10/1/2005
Iowa - 10/1/2005
Kansas - 10/1/2005
Kentucky - 10/1/2005
Michigan - 10/1/2005
Minnesota - 10/1/2005
Nebraska - 10/1/2005
Nevada - 4/1/2008
New Jersey 10/1/2005
North Carolina - 10/1/2005
North Dakota - 10/1/2005
Oklahoma - 10/1/2005
Rhode Island - 1/1/2007
South Dakota - 10/1/2005
Vermont - 1/1/2007
Washington - 7/1/2007
West Virginia - 10/1/2005
Wyoming - 1/1/2008

21. Has the program been fully implemented? If NO, what actions remain to be taken?

Yes, the change to destination-based sales tax occurred on July 1, 2008 and Washington became a full member of the SSUTA. Now, Washington anxiously awaits the day the national agreement becomes federal law and all remote sellers are required to collect sales tax.

22. Briefly evaluate (pro and con) the program’s effectiveness in addressing the defined problem[s] or issue[s]. Provide tangible examples.

Pros:

- 1,181 businesses from around the country have voluntarily registered through SSUTA and are reporting regularly to Washington and other full member states. These businesses have reported more than \$5.8 million dollars since Washington became an associate member on July 1, 2007. Had Washington not become a member of the SSUTA, it would not have received this additional revenue.
- At our Tacoma workshop, one business commented, “As a business that is getting eaten alive by Internet sales that are taking all my business and local tax base away, I support the national movement. Without some sort of effort, businesses in Washington will be gone along with local tax money.”
- The Association of Washington Business, Washington Retail Association, Association of Washington Cities, Washington State Association of Counties, Washington Association of Washington Officials, the Prosperity Partnership, Washington Technology Industry Association, Washington Council of Police and Sheriffs, American Federation of State County, and Municipal Employees, and National Association of Industrial and Office Properties, among others, asked the Legislature to pass legislation necessary to join the SSUTA.
- A taxpayer responding to one of our surveys commented, “I love the new tax change regarding taxable sales from one jurisdiction to another, changing from origin to destination. Like most other states now, Love it!”

Cons:

- The move to destination-based sales tax added complexity for Washington retailers in determining the correct tax rate to charge.
- The change resulted in some local jurisdictions receiving less tax revenue. Those receiving less revenue as a result of the move to destination-based sales tax get mitigated for their loss until new revenue from voluntary SSUTA registrants compensates for the difference. The mitigation calculation formula is very complex and requires extensive work from staff in the Department’s Research Division.

23. How has the program grown and/or changed since its inception?

The Department continues to monitor business feedback and use of the tools to determine when improvements are necessary and if new tools need to be developed.

24. What limitations or obstacles might other states expect to encounter if they attempt to adopt this program?

- Other states implementing this type of change may not have a full-year to conduct research, involve customers, develop tools, communicate, and educate.
- The Washington Department of Revenue is fortunate to have a useful online survey tool. Other states may not have a quick, simple method to survey their customers.
- The Department already had a robust online tax rate lookup tool which continues to be widely used for businesses with low volumes of sales. Having this tool already in place enabled the Department to focus on other tools.
- It took Washington stakeholders several years to reach agreement on how to accommodate the needs of local jurisdictions that would lose revenue because of the shift to destination-based sales tax. This was the biggest hurdle to passing the legislation in the first place.