

oppaga

Special Review



January 2003

Report No. 03-05

Federal Law Restricts the Outsourcing of Many Unemployment Compensation Tax Collection Services

at a glance

It is not currently feasible to privatize tax collection services for the Unemployment Compensation Program, but this could change in the future. Although federal law currently requires that public employees must perform this function, there are proposals that could eliminate this requirement.

The Department of Revenue has streamlined the unemployment tax collection process since it assumed responsibility for this function from the Department of Labor and Employment Security. It has been able to reduce the number of staff allocated to this function by 30%.

Purpose

Chapter 2000-165, *Laws of Florida*, directed OPPAGA to study the feasibility of privatizing the unemployment tax collection services provided by the Department of Revenue. This law also transferred the Unemployment Compensation Program from the former Department of Labor and Employment Security to the Agency for Workforce Innovation and directed the agency to contract with the Department of Revenue to perform the program's tax collection services.

Background

The Unemployment Compensation Program collects state unemployment taxes from liable employers and distributes benefit payments to qualified claimants.¹ The Department of Revenue (under contract with the Agency for Workforce Innovation) collects the state unemployment tax. These funds are transferred to Florida's account in the federal Unemployment Trust Fund, which is used to pay benefits. Businesses also pay a federal unemployment tax that is collected separately by the Internal Revenue Service. These funds are deposited into the Federal Employment Security Administration Trust Fund, which is used to fund states' administrative costs for the program.² Federal funding of Florida's program varies and is based on economic conditions and workload, but has averaged about \$72 million per year over the last two fiscal years.

¹ OPPAGA examined the overall operations of the Unemployment Compensation program in a 1996 reports. OPPAGA [Report No. 95-37](#), *Review of the Unemployment Compensation Program Administered by the Department of Labor and Employment Security*, February 1996. The Florida Senate examined the program in Florida Senate Interim Project Report [2002-122](#), *Solvency of the Unemployment Compensation Trust Fund and the Tax "Trigger"*, October 2001.

² The federal tax also funds other programs of the U.S. Department of Labor such as the reserve fund for state unemployment compensation benefits and Wagner-Peyser workforce programs.

Privatization Feasibility —

Current federal restrictions prevent outsourcing of most tax collection services

Florida has outsourced some state tax collection services.³ However, this step is not feasible for most unemployment compensation tax collection services at this time due to federal restrictions.

Florida’s Department of Revenue (DOR) has outsourced some minor tax collection services for general taxes collected by the department. As shown in Exhibit 1, several of these functions could be considered for the collection of unemployment compensation taxes within the limits of federal law.

Exhibit 1 Federal Law Allows for the Outsourcing of Some Minor Unemployment Compensation Tax Collection Functions

Allowed Functions	Florida’s Program
Collection of delinquent taxes, but only when declared not collectable by the agency	DOR currently has a program for outsourcing collection of this category of delinquent taxes in its general tax program. DOR is considering including similar delinquent UC taxes in the program.
Lockbox collections	DOR has an in-house system for all taxes payable through a lockbox system, including unemployment compensation taxes. DOR periodically considers outsourcing of its lockbox system but thus far has found it more efficient to perform this service in-house.
Audits that do not include liability and monetary determinations	DOR audits always include liability and monetary determinations. DOR considers it inefficient to segregate audits in this way.

Source: Florida Department of Revenue.

However, outsourcing is not currently feasible for most tax collection services of the Unemployment Compensation Program. Because the program is a joint federal-state activity, Florida’s administration of the program

³ The term ‘privatization’ typically implies assumption of the entire program, including funding, by a non-government entity. Outsourcing typically involves contracting out a program function.

is subject to federal restrictions. Current federal law and policy mandate that certain unemployment compensation activities must be performed by employees who are subject to a state merit system. Specifically, federal law requires government employees to perform functions that affect tax amounts, penalties, and audits within the program. (See Exhibit 2.) The unemployment compensation program and its tax collection functions are some of the most federally restrictive areas regarding outsourcing. The rationale given for these restrictions by the U.S. Department of Labor is to protect individual rights by keeping sensitive functions under the direct responsibility of elected officials who can be held accountable for ensuring that decisions are unbiased and without outside undue influence. The mandated use of government employees also is intended to prevent access to confidential taxpayer and employee information needed to operate the program.

Exhibit 2 Many Unemployment Compensation Tax Collection Functions Are Restricted from Outsourcing

Disallowed Functions	Federal Citation
Federal law requires government merit employees perform	<u>Personnel program</u> 5 <i>U.S.C.</i> 2301
• Management of the Unemployment Compensation Trust Fund, such as assigning a tax rate, collection and deposit of such taxes, and control of monetary accounts	5 <i>C.F.R.</i> 900.603 <u>Unemployment compensation program</u> 42 <i>U.S.C.</i> , 501 <i>et seq.</i>
• Determination of tax liability	42 <i>U.S.C.</i> 4701
• Determination of tax rate for employers	42 <i>U.S.C.</i> 4728
Federal law restricts access to confidential data bases containing such information as employee personal identifiers to government merit employees ¹	

¹ The unemployment compensation reporting system requires employers to submit quarterly information on covered employees including pay and social security numbers.

Source: U.S. Department of Labor.

Both the U.S. Department of Labor and Office of Management and Budget have issued official policy and interpretation letters on this topic. Federal law and policy provide that states that violate outsourcing limitations face loss of

federal grant funding. Thus, if Florida’s tax collection services were outsourced, \$72 million in federal grant funds would be jeopardized.

Department of Revenue performing well

The Department of Revenue has streamlined collection of unemployment taxes since it assumed responsibility for this function in 2000, and it has achieved program improvements. Whereas the Florida Department of Labor and Employment Security formerly maintained a separate unit to collect these taxes, the Department of Revenue has fully integrated this effort into its other tax collection services. As a result, it has reduced the number of full-time equivalent (FTE) staff allocated to this function by 30%. The Department of Labor and Employment Security formerly was allocated 438 FTE for this function.⁴ In contrast, the Agency for Workforce Innovation’s current contract with the Department of Revenue allows for 306 FTE to perform these same functions.

Federal and legislative measures indicate that under the Department of Revenue’s administration, tax collection performance has generally improved. Exhibit 3 shows comparative performance in four key areas.

**Exhibit 3
Unemployment Compensation Tax Collections
Services Have Improved Under the
Department of Revenue**

	1999-00	2001-02
Federal Measures		
New employee determinations issued within 90 days of the end of the quarter in which liability was reached	78.3%	87.0%
Cashiering deposit timeliness (within three business days)	96.3%	97.9%
State Measures		
Percentage of current quarter unemployment compensation taxes paid timely	95.6%	95.6%
Percentage of new unemployment compensation employer liability determinations made timely (within 180 days)	90.7%	93.0%

Source: Florida Department of Revenue.

⁴ Of the 438 FTE allocated, the Agency for Workforce Innovation reports that only 374 FTE were utilized at the time of function transfer.

Cost analysis should be conducted if federal restrictions are lifted

Due to the current federal limitations on outsourcing, OPPAGA did not conduct a cost analysis of the impact of privatizing unemployment compensation tax collection services. However, federal legislation has been proposed that would significantly change the unemployment compensation program and remove the current prohibition.⁵ These changes would transfer full funding responsibility for the program to the states and grant states additional administrative flexibility. Depending on final form and passage, federal restrictions on outsourcing could be eliminated.

If federal restrictions are lifted, the Department of Revenue and the Agency for Workforce Innovation should examine whether outsourcing unemployment compensation tax collection would be desirable. This analysis should assess whether cost savings would be achieved through privatization, as well as whether provisions to protect the confidentiality of taxpayer and employee information would be maintained by the program. Additional factors that should be considered in privatization assessments are discussed in a prior OPPAGA report.⁶

Agency Responses

Pursuant to s. 11.51(1), *Florida Statutes*, the Agency for Workforce Innovations and the Department of Revenue were provided the opportunity to comment on a draft copy of our report. Both agencies provided written responses that generally concurred with our report. We revised our report to reflect information provided in their responses. Both written responses have been appended to the electronic report document and can be viewed in their entirety on our website.

⁵ United States House of Representative Bill 5418.

⁶ *Assessing Privatization in State Agency Programs*, OPPAGA Report No. 98-64, February 1999.



Jeb Bush
Governor
Susan Pareigis
Director

January 9, 2003

Mr. John W. Turcotte, Director
Office of Program Policy Analysis and
Government Accountability
111 West Madison Street
Tallahassee, Florida 32399-1475

Dear Mr. Turcotte:

Thank you for the opportunity to review the preliminary findings and recommendations your office has produced in the special review required by Chapter 2000-165, L.O.F., relating to the privatization of unemployment tax collection services.

While we agree with your conclusions relative to privatizing, we do question a particular data element for which the source is not documented in the report. In the section on page three that concludes the Department of Revenue is performing well, it is noted the Department of Labor and Employment Security was allocated 440 FTE's for the tax function at a cost of \$25 million.

According to information available to us, the former Bureau of Tax utilized 374 FTE's of the 438 that were authorized at the time the Bureau was abolished. For the period from fiscal year 1991-1992 through fiscal year 1998-1999, the last full year the Bureau of Tax was in operation, the average total cost for the tax operation was \$19,115,187. The highest cost years were 1994-95 and 1995-96 during which the cost of planning and programming a new mainframe computer tax system resulted in expenditures of \$21,013,907 and \$21,885,561. During the last full year of the Bureau's operation, 1998-99, the operating costs were \$18,007,969.

While we do not dispute the Department of Revenue is able to streamline tax collection processes and can provide some improvement to the tax operation, we believe the savings attributed to the performance of these duties by the department is overstated.

Thank you again for the chance to review the draft of your report. If you have any questions or need additional information, please call Tom Clendenning at 245-7499.

Sincerely,

/s/
Susan Pareigis

SP/wdh

cc: Ms. Barbara Griffin
Mr. Tom Clendenning
Mr. David Hagen



DEPARTMENT OF REVENUE

TALLAHASSEE, FLORIDA 32399-0100

JIM ZINGALE
EXECUTIVE DIRECTOR

January 10, 2003

Mr. John W. Turcotte, Director
Office of Program Policy Analysis and
Government Accountability
111 West Madison Street, Room 312
Tallahassee, Florida 32302

Dear Mr. Turcotte:

Attached is the Department's response to the preliminary findings and recommendations presented in OPPAGA's draft report, ***Special Review: Federal Law Restricts Outsourcing of Many Unemployment Compensation Tax Collection Services***, dated December 2002.

We appreciate the professionalism displayed by your staff during this review. If further information is needed, please contact Fred Roche, our Inspector General, at 488-4328.

Sincerely

/s/
Jim Zingale

JZ/bso

Agency Response
OPPAGA Special Examination
Federal Law Restricts Outsourcing of Many
Unemployment Compensation Tax Collection Services

January 10, 2003

The Department is very pleased with the overall report findings. However, there are a couple of issues that may need clarification.

Page three of OPPAGA's report contains the following statement: "Thus, if Florida's tax collection services were outsourced, \$72 million in federal grant funds *could* be jeopardized." We feel that the phrase should be changed to "...\$72 million in federal grant funds *would* be jeopardized." The reason for this is that privatizing the tax collection function automatically places federal funding in jeopardy. The word "could" suggests that the funding would not automatically be in jeopardy.

It should also be pointed out that the Department has dramatically improved the collections process by last year's legislation which, under Section 213.67, allows the Department to use garnishments provisions to collect unemployment tax. The new process is faster, cheaper and more efficient than any other collection process previously available for the collection of unemployment tax from delinquent employers. For the fiscal year ending June 30, 2002, the Florida Department of Revenue ranked first among the eight largest states and eleventh among all states in performance as determined by primary U. S. Department of Labor measurements.

Regarding the recommendation, "DOR should conduct a cost analysis of the impact of privatizing unemployment compensation tax collection services," the Department continues to benchmark itself against private industry. Once federal legislation has passed to authorize such action, we will work with the Agency for Workforce Innovation in performing a cost analysis of the impact of outsourcing tax collection services.

The Florida Legislature

Office of Program Policy Analysis and Government Accountability



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