Department of Taxation and Finance

Sales Tax Vendor Registration Practices

Report 2020-S-40 | October 2021

OFFICE OF THE NEW YORK STATE COMPTROLLER
Thomas P. DiNapoli, State Comptroller
Division of State Government Accountability

Audit Highlights

Objective

To determine whether the Department of Taxation and Finance (Department) has taken steps to ensure that persons who are required to register as sales tax vendors, including those with no physical presence in the State, have done so. The audit covered vendors with a Certificate of Authority that was active at any time during the period from June 1, 2018 to August 5, 2020, as well as applications for sales tax registration received by the Department from June 1, 2018 to August 5, 2020 and their application status as of November 20, 2020.

About the Program

The Department is responsible for administering more than 40 State and local taxes, including the sales and use tax. Provisions of State Tax Law (Law) impose a tax on sales of tangible personal property and certain services, with some exemptions, and require vendors that make these sales to register for a Certificate of Authority (COA), collect the tax from customers, and remit the tax to the State. New York's sales tax is imposed at a rate of 4%. Additional sales taxes are administered by the Department and imposed by localities and range from 3% to 4.875%, and in the Metropolitan Commuter Transportation District at 0.375%. The use tax is imposed on taxable items or services used in New York when a sales tax has not been paid.

Under the Law, the term vendor encompasses anyone, including out-of-state sellers, who regularly or systematically solicits business in the State. Vendors without a physical presence in New York must register if they have both sold more than $500,000 of tangible personal property that was delivered in New York and conducted more than 100 sales of tangible personal property delivered in New York during the preceding four tax quarters. The Department may deny a COA in some circumstances, such as when a vendor submits an incomplete application or has unpaid tax debts. The Department may also assess penalties of up to $10,000 on vendors that make taxable sales without a valid COA. According to the Department, as of August 5, 2020, there were approximately 540,955 active registered vendors in New York.

Key Findings

- The Department has generally taken steps to ensure that entities required to register as sales tax vendors, including those with no physical presence in the State, have done so. However, we found several opportunities for improvement.
- We identified vendors that were denied a COA yet continued to operate and likely made taxable sales, as well as unregistered vendors that submitted sales tax returns showing taxable sales. For the two samples of 50 and 43 vendors tested in these areas, we identified 18 vendors that reported taxable sales, or were potentially making taxable sales, without a valid COA. These 18 vendors may have been subject to penalties totaling up to $180,000. These findings were attributable, in part, to the lack of information-sharing among the Department's divisions and the lack of relevant follow-up.

Key Recommendation

- Improve inter-Department communication and follow-up measures to:
  - Identify and address unauthorized sales activity among vendors for whom the Department denied a COA; and
  - Provide better assurance that unregistered vendors that are notified of the conditions requiring them to register as sales tax vendors have done so where necessary.

Office of the New York State Comptroller
Division of State Government Accountability

October 14, 2021

Amanda Hiller
Acting Commissioner
Department of Taxation and Finance
William A. Harriman State Campus, Bldg. 9
Albany, NY 12227

Dear Ms. Hiller:

The Office of the State Comptroller is committed to helping State agencies, public authorities, and local government agencies manage their resources efficiently and effectively. By so doing, it provides accountability for the tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of State agencies, public authorities, and local government agencies, as well as their compliance with relevant statutes and their observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations. Audits can also identify strategies for reducing costs and strengthening controls that are intended to safeguard assets.

Following is a report of our audit entitled *Sales Tax Vendor Registration Practices*. This audit was performed pursuant to the State Comptroller's authority under Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

This audit's results and recommendations are resources for you to use in effectively managing your operations and in meeting the expectations of taxpayers. If you have any questions about this report, please feel free to contact us.

Respectfully submitted,

Division of State Government Accountability

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Glossary of Terms

Term	Description	Identifier
BTB	Business Tax Bureau	*Division*
COA	Certificate of Authority allowing registered vendors to collect New York State sales tax	*Key Term*
Department	Department of Taxation and Finance	*Auditee*
eMPIRE	Electronic system for Department processing of COA registration applications	*System*
Law	State Tax Law	*Law*
Marketplace Legislation	Legislation effective June 2019 that requires marketplace providers to collect and remit State sales tax on sales they facilitate	*Law*
Marketplace provider	Any person that, pursuant to an agreement, facilitates sales of tangible personal property by a marketplace seller or sellers	*Key Term*
NYBE	New York Business Express, an online portal for vendors to submit COA registration applications	*System*
Person	A "person" for sales tax purposes includes an individual, partnership (including a general, limited, or special partnership or joint venture), limited liability company, society, association, joint stock company, corporation, estate, receiver, trustee, assignee, referee, or any other person acting as an agent or in a fiduciary or representative capacity, whether appointed by a court or otherwise, and any combination of the foregoing and any State, municipality, or instrumentality thereof.	*Key Term*
RASB	Registration and Accounts Services Bureau	*Division*
Vendor	Any person or business, including out-of-state sellers, that regularly or systematically solicits business and sells taxable goods to any person in New York State	*Key Term*

Background

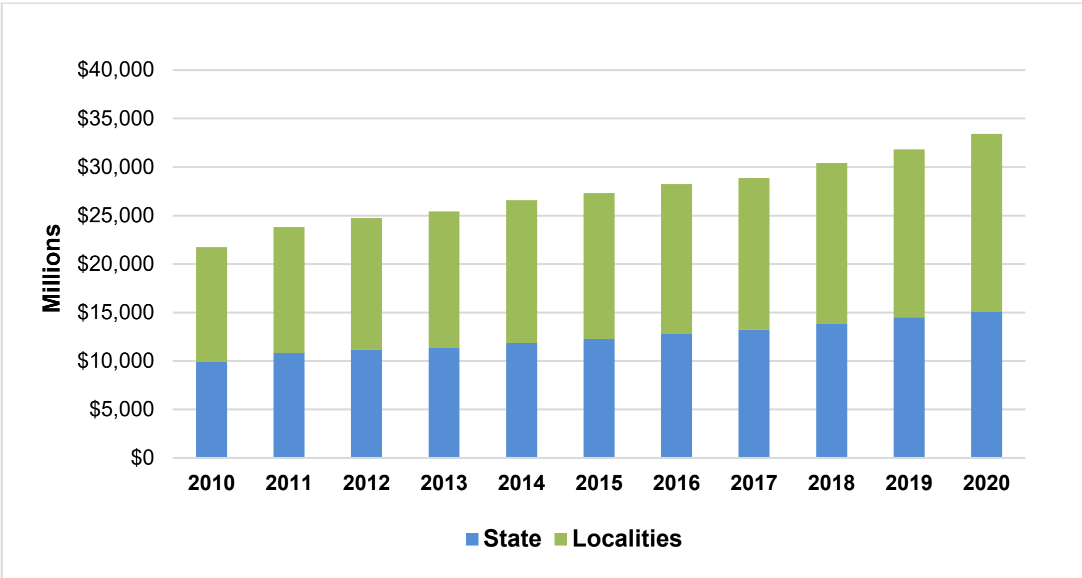
The Department of Taxation and Finance (Department) is responsible for administering more than 40 State and local taxes, including the sales and use tax. Provisions of State Tax Law (Law) impose a tax on sales of tangible personal property and certain services, with some exemptions, and require vendors that make these sales to register for a Certificate of Authority (COA), collect the tax from customers, and remit the tax to the State.

New York's sales tax is imposed at a rate of 4%. Additional sales taxes are administered by the Department and imposed by localities and range from 3% to 4.875%, and in the Metropolitan Commuter Transportation District at 0.375%. The use tax is imposed on taxable items or services used in New York when a sales tax has not been paid. The Department may deny a COA in some circumstances, such as when a vendor submits an incomplete application or has unpaid tax debts. The Department may also assess penalties on vendors that make taxable sales without a COA.

Since the 1980s, the Law has defined a vendor to encompass anyone, including out-of-state sellers, that regularly or systematically solicits business to any person in the State. A 1992 U.S. Supreme Court ruling, *Quill Corp. v. North Dakota*, generally established that businesses needed to have some physical presence in a state to be liable for collecting sales tax pursuant to state law. However, in a 2018 decision, *South Dakota v. Wayfair, Inc.*, the Supreme Court eliminated the physical presence test. As a result of this later ruling, New York began enforcing its long-standing provision in the Law for vendors without a physical presence in the State who met certain thresholds to register for a COA and collect sales tax. These vendors must register if they have both sold more than $500,000 of tangible personal property that was delivered in New York and conducted more than 100 sales of tangible personal property delivered in New York during the immediately preceding four sales tax quarters.

The State share of sales and use tax collections is the second largest tax amount collected annually and represented 19.2% of all taxes collected by the Department for the State Fiscal Year (SFY) ending March 31, 2020. Only personal income tax collections were higher, at 64.7% of tax revenues collected that year. Sales tax is also a significant source of revenue for localities. During SFY ending March 31, 2020, the Department distributed over $33 billion in sales and use taxes, with approximately $15 billion going to the State and over $18 billion going to localities. New York has generally experienced a trend of growing sales and use tax collections over the past decade (Figure 1).

Figure 1 – Sales and Use Tax Distributions

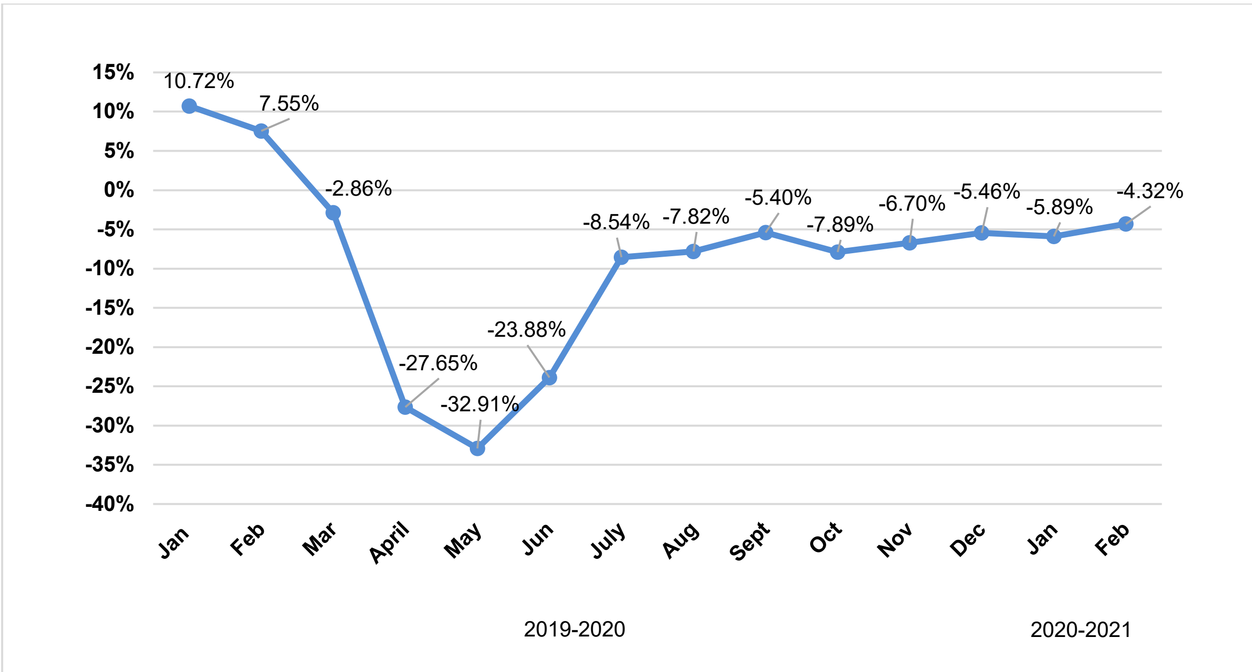


Source: Open Data NY

Taxable online sales have been rising, with large retailers such as Walmart reporting a 79% growth in e-commerce sales in a single quarter of 2020. Online marketplaces such as Amazon also saw increased sales in 2020. According to at least one estimate, these marketplaces account for nearly 50% of online sales, while another 26% come from large retailers. In 2019, the Law was amended to require marketplace providers to collect and remit sales tax on all sales they facilitate for each of their individual sellers on or after June 1, 2019. The Department defines marketplace provider as a person that, pursuant to an agreement, facilitates sales of tangible personal property by a marketplace seller or sellers. For sales tax purposes, a "person" may be an individual or one of many types of businesses. As a result of this statutory change, referred to as Marketplace Legislation, the Department's responsibility to register and collect sales taxes from many dispersed vendors was simplified. For example, as of March 16, 2021, Amazon alone had 1.9 million active sellers worldwide, with 493,000 active sellers on its Amazon.com domain; however, the Department need only ensure that Amazon is registered and has a COA. Rather than having to ensure that each individual marketplace seller is registered, the Department can focus its efforts on ensuring that marketplace providers are registered and have a COA, since they are now the parties responsible for collecting and remitting sales tax on sales they facilitate. According to the Department, as of August 5, 2020, there were 540,955 active registered vendors in New York.

The COVID-19 pandemic has negatively impacted sales tax collections due to restrictions on businesses throughout 2020 and into 2021. The largest drop was nearly 33% in May 2020. From March 2020 through February 2021, the Department has collected less State sales and use tax each month than in the same month the year before (Figure 2). Collections have since begun to rebound, and, as of May 2021, State sales tax collections increased by nearly 60% over the same month in 2020.

Figure 2 – Year-Over-Year Monthly Change in Sales and Use Tax Collection



Source: [New York State Comptroller Monthly Cash Basis Reports]

Audit Findings and Recommendation

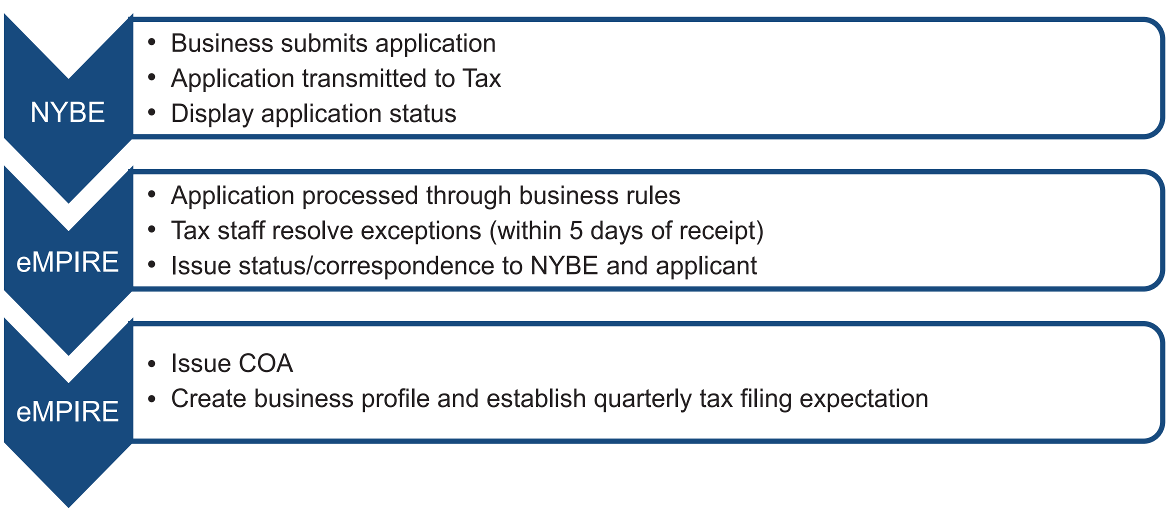
The Department has generally taken steps to ensure that entities required to register as sales tax vendors, including those with no physical presence in the State, have done so. However, we found several opportunities for improvement. There were instances in which vendors that were denied a COA continued to operate and likely made taxable sales. We also identified instances in which unregistered vendors submitted sales tax returns showing taxable sales. We attribute these findings, in part, to the lack of information-sharing among the Department's divisions and the lack of relevant follow-up. Additionally, we estimate that the Department could have assessed penalties on 18 vendors, totaling up to $180,000, that we identified as making – or potentially making – taxable sales without a COA. Department officials generally agreed with our audit findings.

Sales Tax Vendor Registration

Registration and Accounts Services Bureau

The Department has implemented processes for vendors to register and be issued a COA in accordance with the Law. Vendors, including those with no physical presence in the State, submit an application to register for a COA online through New York Business Express (NYBE), a multi-agency portal managed by the Office of Information Technology Services. Applications are then transferred to the Department's eMPIRE system for review and processing, as shown in Figure 3, which depicts information provided by the Department.

Figure 3 - Application process



Source: Department of Taxation and Finance

If an application meets all criteria, the vendor is issued a COA automatically. However, applications that don't meet all criteria, such as those that lack required information, must be reviewed manually by staff in the Department's Registration and

Accounts Services Bureau (RASB). According to Department officials, about 60% of COA applications received must be reviewed and resolved by Department staff.

Depending on the exception, the Department may, for example, send a letter requesting more information, or work with the applicant to resolve outstanding tax liabilities that were identified. If an exception can't be resolved, the Department may deny the applicant a COA. The Department also processes a small number of applications in paper form.

Audit Division and Civil Enforcement Division Actions

In addition to RASB's management of the registration process, other Department divisions assist in identifying unregistered vendors. The Audit Division uses data analytics to assist in identifying unregistered vendors and also conducts audits of unregistered vendors. The Civil Enforcement Division may also identify unregistered vendors through visits to retail locations. Further, staff assigned to the Department's 11 district offices, which oversee specific areas of the country, assist with ensuring out-of-state vendors are also in compliance with registration requirements.

Marketplace Legislation

As part of the SFY 2019-20 Enacted Budget, a provision was included to require online marketplace providers to collect and remit sales tax on sales they facilitate for marketplace sellers (Marketplace Legislation), effective for sales made on or after June 1, 2019. The Marketplace Legislation effectively simplified the Department's administration of the sales tax registration process for out-of-state vendors and reduced its responsibilities with respect to the volume of vendors that require registration. We note, however, that vendors that use a marketplace provider but either have a physical presence in New York or sell directly into New York via other methods, such as by phone or via websites, must still register for a COA. We discussed the effects of similar legislation with officials from several other states, who agreed that it is a helpful tool for ensuring vendors are registered and required sales taxes are being collected and remitted.

The Department received an average of 5,176 applications for COAs each month between June 1, 2018 and July 31, 2020, and issued an average of 4,958 COAs each month. In addition, the Audit Division completed sales and use tax audits of 359 unregistered vendors from April 1, 2019 to March 31, 2020 and identified over $28 million in amounts due (i.e., sales tax, use tax, interest, and penalties), nearly $13.4 million (48%) of which was collected.

Vendors Denied a COA

In certain instances, the Department may deny vendors a COA due to circumstances such as a vendor's incomplete application, unpaid tax debts, or commission of tax crimes. In these cases, the Department issues a letter informing the vendor of the denial, requesting that the vendor cease making any taxable sales in the State, and educating them on the requirements to register.

We determined that the Department does not always follow up on vendors that are denied a COA to determine if they are making taxable sales in the State. We reviewed a sample of 50 vendors that were denied a COA and determined that, despite not being registered, 13 vendors (26%) showed signs they were operating and potentially making taxable sales. Some of these vendors had active online ordering systems or active websites with information that indicated they were operating. In the remaining cases, we concluded that the vendors were operating and making potentially taxable sales based on phone conversations or online contact. Department officials confirmed that none of these 13 vendors were authorized to be making taxable sales in the State.

According to the Law, the Department may assess penalties of up to $500 for the first day a vendor makes taxable sales or purchases without a valid COA, plus up to $200 for each subsequent day, up to a total penalty of $10,000. Consequently, these 13 vendors could have been subject to penalties of up to $130,000.

We also found that the RASB does not regularly share information about vendors that have been denied a COA with the Department's other bureaus or divisions, which instead identify unregistered vendors through their own procedures. As a result, there is a risk of vendors that are denied a COA, and are therefore not registered, continuing to make potentially taxable sales.

Unregistered Vendors Submitting Sales Tax Returns

Any vendor approved for a COA must file regular sales tax returns with the Department, even if no taxable sales occurred during a period. However, vendors without a COA sometimes submit sales tax returns to the Department. Such vendors are identified by the Department's eMPIRE system, which generates an exception notification to the Business Tax Bureau (BTB) for staff to then resolve with the vendor. If BTB staff determine the vendor is not registered and should be, they notify the vendor with information about the registration requirements, process, and potential penalties.

However, the BTB does not subsequently follow up with vendors to ensure that they register. We examined a sample of 43 unregistered vendors that submitted sales tax returns and found that five vendors (12%) continued to file sales tax returns and report taxable sales without having a COA, despite having been notified of the registration requirements. Similar to the 13 vendors above, these five vendors could have been subject to penalties of up to $50,000.

Additionally, similar to RASB not regularly sharing information, BTB does not notify other Department divisions of the unregistered vendors that submit sales tax returns. As a result, other divisions, such as the Audit or Civil Enforcement Division, lack information that may help them follow up with some of these vendors to determine if they are potentially making taxable sales.

Recommendation

1. Improve inter-Department communication and follow-up measures to:
   - Identify and address unauthorized sales activity among vendors for whom the Department denied a COA; and
   - Provide better assurance that unregistered vendors that are notified of the conditions requiring them to register as sales tax vendors have done so where necessary.

Audit Scope, Objective, and Methodology

The objective of our audit was to determine whether the Department of Taxation and Finance (Department) has taken steps to ensure that persons who are required to register as sales tax vendors, including those with no physical presence in the State, have done so. The audit covered vendors with a COA that was active at any time during the period from June 1, 2018 to August 5, 2020, as well as applications for sales tax registration received by the Department from June 1, 2018 to August 5, 2020 and their application status as of November 20, 2020.

To accomplish our objective and assess related internal controls, we reviewed relevant laws, rules, and regulations related to sales tax registration. We reviewed the Department's policies and procedures and met with Department personnel to gain an understanding of their processes for registering vendors and issuing COAs, identifying unregistered vendors, and resolving exceptions. We also met with officials from other states to learn about their methods for identifying unregistered vendors to identify possible best practices.

To understand the Audit Division's process for identifying and conducting its audits of unregistered vendors, we reviewed a judgmental sample of 13 of 359 sales and use tax-related audits that addressed vendor registration, selecting those with the highest tax liability amounts. We also reviewed a judgmental sample of 50 vendors (half with physical addresses in New York and half with addresses in other states) of the 2,277 vendors for whom the Department denied a COA to research and conclude on whether they appeared to be making taxable sales in the State without a COA. Factors in the sample selection included geographic location and the date the vendor was notified of the denial.

We also reviewed a judgmental sample of 43 of 4,601 vendors that were identified in Department data as being unregistered and having submitted sales tax returns to assess the Department's actions in those circumstances. Factors for selection included the number of exceptions a vendor had and their registration status. Our testing results apply only to those items in our samples and cannot be projected to the populations from which they arose.

Statutory Requirements

Authority

The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

We conducted our performance audit 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our professional judgment, these duties do not affect our ability to conduct this independent audit of the Department of Taxation and Finance's sales tax vendor registration practices.

Reporting Requirements

We provided a draft copy of this report to Department officials for their review and formal written response. We considered their response in preparing this report, and have included it in its entirety at the end of this report. The Department's response reflects a misunderstanding of aspects of our conclusions, which we address in a Comptroller's Comment. The response also describes actions the Department is undertaking that will address our recommendation. Our State Comptroller's Comments addressing certain Department remarks are embedded within the Department's response.

Within 180 days after final release of this report, as required by Section 170 of the Executive Law, the Commissioner of the Department of Taxation and Finance shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendation contained herein, and where the recommendation was not implemented, the reasons why.

Department of Taxation and Finance

OFFICE OF PROCESSING AND TAXPAYER SERVICES

MICHAEL SHOLLAR
Deputy Commissioner of Processing and Taxpayer Services

August 25, 2021

Nadine Morrell
Office of the State Comptroller
Division of State Government Accountability
110 State Street - 11th Floor
Albany, New York 12236

Re: Report 2020-S-40 - Sales Tax Vendor Registration Practices

Dear Ms. Morrell:

The Office of the State Comptroller (OSC) examined the 2020-S-40 Sales Tax Vendor Registration Practices by the Department of Taxation and Finance (Department) for the audit period covering June 1, 2018, through August 5, 2020, and the status as of November 20, 2020, of applications made during that period. This letter responds to the recommendation made in the draft report for this audit.

Recommendation: Improve inter-Department communication and follow-up measures to identify and address unauthorized sales activity among vendors for whom the Department denied a COA, and provide better assurance that unregistered vendors that are notified of the conditions requiring them to register as sales tax vendors have done so where necessary.

Initially, the Department continues to disagree with the draft report's conclusion that thirteen of the fifty sampled vendors were conducting unauthorized sales activity. As we explained during the course of the audit, not all sales are taxable and not all out-of-state vendors making taxable sales make sufficient in-state sales to trigger sales tax registration requirements. The appearance of an active website or online ordering system, or information suggesting the possibility that an entity is making sales, simply does not give rise to a conclusion that a vendor is evading sales tax responsibilities and should be subject to financial penalties.

State Comptroller's Comment – As expressly stated in the draft report, we concluded that these 13 vendors were operating and *potentially* making taxable sales, not – as the Department has characterized our conclusion – that they were conducting unauthorized sales activity and evading sales tax responsibility. As stated in the report on page 11, some of these vendors had active online ordering systems or active websites with information that indicated they were operating. In the remaining cases, auditors concluded that the vendors were operating and making potentially taxable sales based on telephone conversations or online contact. Though

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we were not able to determine if these vendors were, in fact, conducting unauthorized sales activity, the potential exists that they were, which is reflected as such in our conclusion. In fact, it is precisely because we understand not all sales are taxable, and we considered the factors that trigger sales tax registration requirements, that we described this risk area as *potentially* taxable sales.

The Department's communications with vendors that have been denied a Certificate of Authority (COA) advises these vendors that they cannot engage in certain sales activities without a valid Certificate of Authority and includes information (Publication 750) that details those activities. The Department has established a multi-division workgroup to expand our ability to identify possible instances of unauthorized sales activity by these vendors. This workgroup will also explore additional opportunities to collaborate in follow-up enforcement against unregistered vendors.

State Comptroller's Comment – We are pleased the Department is taking a multi-division approach in its efforts to identify possible unauthorized sales activity by vendors for whom it denied a Certificate of Authority.

Thank you for the opportunity to comment on the draft report. The Department would like to thank the OSC auditors for their professionalism during the conduct of this audit.

Sincerely,

Michael Shollar

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