THE FLORIDA LEGISLATURE

Office of
Program Policy Analysis
And Government Accountability

John W. Turcotte, Director

June 1997

Executive Summary for Report No. 96-89
Program Evaluation and Justification Review: General Tax Administration Program Administered by the Department of Revenue

Scope

OPPAGA is required to complete a Program Evaluation and Justification Review of each state agency program that is operating under a performance-based program budget. This report examines the performance of the General Tax Administration Program and presents options for improving Program performance.

Background

The Department of Revenue administers the General Tax Administration Program, which involves the collection of 38 taxes, including the sales tax, corporate income tax, intangible property tax, and fuel tax. According to s. 213.01, F.S., the Legislature's intent is that the revenue laws of the state be administered in a fair, efficient, and impartial manner. The Program comprises six major functions: taxpayer education and assistance, tax returns processing and reconciliation, collections, audit, compliance enforcement, and adjudication. The primary goal of these functions is to timely, accurately, and fairly collect owed taxes.

Conclusions

The General Tax Administration Program is an essential state function. Without this Program, the state would be unable to fund state government programs such as education, corrections, transportation, and social services.

Over the past three years, the Department has improved the efficiency and effectiveness of the General Tax Administration Program and has collected more tax revenues with fewer staff. For example, from fiscal year 1994-95 to fiscal year 1995-96, total tax collections increased by more than 7% while full-time equivalent positions assigned to the Program declined by about 7%.

However, the Department can further improve the efficiency and effectiveness of the General Tax Administration Program.

Options for Improvement: Opportunities for further improving performance exist in two areas.

1. **Giving more emphasis and focus to its auditing and compliance enforcement functions.** Although the Department's emphasis on voluntary compliance appears to have positive results, its performance in two of the three General Tax Administration Program functions aimed at identifying and collecting taxes from taxpayers who do not comply with tax laws has decreased. Over the past few years, the Department has emphasized taxpayer education and assistance activities in an effort to improve voluntary compliance with tax laws. This emphasis appears to have had positive returns, as the percentage of taxpayers who timely and accurately filed their tax returns increased. However, its performance in tax auditing and compliance enforcement functions declined. These tax collection functions are a vital component to a successful General Tax Administration Program not only because they increase the state's net revenue from the Program, but also because they serve to increase voluntary compliance with tax laws. Department managers need to place more emphasis on these functions and develop strategies to improve their performance.

2. **Providing more balance between sales tax and other major taxes.** The Department's focus on collecting sales tax has limited its performance in collecting other major taxes. Because sales tax collections account for approximately two-thirds of all tax payments, the Department has placed a priority on activities related to the sales tax. As a result, its performance in collecting and processing sales taxes exceeds its performance in collecting and processing other major taxes.

The Department could generate additional revenues for the state and further improve voluntary compliance if it paid more attention to these other major taxes. For example, since the rate of return for sales tax audits is less than the rate of return for audits of other major taxes, the Department could increase the total revenue it collects through the audit function by shifting audit resources from sales taxpayers to corporate and intangible taxpayers. It also could use the spending flexibility it obtained under performance-based program budgeting to contract with private vendors to handle the peak workload associated with corporate and intangible taxes and to augment its efforts to collect taxes from corporate and intangible taxpayers who have not paid the taxes they owe. We estimate the Department could generate an additional $38.7 million if it shifted resources from sales to corporate and intangible taxes (see Table 1).

Recommendations

Table 2 summarizes our revenue enhancement recommendations.

Agency Response

The Executive Director of the Department of Revenue provided a detailed response to our preliminary and tentative findings and recommendations. In the response, the Executive Director noted actions the Department is considering to address our recommendations, but expressed concerns about some issues in the report.

Table 1
Shifting Resources From Sales Tax to Other Taxes
Could Generate an Additional $38.7 Million in Revenues for the State

Strategy	Amount (in Millions)
Shift audit resources	$30.5
Improve timeliness of delinquency notices	5.3
Refer unpaid corporate bills to private collection agencies	2.7
Deposit intangible tax receipts faster	.2
Potential additional tax revenues	**$38.7**

Source: Developed by OPPAGA.

Table 2
Recommendations for Changes to Improve the
General Tax Administration Program's Efficiency and Effectiveness

Program Activity	Recommended Improvements
	The General Tax Administration Program should:
Taxpayer Education and Assistance	• More consistently use the results of its taxpayer education and assistance studies to improve performance • Increase the timeliness in informing taxpayers of changes in tax administration requirements and response to taxpayer inquiries
Tax Processing	• Make faster deposits of intangible tax payments • More timely and accurately process intangible and corporate returns to enable more timely and accurate bills to be issued
Collections	• Refer accounts to contract collection agencies that exceed internal collection capacity • Use contract collectors for the more labor-intensive collection activities • Use a risk-based collection strategy
Audit	• Modify its audit selection strategy by shifting efforts to more productive tax accounts and reevaluating its "very large taxpayer" audit priorities • Explore which accounts the Department assigns to private auditors
Compliance Enforcement	• Shift compliance enforcement efforts to more productive areas • Provide alternative compliance enforcement case selection methods

This project was conducted in accordance with applicable evaluation standards. Copies of the entire report may be obtained by telephone (850/488-0021 or 800/531-2477), by FAX (850/487-3804), in person (Claude Pepper Building, Room 312, 111 W. Madison St.), or by mail (OPPAGA Report Production, P.O. Box 1735, Tallahassee, FL 32302). Web site: http://www.state.fl.us/oppaga/

Project Supervised by: Debbie Gilreath (487-9278)

Project Conducted by: Frank Alvarez (487-9274), Janice Foley, Carol Matthews, and Don Wolf

Program Evaluation and Justification Review

General Tax Administration Program Administered by the Department of Revenue

June 1997

Office of Program Policy Analysis and Government Accountability

Report No. 96-89

OPPAGA Mission Statement

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The Florida Legislature

OFFICE OF PROGRAM POLICY ANALYSIS AND
GOVERNMENT ACCOUNTABILITY

John W. Turcotte, Director

June 1997

The President of the Senate,
the Speaker of the House of Representatives,
and the Legislative Auditing Committee

I have directed that a program evaluation and justification review be made of the General Tax Administration Program administered by the Department of Revenue. The results of this review are presented to you in this report. This review was made as a part of a series of justification reviews to be conducted by OPPAGA under the Government Performance and Accountability Act of 1994. This review was conducted by Frank Alvarez, Janice Foley, Carol Matthews, and Don Wolf, under the supervision of Debbie Gilreath.

We wish to express our appreciation to the staff of the Department of Revenue for their assistance.

Sincerely

John W. Turcotte
Director

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The General Tax Administration Program is an essential state function. Without this Program, the state would be unable to fund state government programs such as education, corrections, transportation, and social services.

Over the past three years, the Department has improved the efficiency and effectiveness of the General Tax Administration Program and has collected more tax revenues with fewer staff. For example, from fiscal year 1994-95 to fiscal year 1995-96, total tax collections increased by more than 7% while full-time equivalent positions assigned to the Program declined by about 7%.

However, the Department can further improve the efficiency and effectiveness of the General Tax Administration Program.

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Program functions aimed at identifying and collecting taxes from taxpayers who do not comply with tax laws has decreased. Over the past few years, the Department has emphasized taxpayer education and assistance activities in an effort to improve voluntary compliance with tax laws. This emphasis appears to have had positive returns, as the percentage of taxpayers who timely and accurately filed their tax returns increased. (See Chapter 4.) However, its performance in tax auditing and compliance enforcement functions declined. (See Chapters 6 and 7.) These tax collection functions are a vital component to a successful General Tax Administration Program not only because they increase the state's net revenue from the Program, but also because they serve to increase voluntary compliance with tax laws. Department managers need to place more emphasis on these functions and develop strategies to improve their performance.

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   The Department could generate additional revenues for the state and further improve voluntary compliance if it paid more attention to these other major taxes. For example, since the rate of return for sales tax audits is less than the rate of return for audits of other major taxes, the Department could increase the total revenue it collects through the audit function by shifting audit resources from sales taxpayers to corporate and intangible taxpayers. (See Chapter 6.) It also could use the spending flexibility it obtained under performance-based program budgeting to contract with private vendors to handle the peak workload associated with corporate and intangible taxes and to augment its efforts to collect taxes from corporate and intangible taxpayers who have not paid the taxes they owe. (See Chapters 4, 5, and 6.) We estimate the Department could generate an additional $38.7 million if it shifted resources from sales to corporate and intangible taxes (see Table 1).

Table 1
Shifting Resources From Sales Tax to Other Taxes Could Generate an Additional $38.7 Million in Revenues for the State

Strategy	Amount (in Millions)
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Recommendations

Table 2 summarizes our revenue enhancement recommendations

Table 2
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Agency Response

The Executive Director of the Department of Revenue provided a detailed response to our preliminary and tentative findings and recommendations. (See Appendix C, page 36.) In the response, the Executive Director noted actions the Department is considering to address our recommendations, but expressed concerns about some issues in the report.

Chapter 1: Introduction

Purpose

This is the second of two reports presenting the results of our Program Evaluation and Justification Review of the Department of Revenue's General Tax Administration Program, which began operating under a performance-based program budget in fiscal year 1995-96. State law directs OPPAGA to complete a justification review of each state agency program that is operating under performance-based program budget. Pursuant to state law, our review of this Program is due no later than July 1, 1997. The law also requires justification reviews to be comprehensive, evaluate program performance, and identify policy alternatives for improving services and reducing costs. The law specifies that the reviews shall provide information about nine areas concerning a program and its performance. Appendix A lists these areas and provides a synopsis of our conclusions for each area.

This report examines the performance of the General Tax Administration Program and presents options for improving Program performance. Our review focused on the Department's efforts to collect sales, corporate, and intangible taxes. Although fuel tax is another major source of revenue for the state, in 1996, the Legislature made substantial changes in the fuel tax laws. These changes affected the Department's ability to collect fuel taxes, making it difficult to determine whether changes in performance resulted from changes in the law or Department procedures.

Background

The Department of Revenue administers the General Tax Administration Program, which involves the collection of 38 taxes, including the sales tax, corporate income tax, intangible property tax, and fuel tax. (See Exhibit B.) According to s. 213.01, F.S., the Legislature's intent is that the revenue laws of the state be administered in a fair, efficient, and impartial manner. To ensure that Florida taxpayers are adequately safeguarded and protected during tax assessment, collection, and enforcement processes, the Legislature established the Florida Taxpayer's Bill of Rights. Among the rights guaranteed Florida taxpayers is the right to available information and prompt and accurate responses to questions and requests for assistance and the right to seek either formal or informal review of any adverse decisions relating to the Department's audit or collection processes.

The Program comprises six major functions: taxpayer education and assistance, tax returns processing and reconciliation, collections, audit, compliance enforcement, and adjudication. The primary goal of these functions is to timely, accurately, and fairly collect all owed taxes by encouraging taxpayers to voluntarily pay their taxes and by identifying those taxpayers who unintentionally or purposefully violate tax laws and collecting the taxes they owe.

Taxpayer Education and Assistance. The Department provides taxpayers with information that encourages and helps them comply with tax laws. The Department's education and assistance activities include preparing and distributing instructions and brochures, responding to taxpayer inquiries in writing or by phone, meeting with individual taxpayers, and conducting seminars for different groups of taxpayers.

Tax Returns Processing and Reconciliation. The Department receives tax returns and payments, deposits payments, distributes tax revenues to the appropriate state and local government entities, reviews and analyzes tax returns, and notifies taxpayers who have made incorrect payments.

Collections. The Department identifies registered taxpayers who have not paid their taxes and collects unpaid taxes by writing, telephoning, or meeting with taxpayers to remind them of their outstanding obligations. If taxpayers do not respond to these reminders, the Department initiates legal actions, such as filing tax warrants to create liens against taxpayers' property or seizing and selling taxpayers' assets.

Audit. The Department reviews registered taxpayers' financial records to ensure that taxpayers have correctly calculated and reported all of the taxes they owe. If it discovers underreported tax liabilities, the Department then assesses and collects the additional owed taxes.

Compliance Enforcement. The Department uses investigative techniques to identify registered and unregistered taxpayers who do not pay owed taxes. These techniques include checking bills of lading at key entry points into Florida, canvassing flea markets, malls, and other businesses, and collecting evidence of criminal tax violations.

Adjudication. The Department reviews taxpayer appeals of Department tax decisions, such as audit assessments, prior to any formal litigation.

For fiscal year 1997-98, the General Tax Administration Program had 2,371 authorized positions and was appropriated about $121 million. As shown in Exhibit 1, Program staffing has decreased over the past four years and appropriations have generally remained stable.

Exhibit 1
Program Staffing Decreased Over the Past Four Years and Appropriations Generally Remained Stable

	Final Appropriations			
	1994-95	**1995-96**	**1996-97**	**1997-98**
Total Appropriations	**$114,565,463**	**$112,653, 810**	**$113,343,976**	**$120,969,619**
Number of Full-Time Equivalent Staff Positions	***2,703***	***2,512***	***2,368***	***2,371***

Source: General Appropriations Act for fiscal years 1994-95 through 1997-98.

Chapter 2: General Conclusions

The Department of Revenue's General Tax Administration Program is an essential state function. This Program collects revenues needed to support other state government programs. Without this Program, the state would be unable to fund public programs such as education, corrections, transportation, and social services.

In the past three years, the Department has improved the efficiency and effectiveness of the General Tax Administration Program and has collected more tax revenues with fewer staff. For example, from fiscal year 1994-95 to fiscal year 1995-96, total tax collections increased by more than 7% while full-time equivalent positions assigned to the Program declined by about 7%.

To further improve its efficiency and effectiveness, the Department has begun to develop a tax data base system, called SUNTAX. Conceived in 1991, SUNTAX is a concerted effort to replace the current outdated and fragmented tax processing system with modern technology in order to provide taxpayers with "one-stop" service to get information on their accounts. Although the Department has experienced problems developing SUNTAX, some parts of the system are currently operational and Department officials expect the system to be fully implemented before the year 2000. As of June 1997, the state had spent about $8.1 million on SUNTAX. The Legislature appropriated $6.2 million for the project for fiscal year 1997-98. Total costs for the project have been estimated to be between $30 million and $50 million.

However, the Department can even further improve the effectiveness of the General Tax Administration Program by:

- Giving more emphasis to its auditing and compliance enforcement functions; and
- Paying more attention to the collection of intangible and corporate income taxes.

Giving more emphasis and focus to its auditing and compliance enforcement functions. Although the Department's emphasis on voluntary compliance appears to have had positive results, its performance in two of the three General Tax Administration Program functions aimed at identifying and collecting taxes from taxpayers who do not comply with tax laws has decreased. Over the past few years, the Department has emphasized taxpayer education and assistance activities in an effort to improve voluntary compliance with tax laws. This emphasis appears to have had positive returns, as the percentage of taxpayers who timely and accurately filed their tax returns increased. (See Chapter 3.) However, its performance in tax auditing and compliance enforcement functions declined. (See Chapters 6 and 7.) These tax collection functions are a vital component to a successful General Tax Administration Program not only because they increase the state's net revenue from the Program, but also because they serve to increase voluntary compliance with tax laws. Department managers need to place more emphasis on these functions and develop strategies to improve their performance.

Providing More Balance Between Sales and Other Major Taxes. The Department's focus on collecting sales tax has limited its performance in collecting other major taxes. Because sales tax collections account for approximately two-thirds of all tax payments, the Department has placed a priority on sales tax activities. As a result, its performance in collecting and processing sales tax exceeds its performance in collecting and processing other major taxes. (See Chapters 4 and 5.)

The Department could generate additional revenues for the state and further improve voluntary compliance if it paid more attention to these other major taxes. For example, since the rate of return for sales tax audits is less than the rate of return for audits of other major taxes, the Department could increase the total revenue it collects through the audit function by shifting audit resources from sales taxpayers to corporate and intangible taxpayers. (See Chapter 6.) It also could use the spending flexibility it obtained under performance-based program budgeting to contract with private vendors to handle the peak workload associated with corporate and intangible taxes and to augment its efforts to collect taxes from corporate and intangible taxpayers who have not paid the taxes they owe. (See Chapters 4, 5, and 6.) We estimate the Department could generate an additional $38.7 million if it shifted resources from sales to corporate and intangible taxes (see Exhibit 2).

Exhibit 2
Shifting Resources From Sales to Other Taxes Could Generate an Additional $38.7 Million in Revenues for the State

Strategy	Amount (in Millions)
Shift audit resources	$30.5
Improve timeliness of delinquency notices	5.3
Refer unpaid corporate bills to private collection agencies	2.7
Deposit intangible tax receipts faster	.2
Potential additional tax revenues	**$38.7**

Source: Developed by OPPAGA.

Chapter 3: Taxpayer Education and Assistance

Introduction

One of the underlying principles of Florida's revenue management process is that taxpayers will voluntarily pay taxes they owe the state. The General Tax Administration Program's education and assistance activities help taxpayers obtain the information they need to understand and voluntarily comply with tax laws. These activities include preparing and distributing instructions and brochures, responding to taxpayer inquiries in writing or by phone, meeting with individual taxpayers, and conducting seminars for different groups of taxpayers.

Nearly every organizational unit involved in the General Tax Administration Program performs education and assistance activities. For example, when auditing staff help taxpayers understand why they owe additional taxes and how they can take corrective action, staff are educating those taxpayers.

Need for State Function

Most education and assistance activities are essential for a successful General Tax Administration Program. For example, the state needs a mechanism for informing taxpayers about their tax obligations and responding to their requests for information and assistance. Without this information, taxpayers would not know how to comply with tax laws. Thus, educating and assisting taxpayers is required by Florida's Taxpayer Bill of Rights, which was enacted in 1992 to safeguard and protect taxpayers during the tax assessment, collection and enforcement processes.[1]

Other education and assistance activities, such as conducting seminars, are not essential but provide benefits to both taxpayers and the state. Taxpayers benefit by obtaining the information they need to avoid making penalty or interest payments or becoming subject to other sanctions. The state benefits because obtaining tax revenue through voluntary payment is much less expensive than obtaining it through involuntary payment. For example, although taxpayers voluntarily pay 97% of the revenue collected through the General Tax Administration Program, approximately 80% of Program staff are primarily dedicated to collecting the remaining 3%.

[1] Section. 213.015, F.S.

Opportunities for Privatization

Most education and assistance activities cannot be privatized apart from other tax administration functions because Program staff generally perform these activities in conjunction with their other duties. However, if the Department privatizes other functions, such as field collections, the private vendor would also need to perform the education and assistance activities related to those functions.

Program Performance

The performance of the Department's education and assistance activities appears to be improving. The primary outcome measure for these activities, the percent of returns taxpayers filed timely and accurately, improved from 75% to 76.5% between fiscal year 1994-95 and fiscal year 1995-96. This increase is more significant than it seems because of the large number of returns the Department receives. For example, for fiscal year 1995-96, the Department processed more than 5 million sales tax returns.

Although factors beyond the Department's control can affect taxpayers' ability and willingness to timely and accurately pay the taxes they owe, at least some of this improvement appears to have resulted from improvements the Department has made in its educational and assistance efforts. For example, as shown in Exhibit 3, the Department has increased its educational contacts with taxpayers, improved the readability of its publications, and decreased the time staff take to answer telephone inquiries.

Exhibit 3
Some of the Department's Education and Assistance Activities Have Improved

Activity	Previous Performance	Current Performance
DOR-initiated educational contacts with taxpayers	29,151 contacts in fiscal year 1994-95	35,509 contacts in fiscal year 1995-96, a 22% increase
Readability of publications	Sampled publications could be understood by individuals with some college education, or 44% of the state's population.	Sampled publications could be understood by individuals with a 12^{th} grade education, or 74% of the state's population.
Telephone monitoring and answer speed	The Department was not meeting its goal to place taxpayer phone calls on hold for no longer than one minute. The average response time was 131 seconds in 1994 and 87 seconds in 1996.	In 1997, the average telephone response time was 48 seconds, well within the goal of one minute.

Source: Department of Revenue data and OPPAGA Report Nos. 12210, 94-13, and 96-17.

In addition, the Department has conducted studies to evaluate the cost-effectiveness of its educational activities. For example, the Department has studied how different forms of educational activities affect taxpayer behavior in complying with tax laws. One study revealed that one-on-one meetings between Program staff and taxpayers have no greater long lasting effect on compliance than group seminars. As a result of this study, the Department started to conduct more group seminars and fewer one-on-one meetings. Since group seminars are less costly per taxpayer, this improved the cost-effectiveness of the Department's education and assistance activities.

However, the Department does not always use study results to improve its performance. For example, one study showed that seminars stressing sanctions given to non-complying taxpayers are more effective in getting taxpayers to voluntarily comply than seminars that do not stress these sanctions. However, the Department's taxpayer education materials do not emphasize sanctions.

In addition, the Department needs to work on further improving and streamlining its education and assistance activities. For example, as shown in Exhibit 4, the Department is still not providing taxpayers with timely notification of changes in tax laws involving changes in tax rates and reporting dates. When the Department does not provide such information in a timely manner, taxpayers may not have the knowledge they need to comply with new requirements.

Exhibit 4
Some of the Department's Education and Assistance Activities Have Not Improved

Activity	Previous Performance	Current Performance
Taxpayer notification of changes in tax law or procedures	The Department was late in notifying taxpayers of tax law changes in 8 of the 21 notices sampled.[1]	The Department was late in notifying taxpayers of tax law changes in 8 of the 21 notices sampled.[1]
Correspondence response system	The Department was not monitoring timeliness of response to written taxpayer inquiries.	The Department is working on but has not implemented a system to monitor its responses to written taxpayer inquiries. In April 1997, the Department was answering 45% of the inquiries it received within its goal of 18 days.

[1] Department standard is to notify taxpayers at least 14 days before the effective date of changes.

Source: Department of Revenue data and OPPAGA Report Nos. 96-13 and 96-17.

Conclusions and Recommendations

The General Tax Administration Program's education and assistance activities are needed to give taxpayers the information they need to voluntarily comply with tax laws. The Department has improved the performance of education and assistance programs, and voluntary compliance has increased. It also has conducted several studies to determine which types of education and assistance activities are most effective. However, it needs to consistently use the results of its studies to improve its performance. It also needs to take steps to improve its timeliness in informing taxpayers of changes in tax requirements and responding to written taxpayer inquiries.

Chapter 4: Tax Remittance and Return Processing and Reconciliation

Introduction

The tax processing function's activities include depositing tax payments, distributing tax receipts to appropriate state and local government entities, and processing tax returns. In addition, tax processing staff review and analyze tax payments in order to generate tax bills to taxpayers who made incorrect payments. The Department's goal is to perform these activities in a timely and accurate manner.

Much of the work for this function is automated. For example, 70% of all tax dollars received are handled through electronic funds transfer rather than through individual checks sent in by taxpayers. In addition, the Department uses high-speed electronic equipment to help sort mail and to reconcile check amounts to data contained in the tax returns. Automation is critical to the efficiency of this process as significant peak workload periods occur at certain times of the month and year. For example, the monthly peak period is the 20^{th} when sales tax payments are due. The annual peak period occurs from February to June when the Department processes the bulk of intangible and corporate tax returns. For fiscal year 1995-96, staff processed over 8 million documents and deposited and distributed over $20 billion.

Need for State Function

The tax processing function is essential for a successful tax administration program. To fund public programs, tax revenues need to be deposited and distributed to appropriate government entities. In addition, taxpayers who paid less taxes than they owed need to be identified in order to pursue collection efforts and to ensure that all taxpayers are treated consistently and fairly.

Opportunities for Privatization

Most of the activities for this function can be performed by private vendors because they do not require extensive tax law expertise. Some other states have cost-effectively privatized most of their processing activities. For example, a New York Department of Revenue official estimated that they will save 17% from outsourcing activities such as the deposit of checks, data entry, and microfilming. Florida's Department of Revenue should consider contracting with private vendors if it proves to be cost-effective to do so.

Program Performance

The tax processing function has generally become more efficient over time. For example, for the past three years the Department has become more timely in making deposits of sales tax receipts, which enhances state interest earnings. In addition, the Department has improved the accuracy of distributions to local government accounts and the timeliness of final distributions made to state and local accounts.[2] Furthermore, the Department has become more timely in issuing sales tax bills, which serves to enhance collection efforts. (See Chapter 5.) Department officials attribute increased tax processing efficiency primarily to improvements made to internal processes, modifications that made forms easier to process, and changes in legal requirements that allowed some taxpayers to file quarterly rather than monthly, thus reducing the number of documents processed.

Despite these improvements, some continuing problems have impeded the efficiency and effectiveness of this function:

- The Department made slower deposits of intangible tax payments than it did for other major taxes, which reduced state interest earnings;

- The Department issued untimely intangible and corporate bills due to delays in processing intangible and corporate tax payments, which diminished the chance of collecting these payments and unfairly burdened taxpayers who had to pay accrued interest from late billings; and

- The Department has not improved the accuracy of its bills and delinquency notices, which inconvenienced taxpayers and created more work for Department staff. Data entry errors can result in inaccurate bills and delinquency notices.

Slower deposits of intangible tax payments. Department data shows that it made slower deposits of intangible tax payments than it did for sales and corporate tax payments, which reduced interest earnings for the state. As shown in Exhibit 5, the Department took longer to deposit intangible tax receipts than it did to make deposits of sales and corporate tax payments. The Department's performance in depositing intangible tax payments in January 1997

[2] Problems with the accuracy of distributions to local governments will impede their operations because local governments require steady and predictable revenue streams in order to forecast and manage their budgets.

is almost two days longer than the 0.95-day standard established in the 1995-96 Legislative Budget Request. The primary impediment to the Department's ability to be more timely is the peak workload associated with intangible tax payments.

Faster deposits of intangible tax receipts would increase interest earnings resulting in more revenues for the state. For example, the state would have earned an additional $242,000 in interest in fiscal year 1995-96 if the Department had deposited intangible receipts two days faster than it did.

Exhibit 5
Deposits of Intangible Tax Payments Have Not Been as Timely as Deposits for Payments of Sales and Corporate Taxes

(Average number of days to deposit tax payments)

Tax	January-June 1995	January 1996	January 1997
Sales	.75	.81	.59
Corporate	.28	.27	.07
Intangible	3.74	3.38	2.85
Overall	.87	.71	.57

Source: OPPAGA compilation of Department of Revenue data.

Delays in processing intangible and corporate tax returns. The Department issued untimely bills for incorrect payments of intangible and corporate tax payments due to delays in processing these payments. Untimely bills diminish the likelihood that the Department will collect owed taxes and causes taxpayers to pay additional interest due to Department delays in issuing bills. The Department's goal is to process all tax returns within 45 days. As shown in Exhibit 6, the Department has achieved this goal for processing sales tax returns, but its performance is lagging for intangible and corporate tax returns. However, this year's performance is a marked improvement from fiscal year 1993-94, when it was taking the Department 12 months to process intangible and corporate tax returns.

Department officials indicated that generating sales tax bills had priority over other taxes due to their higher volume and dollar value and that tax processing staff have more difficulty issuing timely bills during workload peaks. Although the processing workload for sales tax returns is fairly evenly distributed throughout the year, the Department receives most intangible and corporate tax returns from February to June of each year. To handle this peak workload period, the Department uses about 115 additional temporary staff to process mail, microfilm, and enter data from returns. Department officials said that better training of these temporary staff in fiscal year 1996-97 may result in more timely processing of intangible and corporate tax returns, which would improve the timeliness of issuing bills.

Exhibit 6
Bills for Intangible and Corporate Taxes Have Not Been Issued as Timely as Sales Tax Bills

(Average number of days from validation to mailing of bills)

Tax	1994-95	1995-96	March 1997
Sales	56	47	43
Corporate	256	190	161
Intangible	---[1]	154	71

[1]Data for fiscal year 1994-95 is unavailable.

Source: OPPAGA analysis of Department of Revenue data.

Inaccurate bills and delinquency notices. The Department has not improved the accuracy of bills and delinquency notices issued in the past three years and has not met the 93.2% standard for accuracy established in the 1995-96 Legislative Budget Request. (See Exhibit 7.) Inaccurate bills and delinquency notices can result from errors made by taxpayers, such as completing tax returns incorrectly, or from errors made by staff, such as data entry errors involving incorrect payments being entered in the tax database or being applied to the wrong taxpayer account. Inaccurate bills and delinquency notices cause inconvenience for the taxpayer and more work for Department staff. To reduce data entry errors, staff said that they currently do key edit checks and a limited amount of key verification for sales tax returns.[3] Although the Department lacks precise information on the portion of bills and delinquency notices that it issued incorrectly due to data entry errors, Department staff conduct periodic testing to determine the data entry error rate. According to staff, fewer data entry errors have been made recently, which should improve the accuracy rate for bills and delinquency notices.

Department officials indicated that newer technologies, such as electronic data interchange (EDI) and imaging, would help to

[3] Key edit involves reviewing a sample of returns to verify data accuracy while key verification involves data being entered twice to ensure accuracy.

reduce data entry errors.[4] Preliminary data indicated a much lower error rate for returns filed through electronic means compared to those returns processed in a more conventional manner. Although the Department has experienced problems implementing systems using newer technologies, Department officials indicated that implementation of these systems is expected to take place by July 1997.[5]

Exhibit 7
The Accuracy of Bills and Delinquency Notices Has Not Improved in the Past Three Years

(Percent of bills and delinquency notices issued accurately by the Department)

	1994-95	1995-96	1996-97[1]
Accuracy Rate	91.0%	87.6%	89.3%

[1]Data for July 1996 through February 1997.

Source: OPPAGA analysis of Department of Revenue data.

Conclusions and Recommendations

Despite overall improvements, some aspects of the tax processing function could be improved to further enhance collection efforts and potentially increase state revenues. For example, the Department needs to make faster deposits of intangible tax payments and to be faster and more accurate in processing intangible and corporate tax returns to enable more timely and accurate bills to be issued.

To make further improvements to the tax processing function, the Department should:

- Continue its efforts to implement the imaging system. Once implemented, this new system should help the Department process tax payments and returns more quickly and issue more accurate bills due to fewer data entry errors. In addition, the imaging system may result in cost savings to the state. For example, the Pennsylvania Department of Revenue was able

[4] EDI and imaging technologies decrease the possibility of errors because these technologies eliminate mathematical errors in tax returns and make data entry unnecessary.

[5] Department officials estimate costs for implementing imaging technology to be $3.7 million.

to cut staff by one-third over a period of two years due partly to the implementation of an image-based system. However, even with this new system the Department may still have problems achieving greater efficiency and effectiveness due to a heavy processing workload for intangible and corporate tax payments and returns.

- Consider contracting with private vendors to better manage the peak workload. While the Department has become more timely in processing intangible and corporate tax payments and returns since it began using temporary staff, its performance is still not at desired levels. Outsourcing some tax processing activities may result in potential cost savings and additional revenues for the state. For example, Department of State's Division of Corporations' officials indicated that deposit and data entry costs were lower using a private vendor to perform these activities rather than using the Division's staff for these activities. Other potential benefits of contracting with a private vendor may be faster deposit of payments, which would result in greater interest earnings for the state, and reduced data entry errors. According to Division of Corporations' officials, the private vendor they currently contract with makes same-day deposits of funds and has a lower data entry error rate. Therefore, the Department should request proposals for some or all tax processing activities to determine the cost-effectiveness of privatization. OPPAGA estimates the Department could have generated an additional $242,000 in interest in fiscal year 1995-96 if it deposited intangible tax receipts two days sooner.

- Consider options to help reduce data entry errors. One method to reduce data entry errors, which the Department uses on a limited basis currently, is key verification. This method involves information being entered twice to ensure accuracy. Although this method may be more costly than other verification techniques, its costs may be offset by the costs associated with correcting data entry errors. Another option would be for the Department to contract with a private vendor to perform this function. The advantages to this option are that the Department may monitor performance and establish accuracy standards in the contract.

Chapter 5: Collections

Introduction

The General Tax Administration Program's tax collection function involves four major activities: (1) identifying individuals or businesses that have not paid all the taxes they owe and sending them delinquency notices, (2) collecting unpaid taxes from taxpayers who have received bills or delinquency notices, (3) correcting inaccurate billings, and (4) assessing penalties for untimely tax payment. To identify entities that have not paid the taxes they owe, collections staff use automated systems to find registered taxpayers who have not filed tax returns. They also analyze tax returns to correct inaccurate billings and detect previously undiscovered tax underpayments. To collect unpaid taxes, collections staff try to contact taxpayers by mail, phone, or personal contacts. If taxpayers do not respond to these efforts, staff initiate legal actions such as filing tax warrants to create liens against taxpayers' property or seizing and selling taxpayers' assets. In addition to collecting unpaid taxes, Program staff also assess and collect penalties taxpayers must pay when they do not pay their taxes on time.

Collections staff are located in the central office and in field offices. Central office staff tend to perform the more automated collection activities, such as identifying entities that owe taxes and contacting these entities through automated telephone and written communications systems. Field office staff perform more labor-intensive collection activities, such as making personal contacts and filing tax liens.

Need for State Function

The tax collection function is essential for a successful General Tax Administration Program. Without collection, some taxpayers may not voluntarily pay owed taxes or may remit less than they owe. This could create a situation in which some individuals or businesses could unfairly avoid paying taxes. It also could decrease the amount of revenue raised though the General Tax Administration Program. In fiscal year 1995-96, the tax collection function provided more than $300 million by returning $13.65 for every $1 the state invested in collection activities.

Opportunities for Privatization

Currently, some collection activities are privatized or handled by entities other than the Department of Revenue. The Department currently uses private collection agencies to collect some owed taxes, but it primarily uses these agencies when the amounts to be collected are small (less than $250) or remain unpaid after several collection attempts. In addition, pursuant to 1996 legislation, the Department plans to use local tax collectors in five pilot counties to collect unpaid intangible tax bills for less than $750.

However, the Department could improve its use of outside collection entities by assessing its in-house capacity to perform collection work and referring work that exceeds that capacity. According to Department officials, the Department is unable to pursue all unpaid taxes due to resource limitations. Because sales tax provides the most revenue, the Department focuses its collection effort on unpaid sales tax. This limits its ability to pursue collection of other taxes. For example, Program staff generally do not phone or otherwise contact taxpayers who have unpaid corporate taxes of less than $500 and have not responded to bills or delinquency notices. Furthermore, these cases are not referred to collection agencies. In fiscal year 1995-96, the total value of unpaid corporate taxes was $10.8 million. OPPAGA estimates the Department could have collected approximately $2.7 million of this amount if it had referred unpaid corporate tax accounts to private collection agencies.[6]

Program Performance

Overall, the Department's tax collection performance improved. The primary indicator of collection performance, percentage of billed taxes the Department collected, increased from 62% in fiscal year 1994-95 to 77% in fiscal year 1995-96. As shown in Exhibit 8, collection performance differed by type of tax, with a slight improvement in the collection of owed sales and intangible taxes and a significant improvement in the collection of corporate tax.

[6] OPPAGA's estimate assumes collection of 30% of the $11.3 million unpaid corporate taxes and assumes collection fees totaling 20% of the amount collected.

Exhibit 8
The Percentage of Billed Tax Collected Improved Significantly for Corporate Tax and Improved Slightly for Sales and Intangible Taxes

	Sales Tax	Corporate Tax	Intangible Tax
1994-95	79.9%	32.1%	87.2%
1995-96	83.9%	59.6%	90.6%
Difference	4.0%	27.5%	3.4%

Source: Department of Revenue information about bills issued or created by fiscal year and the amounts paid, corrected, or waived for these bills. The percentage collected reflects the portion of valid billed amounts collected by the Department. This was calculated by dividing total paid amounts by: the value of the original billed amounts, plus accumulated interest, minus bill adjustments.

Additional improvement in collection performance is possible, particularly for corporate and intangible taxes. The Department could further improve the efficiency and effectiveness of its collection activities by:

- Modifying its collection strategy by using aggressive collection techniques for accounts that have a high risk of remaining uncollected;
- Increasing the timeliness with which it sends taxpayers notices of delinquent taxes; and
- Streamlining its penalty assessment and waiver process.

Modifying Collection Efforts to Reflect Collection Risk. The Department does not currently use aggressive techniques to collect taxes owed by taxpayers who pose high collection risks because they are not likely to pay in a timely manner. Instead, Program staff either treat all accounts in the same manner or use aggressive techniques for sales tax accounts or high-value accounts.

However, risk-based collection strategies enable private companies and other states to be more efficient and effective in collecting money owed to them. According to a GAO report, private companies are using information such as past payment histories, age of account, recent account balances, and previous collection actions to forecast the likelihood that debtors will pose serious collection problems.[7] The companies then use aggressive collection techniques, such as phone calls, to collect funds from high risk debtors and less aggressive techniques, such as past-due notices for low risk debtors. Other states also use risk-based

[7] United States General Accounting Office, Tax Administration: New Delinquent Tax Collection Methods for IRS. (GAO/GGD-93-67, May1993).

collection strategies. For example, Minnesota sends accounts that have histories of being collection problems directly to field office staff for collection.

Although it has not yet done so, the Department plans to modify its collection practices. For example, the Department is considering initiating a pilot project to allow central office staff to more quickly refer high-value delinquent sales tax accounts to field offices, which can pursue more aggressive collections techniques. It also intends to implement a campaign to telephone taxpayers who frequently have been late in paying sales taxes. The purpose of the phone calls will be to educate these taxpayers and to collect any taxes they owe.

Improving the Timeliness of Delinquency Notices. Although taxpayers who receive prompt notification of their tax obligations are more likely to pay owed taxes, the Department has not sent timely delinquency notices to taxpayers who are late in paying their corporate or intangible taxes. According to an internal Department study, its chance of collecting taxes that have remained unpaid for two months is 85.2%. After a year, however, this chance drops to 26.6%. According to a GAO report, because timely notification increases the chance of payment, private companies generally strive to contact entities with delinquent accounts within 60 days of the accounts becoming past due.[8] In contrast, the Department generally takes 9 months to identify entities that have not paid their corporate taxes and 13 months to identify entities that have not paid their intangible taxes. According to Department staff, these delays are due to other priorities and to the large volume of delinquent accounts. OPPAGA estimates the Department could have collected approximately $5.3 million in additional revenues if it had sent out delinquency notices for corporate and intangible taxes within six months of the accounts becoming past due.

Streamlining the Assessment and Waiver of Penalties. The procedures the Department uses to assess or waive penalties for violations of tax laws are inefficient. The law requires the Department to assess penalties against taxpayers who do not pay taxes when due. However, the law also authorizes the Department to waive these penalties in certain circumstances. In order to encourage timely payment of taxes, Department rules allow staff to consider a taxpayer's compliance history when they grant waivers. In practice, staff generally waive penalties for taxpayers who have not previously violated tax requirements. This creates inefficiencies because the Department must first prepare and issue

[8] United States General Accounting Office, Tax Administration: New Delinquent Tax Collection Methods for IRS. (GAO/GGD-93-67, May1993).

penalty assessment notices, then review and ultimately waive the penalties. According to central office staff who process penalty assessment notices and waivers, they spend 20% to 50% of their working hours processing penalties and waivers for first-time offenders. If the Department were able to automatically waive penalties for first-time offenders, this staff time could be used for more productive activities, such as sending out delinquency notices.

Conclusions and Recommendations

The General Tax Administration Program's collection function is needed to ensure that taxpayers pay owed taxes. During the past five years, the Department has established various initiatives to improve the collection of owed taxes and has improved its performance in collecting owed sales and corporate taxes. However, the Department could further improve its productivity and efficiency in collecting owed taxes. In order to increase the likelihood of collecting owed taxes, we recommend that the Department:

- Assess its in-house collection capacity and refer accounts in excess of this capacity to collection agencies or county tax collectors. OPPAGA estimates the Department could have collected an additional $2.7 million if it had referred unpaid corporate tax accounts to private collection agencies.[9] The Department should also monitor the collection performance of its staff, collection agencies, and county tax collectors to assess which entities are more effective at collecting various types of liabilities and to ensure its collection efforts are efficient;

- Mail delinquency notices to taxpayers sooner. One way of accomplishing this would be to make greater use of private collection agencies or tax collectors for the more labor-intensive collection activities, such as making personal contacts, and transfer staff currently performing these activities to the organizational units that process delinquency notices.

- Use a risk-based collection strategy by using information such as past payment history and previous collection actions to identify accounts that have a high risk of remaining uncollected and using more aggressive collection techniques for these accounts.

[9] OPPAGA's estimate assumes collection of 30% of the $11.3 million unpaid corporate taxes and assumes collection fees totaling 20% of the amount collected.

In addition, we recommend that the Legislature authorize the Department to waive penalties for taxpayers who have not previously violated tax requirements. This would allow the Department to cease issuing penalty assessment notices for penalties it will later waive. The Department can then transfer some of the staff who handle documents concerning penalties and waivers to more productive activities, such as issuing delinquency notices.

Chapter 6: Audit

Introduction

The General Tax Administration Program not only depends on taxpayers' voluntary compliance with tax laws, it also relies on them to correctly calculate and report their tax liabilities and to keep records supporting their calculations. The audit function provides a means for the Department to check taxpayers' financial records to determine whether they have accurately calculated and reported their tax liabilities. During this process, tax auditors examine and analyze a taxpayer's returns and records. When they discover underreported tax liabilities, they then assess and collect the owed taxes. In fiscal year 1995-96, Department auditors closed 22,988 audits and collected $174.5 million.

The Department only audits a limited number of taxpayer accounts. Since many taxpayers correctly calculate their tax liabilities and remit all the taxes they owe, auditing all taxpayer accounts would be an inefficient use of state resources. Instead the Department must strive to maximize its use of available audit resources by deploying them in a manner that creates a likelihood that any taxpayer could be selected for audit yet produces a high return on investment.

Need for State Function

Auditing is an essential component of the General Tax Administration Program. Without tax audits, taxpayers may inadvertently or intentionally underreport their tax liabilities and thus may not pay all of the taxes they owe. Tax auditing benefits the state in two ways. First, by identifying tax liabilities that have not been accurately reported or voluntarily paid, this activity serves to generate additional funds for the state. In fiscal year 1995-96, tax auditors returned $3.29 for every $1 the state invested in the auditing function. Second, tax auditing improves voluntary compliance with tax laws by encouraging taxpayers to fully disclose and pay owed taxes rather than endure the participation in and consequences of an audit. In addition, tax auditing helps to ensure equal treatment of all taxpayers. Without audits, taxpayers who correctly calculate and pay their full tax liabilities are put at a competitive disadvantage by taxpayers who do not pay all the taxes they owe.

Opportunities for Privatization

The Department has used private sector CPA firms to perform some tax audits, but its use of these firms is limited. Through the Contract Audit Program, the Department certifies private CPA firms as capable of performing tax audits and contracts with these firms to perform tax audits. Currently, the Department makes limited use of the Contract Audit Program. In fiscal year 1995-96, private CPA firms performed 3% of the sales tax audits and did not perform corporate or intangible tax audits.

The Department could increase its use of private CPA firms for sales tax audits. The primary advantages of using private firms are their potential to increase the rate of return of the tax audit function and to increase audit coverage. Although the Department reports that contract auditors' rate of return is slightly lower than that of Department staff, they handle accounts with less potential for recovery than Department auditors. With comparable accounts, the rate of return produced by private sector audits could equal or exceed the rate of return produced by Department audits. The Department should expand its use of private firms if they prove to be cost-effective.

Program Performance

Although the Department has increased the efficiency of the tax audit function, its productivity has declined. Despite an 8% reduction in auditing staff in fiscal year 1995-96, the Department increased audit hours that year by 10.3%. By improving efficiency, the Department increased the auditing function's return on investment. However, the total revenue produced from tax audits decreased by 2.6%, going from $179.2 million in fiscal year 1994-95 to $174.5 million in fiscal year 1995-96. This revenue decrease was due to a lower productivity of the Department's tax auditing efforts. As shown in Exhibit 9, the average revenue recovered for every hour of audit work and the percent of audits resulting in assessments both decreased in fiscal year 1995-96.

Exhibit 9
Tax Audit Productivity Has Declined

	1992-93	1993-94	1994-95	1995-96
Average Revenue Recovered Per Hour	$261	$281	$251	$221
Percent of Audits Resulting in Assessment	74.1%	71.3%	70.9%	69.9%
Return on Investment[1]	$4.42	$4.33	$3.02	$3.29

[1] "Return on Investment" refers to the dollars collected for every $1 spent on the audit function.

Source: OPPAGA analysis of Department of Revenue data.

This decline in audit productivity appears to have resulted from deficiencies in the Department's two primary audit selection strategies:

- Focusing on audits of sales tax accounts, and
- Mandating audits of "very large taxpayers."[10]

Focusing on audits of sales tax accounts. Because sales tax contributes the greatest amount of revenue, the Department focuses its audits on sales tax accounts. This strategy is apparent from the variation in the Department's coverage of tax accounts for the three major taxes. As shown in Exhibit 10, the percentage of sales tax accounts the Department audits is 5 times higher than the percentage of corporate tax accounts and 6.5 times higher than the percentage of intangible tax accounts it audits.

Exhibit 10
Audit Coverage Emphasizes Sales Tax

Coverage	1992-93	1993-94	1994-95	1995-96
Sales Tax	3.4%	3.8%	2.8%	4.0%
Corporate Income Tax	.6%	.5%	.6%	.8%
Intangible Tax	.8%	.7%	.5%	.6%
All Taxes Combined	2.2%	2.3%	1.9%	2.4%

Source: OPPAGA analysis of Department of Revenue data.

However, on average, audits of corporate and intangible tax accounts have higher potential for recovering unpaid taxes than audits of sales tax accounts. In fiscal year 1995-96, the average amount the Department recovered from every hour it audited sales

[10] "Very large taxpayers" are those taxpayers who pay more than $100,000 per year in taxes.

tax accounts was $188, while the average amount recovered for every hour it audited corporate and intangible accounts was $500 and $284, respectively. By shifting audit resources from sales tax accounts to corporate and intangible tax accounts, the Department potentially could increase the audit function's rate of return and total recoveries. For example, if average recoveries remained constant and the Department increased its coverage of corporate tax accounts from 0.8% to 2% percent by decreasing its coverage of sales tax accounts, it would increase the audit function's return on investment from $3.29 to $3.87 and total recoveries from $174.5 million to $205 million.[11]

Conducting audits of all very large taxpayers. The Department's current strategy of routinely conducting audits of all taxpayers who pay more than $100,000 per year in taxes has lost effectiveness over time. When the Department first began auditing all "very large taxpayers" approximately five years ago, the audit function's rate of return and total recoveries increased. However, as more very large taxpayers have begun to voluntarily pay the taxes they owe, this audit selection strategy has lost effectiveness. For example, the percent of very large taxpayer audits resulting in assessment dropped from 81.2% in fiscal year 1994-95 to 74.8% in fiscal year 1995-96. During the same time period, the average amount collected from very large taxpayers whose audits resulted in assessments also dropped from $68,000 to $60,000.

The Department could increase its rate of return and total recoveries by altering this strategy to routinely audit only those very large taxpayers with a recent history of underreporting their tax liabilities. To continue to provide some audit coverage of the remaining very large taxpayers the Department could increase the time period between its audits of those taxpayers or randomly select some of them for periodic audit. Very large taxpayers comprise less than 1% of all taxpayers but account for approximately 70% of tax revenues collected. Therefore, the importance of audit coverage for this pool of taxpayers is underscored by its proportion of tax dollars remitted.

[11] "Return on Investment" refers to the dollars collected for every $1 spent on the audit function.

Conclusions and Recommendations

The General Tax Administration Program's audit function is needed to ensure that taxpayers correctly calculate their tax liabilities and pay owed taxes. Tax audits also help encourage taxpayers to voluntarily comply with tax laws.

The Department has increased the efficiency of the auditing function and is seeking ways of becoming more efficient in the future. For example, the Department has proposed sending out forms to help taxpayers who may not have paid owed taxes. These forms will help these taxpayers correctly compute the taxes they owe. According to Department staff, these taxpayer "self-audits" will help increase audit coverage at minimal cost.

However, the revenue produced by the audit function has declined, and the Department needs to take steps to improve its productivity. To accomplish this, we recommend that the Department alter its audit selection strategies by:

- Shifting audit resources away from less productive sales tax accounts to more productive corporate tax accounts. OPPAGA estimates the Department could have collected $30.5 million in additional revenues if it shifted resources from sales tax to corporate tax. In addition, the Department should continually examine the rate of return it receives from audits of different types of tax accounts and increase coverage for the types of accounts that produce the highest return. This should not only result in the recovery of more revenues, it should also focus audit resources on those taxpayers who need the greatest encouragement to voluntarily comply with tax laws.

- Reevaluating its policy to routinely audit all very large taxpayers. In its 1997-98 Compliance Review Work Plan, the Department recognized that it needed to change this strategy by reviewing the audit worthiness of very large taxpayer accounts before selecting these accounts for audits. The Department also has developed initiatives to develop taxpayer profiles it can use to increase the likelihood that it will recover unpaid taxes from the accounts it selects for audit and has purchased databases to automate the audit selection process.

In addition, the Department should further explore the potential of increasing the auditing function's rate of return through privatization. In doing this the Department should have CPA firms audit tax accounts that have the same potential for recovery as those audited by Department staff and compare their respective rates of return.

Chapter 7: Compliance Enforcement

Introduction

The General Tax Administration Program's compliance enforcement process involves three activities: enforcement operations, registration compliance enforcement, and investigations. Enforcement operations consists of specialized efforts designed to identify and collect owed taxes from registered or unregistered taxpayers. For example, enforcement operations efforts are aimed at collecting owed sales tax on imported items and expensive purchases such as boats, aircraft, and recreational vehicles, and at collecting owed fuel taxes on the unreported or underreported fuel used in Florida. Registration compliance enforcement staff are responsible for identifying and collecting sales tax from unregistered taxpayers through various efforts, such as canvassing flea markets, malls, and other businesses. Investigations staff are responsible for conducting investigations of suspected criminal tax violations and pursuing criminal and civil sanctions of tax violators. In fiscal year 1995-96, Department compliance enforcement staff contacted 270,000 taxpayers and closed approximately 4,600 cases.

Need for State Function

Compliance enforcement activities are needed because they serve to induce taxpayers to voluntarily comply with the state's tax laws, to ensure fairness for honest taxpayers by making tax cheats pay owed taxes, and to generate additional revenues for the state. These activities have had some positive results. For example, of the contacts made by compliance enforcement staff for the period of July 1, 1996, through December 31, 1996, 5% resulted in previously unregistered taxpayers being registered with the Department and 24% resulted in the collection of owed taxes. The Department has consistently collected more revenues from compliance enforcement activities than the state has spent on compliance enforcement operations. For example, collections from compliance enforcement activities in the first six months of fiscal year 1996-97 recovered $5.59 for every $1 it cost the state to fund compliance enforcement operations.

Opportunities for Privatization

While the compliance enforcement function is necessary, some of its activities could be performed by private vendors instead of state employees. For example, private investigative agencies could conduct investigation activities currently done by Program staff. Privatizing enforcement activities may be less costly than using state employees; however, Department officials are concerned that private agency personnel may not have the tax law expertise needed to educate taxpayers. If the Department pursues privatizing this function it should ensure that the request-for-proposal specifies the level of experience and knowledge needed by private agency personnel.

Program Performance

The compliance enforcement function's productivity has been inconsistent since fiscal year 1994-95. As shown in Exhibit 11, the compliance enforcement function's productivity for fiscal year 1995-96 increased compared to the prior year. However, Department data for the first half of 1996-97 indicates productivity has decreased to earlier performance levels.

Exhibit 11
Average Return on Investment
From Compliance Enforcement Activities

	Fiscal Year		July 1996 -
	1994-95	**1995-96**	**December 1997**
Enforcement Operations	$8.45	$12.58	$7.93
Registration Compliance	6.30	9.62	6.97
Investigations	.78	1.53	1.20
Compliance Enforcement Return on Investment[1]	**$5.63**	**$8.38**	**$5.59**

[1]"Return on Investment" refers to the dollars collected for every $1 spent on the compliance enforcement function

Source: OPPAGA analysis of Department of Revenue data.

The primary reason for inconsistent enforcement productivity is that the Department has not developed an effective strategy for allocating limited available enforcement resources. Currently, the Department seeks to provide enforcement coverage in many areas in order to ensure an overall enforcement "presence" rather than focus on fewer but potentially more productive areas. The Department uses minimal resources in some activities that could be potentially more productive, such as reviewing invoices from items imported through shipping and air freight methods.

According to Department officials, individuals and businesses may be purchasing products from out-of-state vendors and shipping the products by air or ship in a deliberate attempt to defraud the state. Therefore, it may be worthwhile for the Department to pursue enforcement activities in these areas. The Department is in the process of developing a workload planning model that will enable it to target enforcement resources to achieve a greater return on enforcement resources.

Conclusions and Recommendations

Historically, compliance enforcement activities have generated more revenues for the state than their operating costs. However, the Department could generate even more revenues if it used existing resources more efficiently. For example, the Department could shift existing resources to areas that have the potential to be more productive, such as shipping and air freight.

To maximize its return on enforcement resources, the Department is currently developing a plan that would target resources in areas that have the greatest potential for collecting owed taxes. In developing this plan, the Department should consider whether contracting with private vendors would be cost-effective and which Program activities, if any, could be better performed by the private sector.

The Department is also currently in the process of reviewing its methods for selecting enforcement cases. We believe the Department needs to develop alternative case selection methods to ensure that limited resources are not used to pursue unproductive cases.

Chapter 8: Adjudication

Introduction

Adjudication is an informal appeal process taxpayers can use to resolve any tax disputes they may have with the Department. These disputes commonly arise when taxpayers perceive an ambiguity in the law or disagree with the Department's policies or interpretation of the law. Taxpayers may settle disputes informally by requesting adjudication or formally by making an appeal to circuit court or the Division of Administrative Hearings. Because of the time and expense associated with formal appeals, the adjudication process was established in 1981 to save the state and the taxpayer time and money.

The adjudication process consists of two phases. First, audit or collection staff review the case and attempt to settle the dispute. These reviews resolve approximately 15% of all adjudication cases. Second, professional appeals staff hear the case and decide on the Department's final position. Appeals staff attempt to fairly interpret tax law, and their decisions may support the taxpayer's position, the Department's position, or a compromise position. Approximately 95% of adjudication cases are settled without the need for formal litigation.

Need for State Function

Adjudication is not an essential General Tax Administration function, but it provides significant benefits to both the taxpayer and the Department because it enables them to resolve disputes at little expense. Adjudication costs significantly less than the cost of formal court or administrative appeals. For example, the state's cost for informal adjudication averages about $700 per case, while its cost for formal tax appeals averages about $5,000 per case. Since very few adjudication cases are further appealed, adjudication saves the state a significant amount of money.[12] If adjudication were eliminated and all adjudicated cases went to formal court or administrative proceedings, the state's cost for these cases would increase by approximately $10 million a year. Taxpayers' costs would also rise. According to attorneys who routinely handle tax cases, the legal fees taxpayers incur for

[12] Taxpayers file about 2,400 adjudication cases each year. In 1996, only 140 cases were settled through formal litigation.

adjudication are significantly less than fees they incur for formal appeals.

Not only does adjudication avoid costs, it also saves time. Currently, the average time taken to settle a case through adjudication is about 5 to 6 months. In contrast, the average time taken to settle a case through a formal administrative or court appeal is about 18 months. However, these time frames are affected by the resources available to handle cases. Thus, any reduction in funding for adjudication with no corresponding reduction in case load will likely increase the average time needed to settle cases, inconveniencing both the taxpayer and the state.

Program Performance

Over the last two years, the efficiency of the adjudication process has improved. The Department has significantly reduced the time to settle an adjudication case with little change in staffing or incoming case load. The Department reports that the average number of days to resolve a protest case for disputes involving all taxes decreased from over 300 days to under 200 days.

To improve efficiency and effectiveness of the adjudication process, Department staff automated some of the documentation related to processing a case. In addition, the Department is developing an automated case management system to better track and manage cases. Although this new system will improve the Department's ability to manage cases, it may not dramatically lower the average time needed to process a case. According to adjudication staff, the time needed to process cases probably cannot be further reduced to any great extent without impinging on quality or taxpayer rights.

Conclusions and Recommendations

The adjudication process is fulfilling its intended purpose and should be retained. The Department's recent improvement in timeliness of adjudication cases has further enhanced its value as an alternative to formal appeal. Nevertheless, the Department should be alert for additional process efficiencies and continue to monitor the timeliness and cost of the adjudication process.

Appendices

Appendix A
Statutory Requirements for Program Evaluation and Justification Reviews

Section 11.513(3), F.S., provides that the OPPAGA Program Evaluation and Justification Review shall be conducted on major programs, but may include other programs. As provided by law, our reviews address the following issues:

- The identifiable cost of each program;
- The specific purpose of each program, as well as the specific public benefit derived therefrom;
- Progress towards achieving the outputs and outcomes associated with each program;
- An explanation of circumstances contributing to the state agency's ability to achieve, not achieve, or exceed its projected outputs and outcomes, as defined in s. 216.011, F.S., associated with each program; and
- Alternative courses of action that would result in administering the program more efficiently or effectively.

Exhibit A-1 identifies the specific issues that the law requires that we consider in our Program Evaluation and Justification Reviews and summarizes our conclusions pertaining to the General Tax Administration Program. As appropriate, the exhibit makes references to pages in this report and our earlier Performance Report (OPPAGA Report No. 96-56) where our analysis is discussed at greater length.

Exhibit A-1
Summary of the Program Evaluation and Justification Review of the General Tax Administration Program

Issue	OPPAGA Conclusions
The identifiable cost of each program.	The Program was appropriated $121 million for operations for fiscal year 1996-97. Non-operational appropriations were for pass through of DOR collected local taxes.
The specific purpose of the program, as well as the specific public benefit derived therefrom.	The Program's purpose is to fairly, efficiently and impartially administer the revenue laws of the state. The Department administers the collection of 38 different taxes totaling over $20 billion which funds many of the state's programs.

(Continued on next page)

Issue	OPPAGA Conclusions
Progress toward achieving the outputs and outcomes associated with each program.	The Program's performance measures indicate the General Tax Administration Program has gained some efficiency in its tax processing. However, the performance measurement system needs improvement. (See OPPAGA Report No. 96-56.)
An explanation of circumstances contributing to the state agency's ability to achieve, not achieve, or exceed its projected outputs and outcomes, as defined in s. 216.011, F.S., associated with the program.	(See OPPAGA Report No. 96-56.)
Alternative courses of action that would result in administering the program more efficiently and effectively • Whether the program could be organized in a more efficient and effective manner, whether the program's mission or goals, or objectives should be redefined, or, when the state agency cannot demonstrate that its efforts have had a positive effect, whether the program should be reduced in size or eliminated. • Whether the program could be administered more efficiently or effectively to avoid duplication of activities and ensure that activities are adequately coordinated. • Whether the program could be performed more efficiently or more effectively by another unit of government or a private entity, or whether a program performed by a private entity could be performed more efficiently and effectively by a state agency. • When compared to costs, whether effectiveness warrants elimination of the program or, if the program serves a limited interest, whether it could be redesigned to require users to finance program cost. • Whether the cost to administer the program exceeds license and other fee revenues paid by those being regulated. • Whether other changes could improve the efficiency and effectiveness of the program.	The General Tax Administration Program's efficiency and effectiveness could be improved by: • More consistently using the results of its taxpayer education and assistance studies to improve performance. (See pages 6 - 9.) • Increasing the timeliness in informing taxpayers of changes in tax administration requirements and response to written taxpayer inquires. (See pages 6 - 9.) • Making faster deposits of intangible tax payments. (See pages 11 and 12.) • More accurately and timely processing intangible and corporate tax returns to enable more timely and accurate bills to be issued. (See pages 12 and 13.) • Referring accounts to contract collection agencies that exceed internal collection capacity. (See pages 17 - 19.) • Using contract collectors for the more labor intensive collection activities. (See page 17.) • Using a risk-based collection strategy. (See pages 18 and 19.) • Exploring which accounts the Department assigns to private auditors. (See page 23.) • Altering its audit selection strategy by shifting efforts to more productive tax accounts and reevaluating its "very large taxpayer" audit priorities. (See pages 24 and 25.) • Shifting compliance enforcement efforts to more productive areas. (See pages 28 and 29.) • Providing alternative compliance enforcement case selection methods. (See pages 29.)
The consequences of discontinuing such program.	Eliminating the Program would significantly restrict funding for public programs, such as education, corrections, and social services.
Determination as to public policy, which may include recommendations as to whether it would be sound public policy to continue or discontinue funding the program, either in whole or in part, in the existing manner.	It is sound public policy to continue funding this Program. This function is necessary to support other state government programs.
Whether the information reported pursuant to s. 216.031(5), F.S., has relevance and utility for the evaluation of each program.	Some performance measures are not comprehensive or valid. (See OPPAGA Report No. 96-56.)
Whether state agency management has established control systems sufficient to ensure that performance data are maintained and supported by state agency records and accurately presented in state agency performance reports.	Some measures reported inaccurate performance data and most measures have unreasonable standards. (See OPPAGA Report No. 96-56.)

Appendix B

Glossary of Major Taxes Collected by the Department of Revenue

Type of Tax	1995-96 Collections	Generally, What Taxed	How Collected
Sales and Use (Sales tax if purchased in-state. Use tax if brought into the state for use but untaxed or under taxed at origin)	**$11.930** *billion*	Tangible property, admissions, and some services. Exemptions include groceries, many professional services, and medical items.	Sales tax by retailer. Use tax directly remitted to the Department by user.
Fuel, and Fuel Related (e.g., motor fuel, gasohol, aviation fuel, pollutants, local option gas taxes)	**$2.192** *billion*	Motor fuels	Terminal suppliers, importers, and wholesalers.
Corporate Income	**$1.143** *billion*	Corporate income	Directly by the Department from each corporation
Intangible (stocks and mortgages)	**$878** *million*	Accounts or documents that represent value of ownership	From each citizen or business entity
Documentary Stamp	**$772** *million*	Recorded documents that deal with financial transactions	Usually through the document recorder or an approved agent for the Department.
Gross Receipts	**$551** *million*	Utilities	Utility entities, private and public
Estate	**$421** *million*	Estates of deceased	Administrator of estate
Insurance	**$356** *million*	Insurance premiums	Insurance companies

Source: Developed by OPPAGA.

Appendix C
Response From the Department of Revenue

In accordance with the provisions of s. 11.45(7)(d), F.S., a list of preliminary and tentative review findings was submitted to the Executive Director of the Department of Revenue for his review and response.

The Department's written response is reprinted herein beginning on page 37.

June 26, 1997

Mr. John W. Turcotte
Director
Office of Program Policy Analysis
and Government Accountability
Post Office Box 1735
Tallahassee, Florida 32302

Dear Mr. Turcotte:

We appreciate the opportunity to respond to the Program Evaluation and Justification Review of the Department of Revenue's General Tax Administration Program. Unbiased external reviews, such as those prepared by the Office of Program Policy Analysis and Government Accountability, are valuable feedback in the Department's continued efforts to operate more efficiently and effectively.

In general, we are pleased with OPPAGA's findings that the Department ". . . has improved the efficiency and effectiveness of the General Tax Administration program." In this respect, we believe that the findings validate our strategic and tactical initiatives to increase voluntary compliance, reduce the burden on taxpayers, and to continually improve the way we do business. The OPPAGA report also validates our efforts to take advantage of advanced technological opportunities, such as the development of the SUNTAX integrated tax system and imaging.

We agree on the need to constantly monitor performance to improve productivity, and will continue to do so. We currently use performance measures, allocation models, and workload plans to deploy resources in a cost-effective manner while maximizing return on investment. One example is the leveraging of our audit resources. By using a combination of both public and private auditors, enhanced case selection, and techniques such as managed and self audits, we are expanding coverage and increasing recoveries.

We agree with OPPAGA's recommendations to assess the cost-effectiveness of many of our processes and to consider opportunities for privatization of selected functions when it makes good business sense. We currently use privatized collection and audit services, and have partnered with the private sector for our EFT, EDI, and Telefile programs. We are in the process of benchmarking the cost-effectiveness of our core processes specifically in relation to "return-on-investment." Additionally, we are taking a leadership role in a national effort to determine benchmarks and "best-practices" for all state revenue agencies. We also plan to issue RFP's during fiscal year 1997-98 to ascertain which processes might be more efficiently performed by the private sector.

We agree with the OPPAGA findings to continue to utilize and expand our use of technology (e.g., imaging) to support our tax remittance and return processing functions. In accordance with OPPAGA's recommendation, we will consider contracting with private vendors, but only if it proves to be cost-effective to do so. For instance, OPPAGA states that New York estimates a savings of 17% via the outsourcing of these processes, but fails to point out that the Florida Department of Revenue currently processes documents at one-half the cost of the privatized New York processing system. It should also be noted that six state agencies have opted to utilize the Florida Department of Revenue's services to process their workloads.

We agree with OPPAGA's conclusions that improvements were needed in the timeliness of informing taxpayers of changes to filing requirements, and we have already taken steps to do so. During the past fiscal year, new procedures were put into place to better coordinate the issuance of Taxpayer Information Publications to insure that taxpayers are more timely notified of changes in tax requirements.

We agree with the importance of improving the accuracy and timeliness of the issuance of bills as pointed out by OPPAGA. We believe the implementation of the imaging system will provide those improvements in the coming year. OPPAGA's Exhibit 5 displays the already significant gains made by the Department in the timely issuance of bills over the last three years: Sales Tax - 23% improvement; Corporate Tax - 37% improvement; and Intangible Tax - 54% improvement.

We also agree with OPPAGA's recommendation that legislation be enacted to authorize automatic waiver of penalties for taxpayers who have not previously violated tax requirements. We currently take such action by rule upon request from the taxpayer. We strongly believe that enforcement efforts should be directed primarily at habitually non-compliant taxpayers and that taxpayers who are honestly attempting to comply should not be unduly burdened. The provision of an automatic penalty waiver, when applicable, will allow us to shift enforcement and collection resources toward the non-compliant taxpayers.

We agree that audit productivity has declined when compared to fiscal 1992-93 and 1993-94. OPPAGA, however, fails to recognize that those years display the initial results of our strategy to audit all of the "very large taxpayers," and represent the highest historical recoveries from the audit program. We believe the strategies to concentrate resources on these largest taxpayers, and a pro-active approach to taxpayer education, are indeed having the desired impact of increasing voluntary compliance. Such an effect would naturally result in the appearance of declining audit productivity when measured only by direct audit recoveries.

OPPAGA's Exhibit 8 supports the conclusion that our current selection strategy has resulted in an increase in voluntary compliance, as evidenced by the percent of audits resulting in an assessment which has had a steady decline over the past four years. Additionally, we believe the current strategy to cyclicly audit the largest taxpayers is sound in that this policy provides assurance to the Legislature that approximately 80 percent of the Florida revenue base is regularly verified.

We disagree with the OPPAGA finding that an additional $30.5 million in audit recoveries would be obtained through ". . . increas(ing) its audit coverage of corporate income tax accounts from 0.8% to 2%." Current selection strategy and methodology already provides for the review and scrutiny of 100% of the corporate tax returns for recovery potential. Increasing the number of corporate tax audits would only result in an increase in the number with little probability of additional recovery. The outcome could be a less cost-effective deployment of resources than is currently the case.

OPPAGA's Comment

Irrespective of the executive director's comment, the Department's 1997-98 Compliance Review Work Plan indicates that "small shifts in the allocation of direct time from sales and use tax standard coverage taxpayers to other taxes . . . (would result in) extraordinary benefits in terms of assessments (and) payments per hour." We agree with the analysis and conclusions made in the 1997-98 Compliance Review Work Plan.

Once again, we appreciate the thoroughness of your review and report, and look forward to working with OPPAGA in our cooperative effort to continually improve the General Tax Administration Program.

Sincerely,
/s/ Jim Zingale (for)
L. H. Fuchs

LHF/mo