

## **Mitigation Plan November 2006**

The amount of mitigation will be based on the loss to a jurisdiction that is caused by the change to destination based sourcing. This loss will be adjusted by subtracting the amount of local sales tax each jurisdiction receives from voluntary compliance.

### **The Two Stages of Mitigation Analysis**

The determination of mitigation amounts will be done in two stages. The first stage will be from December 31, 2008 until September 30, 2009. During this period, a new loss amount will be determined each quarter. On September 30, 2009, the department expects to have sufficient data to evaluate the loss amount for each jurisdiction on which mitigation will be based. That loss amount will be fixed on December 31, 2009, unless, in consultation with the advisory committee, the department believes more time is needed to establish accurate loss amounts. Mitigation after this point will only be adjusted for the change in voluntary compliance and in-state sellers coming into compliance with SSTA sourcing after the reporting periods analyzed to determine mitigation.

### **Timing of Mitigation--Stage One**

The first stage of mitigation will begin December 31, 2008, when the first mitigation checks will be distributed to local taxing jurisdictions. This mitigation will cover retail sales tax collections for July, August, September and October. Note that subsequent mitigation distributions will cover a calendar quarter (three months of collections).

Mitigation will continue for stage one each quarter until September 30, 2009. Mitigation for stage one will be based on loss calculations made by DOR each quarter. The quarterly figures will use actual tax return data for the mitigation period, compared with tax return data for the same quarter in the previous year (e.g. July, August, September, and October, 2008 will be compared to July, August, September, and October, 2007). (See below for more detail on the loss methodology.)

Remote sellers registering under the Agreement are being assigned unique tax registrations by certified service providers. Consequently, voluntary compliance revenues under the agreement are being tracked separately from other retail sales tax revenues. DOR will know the amount of voluntary compliance revenues collected for each local taxing jurisdiction and will offset the amount of mitigation by that amount.

### **Timing of Mitigation--Stage Two**

By September 30, 2009, the Department expects to have enough data, one full year, to conduct the study to determine permanent retail sales tax losses that will remain a fixed amount for future mitigation distributions used on December 31, 2009 and thereafter. The evaluation will be done by comparing a year of destination-based sourcing data (from July, 2008 through June 2009) with a year or more of origin-based sourcing (e.g. from July, 2007 through June 2008). As with stage one, the amount of mitigation will be offset by voluntary compliance revenues. Distributions will be made quarterly.

An advisory committee made up of representatives from local jurisdictions will work with the Department to determine the exact methodology for quarterly distributions and ongoing mitigation. Local jurisdictions may work through the advisory committee to present data that would improve the data for their jurisdiction.

### **Proposed Methodology to Determine Losses**

Between September 30, 2009 and December 31, 2009, the Department will analyze the data in order to determine mitigation amounts for stage two. The methodologies for stage one and stage two are the same. The only differences are that 1) the reporting periods (the data) used for the analysis and 2) stage one mitigation will change from quarter to quarter while stage two mitigation will be more stable because the loss will be defined in stage two. In stage one, the losses are calculated each quarter.

The proposed methodology would use a comparison of before and after-the-fact data on all firms in all impacted jurisdictions. For each firm that is impacted by a change in sourcing, a comparison of their taxable retail sales by location before and after the sourcing change would be made. Because taxpayers are required to code local retail sales tax on DOR's excise tax return, we can accomplish the analysis without supplemental reporting. The before-sourcing percentage allocation of sales by jurisdiction would be compared with the after-sourcing total firm sales in order to determine what a jurisdiction would have received, but for SSTA sourcing. This amount would be compared with what they do receive with SSTA sourcing. The difference, less the voluntary compliance distributions, would be fully mitigated.

For stage one, the comparison will be from quarter to quarter (for example, August, September, October 2008 compared to the same three months in 2007). For stage two, the comparison will be for September 2008 to September 2009 compared to a base period. The base period can be either one year (e.g. July 1, 2007 to June 30, 2008) or an average of multiple years (e.g. FY 07 and FY 08) before the adoption of SSTA destination-based sourcing. The multiple year average should be considered by cities as an option because it can be useful in addressing return data volatility from year to year in individual firms' origin based deliveries.

### **Example**

In 2007, Firm A sold \$1 million in total retail sales, \$600,000 or 60% were coded by the retailer on its excise tax return as being sourced to City AWC. In 2008 (after destination sourcing), Firm A sells \$2 million in sales, but only \$200,000 is coded to City AWC. If sales had continued with the same pattern as before the implementation of SSTA sourcing, City AWC is assumed to have had \$1.2 million in sales. Therefore their estimated loss would be the \$1 million difference in sales, multiplied by their local tax rate. Mitigation would be equal to this loss minus the adjustment for voluntary compliance.

Assume City AWC's tax rate is 1%. Also assume that City AWC receives \$2,000 in sales tax from voluntary compliance. City AWC would then receive \$8,000 in mitigation (equal to 1% multiplied by \$1 million loss in tax base, less \$2,000 for voluntary compliance). The equations for calculating the mitigation are as follows:

Firm A during CY 2007 (origin-based sourcing) sources sales to City AWC: \$600,000 of \$1,000,000 in sales (or 60% of total sales)

Firm A during CY 2008 (destination-based sourcing) sources to City AWC: \$200,000 of \$2,000,000 in sales

If sales from Firm A during 2008 were sourced under (pre-SSTA) origin-based sourcing, estimated sales to City AWC:  $\$2,000,000 \times 60\% = \$1,200,000$

Therefore, City AWC's estimated loss in sales base due to SSTA sourcing:  $\$1,200,000 - \$200,000 = \$1,000,000$

Estimated loss of tax at 1% rate:  $\$1,000,000 \times 1\% = \$10,000$

City AWC's voluntary compliance: \$2,000

Mitigation for Firm A losses after voluntary compliance adjustment:  
 $\$10,000 - \$2,000 = \$8,000$

Assume that City AWC's voluntary compliance revenues increase 10% each year. Mitigation for the next five years associated with Firm A:

CY 2010:  $\$10,000 - \$2,200 = \$7,800$

CY 2011:  $\$10,000 - \$2,420 = \$7,580$

CY 2012:  $\$10,000 - \$2,662 = \$7,338$

CY 2013:  $\$10,000 - \$2,928 = \$7,072$

CY 2014:  $\$10,000 - \$3,220 = \$6,780$

### **Adjustment for Local Sales Tax from Voluntary Collections**

Retailers that collect retail sales tax under the SSTA amnesty agreement will be tracked. The local distributions from these sales will therefore be known each quarter.

### **Advisory Committee and Jurisdictional Input**

An advisory committee consisting of local jurisdictional representatives with technical expertise will work with DOR to refine the methodology for determining each jurisdiction's loss related to SSTA sourcing. The advisory committee will meet at least quarterly during the first stage of the process and at least annually prior to distributions thereafter. Additionally meetings may be scheduled as necessary. The purposes of these meetings are to review the department's methodology, gather local jurisdiction input, and determine whether compliance regarding SSTA sourcing has stabilized. At the meetings, jurisdictions can provide information to the advisory committee regarding SSTA sourcing compliance of firms in their jurisdiction. For example, a jurisdiction may be aware that a firm did not change to SSTA sourcing until July, 2009. In this case, the retail sales tax loss to the jurisdiction would not be measured by the stage two analysis. By informing the advisory committee of the firm's late compliance, the mitigation for that jurisdiction would be adjusted (increased) from that time onward.