

MINNESOTA • REVENUE

January 25, 2005

To the 2005 Legislature:

On behalf of Governor Pawlenty, I am pleased to submit the Department of Revenue's recommendation for the FY 2006-07 budget. This budget consists of \$198.262 million from the state's General Fund and \$12.184 million from other funds.

The department's budget includes a cut of \$6 million from the FY 2004-05 budget for support activities, and an increase of \$13.296 million for stepped-up tax enforcement activities that are expected to generate an added \$67.9 million in state revenue. In the absence of the increase in funds for new tax enforcement activities, the department's budget represents a reduction of about 3% from the FY 2004-05 budget.

Overall, this budget simultaneously makes cuts in the budget, generates additional revenue through increased tax enforcement and preserves current tax revenue-producing enforcement and support activities.

The resources the department is requesting, \$198.3 million for the biennium, permits us to achieve our mission of "making the revenue system work well for Minnesota."

To advance this mission, the department will continue to carry out its core functions:

- providing taxpayers with the services and information they need to meet their filing and paying obligation, including forms and instructions and telephone assistance;
- processing returns and payments, issuing refunds and managing taxpayer accounts;
- auditing to resolve discrepancies, discourage tax evasion and identify patterns of noncompliance;
- enforcing the tax laws for those who do not comply voluntarily; and
- identifying and recommending improvements to the revenue system.

The Governor's budget recommendation will allow us to continue performing these activities to ensure that citizens have the services they need to fulfill their tax obligations; the information they need to make informed decisions about their tax obligations; and confidence that the system is fair to all citizens.

The Department of Revenue's operational budget request includes two separate components.

Operating Budget Reduction

This budget request appropriates \$191.1 million over the biennium for current operations. This represents a \$6.0 million reduction in basic operations or a 3% reduction in resources from the previous biennium. In planning this reduction, the department preserved tax auditing, non-filer detection, criminal investigation and delinquent tax collection activities for all tax types. These activities are essential in order to forestall losses in the state's revenue. These revenue-producing activities make up the bulk of the agency's budget.

The department will make its reduction in activities that do not have a direct impact on state revenue collections. Briefly, these reductions include:

- cuts in technology development and infrastructure investments; and
- reductions in office rents for facilities that are not designated revenue-producing activities.

The department will still focus on four principal goals designed to improve filing and paying systems for citizens and businesses, increase revenues through expanded compliance, and deliver services at lower costs. The four goals are:

1. Continuing to transform tax filing and paying from high-cost paper processes to cost-saving electronic transactions. E-filing also increases the speed, accuracy, convenience and ease of taxpayer transactions.

2. Creating web-based self-service systems to enable taxpayers to get the information they need to file and pay their taxes, monitor the status of their refund or payment, make corrections to their records and view their filing and payment history.
3. Continuing to improve existing tax audit and collection efforts to generate added revenues from citizens and businesses that evade or under pay their tax.
4. Modernizing the tax system to keep pace with changes in the economy, demographics and technology. This includes making it easier for retailers, especially internet based and mail order companies, to collect and pay the state's sales and use tax obligations.

New Compliance Activities

Our budget proposal also requests an appropriation of \$13.3 million for new tax auditing and enforcement activities. This investment will generate \$67.9 million in additional revenues in the next biennium. These compliance activities will be similar to those funded in the prior two biennia, which were extremely successful.

In the 2002-03 biennium, the department was appropriated \$9.7 million to generate \$60.1 million through increased tax compliance activities. Those efforts generated \$97.2 million, or \$37.1 million more than expected. The department also received \$12.8 million in the 2004-05 biennium to generate an added \$59.8 million. As of December 1, 2004, this effort has generated \$63.9 million, or \$4.9 million more than anticipated with seven months remaining in the biennium.

In summary, the department intends to assist in solving the state's current budget problem by making reductions in tax compliance support activities and by raising significant new revenues through additional tax enforcement activities.

Respectfully,



Daniel A. Salomone
Commissioner

Dollars in Thousands

	Current		Governor Recomm.		Biennium
	FY2004	FY2005	FY2006	FY2007	2006-07
<u>Direct Appropriations by Fund</u>					
General					
Current Appropriation	89,669	93,683	93,683	93,683	187,366
Recommended	89,669	93,683	95,869	98,593	194,462
Change		0	2,186	4,910	7,096
% Biennial Change from 2004-05					6.1%
Health Care Access					
Current Appropriation	1,693	1,654	1,654	1,654	3,308
Recommended	1,693	1,654	1,654	1,654	3,308
Change		0	0	0	0
% Biennial Change from 2004-05					-1.2%
Highway Users Tax Distribution					
Current Appropriation	2,097	2,097	2,097	2,097	4,194
Recommended	2,097	2,097	2,097	2,097	4,194
Change		0	0	0	0
% Biennial Change from 2004-05					0%
Environmental					
Current Appropriation	0	291	291	291	582
Recommended	0	291	291	291	582
Change		0	0	0	0
% Biennial Change from 2004-05					100%
<u>Expenditures by Fund</u>					
Direct Appropriations					
General	85,271	97,601	95,869	98,593	194,462
Health Care Access	1,509	1,838	1,654	1,654	3,308
Highway Users Tax Distribution	1,999	2,195	2,097	2,097	4,194
Environmental	0	313	291	291	582
Open Appropriations					
General	1,856	1,900	1,900	1,900	3,800
Statutory Appropriations					
Special Revenue	2,409	2,960	2,050	2,050	4,100
Environmental	353	0	0	0	0
Total	93,397	106,807	103,861	106,585	210,446
<u>Expenditures by Category</u>					
Total Compensation	71,059	75,893	79,580	81,607	161,187
Other Operating Expenses	21,649	30,146	23,616	24,313	47,929
Capital Outlay & Real Property	592	665	665	665	1,330
Local Assistance	97	103	0	0	0
Total	93,397	106,807	103,861	106,585	210,446
<u>Expenditures by Program</u>					
Tax System Management	77,161	88,815	85,473	87,567	173,040
Debt Collection Management	16,236	17,992	18,388	19,018	37,406
Total	93,397	106,807	103,861	106,585	210,446
Full-Time Equivalent (FTE)	1,129.7	1,185.5	1,139.5	1,095.3	

<i>Dollars in Thousands</i>				
	FY2005	Governor's Recomm.		Biennium
		FY2006	FY2007	2006-07
Fund: GENERAL				
FY 2005 Appropriations	93,683	93,683	93,683	187,366
Technical Adjustments				
One-time Appropriations		(100)	(100)	(200)
Subtotal - Forecast Base	93,683	93,583	93,583	187,166
Change Items				
Enhanced Tax Compliance Initiative	0	5,786	7,510	13,296
Operating Reduction	0	(3,500)	(2,500)	(6,000)
Total Governor's Recommendations	93,683	95,869	98,593	194,462
Fund: HEALTH CARE ACCESS				
FY 2005 Appropriations	1,654	1,654	1,654	3,308
Subtotal - Forecast Base	1,654	1,654	1,654	3,308
Total Governor's Recommendations	1,654	1,654	1,654	3,308
Fund: HIGHWAY USERS TAX DISTRIBUTION				
FY 2005 Appropriations	2,097	2,097	2,097	4,194
Subtotal - Forecast Base	2,097	2,097	2,097	4,194
Total Governor's Recommendations	2,097	2,097	2,097	4,194
Fund: ENVIRONMENTAL				
FY 2005 Appropriations	291	291	291	582
Subtotal - Forecast Base	291	291	291	582
Total Governor's Recommendations	291	291	291	582
Fund: GENERAL				
Planned Open Spending	1,900	1,900	1,900	3,800
Total Governor's Recommendations	1,900	1,900	1,900	3,800
Fund: SPECIAL REVENUE				
Planned Statutory Spending	2,960	2,050	2,050	4,100
Total Governor's Recommendations	2,960	2,050	2,050	4,100
Revenue Change Items				
Fund: GENERAL				
Change Items				
Enhanced Tax Compliance Initiative	0	26,200	41,800	68,000

REVENUE DEPARTMENT

Change Item: Enhanced Tax Compliance Initiative

Fiscal Impact (\$000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	\$5,786	\$7,510	\$7,510	\$7,510
Revenues	26,200	41,800	41,800	41,800
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact *	(\$20,414)	(\$34,290)	(\$34,290)	(\$34,290)

* Net Fiscal Impact is expenditure changes minus revenue changes. A positive Net Fiscal Impact is either an expenditure increase or a revenue decrease. A negative Net Fiscal Impact is either an expenditure reduction or a revenue increase.

Recommendation

The Governor recommends an appropriation of \$5.786 million in FY 2006 and \$7.510 million in FY 2007 to support 105 additional FTE to identify and collect tax liabilities from individuals and businesses that currently under-report their tax liabilities or do not file and pay at all.

Background

The first goal in the department's strategic plan is that everyone pays the right amount of tax, no more, no less. However, there are a significant number of individuals and businesses with Minnesota tax liability that do not pay all that is owed or do not file or pay anything. To create a fairer tax system for all taxpayers and to level the playing field for all businesses, these "under-reporters" and "non-filers" will be identified and brought permanently onto the tax rolls. Department of Revenue (DOR) wants to increase its focus on taxpayers that are furthest from compliance, with a special emphasis on businesses using Foreign Operating Corporation (FOC) status inappropriately.

Relationship to Base Budget

This change item will be funded by an on-going General Fund appropriation. The eventual \$7.51 million increase represents approximately 7.5% of the department's current General Fund appropriation. However, the increased appropriation will lead to additional General Fund tax collections well in excess of on-going funding. In conjunction with recent reductions in indirect compliance activities, this change item continues to reshape the department's budget by placing more emphasis on direct compliance activities. This initiative will have much greater impact than traditional one-time compliance initiatives by providing on-going revenue to the General Fund.

Key Measures

DOR will monitor the activities funded under this change item and will report the results to the legislature as part of the 2007 budget process. We fully expect to meet or exceed the performance outcome identified above. Performance Measures include:

- ◆ return on investment (revenues to expenditures);
- ◆ new businesses and individuals brought into the tax system; and
- ◆ cases resolved.

Alternatives Considered

The department considered many different types and configurations of compliance initiatives. The activities we have planned will derive the greatest revenue-to-expenditure ratio on a long-term basis.

REVENUE DEPARTMENT

Change Item: Operating Reduction

Fiscal Impact (\$000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	(\$3,500)	(\$2,500)	(\$2,500)	(\$2,500)
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	(\$3,500)	(\$2,500)	(\$2,500)	(\$2,500)

Recommendation

The Governor recommends a General Fund budget reduction of \$3.5 million in FY 2006 and \$2.5 million in FY 2007 (3.2%) for the Department of Revenue (DOR).

Background

The proposed reduction will be made in two areas, neither of which is directly related to the department's growing emphasis on enforcing tax compliance.

- ⇒ Rents and leases. In FY 2006-07, the department will return \$2 million in savings related to rents and leases. The largest portion of that will be a one-time \$1.6 million reduction in rent due to a surplus of funds in the Department of Administration's building account for 600 North Robert Street. In FY 2008-09, the savings are expected to be \$.5 million per year as the department's conversion to electronic filing allows it to reduce the amount of space required for storage of paper records.
- ⇒ Computer hardware and systems. The balance of the reduction (\$2 million per year) will be made by delaying the purchase of computer hardware and software systems. While there are risks associated with aging equipment and systems, the department is making every effort to maintain the integrity of its highest priority activities—those that relate to ensuring full compliance with Minnesota's tax laws.

Relationship to Base Budget

The apportionment of the department's budget between voluntary and enforced tax compliance has been shifting over time. Prior to 2002, 52% of the budget was committed to taxpayer services that support voluntary compliance by citizens and businesses. It is worth noting that 90% to 95% of the state's revenues are collected through voluntary compliance. As additional funds have been appropriated for enforced compliance (tax auditing and enforcement activities) and reductions have been made in service and processing activities, the portion of the budget devoted to voluntary compliance is now closer to 37% (c. \$80 million).

Key Measures

- ◆ service-level indicators; and
- ◆ customer surveys.

Alternatives Considered

The agency considered reductions in direct compliance activities, but rejected them because of their negative impact on General Fund revenue collections.

Agency Purpose

The Department of Revenue's mission "is to make the state's revenue system work well for Minnesota." Its tax information, filing and paying services, and enforcement activities help ensure that citizens have the information and means to fulfill their tax obligations.

Core Functions

The Department of Revenue oversees Minnesota's revenue system, which is made up of 28 state taxes and property taxes collected by local governments. State taxes include individual income, sales, corporate franchise, petroleum, environmental, gambling, cigarette and tobacco, beer, wine, liquor, insurance and health care provider taxes.

The department collects approximately \$13.7 billion per year in state taxes, and oversees the uniform application of the property tax laws. Property taxes, which are administered by local governments, raise \$5 billion annually for Minnesota's communities. The department also pays out over \$1 billion in state aid through 32 different state programs to counties, cities, towns and special taxing districts.

The department's six goals are:

- ⇒ *Achieving taxpayer compliance*: everyone is paying the right amount of taxes, no more, no less.
- ⇒ *Citizen satisfaction*: citizens have the services and information they need to meet their obligations and to be informed about the tax system.
- ⇒ *Customer satisfaction*: taxpayers have filing, paying and refund systems that are fast, convenient, easy to use, secure and accurate.
- ⇒ *Operational excellence*: the revenue system keeps pace with changes in the economy and in technology.
- ⇒ *Responsible stewardship of information*: taxpayers trust us to protect their data.
- ⇒ *Employee excellence*: employees perform meaningful and challenging work, and have opportunities to learn and grow.

In support of these goals, we carry out the following core functions:

- ◆ Interpreting the law and informing taxpayers of their obligations and rights;
- ◆ Providing taxpayers with the services and information they need to meet their filing and paying obligations;
- ◆ Processing returns and payments, issuing refunds, and managing taxpayer accounts;
- ◆ Auditing to resolve discrepancies, discourage tax evasion, and identify levels and patterns of noncompliance;
- ◆ Enforcing the tax laws for those who do not comply voluntarily; and
- ◆ Identifying and recommending improvements to the revenue system.

Tax Compliance and Enforcement Operations

Tax Compliance and Enforcement activities include Individual Taxes, Business Taxes, Collections and Criminal Investigations.

- ◆ **Individual Taxes** serves 3.5 million individual income tax payers, 165,000 businesses that withhold income tax, and 500,000 property tax refund claimants.
- ◆ **Business Taxes** serves 260,000 sales tax permit holders and 52,000 corporate franchise taxpayers. This program also administers the S corporation, partnership, fiduciary and estate taxes; the petroleum tax; special taxes, including alcohol, tobacco, environmental, gambling, insurance, mining and MinnesotaCare taxes.

At A Glance

We serve:

- ◆ 3.5 million individual taxpayers
- ◆ 165,000 withholding taxpayers
- ◆ 480,000 taxpayers that remit corporate, sales and use, fiduciary and other taxes
- ◆ 3,400 local units of government
- ◆ 37,000 emails received
- ◆ Over 500,000 callers

We process:

- ◆ 2.4 million income tax returns
- ◆ 1.2 million business tax returns
- ◆ 4.3 million tax payments
- ◆ 2.5 million tax refunds

We collect:

- ◆ \$13.7 billion in tax revenues and other revenue sources
- ◆ \$36 million from 150,000 offsets against state refunds

- ◆ **Collections** manages tax and nontax debt collection on behalf of the department and other clients, including state agencies and other public entities. Services include locating and contacting debtors, billing, monitoring payment plans, locating and evaluating assets, issuing liens and levies, and seizing assets.
- ◆ **Criminal Investigations** investigates possible tax crimes and refers cases to prosecutors.

Tax Compliance Support Operations

Information Technology includes strategic planning for developing and integrating technologies and systems into business operations; computer systems development; software management; and oversight and maintenance of the agency's computer network, systems and equipment.

Tax Filing and Payment processes close to 8 million tax returns and payments, and issues 2.5 million refunds annually; it also issues tax identification numbers to businesses, manages taxpayer records, and ensures the security of taxpayer records.

Tax Research, Property Tax, and Appeals and Legal Services includes:

- ◆ Forecasting revenue sources and aid expenditures for the state budget, and developing revenue estimates for proposed tax legislation;
- ◆ Providing legal support to the agency and resolving tax disputes between the department and taxpayers; and
- ◆ Monitoring local assessor performance, ensuring uniform application of Minnesota's property tax laws, gathering property tax data and computing state aid payments to local governments.

Administrative Support provides mail distribution and receiving services; forms design, public information, website management and printing services; financial management; human resource management; and other administrative functions on behalf of the department. These functions support tax auditing and enforcement operations.

Budget

The department's budget in FY 2004-05 totals \$194.9 million. Department staff includes 1,125 full-time equivalent employees. Of the total budget for the biennium, \$182.9 million (93.9%) comes from General Fund tax dollars, \$8.2 million (4.1%) comes from dedicated funds and \$3.8 million (2%) comes from special revenue funds for administering the Local Option Sales Tax and Revenue Recapture program.

Contact

Department of Revenue
600 North Robert Street
Saint Paul, Minnesota 55146
Phone: (651) 296-3403

For information on how this agency measures its performance or success, please refer to <http://www.departmentresults.state.mn.us/>.

Web site: <http://www.taxes.state.mn.us/> (for tax information, updates and downloadable forms and instructions)

Dollars in Thousands

	Current		Governor Recomm.		Biennium
	FY2004	FY2005	FY2006	FY2007	2006-07
<u>Direct Appropriations by Fund</u>					
General					
Current Appropriation	89,669	93,683	93,683	93,683	187,366
Recommended	89,669	93,683	95,869	98,593	194,462
Change		0	2,186	4,910	7,096
% Biennial Change from 2004-05					6.1%
Health Care Access					
Current Appropriation	1,693	1,654	1,654	1,654	3,308
Recommended	1,693	1,654	1,654	1,654	3,308
Change		0	0	0	0
% Biennial Change from 2004-05					-1.2%
Highway Users Tax Distribution					
Current Appropriation	2,097	2,097	2,097	2,097	4,194
Recommended	2,097	2,097	2,097	2,097	4,194
Change		0	0	0	0
% Biennial Change from 2004-05					0%
Environmental					
Current Appropriation	0	291	291	291	582
Recommended	0	291	291	291	582
Change		0	0	0	0
% Biennial Change from 2004-05					100%
<u>Expenditures by Fund</u>					
Direct Appropriations					
General	85,271	97,601	95,869	98,593	194,462
Health Care Access	1,509	1,838	1,654	1,654	3,308
Highway Users Tax Distribution	1,999	2,195	2,097	2,097	4,194
Environmental	0	313	291	291	582
Open Appropriations					
General	1,856	1,900	1,900	1,900	3,800
Statutory Appropriations					
Special Revenue	2,409	2,960	2,050	2,050	4,100
Environmental	353	0	0	0	0
Total	93,397	106,807	103,861	106,585	210,446
<u>Expenditures by Category</u>					
Total Compensation	71,059	75,893	79,580	81,607	161,187
Other Operating Expenses	21,649	30,146	23,616	24,313	47,929
Capital Outlay & Real Property	592	665	665	665	1,330
Local Assistance	97	103	0	0	0
Total	93,397	106,807	103,861	106,585	210,446
<u>Expenditures by Program</u>					
Tax System Management	77,161	88,815	85,473	87,567	173,040
Debt Collection Management	16,236	17,992	18,388	19,018	37,406
Total	93,397	106,807	103,861	106,585	210,446
Full-Time Equivalents (FTE)	1,129.7	1,185.5	1,139.5	1,095.3	

Program Description

The tax system management program provides the infrastructure that enables the revenue system to work well for Minnesota. This infrastructure consists of the following tasks:

- ◆ interpreting the laws and informing taxpayers of their tax obligations and rights;
- ◆ providing the state's taxpayers with the services and information they need to meet their obligations;
- ◆ processing returns and tax payments, issuing refunds, and managing taxpayer accounts;
- ◆ auditing to resolve tax filing discrepancies, discourage tax evasion, and identify levels and patterns of non-compliance;
- ◆ enforcing the tax laws for those who do not comply voluntarily;
- ◆ identifying and recommending improvements to the revenue system; and
- ◆ estimating revenues for state forecasts and proposed tax law changes.

Budget Activities Included:

- ◆ administrative support;
- ◆ appeals, legal services, and tax research;
- ◆ property tax administration and state aids;
- ◆ tax payment and return processing;
- ◆ tax compliance (individual and business taxes); and
- ◆ technology development, operations and support.

Operating Environment Issues

In this biennium, the agency will continue to face challenges presented by an accelerated growth of electronic commerce, globalization of the economy, demographic changes, and increasingly complex tax laws.

Growth of the digital economy

Internet commerce, for businesses and individuals alike, has grown dramatically over the last several years, and citizens expect that government agencies will provide similar services. As a result, we have been developing new self-service electronic systems to meet this demand. This, in turn, requires us to maintain two infrastructures: one that supports e-commerce, and another that supports traditional, paper-based filing and paying. Our major financial challenge is to continue to develop the information systems that take advantage of the new technology while maintaining legacy systems for traditional filers.

This program now maintains more than 172 computer applications on 11 different platforms for the 28 state taxes it collects, some of which need to be rewritten and redesigned to enable taxpayer interaction via the Internet.

Shift from a local economy to globalization of commerce

The economy is becoming more global and decentralized. In addition, reliance on intermediary businesses is diminishing as direct relationships between sellers and buyers become more common, mostly by means of internet transactions that cross state and national borders. Globalization has also spurred corporate mergers, with the resulting merging of data from their computer systems. These developments make it difficult and more expensive to identify and track transactions and determine who is responsible for paying the tax.

Demographic changes

The department continues to face the challenge of developing specialized outreach programs to meet the needs of non-English speakers to ensure that they become full participants in Minnesota's revenue system. By 2025, Minnesota's Hispanic population will increase by 248%, its Asian population will climb by 104%, and its African American population will jump by 113%. This compares to a growth rate of 8% for Minnesota's white population.

As Minnesota's population becomes more diverse, so must the agency's workforce. In addition, the agency's workforce is aging. In the next five years, about 300 employees (about 25%) will reach retirement age. With the average retirement age for state employees at 59, the critical task of replacing their collective experience and knowledge will be extremely difficult. Although the program has hired younger employees to carry out special

projects and support new tax enforcement initiatives, retaining these new employees in a competitive marketplace will be especially challenging.

Increasing resistance to taxation and growing noncompliance

More and more businesses are aggressively minimizing taxes through doubtful tax shelters and challenges to state tax laws. In addition, tax law and accounting firms are aggressively soliciting clients by offering to lower or eliminate their tax obligations through challenges to state tax laws and the agency's interpretations of the laws. Moreover, an increasing number of citizens believe cheating on tax is acceptable. According to a recent survey conducted by the Internal Revenue Service, nearly one in six of the nation's citizens believe its all right for taxpayers to cheat, up from about one out of every ten, two years ago.

Increasingly complex tax laws

Minnesota's state taxes have grown increasing complex in the last decade. Due to the addition of a multitude of credits and deductions, plus legislative decisions not to fully conform to federal changes, Minnesota has gone from a simple one-page form to a complex two-page form that requires a host of schedules and worksheets. Similarly, the number of exemptions from the sales tax has grown from the 53 in 1985 to 105 in 2004. This growing complexity increases demand for taxpayer information and support and results in more difficult and time-consuming audits. This issue takes on greater importance in times of stretched resources.

REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Program Summary

<i>Dollars in Thousands</i>					
	Current		Governor Recomm.		Biennium
	FY2004	FY2005	FY2006	FY2007	2006-07
<u>Direct Appropriations by Fund</u>					
General					
Current Appropriation	75,069	77,959	77,959	77,959	155,918
Technical Adjustments					
One-time Appropriations			(100)	(100)	(200)
Subtotal - Forecast Base	75,069	77,959	77,859	77,859	155,718
Governor's Recommendations					
Enhanced Tax Compliance Initiative		0	5,096	6,190	11,286
Operating Reduction		0	(3,500)	(2,500)	(6,000)
Total	75,069	77,959	79,455	81,549	161,004
Health Care Access					
Current Appropriation	1,693	1,654	1,654	1,654	3,308
Subtotal - Forecast Base	1,693	1,654	1,654	1,654	3,308
Total	1,693	1,654	1,654	1,654	3,308
Highway Users Tax Distribution					
Current Appropriation	2,097	2,097	2,097	2,097	4,194
Subtotal - Forecast Base	2,097	2,097	2,097	2,097	4,194
Total	2,097	2,097	2,097	2,097	4,194
Environmental					
Current Appropriation	0	291	291	291	582
Subtotal - Forecast Base	0	291	291	291	582
Total	0	291	291	291	582
<u>Expenditures by Fund</u>					
Direct Appropriations					
General	70,965	81,583	79,455	81,549	161,004
Health Care Access	1,509	1,838	1,654	1,654	3,308
Highway Users Tax Distribution	1,999	2,195	2,097	2,097	4,194
Environmental	0	313	291	291	582
Statutory Appropriations					
Special Revenue	2,335	2,886	1,976	1,976	3,952
Environmental	353	0	0	0	0
Total	77,161	88,815	85,473	87,567	173,040
<u>Expenditures by Category</u>					
Total Compensation	58,163	61,600	65,164	66,591	131,755
Other Operating Expenses	18,901	27,112	20,309	20,976	41,285
Local Assistance	97	103	0	0	0
Total	77,161	88,815	85,473	87,567	173,040
<u>Expenditures by Activity</u>					
Administrative Support	4,577	6,058	3,307	4,307	7,614
Appeals, Legal Serv & Tax Res	3,828	4,292	3,982	3,978	7,960
Tax Payment & Return Processing	13,366	12,828	12,564	12,646	25,210
Tax Compliance	40,398	45,920	49,396	50,412	99,808
Technology Dev, Ops & Support	12,753	16,725	13,614	13,614	27,228
Property Tax Admin & State Aid	2,239	2,992	2,610	2,610	5,220
Total	77,161	88,815	85,473	87,567	173,040
Full-Time Equivalentents (FTE)	916.2	950.4	912.9	877.2	

Activity Description

This activity provides overall direction to the agency. Its services include human resource management, facilities and contracts management, budget planning, financial and performance reporting, tax policies development, and publication and tax informational services for taxpayers and employees.

Population Served

This activity serves the state's 3.5 million individual income tax filers and 620,000 registered businesses, the department's 1,125 employees and state policymakers, including the governor and legislature.

Services Provided

The administrative support activity includes six major categories of services:

Human Resource Management. Services include job applicant recruitment and testing; job classification; personnel and payroll transactions; employee benefit administration; labor agreement negotiation; labor contract dispute resolution; Affirmative Action (AA), Equal Employment Opportunity Commission (EEOC) laws and the Americans with Disabilities Act (ADA) enforcement, diversity awareness programs, and employee development and training.

Facilities, Security and Contract Management. Services include building security; negotiation of leases for department facilities in 16 Minnesota and out-of-state locations; equipment, supply, and professional and technical services procurement; office space planning; and contract negotiation and management.

Financial Reporting and Reconciliation Management. Services include coordinating the department's biennial budget and annual spending plans; monitoring annual budgets; preparing financial reports; overseeing all budget accounting functions for the department's operating budget; ensuring that adequate financial controls are in place; and conducting internal audits to ensure the integrity of internal financial and operating systems. Services also include development of performance measures of the agency's activities, financial reports preparation, and transferring of funds to other agencies or funds.

Tax Forms and Informational Services. Services include forms and instruction design for individual and business taxes; website design, maintenance and oversight; publications and report design and editing; printing coordination for all the department's publications, including forms and instructions; media relations; and internal communications, including the employee newsletter.

Management Leadership. This activity provides direction to the agency's work units through business planning, which includes the development of the agency's strategic plan, strategic information systems management plan, biennial budget, division business plans, and annual spending plans. It ensures that the agency's resources, support systems and training systems are aligned with the direction set through the business planning process, and monitors agency performance through the development and use of performance measurements.

Tax Policy Support. This activity develops policies for all types of taxes; identifies obstacles to taxpayer compliance with the tax laws; and identifies unclear, ambiguous or conflicting provisions of tax laws. It also develops proposals to improve tax law understandability, fairness, ease of compliance and administration.

Activity at a Glance

- ◆ Designs 300+ forms and instructions
- ◆ 20 million pieces printed and mailed
- ◆ Website forms and instruction downloads exceeded 1 million in April 2004.
- ◆ Website provides 8,000 pages of information.
- ◆ Over 700 cases resolved by the Taxpayer's Advocate Office.
- ◆ Manages facilities for 1,125 employees in 16 Minnesota and out of state locations.
- ◆ Manages 118 contracts amounting to over \$9.3 million.

Historical Perspective

The budget for these support activities has been substantially cut: nearly 20% in the FY 2004-05 biennium. These reductions impair the activity's ability to provide support activities of all kinds to tax compliance functions and are seriously restricting its ability to respond to the following challenges.

An increasing exodus of experienced, knowledgeable workers: One-quarter of the agency's employees will be eligible for retirement in the next four years. Simultaneously, the agency faces a shrinking and highly-competitive labor market from which to draw new employees.

A more linguistic and culturally diverse population: Minnesota's newest taxpayers are in need of more highly targeted services, including language translation, tax preparation and community outreach services.

Higher service expectations: Taxpayer demand for more personalized, timely and faster services will require the agency to enhance or greatly expand web-based services and to post more information more quickly on the Internet.

The growing obsolescence of the state tax structure: Changes in the economy have created a marked disconnection between it and Minnesota's revenue system. This, in turn, requires a more concerted effort to identify economic changes faster, measure their effect on state tax collections, and to develop tax policy options that respond to the changes.

The threat of terrorism requires the agency to continually evaluate and upgrade the security of its facilities, mail handling operations and computer systems.

Key Measures

As the department transitions from paper to electronic means, more taxpayers are taking advantage of the department's website for getting tax forms and instructions.

Activity Funding

The administrative support budget activity constitutes 5.3% of the department's budget. Of the total biennial budget for the administrative support budget activity, \$10.1 million (97.8%) comes from General Fund tax dollars, \$157,000 (1.5%) comes from dedicated funds and \$68,000 (.7%) comes from special revenue funds for administering the Local Option Sales Tax and the Revenue Recapture program.

Contact

Dennis Erno

Deputy Commissioner

Phone: (651)556-6007

E-mail: dennis.erno@state.mn.us

Web site: <http://www.taxes.state.mn.us>

REVENUE DEPT
 Program: TAX SYSTEM MANAGEMENT
 Activity: ADMINISTRATIVE SUPPORT

Budget Activity Summary

Dollars in Thousands

	Current		Governor's Recomm.		Biennium
	FY2004	FY2005	FY2006	FY2007	2006-07
<u>Expenditures by Fund</u>					
Direct Appropriations					
General	4,462	5,662	3,195	4,195	7,390
Health Care Access	77	78	78	78	156
Statutory Appropriations					
Special Revenue	38	318	34	34	68
Total	4,577	6,058	3,307	4,307	7,614
<u>Expenditures by Category</u>					
Total Compensation	3,932	4,107	4,130	4,130	8,260
Other Operating Expenses	645	1,951	(823)	177	(646)
Total	4,577	6,058	3,307	4,307	7,614
Full-Time Equivalents (FTE)	57.8	57.7	56.1	54.4	

Activity Description

This activity includes legal and legislative services, tax appeal services, and tax research services.

Population Served

Taxpayers, tax administrators, legislators and staff, tax professionals, public policymakers, local elected officials, state agencies, local governments, nonprofit organizations, businesses, and professional and trade associations.

Services Provided**Legal Services.** This activity:

- ⇒ Provides in-house legal counsel and conducts legal analysis and research of tax laws and policies
- ⇒ Provides updated information on law changes and court decisions to taxpayers, business trade organizations, and tax practitioner groups.
- ⇒ Works with legislators, legislative staff, taxpayers, and practitioner groups in drafting legislation, interpreting tax laws and providing expert testimony at hearings.
- ⇒ Drafts rules and revenue notices that announce the department's interpretation of tax laws.
- ⇒ Provides support to the Attorney General's staff in tax litigation.
- ⇒ Monitors federal tax changes that affect Minnesota's tax system.
- ⇒ Negotiates and oversees state tax agreements with tribal governments.
- ⇒

Appeal Services. This activity resolves taxpayer disputes over assessments and denials of tax refunds. It is an independent, impartial work unit that offers taxpayers an informal and inexpensive alternative to litigation in resolving disputes.

Tax Research Services. This activity:

- ⇒ Forecasts revenues from various taxes for the state's November and February forecasts.
- ⇒ Develops the state's official revenue estimates and analyses for proposed tax legislation.
- ⇒ Prepares legislatively mandated studies and reports, including the *Minnesota Tax Incidence Study* and the *Minnesota Tax Expenditure Budget*.
- ⇒ Develops databases for use by the legislature and the executive branch for revenue forecasting and for evaluating the effect of tax proposals.
- ⇒ Assists in measuring tax compliance and identifying data sources for detecting noncompliance.
- ⇒ Disseminates economic and tax information to legislative staff, administration officials, executive branch officials, businesses, associations, nonprofit groups, all of the agency's divisions, and the public.
- ⇒ Maintains an in-house library for tax research and study of tax laws.

Historical Perspective

This activity faced elevated workloads while its budget was reduced by 9% in FY 2004-05 biennium. The high demand for this activity's services continues unabated due to the growing complexity of tax laws, increased challenges to the tax laws, and numerous law proposals that require revenue estimates, drafts of legislation and legal analysis. This situation is not likely to diminish due to the state's current budget shortfalls, which are expected generate a host of tax proposals by state policymakers and increases in legal challenges by businesses that are aggressively pursuing tax reduction strategies.

Key Measures

Legal : In FY 2000, the department published 18 revenue notices, which advise taxpayers on how tax laws will be administered. In FY 2001, revenue notices dropped to three, because resources were diverted to the 2001 tax

Activity at a Glance

In FY 2004, this activity achieved the following:

- ◆ Legal produced 23 revenue notices and spent over 4,200 hours on legislative work and over 5,400 hours providing legal advice to the agency
- ◆ Appeals completed 233 administrative penalty appeals
- ◆ Tax Research provided nearly 300 formal revenue estimates

REVENUE DEPT

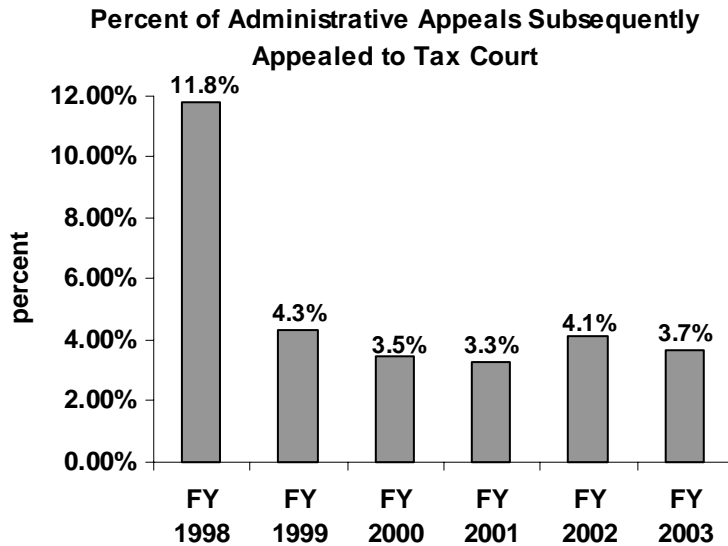
Program: TAX SYSTEM MANAGEMENT

Activity: Appeals, Legal Services & Tax Research

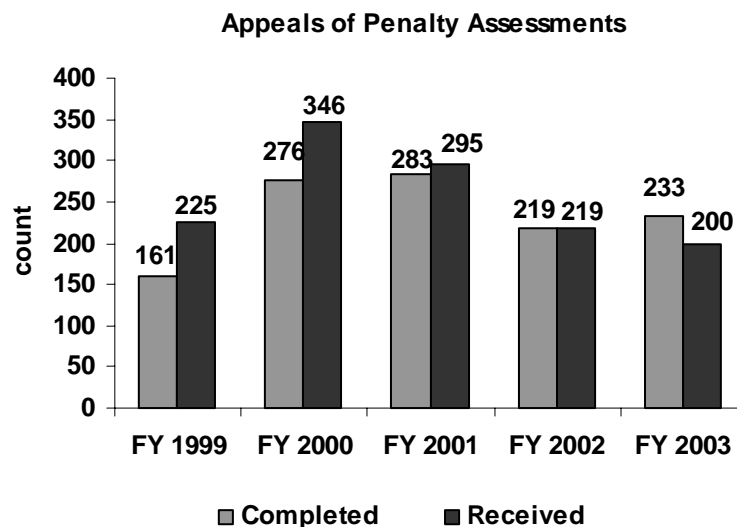
Narrative

reform. In FY 2002, revenue notices increased to 20, and in FY 2003, climbed to 23. Revenue notices are one measure of the legal counsel provided by legal staff.

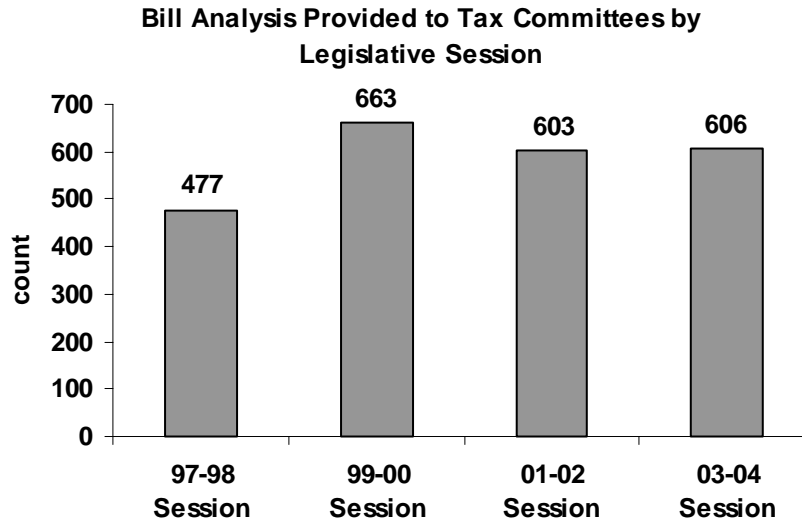
Appeals: Taxpayers are becoming more aggressive in challenging the state's tax laws. The sales and corporate tax area have seen the largest growth in appeals. The appeals division counts cases that are subsequently appealed to tax court to measure taxpayer resolution of issues as part of the dispute resolution process.



Taxpayers are increasingly making appeals solely in connection with the fairness of penalties, rather than on the interpretations of the penalty statute. The following chart measures the number of appeals just on penalties and the number of penalty appeals resolved.



Research: The number of bill analyses prepared by the Research Division in connection with tax legislation has steadily grown from 1997 to 2003 and in 2004 remained at a high level. This activity is the largest resource management issue for the division.



Activity Funding

This activity's biennial budget is \$7.4 million, or about 3.8% of the department's total budget. Of the total biennial budget for the Appeals, Legal Services and Tax Research budget activity, \$7 million (94.6%) comes from General Fund tax dollars, \$323,000 (4.4%) comes from dedicated funds and \$ 76,000 (1%) comes from special revenue funds for administering the Local Option Sales Tax program.

Contact

Terese Mitchell
Director, Legal and Appeals
E-mail: terese.mitchell@state.mn.us
Phone: 651-556-4075

Dick Gebhart,
Director, Tax Research
E-mail: dick.gebhart@state.mn.us
Phone: 651-556-6138

REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Activity: APPEALS, LEGAL SERV & TAX RES

Budget Activity Summary

Dollars in Thousands

	Current		Governor's Recomm.		Biennium
	FY2004	FY2005	FY2006	FY2007	2006-07
<u>Expenditures by Fund</u>					
Direct Appropriations					
General	3,559	4,040	3,783	3,779	7,562
Health Care Access	157	167	161	161	322
Statutory Appropriations					
Special Revenue	112	85	38	38	76
Total	3,828	4,292	3,982	3,978	7,960
<u>Expenditures by Category</u>					
Total Compensation	3,291	3,395	3,385	3,385	6,770
Other Operating Expenses	537	897	597	593	1,190
Total	3,828	4,292	3,982	3,978	7,960
Full-Time Equivalent (FTE)	44.2	43.6	40.9	39.2	

Activity Description

This activity processes all state electronic and paper filed tax returns and payments; issues tax refunds; and manages taxpayer records. It also establishes tax accounts for new businesses, updates taxpayer records for changes, including address changes, and offsets income tax refunds for tax and non-tax debts owed to state agencies and local units of government.

Population Served

- ◆ 3.5 million individual income tax payers who file 2.4 million individual income tax returns;
- ◆ 165,000 employers and 221 third-party bulk filers who remit income tax withholding payments;
- ◆ 638,200 property tax refund applicants;
- ◆ 260,000 businesses that collect and remit sales and use tax;
- ◆ 43,000 corporations and 125,000 S corporations and partner-ships that pay corporate franchise and income taxes;
- ◆ 50,000 fiduciary income tax payers;
- ◆ 1,800 estate tax payers who pay and submit \$128 million in estate taxes;
- ◆ 800 petroleum product distributors who pay \$640 million in gasoline and aviation fuel taxes;
- ◆ 74 cigarette and 146 tobacco distributors who remit \$180 million in cigarette and tobacco taxes;
- ◆ 37 wine and eight liquor distributors, 100 brewers and beer importers, and 17 alcohol commercial carriers, who pay approximately \$65 million in liquor, wine and beer taxes;
- ◆ 2,112 insurance companies who pay \$270 million in gross premium taxes;
- ◆ 7,500 hospitals, health care providers and prescription drug wholesalers who collect approximately \$280 million in health care taxes;
- ◆ 1,500 organizations that conduct lawful gambling and 20 gambling equipment distributors who collect approximately \$60 million in lawful gambling taxes;
- ◆ 7,167 hazardous waste generators and 979 solid waste management services who collect approximately \$63 million in hazardous and solid waste taxes;
- ◆ 6 mining companies that pay approximately \$75 million in taconite production taxes and \$2 million taconite and iron ore occupation taxes;
- ◆ 230 dry cleaning facilities that pay dry cleaner taxes and three solvent distributors that pay approximately \$487,000 in dry cleaner fees;
- ◆ 25 furriers that pay \$185,000 in fur clothing taxes;
- ◆ 87 counties that remit approximately \$298 million in deed and mortgage registry taxes; and
- ◆ 876 state and county agencies whose debts are collected through Revenue Recapture.

Activity at a Glance

- ◆ Processes 2.4 million income tax returns annually
- ◆ Processes over 1.2 million business tax returns and 200,000 business income tax returns.
- ◆ Processes 4.3 million payments
- ◆ Issues 2.5 million refunds
- ◆ Registered 36,000 new businesses in FY 2003
- ◆ Receives and sorts over 4.3 million pieces of incoming mail annually.

Services Provided

This activity processes all electronic and paper state tax returns and payments. Its services include:

- ◆ receiving and sorting over 4.3 million pieces of incoming mail annually;
- ◆ scanning and imaging paper filed individual income tax returns and correspondence;
- ◆ recording and depositing tax payments;
- ◆ verifying tax return accuracy;
- ◆ auditing returns that exceed normal thresholds for credits, deductions and exemptions;
- ◆ issuing refunds to individuals and businesses;
- ◆ receiving and acknowledging electronic tax returns and payments;
- ◆ offsetting refunds for tax and nontax debt owed to government entities;
- ◆ issuing tax identification numbers to new businesses; and
- ◆ recording address and name changes to individual and business tax accounts.

Historical Perspective

This activity has largely transformed individual income tax and business tax filing and payment transactions from paper to electronic means. It has:

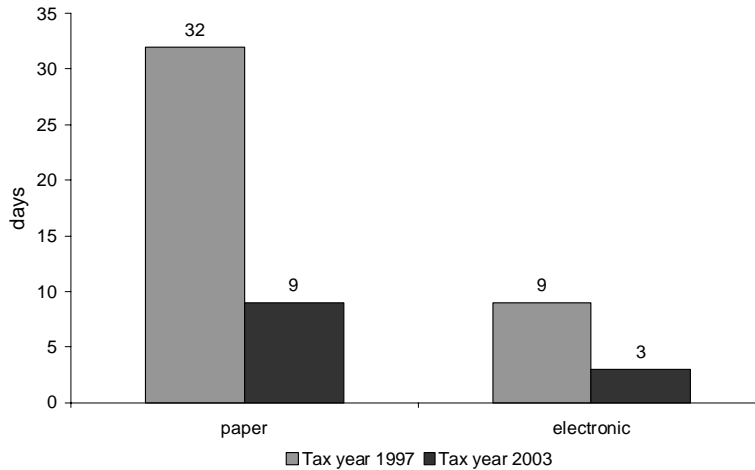
- ◆ established “eFILE Minnesota,” which accepts payment for all types of taxes in addition to return filings for sales, withholding, fiduciary, unemployment compensation, partnerships, MinnesotaCare, and estimated individual income taxes;
- ◆ developed a web-based business registration system;
- ◆ re-engineered the individual income tax computer system and is regularly adding features that set the stage for taxpayer self-service; and
- ◆ adopted scannable individual income tax and property tax forms, which has eliminated the need for storage of paper returns.

In FY 2004, nearly 1.5 million individual income tax returns were filed electronically, and over 1.2 million tax refunds were issued within five days. Over three million business tax electronic filing and payment transactions were processed electronically in FY 2004.

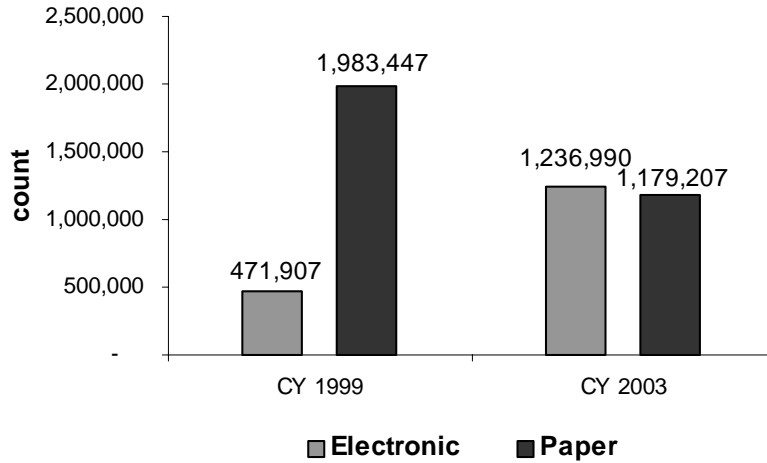
Key Measures

Average days to process individual income tax refund returns calculated from the day the return is received to the date the refund is issued.

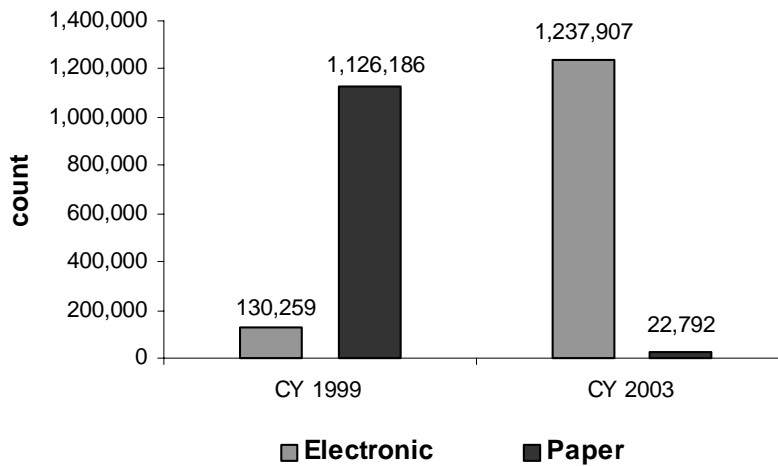
Average days to process Individual Income Tax Refund Returns received by April 15



Individual Income Tax Paper vs. Electronic Returns



Business Tax Paper vs. Electronic Returns



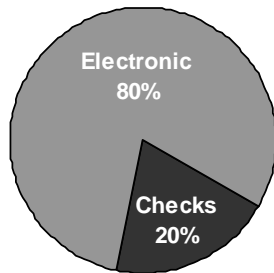
REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

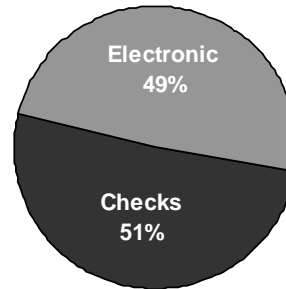
Activity: Tax Payment & Return Processing

Narrative

Taxpayer Payments by Dollars FY2004



Taxpayer Payments by Type - FY2004



Activity Funding

This activity's biennial budget is \$25.1 million, or about 12.9% of the department's total budget. Of the total biennial budget for the Tax Payment & Return Processing budget activity, \$24.2 million (96.2%) comes from General Fund tax dollars, \$118,000 (.5%) comes from dedicated funding, and \$830,000 (3.3%) comes from special revenue funds for administering local option sales taxes and revenue recapture programs.

Contact

Carole Wald

Assistant Commissioner

Phone: (651) 556-6006

E-mail: carole.wald@state.mn.us

Don Trimble

Assistant Commissioner

Phone: (651) 556-6004

E-mail: don.trimble@state.mn.us

Web site: <http://www.taxes.state.mn.us>

REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Activity: TAX PAYMENT & RETURN PROCESSING

Budget Activity Summary

Dollars in Thousands

	Current		Governor's Recomm.		Biennium
	FY2004	FY2005	FY2006	FY2007	2006-07
<u>Expenditures by Fund</u>					
Direct Appropriations					
General	12,711	12,290	12,090	12,172	24,262
Health Care Access	84	59	59	59	118
Statutory Appropriations					
Special Revenue	571	479	415	415	830
Total	13,366	12,828	12,564	12,646	25,210
<u>Expenditures by Category</u>					
Total Compensation	10,649	10,254	10,189	10,271	20,460
Other Operating Expenses	2,717	2,574	2,375	2,375	4,750
Total	13,366	12,828	12,564	12,646	25,210
Full-Time Equivalent (FTE)	208.5	208.4	200.1	191.7	

Activity Description

The tax compliance activity administers and enforces Minnesota's 28 individual and business taxes. These taxes raise \$13.7 billion annually, which amounts to 60% of the state's total revenue.

Population Served

- ◆ 3.5 million individual income tax payers;
- ◆ 638,000 property tax refunds issued to homeowners and renters;
- ◆ 8,000 tax preparers;
- ◆ 260,000 businesses that collect and remit sales and use tax;
- ◆ 50,000 fiduciary and 1,800 estate taxpayers;
- ◆ 165,000 employers that withhold tax and 221 third-party bulk withholding filers;
- ◆ 58,000 corporations, 82,000 S corporations, and 43,000 partnerships;
- ◆ 700 petroleum product distributors;
- ◆ 74 cigarette and 146 tobacco distributors;
- ◆ 37 wine and eight liquor distributors; 100 brewers and beer importers, and 17 alcohol commercial carriers;
- ◆ 2,112 insurance companies;
- ◆ 8,200 hospitals, health care providers, and prescription drug wholesalers;
- ◆ 1,500 organizations that conduct lawful gambling, and 20 gambling equipment distributors;
- ◆ 7,167 hazardous waste generators and 900 solid waste management services;
- ◆ six mining companies;
- ◆ 230 dry cleaning facilities;
- ◆ 25 furriers; and
- ◆ county attorneys and other law enforcement agencies.

Activity at a Glance

- ◆ Over 500,000 phone calls
- ◆ Over 50,000 audits
- ◆ Tax forms, instructions, and other tax information to more than 4 million taxpayers
- ◆ 37,000 Email inquiries

This activity also administers local option sales and use tax on behalf of 10 cities and one county.

Services Provided

This activity ensures that individuals and businesses pay the proper amount of tax through the following tasks:

- ◆ informing taxpayers of their obligations and rights;
- ◆ providing paper and web-based forms and instructions;
- ◆ offering online access to free electronic income tax filing for low and modest income taxpayers, students, senior citizens and members of the armed forces;
- ◆ responding to e-mail, written and telephone inquiries;
- ◆ conducting audits to identify and resolve tax filing and payment discrepancies, detect tax evasion, and measure levels of compliance;
- ◆ interpreting laws and making recommendations for law changes; and
- ◆ providing training courses and seminars to businesses that collect and remit sales taxes.

Historical Perspective

The agency conducted two landmark studies to measure the gap between the amount of taxes that **is** paid and the amount of taxes that **should** have been paid. The first of the two studies, conducted in 2002, revealed a sales tax gap of about \$500 million; that is expected to grow to \$700 million by 2007. Similarly, in 2004, the agency, in consultation with the State Demographer's Office and the Internal Revenue Service (IRS), conducted a study of the individual income tax, which revealed a gap of about \$604 million.

As a part of an effort to solve the state budget shortfall, in FY 2002-03, the legislature appropriated \$10.2 million (of which \$9.7 million was spent) to generate a projected \$60 million in added revenue through expanded tax auditing and enforcement. The agency exceeded this goal by \$30.7 million. The following biennium, the

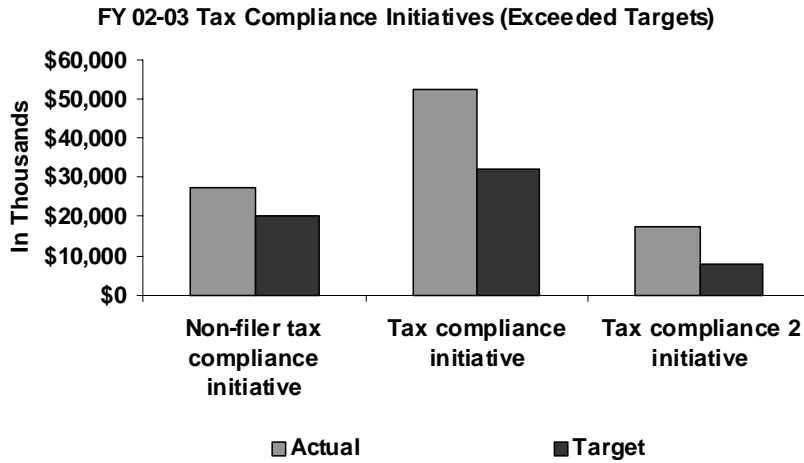
legislature appropriated an additional \$12.8 million to generate \$59.8 million – a goal the agency is on track to achieve. The fact that these expanded tax auditing and enforcement initiatives have yielded much more revenue than expected is further evidence of the substantial gap between the amount of tax paid and the amount that should be paid.

Through its funding decisions in the last two biennial budgets, the legislature has realigned agency resources to focus more directly on tax auditing and enforcement activities. While the legislature was appropriating funds to the agency for expanded tax compliance activities, at the same time, the agency was making budget cuts in its compliance support activities, including technology development and maintenance, taxpayer information services, building security, and tax return recording and payment processing activities. At the start of FY 2001-02 biennium about 49% of the agency's budget was spent on direct tax auditing and enforcement activities, and 51% allotted to processing, technology and other support activities. Today, direct tax compliance activities have grown to 60% of the agency's biennial budget, while compliance support has dwindled to 40% of the total budget.

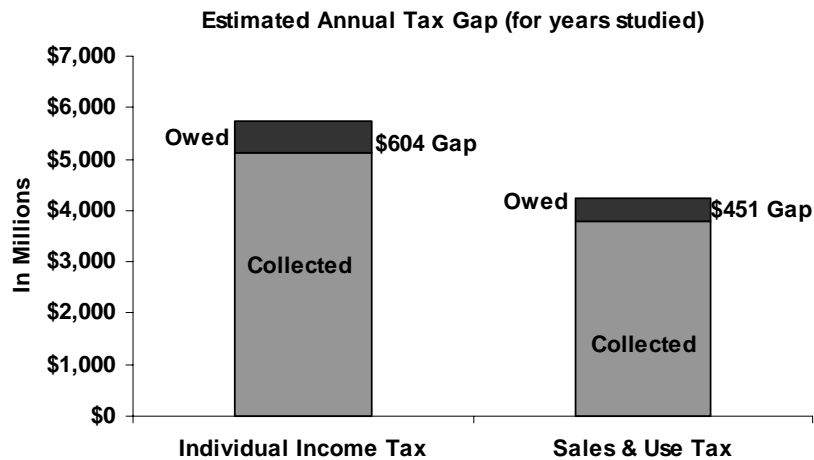
Although expanded tax compliance activities are generating substantial revenue, uncovering tax avoidance remains an overwhelming and daunting task. Here is why:

- ⇒ An increasing number of citizens believe that cheating on taxes is all right. An IRS survey reveals that 17% of the nation's taxpayers think it is all right to cheat on taxes, up from 11% just two years earlier.
- ⇒ More and more, taxpayers are challenging state tax laws. Simultaneously, tax law and accounting firms have become aggressive in soliciting clients by offering to challenge tax laws and the department's interpretations.
- ⇒ The tax laws are growing more complex. As the number of tax credits, deductions and special provisions grows, the greater the complexity, the length of time, and expense of conducting audits.
- ⇒ As businesses move from paper to electronic records and transactions, the agency's employees need more training to enable them to understand and access various computer systems to ensure the accuracy of the systems, as well as the transactions.
- ⇒ As businesses convert to electronic records, they are reducing the types of information included in the records. Less data for department employees to review increases the difficulty of auditing taxpayer records.
- ⇒ Consolidations and mergers among businesses have resulted in the merging of computer systems, making it more difficult to identify transactions and determine who is responsible for paying the tax.
- ⇒ Globalization of commerce increases the number of transactions that cross state and nation borders. As more transactions are made through mail-order firms and the Internet, it is more difficult and expensive for the activity to identify them and determine who is responsible for paying the taxes.
- ⇒ Significant growth in the state's economy has increased the number of retail businesses from 178,000 in 1995 to 260,000 in 2004 – 50% in nine years. This growth restricts the activity's ability to redirect resources from taxpayer support services to more direct tax enforcement activities. This growth has also increased the number of applications for capital equipment sales tax refunds that we must process and audit.

Key Measures



The dollars collected have exceeded our targeted goals, yielding \$97.2 million or \$37.1 million over the target for the FY 2002-03 biennium.



Activity Funding

This activity's biennial budget is \$81.5 million, or about 41.8% of the department's total budget. Of the total biennial budget for the tax compliance budget activity, \$73.0 million (89.6%) comes from General Fund tax dollars, \$7.4 million (9%) comes from dedicated funds, and \$1.1 million (1.4%) comes from special revenue funds for administering the Local Option Sales Tax and Cigarette Stamp account activities.

Contact

Don Trimble

Assistant Commissioner

Phone: (651) 556-6004

E-mail: don.trimble@state.mn.us

Carole Wald

Assistant Commissioner

Phone: (651) 556-6006

E-mail: carole.wald@state.mn.us

Web site: <http://www.taxes.state.mn.us>

REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Activity: TAX COMPLIANCE

Budget Activity Summary

<i>Dollars in Thousands</i>					
	Current		Governor's Recomm.		Biennium
	FY2004	FY2005	FY2006	FY2007	2006-07
<u>Expenditures by Fund</u>					
Direct Appropriations					
General	36,081	40,853	45,050	46,066	91,116
Health Care Access	1,145	1,486	1,309	1,309	2,618
Highway Users Tax Distribution	1,999	2,094	2,046	2,046	4,092
Environmental	0	296	274	274	548
Statutory Appropriations					
Special Revenue	837	1,191	717	717	1,434
Environmental	336	0	0	0	0
Total	40,398	45,920	49,396	50,412	99,808
<u>Expenditures by Category</u>					
Total Compensation	30,428	33,265	36,583	37,928	74,511
Other Operating Expenses	9,873	12,552	12,813	12,484	25,297
Local Assistance	97	103	0	0	0
Total	40,398	45,920	49,396	50,412	99,808
Full-Time Equivalentents (FTE)	489.2	525.4	504.8	485.5	

Activity Description

This activity oversees development and maintenance of the computer systems for all major state taxes administered by the department. It maintains more than 172 computer applications on 11 different platforms that serve more than 1,125 employees. It is responsible for strategic planning for integrating technologies and systems into the agency's business operations; computer systems development; information security and data privacy; and for the day-to-day maintenance of the agency's computer infrastructure, including the overall network, operating systems, and equipment.

Activity at a Glance

- ◆ 1,125 employees served in 16 different office locations
- ◆ \$16 million annual budget
- ◆ 172 computer applications on 11 different platforms
- ◆ 70% of total service and information for citizens is available on-line
- ◆ over four million electronic filing and payment transactions

Population Served

This activity serves policymakers, all citizens and businesses that interact with or are served by our tax systems, local units of government, other state agencies, and about 1,125 department employees.

Services Provided

The Technology Development, Operations and Support activity is responsible for the following services:

- ◆ strategic planning for aligning technologies and systems with the agency's business needs;
- ◆ systems planning, development, implementation and maintenance of computer applications;
- ◆ ensuring that department information systems and networks are efficient, reliable, accessible and responsive;
- ◆ ensuring the security of all computer applications and privacy of data;
- ◆ leadership of the agency business systems planning team, which is the department's process for aligning and integrating business needs with computer operations and systems;
- ◆ establishing and maintaining standards for computer architecture and technology; and
- ◆ monitoring investments in computer applications, projects and systems.

Historical Perspective

Since the early 1990s, the department has been transforming its tax processing from mainframe systems that supported internal, paper-based procedures to integrated, distributed, web-based electronic filing and paying systems. For taxpayers, these new systems will mean faster, easier, and more convenient and accurate filing and paying. However, they are complex and more expensive to develop, maintain and support, in part because they must be available 24 hours a day, seven days per week.

To achieve the transformation from paper, the department shifted funds from other activities to investments in technology. Since 1996, our annual information technology (IT) investment has increased 72%, from \$9.3 million to \$16 million. However, in the 2004-05 biennium the activity's budget was cut by about \$2 million, or 7%. This reduction restricts the agency's ability to complete the planned migration of information and processing systems from outdated mainframe applications, and impairs its ability to maintain and support current web-based systems.

Key Measures

To measure its success in implementing information technology applications, this activity uses a self-assessment process developed by the Pawlenty Administration for evaluating effectiveness in four major categories, including the overall use and management of technology. On a scale of one to five, here is how the agency graded itself according to the criteria in the following four categories in the *Government Reform through Technology* area. (A grade of fe1 is considered "below minimum standards" while a grade of five is deemed "world class excellence." The criteria associated with a specific score appear immediately after the grade.)

Electronic Government Services – **Grade: 4** – Most core services for citizens, businesses, and governmental groups are available on-line.

REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Activity: Technology Development, Operations & Support

Narrative

Enterprise Orientation – **Grade: 3** – This agency has an explicit policy in place that promotes sharing and collaboration initiatives. We are engaged in the identification of shared service opportunities with state agencies and other partners. We are a partner in shared service initiatives that serve statewide objectives.

Customer Focus – **Grade: 4** – We approach the management of our agency and our projects from a collaborative perspective and have successfully used a shared approach on at least 25% of our projects completed in the last 12 months. We have defined and consistently used processes for gathering business partner/customer (user) feedback, and we develop strategic business technology and process improvement plans based on a complete customer/user-centric view. We have at least one success in one-stop delivery of service within our agency or in collaboration with others. Our technology customer satisfaction rating is above 80%.

Strategy and Standards – **Grade: 5** – We provide leadership and are recognized by our peers in the development and advocacy of architectural direction and standards for the greater good of the state enterprise. Of the organizational systems and processes developed in the last 12 months, 100% comply with and leverage documented standards.

Activity Funding

This activity's biennial budget is \$31.4 million, or about 16.1% of the department's total budget. The sources of activity's total biennial budget are: \$29.7 million (94.4%) from General Fund tax dollars, \$229,000 (.7%) from dedicated funds and \$ 1.5 million (4.9%) from special revenue funds for administering the Local Option Sales Tax and the Revenue Recapture program.

Contact

Steve Stedman

Chief Information Officer

E-mail: Steve.Stedman@state.mn.us

Phone: (651) 556-6446

Web site: <http://www.taxes.state.mn.us>

For information on the department's Strategic Information Resource Management Plan for FY 2004-05, please refer to <http://www.advstr.com/sirmp/sirmp.cfm>.

REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Activity: TECHNOLOGY DEV, OPS & SUPPORT

Budget Activity Summary

<i>Dollars in Thousands</i>					
	Current		Governor's Recomm.		Biennium
	FY2004	FY2005	FY2006	FY2007	2006-07
<u>Expenditures by Fund</u>					
Direct Appropriations					
General	11,918	15,787	12,727	12,727	25,454
Health Care Access	46	48	47	47	94
Highway Users Tax Distribution	0	101	51	51	102
Environmental	0	17	17	17	34
Statutory Appropriations					
Special Revenue	772	772	772	772	1,544
Environmental	17	0	0	0	0
Total	12,753	16,725	13,614	13,614	27,228
<u>Expenditures by Category</u>					
Total Compensation	7,810	8,348	8,583	8,583	17,166
Other Operating Expenses	4,943	8,377	5,031	5,031	10,062
Total	12,753	16,725	13,614	13,614	27,228
Full-Time Equivalent (FTE)	85.7	84.5	81.4	78.0	

Activity Description

This activity ensures the uniform application of Minnesota's property tax laws, oversees the performance of local assessors, provides information to taxpayers and policymakers about the property tax system, and computes and pays state aids to local governments.

Population Served

This activity serves 3,400 local units of government and over 2.5 million property tax payers each year. It also serves state policymakers and state agencies such as Education, Human Services and Corrections.

Services Provided

The division provides services in two major program areas: local property tax administration and state aids to local governments.

Local Property Tax Administration. This activity assists county and city assessors in the complete and accurate identification of taxable property, its proper classification and valuation, and equalization of assessments among taxing districts.

It provides information to individual taxpayers, legislators and local government officials about the property tax system and support to the State Board of Assessors, which is responsible for assessor education and licensing.

It conducts annual assessment-to-sales ratio studies to measure assessment levels, ensure their uniformity, and determine the basis for state aid payments to school districts and cities, and staff the State Board of Equalization, which is responsible for monitoring assessment levels for accuracy and uniformity and for issuing corrective orders where necessary.

It assists and monitors local governments in implementing the annual Truth in Taxation process, and educates county auditors and treasurers on requirements and procedures for tax computation and collection, providing consultation when requested.

The activity assesses railroads, public utilities, and airflight property on a statewide basis as required by law.

State aids to local governments. The services provided by the activity include:

- ◆ collecting and maintaining assessment and levy information from all local taxing authorities each year;
- ◆ determining state aid and credit reimbursement payments for each county, city, town, and special taxing district under a variety of statutory formulas, including Local Government Aid (LGA), Market Value Credit Reimbursement Aid, and many other smaller programs;
- ◆ setting the statewide general fund property tax rate for business and cabin properties;
- ◆ making aid payments by statutory deadlines each year; and
- ◆ verifying and issuing state deeds for tax-forfeited property.

Historical Perspective

The activity's ability to oversee the performance of county and city assessors has greatly diminished due to insufficient funding over the last decade. As part of property tax reform, the 2001 legislature appropriated additional funds to strengthen this oversight, but, the added funds were quickly eroded by subsequent budget cuts. These cuts came at a time when the proper classification and valuation of properties had become ever more important because of adoption of a statewide property tax levy. This levy is imposed on properties that are classified and valued by a host of county and city assessors. It contributes \$615 million annually to the state's budget, and has become an important component in the overall state revenue system.

Activity at a Glance

The Property Tax Administration & State Aids activity:

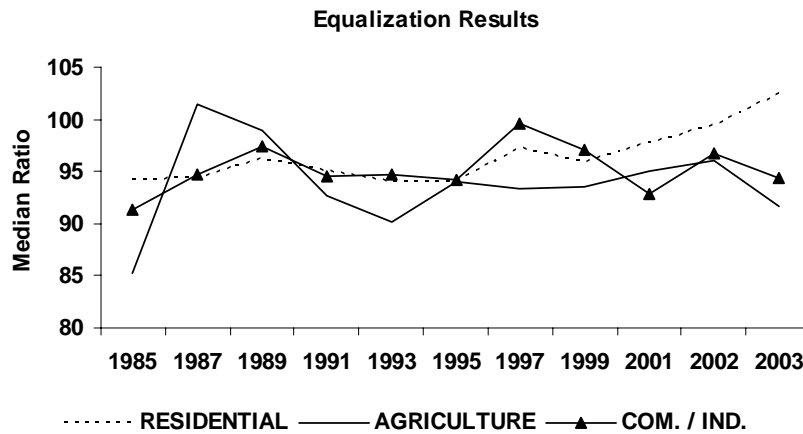
- ◆ Administers over \$1.85 billion in local aids and credits.
- ◆ Oversees the statewide property tax levy which raises \$615 million in payable year 2004.
- ◆ Provides services to local government officials who value and calculate property taxes for 2.5 million parcels of property.
- ◆ Answers 16,000 phone and 17,000 email inquiries from taxpayers and administrators.

This activity's ability to gather property tax information quickly and efficiently is hindered by the failure of local governments and the division to aggressively invest in new technology and computer systems. However, the division is in the process of making internal system design improvements that should result in more timely gathering of property data and will lay the groundwork for improving property tax administration.

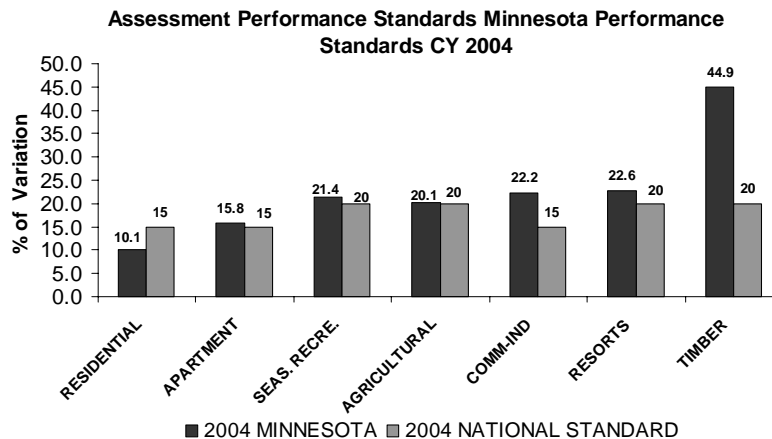
Key Measures

The key measure for this activity is the assessment-to-sales ratio study. In valuing a property, assessors seek to estimate a value that is as close as possible to what the property would sell for in the current market. The division conducts an annual study for each of the state's 87 counties that compares the selling price of all properties sold with the assessor's estimated market value of the property. The following table shows that Minnesota assessors have been estimating the value of residential, farm and commercial property at about 96.2% of its selling prices.

Using the sales ratio data, the following measure shows the degree of variation in individual assessments from the average for the various classes of property in Minnesota, and compares it to the national standard established



by the International Association of Assessing Officers. Overall, Minnesota assessors are fairly close to the national standard on farm property, and actually beat the standard on residential property. Commercial-industrial and timber sales are difficult to estimate because the value tends to be different, depending on the type and use of the property. With few resort properties (defined as nonhomesteaded commercial seasonal properties) in the state, the small sample size makes it difficult to accurately measure assessed value against actual sales.



REVENUE DEPT**Program: TAX SYSTEM MANAGEMENT****Activity: Property Tax Administration & State Aids**

Narrative

Administration of Local Government Aids: The following table outlines the amount of payments made to local government for a variety of aid programs.

**Aids and Credits Paid to Local Government Units
(Dollars in Thousands)**

Payments to Cities, Counties, Towns and Special Jurisdictions	<u>2003 Actual</u>	<u>2004 Actual</u>	<u>2005 Budgeted</u>
Local Government Aid	\$564,991	\$464,942	\$437,513
County Program Aid	0	0	111,620
Residential Hmstd MV Credit	251,949	229,146	219,279
Hmstd Agric Credit Aid - HACA	207,440	134,621	0
Criminal Justice Aid	31,516	32,201	0
Family Preservation Aid	23,406	23,884	0
Agric Hmstd MV Credit	14,354	18,427	18,887
DNR-PILT	12,037	12,703	13,028
Disparity Reduction Aid	9,911	10,959	10,705
Taconite Aid Reimb	4,767	4,896	5,560
Washburn Crosby Project	2,600	0	0
Border City Credit	2,727	4,413	4,412
Attached Machinery Aid	2,382	403	0
Existing Low Inc Housing Aid	1,000	1,844	0
TIF Deficit Aid	34	0	0
Indian Casino County Aid	742	675	675
Public Defender Costs	480	464	595
Used Oil/Filter Refund	50	0	0
Disaster Credit/Rev	7	54	0
Enterprise Zone Credit	0	0	0
Regional Transit Brd Aid	0	0	0
Charity Care Aid	0	0	0
Sub Total	\$1,130,393	\$939,632	\$822,274
Payment to Schools			
Residential Hmstd MV Credit-School	68,860	67,412	68,578
Education Hmstd MV Credit	806	229	0
Disparity Reduction Aid-School	7,802	8,072	8,259
Education Agric Credit	0	0	0
Agric Hmstd MV Credit - School	3,853	4,950	5,343
Hmstd Agric Cr Aid-HACA -School	3,853	115	0
Attached Machinery Aid - School	2,832	138	0
Border City Credit - School	259	567	869
Ag Preservation - School	67	65	68
Enterprise Zone Credit - School	0	0	0
Disaster Credit/Rev - School	2	16	3
Sub Total	\$88,334	\$81,564	\$83,120
Pension Related Payments (payments made to jurisdiction or pension plan)			
Aid to Polic & Fire	61,676	69,868	78,808
PERA Rate Increase Aid	14,586	14,586	14,586
Local Police & Fire Aid	8,285	12,952	11,638
Sub Total	84,547	97,406	105,032
TOTAL	\$1,303,274	\$1,118,602	\$1,010,426

REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Activity: Property Tax Administration & State Aids

Narrative

Activity Funding

This activity's total biennial budget is \$5.75 million, or about 2.9% of the department's total budget. Of this total, \$5.75 million (100%) comes from the General Fund.

Contact

Gordon Folkman
Director, Property Tax Division
E-mail: gordon.folkman@state.mn.us
Phone: 651-556-6104

Matt Massman
Senior Policy Analyst, State and Local Finance
E-mail: matt.massman@state.mn.us
Phone: 651-556-6016

REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Activity: PROPERTY TAX ADMIN & STATE AID

Budget Activity Summary

<i>Dollars in Thousands</i>					
	Current		Governor's Recomm.		Biennium
	FY2004	FY2005	FY2006	FY2007	2006-07
<u>Expenditures by Fund</u>					
Direct Appropriations					
General	2,234	2,951	2,610	2,610	5,220
Statutory Appropriations					
Special Revenue	5	41	0	0	0
Total	2,239	2,992	2,610	2,610	5,220
<u>Expenditures by Category</u>					
Total Compensation	2,053	2,231	2,294	2,294	4,588
Other Operating Expenses	186	761	316	316	632
Total	2,239	2,992	2,610	2,610	5,220
Full-Time Equivalents (FTE)	30.8	30.8	29.6	28.4	

Program Description

The functions of the Debt Collection Management program are carried out by the Department of Revenue's Collection Division. The division collects both tax and non-tax debt owed to various state agencies and boards by individuals and corporations. The collection of debt owed to state agencies was consolidated into this single unit in the Department of Revenue beginning in 1993.

Overall, the division managed a tax debt portfolio of \$404 million and non-tax debt of \$263 million in FY 2004. It collected a total of nearly \$225 million in tax debt and \$24.2 million in non-tax debt.

Once the activity exhausts all measures to collect a debt, it can refer the amount to a for profit collection agency for further action. However, the division retains the right to recall a case from an agency if circumstances warrant. Currently, the division contracts with three private collection agencies, which receive a percentage of the total dollars they collect: 20% for first referrals, 25% for second referrals and 30% for litigated cases. In FY 2004, these agencies collected about \$3.7 million of which \$2.8 million, 76%, constituted delinquent taxes.

Budget Activities Included:

- ◆ Collections

REVENUE DEPT

Program: DEBT COLLECTION MANAGEMENT

Program Summary

<i>Dollars in Thousands</i>					
	Current		Governor Recomm.		Biennium
	FY2004	FY2005	FY2006	FY2007	2006-07
<u>Direct Appropriations by Fund</u>					
General					
Current Appropriation	14,600	15,724	15,724	15,724	31,448
Subtotal - Forecast Base	14,600	15,724	15,724	15,724	31,448
Governor's Recommendations					
Enhanced Tax Compliance Initiative		0	690	1,320	2,010
Total	14,600	15,724	16,414	17,044	33,458
 <u>Expenditures by Fund</u>					
Direct Appropriations					
General	14,306	16,018	16,414	17,044	33,458
Open Appropriations					
General	1,856	1,900	1,900	1,900	3,800
Statutory Appropriations					
Special Revenue	74	74	74	74	148
Total	16,236	17,992	18,388	19,018	37,406
 <u>Expenditures by Category</u>					
Total Compensation	12,896	14,293	14,416	15,016	29,432
Other Operating Expenses	2,748	3,034	3,307	3,337	6,644
Capital Outlay & Real Property	592	665	665	665	1,330
Total	16,236	17,992	18,388	19,018	37,406
 <u>Expenditures by Activity</u>					
Collections	16,236	17,992	18,388	19,018	37,406
Total	16,236	17,992	18,388	19,018	37,406
 <u>Full-Time Equivalents (FTE)</u>					
	213.5	235.1	226.6	218.1	

Activity Description

This activity manages the collection of delinquent tax and non-tax debts on behalf of state agencies and other public entities.

Population Served

Taxpayers, tax administrators, legislators and staff, tax professionals, public policymakers, local elected officials, state agencies, local governments and other public entities.

Services Provided

This activity collects 171 types of fees, fines, taxes, and payments for:

29 State Agencies, including the departments of Administration, Agriculture, Corrections, Commerce, Economic Security, Health, Human Rights, Human Services, Labor and Industry, Military Affairs, Natural Resources, Public Safety, Revenue, Transportation and Veterans Affairs, and the Pollution Control Agency.

4 District Courts, including the District Courts of Hennepin, Ramsey, St. Louis and Stearns counties.

4 State Boards: the State Campaign Finance Disclosure Board, State Board of Client Security, Iron Range Resource Rehabilitation Board, and the State Veterans Home Board.

2 Public Employee Retirement Associations: the Minnesota Retirement System and the Public Employees Retirement Association.

7 Independent State Government Entities. These include the Attorney General's Office, the Secretary of State's Office, the Minnesota Indian Affairs Council, the Higher Education Service Organization, the Minnesota State Lottery, the Minnesota Office of Environmental Assistance and the Minnesota State Colleges and Universities system.

Services include locating debtors, billing, contacting debtor by phone, arranging and receiving payment, monitoring payment plans, locating and evaluating assets, issuing liens and levies, and seizing assets. Other services to agencies include consulting on effective debt management and productive collection practices, and evaluation of the potential for debt collection.

Historical Perspective This activity has always been responsible for collecting delinquent taxes owed to the Department of Revenue. Starting in 1993, its responsibilities were expanded to include the collection of debt owed to other state agencies and boards. Today, of the total \$249 million collected annually by this activity, approximately \$24.2 million is collected on behalf of non-tax debt clients. The collection costs are recovered through fees assessed against the debtors. Currently, the fee is 15%, with an additional 10% charged if legal action is required to collect the debt.

The total tax debt portfolio managed by this activity has climbed from \$290 million in FY 2001 to about \$404 million in FY 2004, an increase of about 39%. Correspondingly, the amount of tax debt collected annually has jumped from \$160.4 in FY 2001 to \$224.8 million in 2004, an increase of slightly more than 40%.

The rapid rise in total tax debt portfolio is partly the result of discontinuing the bad debt write-off program in September 2002. However, in 2004 this program was resumed, and about \$36 million of the total \$71.2 million deemed not collectible was written off. Uncollectible debt includes cases in which the debtor has filed for bankruptcy or died, where the business ceases to exist, the statute of limitations for collection of the debt expires, or the case is not economically feasible to pursue.

Activity at a Glance

- ◆ Managed an average of 178,000 delinquent tax debt cases and an average of \$404 million in delinquent tax debt in FY 2004.
- ◆ Managed an average of 170,000 delinquent non tax debt cases and an average of \$263 million in delinquent non tax debt in FY 2004.
- ◆ Collected \$225 million in delinquent tax debt in FY 2004.

REVENUE DEPT

Program: DEBT COLLECTION MANAGEMENT

Activity: Collections

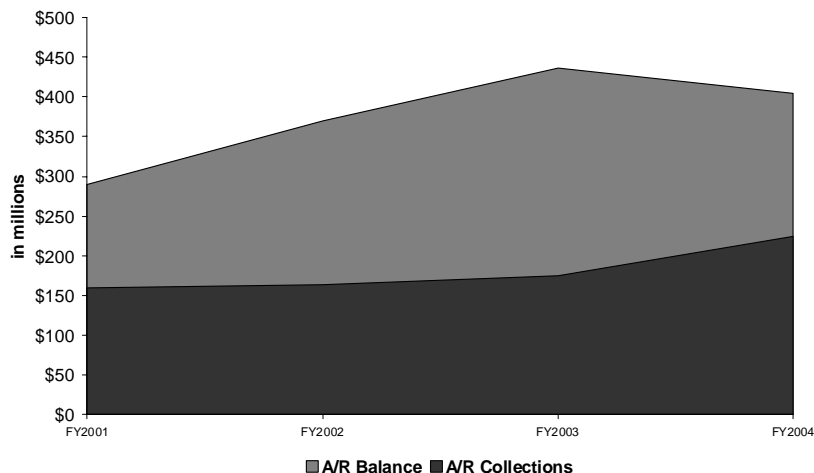
Narrative

About \$41 million of the debt portfolio is made up of dollars received through installment payment plans. Another \$33 million is owed by debtors whose debts are currently in the bankruptcy courts.

Other factors that have contributed to the rise in the tax debt portfolio include increased financial pressures on individuals and businesses due to the recent slump in the economy, an increase in bankruptcy filings, and expanded tax auditing activities undertaken by the agency.

This activity has been able to make significant gains on debt collection as result of several developments, including the appropriation of added funds by the legislation to expand collection activities, law changes to streamline the collection process, the automation of manually intensive processes, the expansion of databases, and reorganization to improve work processes.

Active Accounts Receivable



Key Measures

FY 2004

- ◆ Total dollars collected: \$272.7 Million
 - Tax collections \$224.8 Million
 - Non-tax collections \$24.2 Million
 - 2004 Initiative \$23.7 Million
- ◆ Total cases closed: 220,954
 - Tax cases 156,107
 - Non-tax cases 64,847

Activity Funding

This activity's biennial budget is \$33.3 million, or about 17.1% of the department's total budget. Of the total biennial budget for the Collections budget activity, \$33.1 million (99.6%) comes from General Fund tax dollars, and \$149,000 (.4%) comes from special revenue funds for administering the Local Option Sales Tax program.

Contact

Terri Hilger
Director, Collections
E-mail: terri.hilger@state.mn.us
Phone: 651-556-6366

REVENUE DEPT
 Program: DEBT COLLECTION MANAGEMENT
 Activity: COLLECTIONS

Budget Activity Summary

<i>Dollars in Thousands</i>					
	Current		Governor's Recomm.		Biennium
	FY2004	FY2005	FY2006	FY2007	2006-07
<u>Expenditures by Fund</u>					
Direct Appropriations					
General	14,306	16,018	16,414	17,044	33,458
Open Appropriations					
General	1,856	1,900	1,900	1,900	3,800
Statutory Appropriations					
Special Revenue	74	74	74	74	148
Total	16,236	17,992	18,388	19,018	37,406
<u>Expenditures by Category</u>					
Total Compensation	12,896	14,293	14,416	15,016	29,432
Other Operating Expenses	2,748	3,034	3,307	3,337	6,644
Capital Outlay & Real Property	592	665	665	665	1,330
Total	16,236	17,992	18,388	19,018	37,406
Full-Time Equivalent (FTE)	213.5	235.1	226.6	218.1	