

# MINNESOTA • REVENUE

## **Expanded Tax Compliance Initiatives**

**Fiscal Year 2012**

**Report to the Minnesota  
Legislature**

**July 2012**

# MINNESOTA • REVENUE

July 1, 2012

To the members of the legislature of the State of Minnesota:

The Minnesota Legislature appropriated \$13.7 million to the Department of Revenue in fiscal year 2012 to collect an added \$82.3 million in revenue by increasing tax enforcement activities. This is the first of two required reports on progress toward achieving this revenue goal.

The appropriation for increased compliance activities and wider use of tax analytics methods was authorized by the legislature under Laws of Minnesota 2011, 1st Special Session, Chapter 10, Article 1, Sections 14 and 39.

As of May 31, 2012, the Department has collected \$28.9 million, or 35.1 percent, of the \$82.3 million in revenue targeted for the FY 2012-13 biennium.

Of the \$28.9 million collected to date,


- \$7.7 million resulted from identifying nonfilers and increasing the number of audits of individuals and businesses. This includes the payers of lawful gambling taxes, insurance taxes, tobacco taxes and alcoholic beverage taxes.
- \$21.2 million resulted from an increase in delinquent tax collection activities.

Even as the Department works to meet the expectations of Chapter 10, the vast majority of overall tax revenues are the result of voluntary compliance. Sustained voluntary tax compliance requires multiple strategies beyond increased tax enforcement. Key strategies include: simplifying tax laws; conducting more taxpayer outreach activities; providing convenient access to tax information and education; obtaining better data; providing quality customer service; and creating easy-to-understand forms and instructions. We are committed to pursuing these strategies.

The activities described in this report are a part of the Department's ongoing effort to identify and address patterns of noncompliance with the state's tax laws – and to do so in a way that reinforces sustained voluntary compliance. Copies of this report are available at [www.revenue.state.mn.us](http://www.revenue.state.mn.us).

Please contact me if you need additional information.

Sincerely,



Myron Frans  
Commissioner

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**Laws of Minnesota 2011, 1st Special Session,  
Chapter 10, Article 1, Sections 14 and 39**

**Minnesota Department of Revenue  
600 North Robert Street  
St. Paul, Minnesota 55146  
651-556-6003  
[www.taxes.state.mn.us](http://www.taxes.state.mn.us)**

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## **I. Summary of Performance**

In 2011, the Minnesota Legislature appropriated \$13.7 million to the Department of Revenue for the 2012-13 biennium to collect \$82.3 million by expanding tax compliance activities and making wider use of tax analytics.

This report summarizes the results the Department has achieved through the end of May 2012. During this period — with 46 percent of the biennium completed — the Department has:

- collected \$28.9 million of the added \$82.3 million in revenue sought through the tax compliance initiative;
- expended \$ 2.4 million of the total \$13.7 million appropriated;
- collected 35.1 percent of target revenues while expending 17.2 percent of appropriation funding; and
- hired 51 FTE employees to support the expanded tax compliance initiative.

## **II. Purpose of this Report**

This report provides performance results in accordance with the legislation enacted during the 2011 session. It is the first of two required Department reports for the 2012-13 biennium.

The Department was appropriated \$13.7 million from the general fund to identify and collect taxes owed by individuals and businesses that currently do not pay file or pay taxes as required by state law.

This initiative is expected to result in new general fund revenues of \$82.3 million by the end of FY 2013. These expected new revenues were reflected in the February 2012 state budget forecast.

The Department is required to report to the chairs of the House Ways and Means and Senate Finance committees on the collection of new general fund revenues under this initiative. These reports are due by July 1, 2012, and January 15, 2013.

This report describes the current performance of the expanded tax compliance initiative and related tax analytics strategies. Fiscal year-to-date results referenced in this report reflect the period of July 1, 2011, thru May 31, 2012.

### **III. Tax Compliance History**

The first tax compliance initiative was authorized for the FY 2002-03 biennium. The Legislature appropriated \$10.3 million to the Department. Since then, the Legislature has appropriated funds for new initiatives each biennium – totaling \$99.2 million – including the current initiative for FY 2012-13.

The Department has collected a total of over \$610 million in added revenue since FY 2002 through these compliance initiatives.

These tax compliance appropriations have typically provided the Department with funds to increase FTEs in the Revenue Tax Specialist and Revenue Collection Officer classifications. At the same time, the Department has minimized the number of compliance support staff, which has reduced the support/compliance FTE ratio.

In FY 2001, the Department had 1,142 FTE employees. By FY 2011, that number had grown to 1,516 FTEs, an increase of approximately 33 percent. Currently, the compliance support budget comprises 30 percent of the Department budget, while the other 70 percent is allocated to direct compliance efforts.

### **IV. FY 2012-13 Expanded Tax Compliance Initiative Performance**

This report focuses on the Department's progress toward the expanded tax compliance initiative for FY 2012-13 and the expanded use of tax analytics related to that effort. A successful tax administration strategy must effectively support both voluntary tax compliance efforts and enforced compliance where necessary.

Tax enforcement that focuses on noncompliant taxpayers – including those who may not fully understand complex tax laws – helps ensure fair treatment and promotes respect for tax laws. However, enforced tax compliance is substantially more costly per dollar of revenue collected than voluntary compliance.

To the extent that the Department's emphasis has shifted toward enforcement, we are renewing our efforts to cultivate voluntary compliance while also meeting the expectations of the expanded initiative. These voluntary compliance efforts may include:

- increased taxpayer outreach and education seminars;
- enhanced usability of taxpayer facing compliance technologies, including the agency's website and e-Services (online filing and payment system);
- review of forms, documents and publications to ensure the use of plain language where appropriate;
- expanded development and use of educational videos;
- an expansion of electronic filing options; and
- improvements to communicate more efficiently and securely with taxpayers through email and an "extranet" (to exchange electronic information).

Historically, each tax compliance initiative has started off slowly – as staff, tools or data analysis tools were put into place – and then progressed more rapidly. The current initiative appears to be following a similar pattern. Below is a description of expenditures and collections for the current initiative through May 30, 2012.

### **Expenditures**

As of May 31, 2012, the Department has spent approximately \$2.4 million on this initiative. Payroll is the largest expenditure category, accounting for 95.5 percent of total expenditures. To date, 51 of the 81 FTEs planned for this initiative have been hired. Table 2.0 displays expenditure detail.

**Table 2.0.**  
**FY 2012-13 Expanded Tax Compliance Expenditures (through 5/31/2012)**

	<b>Expenditures</b>	<b>% of Total</b>
Payroll	\$2,251,840	95.5%
Contractual	60,332	2.6%
Equipment	20,535	0.9%
Supplies	5,798	0.2%
Travel	15,661	0.7%
Other	<u>3,665</u>	<u>0.1%</u>
<b>Total</b>	<b>\$2,357,831</b>	<b>100%</b>

### **Revenues**

Additional revenue is collected from increased compliance actions. As of May 31, 2012, (with 46 percent of the biennium completed), the total revenue collected from this initiative is \$28.9 million. Table 2.1 provides detailed financial statistics for each tax type/function from this initiative.

**Table 2.1**  
**Fiscal Year-To-Date Compliance Initiative Revenue Results**

<b>Tax Type/Function</b>	<b>Compliance Revenues</b>	<b>% of Total</b>
Collection	\$21,183,321	73.3%
Corporate Taxes	4,231,476	14.6%
Sales and Use Tax	2,258,503	7.8%
Special Taxes	272,129	0.9%
Tax Operations	104,415	0.4%
Withholding	<u>859,676</u>	<u>3.0%</u>
<b>Total</b>	<b>\$28,909,520</b>	<b>100%</b>

## **IV. Related Items**

The deliberations leading up to the current initiative involved a variety of tax compliance ideas and a clear expectation that the Department expand its use of tax analytics. This section summarizes activities in some of those areas.

### **Federal Reciprocal Program**

- Legislation was passed in July 2011 that allowed the Department to implement the Federal/State Reciprocal Program with the U.S. Department of the Treasury.
  - This program allows the Department to offset Federal vendor payments for Minnesota tax debts or “other agency debts” being collected by the Department. It also allows for the offset of Minnesota vendor payments to collect Federal non-tax debts.
  - The expected revenue from the Federal Reciprocal Agreement is \$4.3 million.
- Completed the following steps to fully develop the Federal Reciprocal Program:
  - Implementation of SWIFT – July 2011.
  - Rollout of non-tax debts into our integrated tax system – December 2011.
  - Rollout of Special Taxes into our integrated tax system – February 2012.
  - Created and tested file formats with SWIFT, DOR, and the U.S. Treasury Department.
- Implemented the Federal Reciprocal Program – May 2012.
  - We have received 215 Federal Vendor Payments that total \$341,486.81 (to date).

### **Tax Analytics – Background**

- The statewide Master Contract for Analytics was approved in December 2011.
- 22 data analytics vendors were certified by the Department of Administration as part of the Master Contract; 10 of those vendors were certified to provide tax analytics.
- Prior to final certification, the Department initiated a team of agency leaders to shape Department strategies around tax analytics so we could engage analytics vendors more quickly.
- In January 2012, the Department met with 9 of the 10 certified vendors to better understand the tools and techniques they were offering. The vendors offer a range of tools, including:
  - Enhanced fraud detection
  - Transfer pricing support
  - Improved audit selection
  - Collection case prioritization
- The Department is reviewing and considering all options, based on vendor demonstrations and “proof-of-concepts.” These proof-of-concepts are a key step to ensure the tools will make our compliance efforts more efficient or effective.



- Work is underway or contracted in the following areas:
  - Fraud detection – to prevent invalid refunds.
  - Improved audit selection – to minimize marginally productive audits and focus instead on taxpayers that are furthest from compliance.
  - Collection case prioritization – to focus our collection efforts on taxpayers who are furthest from compliance.
- The following areas are still under review:
  - Early audit during processing
  - Transfer pricing
  - Flow-through entity visualization
  - Evaluation of statistical software to support analytics

### **Tax Analytics – Ongoing**

- Complete current and additional proof-of-concept studies with certified tax analytics vendors.
- Execute contracts with vendors for services and tools that demonstrate added value for the Department’s compliance activities.
- Incorporate chosen vendor solutions into ongoing operations

### **Tax Analytics – Next Steps**

- Install data analytics software and configure Integrated Tax modules that support statistical integration.
- Provide additional training for agency employees to use the tools and techniques, including dedicated support to ensure users are proficient with best practices and advanced features.
- Create 2 “Model Deployments” that will comprise at least 4 analytic models. (One example of an analytic model is sales tax audit selection.) These models will produce predictive scores that can be used in audit, collection, fraud and processing activities. Each deployment will be documented and approved by the Department.
- Enhance our Data Warehouse as needed to improve the effectiveness and accuracy of the new analytics models. (This will be part of Model Deployment 1 and 2.)
- Modify and enhance our reporting processes to ensure we can accurately measure the results from the tax analytics initiatives.
- Produce a Department report that documents increased revenues, efficiencies and other outcomes.