Not on the money: Performance Economics responds to critique by State Tax Research Institute; Automated Sales Tax Revenue collection software change would benefit Commonwealth

Recently, the State Tax Research Institute (STRI) issued a "critique" of Performance Economics 2019 study "Estimating the Costs and Benefits of an Accelerated Sales Tax Remittance System."

STRI objects to the use of estimates from the literature used by Performance Economics on how much sales tax fraud costs state governments. We stand by our estimates and the distributional methods we use to identify the benefits from ASTR. A proper review will conclude that the numbers are the best estimates based on the best available data. Nonetheless, we are compelled to address several items raised in the STRI "critique."

A major abettor of tax fraud is the use of technology called Zappers which exploit credit card transactions at establishments such as restaurants. The authors of the STRI study identify these fraudulent transactions as a purely cash transaction problem. They conveniently pull quotes from an earlier study by Boston University Professor Richard Ainsworth published in 2009 that points to cash as a source of fraud. However, the authors fail to cite his later study published in 2012, which cites extensive credit card sales tax fraud occurring with Zapper technology. When interviewed by *Governing* magazine in May of 2012, Professor Ainsworth noted:

> When you buy something, the transaction is run through a terminal and we assume the money is taken out of the customer's account and placed in the bank account of the business. But credit card transactions can be switched out and sent to the personal bank account of the business owner -- the Zapper can eliminate the sale.[1]

[1] "Sales Tax Zapped by Zappers," by Penelope Lemov, May 10, 2012. Accessed here: https://www.governing.com/columns/public-finance/col-sales-tax-zapped-tax-zappers.html.

The idea put forth by the authors of the STRI study that sales tax fraud is a cash transaction exclusive problem is disingenuous at best. The sales suppression technology is more sophisticated. To counter the fraud, the Commonwealth needs to match that sophistication which a software application.

The authors of STRI's study cherry-pick one tax fraud estimate from the Department of Revenue of Washington State. This study omits some very critical portions of the retail sector when it comes to tax fraud, such as that it:

- Does not include analysis of businesses that are unregistered, or are registered, but are not filing tax returns;
- Does not include delinquency;
- Does not include remote sellers;
- Does not include analysis of bankruptcies.

STRI ignores these components that contribute to tax avoidance. The issue of bankruptcies could be a large factor in future tax collection given the latest hit to the economy from the COVID-19 pandemic. Often states are listed as an unsecured creditor in these bankruptcies and are left to wait with other creditors to see how much of the sales tax owed, if any, they will ultimately receive. This would be a nonissue with ASTR.

Our study, rightly so, does not use a single-point estimate to calculate new revenue generated by increased tax compliance. We employ a Monte Carlo simulation and let the important factors vary within a reasonable distribution. As a result, we generate a range of increased tax revenue collection through improved compliance with an average of $770 million.

A large percentage of the STRI "critique" is dedicated to attempting to discredit Performance Economics' study. But that effort is misplaced. STRI should revisit its own very dubious estimates of costs associated with ASTR technology. The survey used to derive the cost estimates in the first STRI study— and that are again quoted in its most recent study— still suffers from lack of statistical credibility.

By its own admission, the initial STRI study claims there are over 70,000 retailers operating in Massachusetts. The sample size used to draw STRI's estimate of cost of implementation of ASTR is 20 retailers out of a sample size of 70,000. The results coming from a survey with this sample size is assuredly not statistically significant. The "sample" was made of "big box" retailers, financial institutions and payment processors, the very group of entities that stand to lose if ASTR is implemented.

Furthermore, the questions posed were misleading and were based on concepts and issues that don't relate to ASTR. STRI never published the survey instrument. With such a flawed instrument, STRI's cost estimate to implement ASTR unsurprisingly is well beyond the reality of implementing ASTR.
The truth is the payment processors already possess the technology to implement ASTR and have said so publicly. The implementation would require a revenue stream from every taxable transaction to be forwarded to the Commonwealth's coffers automatically, the same as what is done for the processor's fee currently.

In public testimony, executives from two payment processor firms, Vantiv and First Data Corporation, acknowledged that the technology already exists to implement "split funding" which is what ASTR would do.

Performance Economics' report is transparent and based on a sound methodology. The estimates of cost to implement ASTR were derived from interviews with experts in the industry, not based on a deeply-flawed survey where the respondents were hardly representative of the population and the questions were presented in a biased fashion. The second STRI study does nothing to address this glaring flaw.

Performance Economics study explains in great detail how exactly the process and technology of ASTR will work. In contrast, STRI gives a vague accounting on how it purports ASTR would be implemented based on misleading and nontransparent information.

Instead, the STRI study employs much hand waving, little evidence to support the claims of skyrocketing costs, but even less on generating estimates and outcomes built on defensible data. Statements made from such a source should be eyed with caution.