

# MINNESOTA · REVENUE



## Expanded Tax Compliance Initiatives

Fiscal Year 2013

Report to the Minnesota  
Legislature

January 2013

## MINNESOTA • REVENUE

January 15, 2013

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 years 2012-13 with the expectation that the Department collect \$82.3 million from increased compliance enforcement. In addition, the legislation (Laws of Minnesota 2011, 1st Special Session, Chapter 10, Article 1, Sections 14 and 39) supported a wider use of tax analytics methods as part of the compliance initiative. This is the second of two required reports on progress toward achieving this revenue goal.

As of November 30, 2012, the Department has collected \$57.3 million, or 70 percent, of the \$82.3 million in revenue targeted for the FY 2012-13 biennium.

Of the \$57.3 million collected to date,

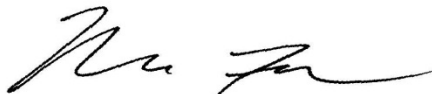
- \$16.6 million resulted from identifying nonfilers and increasing the number of audits of individuals and businesses. This includes the payers of lawful gambling taxes, insurance taxes, tobacco taxes and alcoholic beverage taxes.
- \$40.7 million resulted from an increase in delinquent tax collection 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. Strengthening our voluntary compliance efforts is a key agency priority for the coming biennium.


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



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

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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 November 2012. During this period — with 71 percent of the biennium completed — the Department has:

- collected \$57.3 million of the added \$82.3 million in revenue sought through the tax compliance initiative;
- expended \$ 6.3 million of the total \$13.7 million appropriated;
- collected 70 percent of target revenues while expending 46 percent of appropriation funding; and
- hired 84 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 second 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 file or pay taxes as required by state law. At least \$1.7 million of the amounts appropriated in the first year were for advanced tax analytics and business intelligence tools.

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, through November 30, 2012.

### **III. FY 2012-13 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 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 November 30, 2012.

#### **Expenditures**

As of November 30, 2012, the Department has spent approximately \$6.3 million on this initiative. Payroll is the largest expenditure category, accounting for 75.3 percent of total expenditures. To date, all of the FTEs planned for this initiative have been hired.

Table 1 details expenditures for this initiative.

**Table 1.**  
**FY 2012-13 Expanded Tax Compliance Expenditures (through 11/30/12)**

	<b>Expenditures</b>	<b>% of Total</b>
Payroll	\$4,727,608	75.3%
Contractual	1,341,892	21.4%
Equipment	54,534	0.9%
Supplies	85,073	1.3%
Travel	57,652	0.9%
Other	14,163	0.2%
<b>Total</b>	<b>\$6,280,922</b>	<b>100%</b>

Initiative expenditures have ramped up with the completion of all biennium FTE hiring since last reported in July 2012. Average monthly expenditures reported in July for the first 11 months of the biennium were \$214,348 and have since averaged \$653,849.

**Revenues**

Additional revenue is collected from increased compliance actions. As of November 30, 2012, (with 71 percent of the biennium completed), the total revenue collected from this initiative is \$57.3 million. Table 2 provides detailed financial statistics for each tax type/function from this initiative.

**Table 2**  
**Fiscal Year-To-Date Compliance Initiative Revenue Results**

<b>Tax Type/Function</b>	<b>Compliance Revenues</b>	<b>% of Total</b>
Collection	\$40,738,174	71.0%
Corporate Taxes	5,700,117	9.9%
Individual Income	870,025	1.5 %
Sales and Use Tax	4,059,123	7.1%
Special Taxes	1,467,857	2.6%
Tax Operations	940,878	1.7%
Withholding	3,566,786	6.2%
<b>Total</b>	<b>\$57,342,960</b>	<b>100%</b>

Monthly revenue generation also has accelerated with the additional FTE hiring since the last report in July 2012. As reported in July, average monthly revenue for the first 11 months of the biennium was \$2.6 million and has since accelerated to \$4.7 million.

## **IV. Tax Analytics**

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 our expanded tax analytics activities.

### **Background**

Laws of Minnesota 2011, Chapter 10, 1<sup>st</sup> Special Session, directed the Department to invest \$1.7 million of the compliance initiative funding to expand use of tax analytics in its audit and collection efforts. Analytics involves the use of computer modeling and software to analyze tax returns, revenue collections and other data to increase efficiency, detect tax fraud, and prioritize audit and collection activities.

Starting in January 2012, the Department met with 10 tax analytics vendors. We conducted seven “proof-of-concepts” to identify tools that would add to existing tax analytics efforts at the agency. We contracted with four vendors whose products or services showed potential “added value” for the Department.

These contracts include:

- Data comparison services to look at the Department’s fraud detection processes and compare them with alternatives. The results verified our existing processes are working and offered some new ideas to consider on how to identify potentially fraudulent returns.
- Data “scoring” services to help develop an audit selection model for small-to-medium business filers. This model could help focus our efforts on businesses that are furthest from tax compliance, rather than those who simply made a mistake on their return(s).
- Software and modeling services for the Department to develop an ongoing analytics program within our Integrated Tax System. .
- Specialized modeling services that enhance our ability to identify nonfilers who fail to report substantial income they earn from online sales.



**Expenditures**

Table 3 details our expenditures on expanded tax analytics through June 30, 2012.

**Table 3  
Tax Analytics Expenditures**

<b>Type/Purpose of Expenditure</b>	<b>Amount*</b>
Project manager to evaluate Master Contract offerings, pilots	\$100,000
Consulting and software to enhance Integrated Tax System	\$522,000
Modeling services to identify noncompliance relating to online sales	\$38,000
Software and contractor to enhance Data Warehouse	\$200,000
Pilot program to identify potential tax refund fraud	\$1,000
Pilot program to enhance small-to-medium business audit selection	\$100,000
Software and services to support tax analytics, other data analytics	\$551,000
Hardware to expand tax analytics capabilities	\$139,000
<b>Total</b>	<b>\$1,651,000</b>

*\* The department planned two additional pilots, at a cost of \$100,000 each. But one vendor withdrew from the project, while the other experienced delays (we continue to review this vendor for future pilots).*

**Ongoing**

As new tax analytics models come online, the Department is training agency employees to use the tools and techniques. This effort includes dedicated support to ensure users are proficient with best practices and advanced features.

To date, we have developed and deployed three software models into our Integrated Tax System, with three more under development. These models will produce predictive scores to be used in audit, collection, fraud and processing activities. They are summarized in Table 4 (see next page).

**Table 4**  
**Tax Analytics Model Deployments**

<b>Type/Purpose of Analytics Model</b>	<b>Status</b>
Identify potentially fraudulent returns as they are processed	Deployed
Prioritize collections cases to focus on least compliant taxpayers	Deployed
Select sales tax audit candidates	Deployed
Select corporate tax audit candidates	Development
Select withholding tax audit candidates	Development
“Early audit” of returns claiming refundable tax credits identify potential fraud	Development

**Next Steps**

The use of these advanced tools will help the Department build on its earlier “homegrown” tax analytics efforts – such as our Data Mining Pilot with the University of Minnesota – and support Governor Mark Dayton’s goal of an efficient, customer-focused state government.

To support this effort, we have enhanced our reporting processes to ensure we can accurately measure the results from tax analytics and other related initiatives. We will monitor the results of this effort and track any revenue increases, efficiency savings or other outcomes.

We are also exploring how the Department can use tax analytics to provide better customer service and support voluntary compliance. One example of this would be using analytics results to focus and tailor the Department’s outreach and education efforts for various taxpayer groups.