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1998 Annual Performance Report

Our mission is to achieve compliance with the tax laws.



January 1999

A message from the commissioner

I am pleased to present the 1998 Annual Performance Report of the Minnesota Department of Revenue. Within these pages we'll tell a little about what we do, how well we do it, and where and how we're trying to improve our service and performance.

You may be thinking to yourself, "I already KNOW what the Department of Revenue does—they collect state taxes!" That's true enough, but did you know that we also...

- send over a billion dollars annually back to cities, counties, and school districts to hold down local property taxes.
- send over a half-billion dollars annually back to homeowners and renters for property tax relief.
- collect and distribute \$65 million annually in local sales taxes.
- collect and distribute, on average, over \$1.5 million annually in non-tax debts owed to other agencies, local governments, and individuals.

The way we approach tax collection might also surprise you: our mission is to do what it takes for citizens to successfully meet their tax obligations. That means every taxpayer should pay the correct amount of tax, no more and no less than they owe. It also means we want you and every other taxpayer to receive every credit, deduction and refund to which you are legally entitled. After all, it's your money!

We have also long since realized that we can't audit our way to a good tax system. While audit has an important role in tax administration and always will, we know that the vast majority of taxpayers want to do things right. Our job is to see that they get the information and help they need to be successful. This report shows how well we've achieved that goal thus far.

I am proud of the progress we've made over the past several years—including sharpening our focus on our agency's key goals and performance and managing our resources better to achieve them. Among other things, this has led to dramatic improvements in telephone service levels, innovations in audit and education practices, and a reduction in the overall cost to collect a hundred dollars of state tax, from \$1.09 in 1991 to 83 cents in 1998.

We also face some continuing challenges. Two in particular loom large:

- Complicated, constantly changing tax laws make it harder for taxpayers to do things right.
- Managing technology: both keeping up with rapid change, and replacing the outdated systems and processes that limit our ability to meet our customers' needs.

This report provides a snapshot of who we are, what we do, the results we've achieved thus far, and what we hope to achieve in the future on behalf of Minnesota citizens and taxpayers. We believe we are on the right track, and I hope you will think so, too.

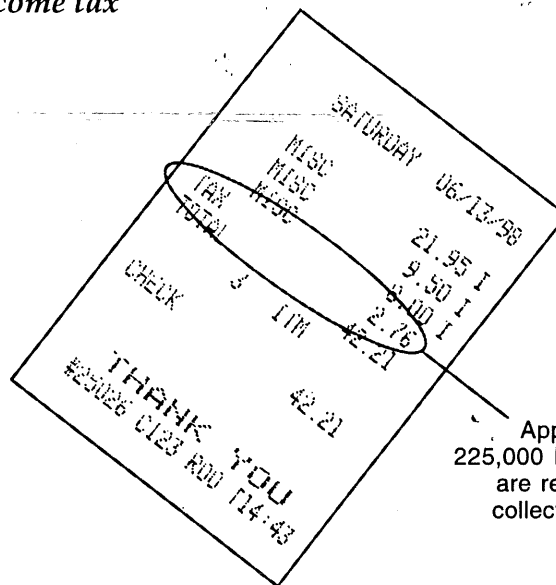
Matt Smith
commissioner

The Minnesota Tax Picture

The Minnesota tax picture—you'd need a really big lens to capture it! Whether you're a consumer, a homeowner or renter, a business owner or one of the 3.2 million people who file individual income tax returns, you're part of it.

We are responsible for administering Minnesota's tax laws. The money we collect from taxpayers—close to **\$10 billion** annually—helps fund nearly all programs and services provided by the state and (through state aid payments) local governments.

Last year, 2.4 million Minnesota individual income tax returns were filed. That's the equivalent of one return for every two of Minnesota's 4.7 million citizens.



Approximately 225,000 businesses are registered to collect sales and use tax.

Our mission: to achieve compliance with the tax laws

To carry out our mission, we work toward these goals:

Tax Compliance

Everyone is paying what is owed, no more and no less.

Customer Satisfaction

Taxpayers are satisfied because they are treated like customers and we deliver services that meet their expectations.

Operational Excellence

The revenue system is fair, efficient, reliable, competitive and understandable in structure and operation.

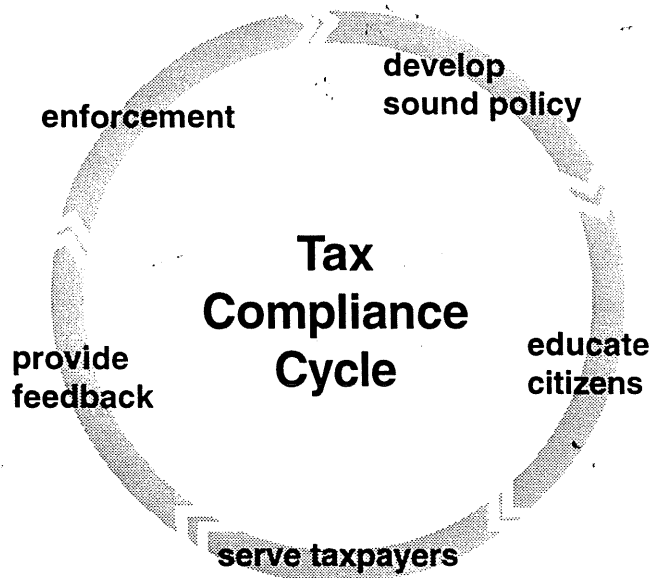
Employee Learning and Growth

Employees receive the support and training they need to effectively perform their work.

Minnesota's tax system is based on voluntary compliance.

Our tax system depends on citizens voluntarily complying with the tax laws. We believe that most citizens want to do their taxes right. Voluntary compliance means that taxpayers understand their responsibilities, they receive the appropriate information and services to correctly determine their tax liabilities, and they meet their filing and payment obligations.

Each year, on average, 95 percent of the tax revenue we receive represents voluntary payments for tax liabilities as reported by taxpayers. Approximately 5 percent of revenue is the result of audit and collection efforts.



Our fundamental business strategy is to support and expand voluntary compliance through a five-step "Achieving Tax Compliance Cycle."

- We **develop sound policy** and efficient operations that support tax compliance and satisfied customers.
- We **educate citizens** about their rights and obligations under the tax laws and help people meet their obligations.
- We **serve taxpayers** by helping them comply with the law through information and assistance. We provide fast transaction processing and accurate account management.
- We **provide feedback** through auditing and other means to tell taxpayers how well they are understanding and complying with their obligations.
- We use progressively tougher **enforcement** as needed when taxpayers fail to meet their obligations.

Each step in the cycle is vital to our mission. Our challenge is to find—and fine-tune—the right "mix" of activities in order to reach and maintain the highest possible level of voluntary compliance.

Our performance measures indicate how successful we are at finding and implementing this "mix."

What our customers want

A focus on service needs

We know that paying taxes is not easy. We also know that most people want to do the right thing and meet their tax obligations. Our customers are entitled to the services and support they need in order to meet their obligations, including:

*clear and understandable tax laws, forms, and instructions,
simple, straightforward processes for filing and paying, and
timely assistance they can rely on.*

They also expect:

*to be treated the same as other taxpayers in similar situations,
that the information they give us will be kept confidential,
that we will maintain accurate records on their behalf, and
that we will work on their behalf to identify people who are not
filing and paying.*



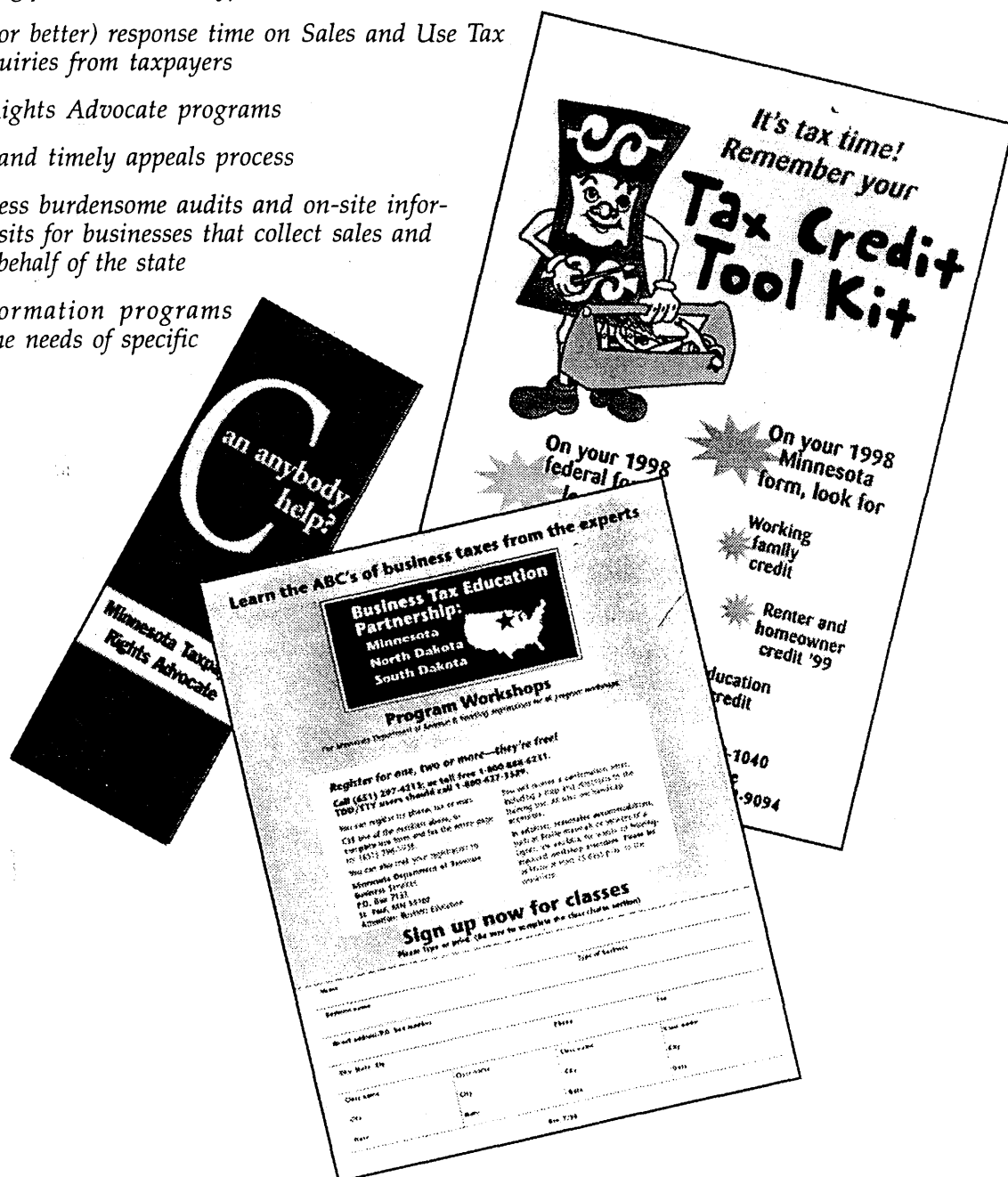
How do we know what our customers want? We gather information through a variety of means:

- *the comments they make to our employees*
- *analyzing the reasons for calls and letters*
- *surveys*
- *customer group meetings*
- *taxpayer education class participant evaluations*
- *interaction with industry groups and tax professional organizations*
- *partnerships with other taxing authorities, including local units of government and the IRS*

How we serve our customers

We are committed to treating the taxpayers of Minnesota as valued customers who need our services in order to meet their state tax obligations. We work hard to respond to their needs for service and information. Our products and services include:

- tax forms and packets mailed to homes and businesses, and provided at libraries, malls and on our web site on the Internet
- regular information and education classes for several tax types
- 24-hour phone service and 95 percent of calls answered the first time
- internet filing for selected tax types
- seven-day (or better) response time on Sales and Use Tax written inquiries from taxpayers
- Taxpayer Rights Advocate programs
- responsive and timely appeals process
- expedited, less burdensome audits and on-site informational visits for businesses that collect sales and use tax on behalf of the state
- public information programs geared to the needs of specific audiences

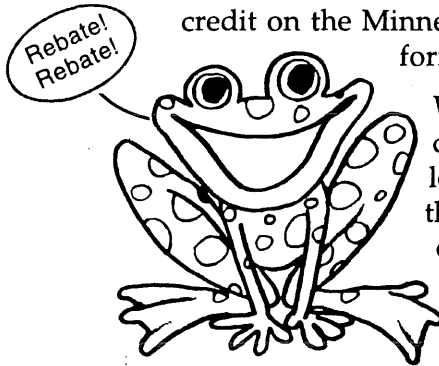


The Minnesota Tax Picture

1998 in review — major accomplishments

Returning the budget surplus

Presented with a record \$2.3 billion state budget surplus, the governor and the 1997 Minnesota Legislature had the enviable task of returning tax dollars to the people. How best to do this? Through a rebate, calculated as a percentage of property tax paid. Instructions for calculating the rebate were included in the 1997 income tax instructions, and the rebate amount was listed as a credit on the Minnesota income tax form.



We worked closely with legislators and the governor's office to publicize the new rebate. We held press confer-

ences, participated in call-in radio and television programs statewide, and presented information at trade shows and other venues.

Our goal was to ensure that everyone who was eligible for the rebate actually received it. We added more staff to answer phones, kept seasonal employees on board longer to handle the additional work volume and the more complicated returns, and increased marketing efforts to promote electronic filing and to respond to problems with errors on returns.

Average rebate:	\$265
Homeowners receiving rebate:	1,238,000
Renters receiving rebate:	415,000

Revenue Relocates

The Department of Revenue's most notable change during 1998 was its move from 10 River Park Plaza, across the Mississippi River from

downtown St. Paul, to a gleaming new building at 600 North Robert Street, near the State Capitol.

In just 13 months (September 1997 to October 1998) from ground-breaking to completion,

Revenue successfully moved its more than 1,100 St. Paul employees — plus more than 500 tons of files, equipment and office furniture — to a new, state-of-the-art facility equipped to handle the challenges of the new millennium and to serve the public better. The move was executed with minimal interruption of service to customers; most taxpayers probably didn't detect a difference, save for the address change. The new Revenue building was completed on time and on budget.

600 North Robert

381,000 sq. ft. of high-tech space
263,000 sq. ft. of parking
2,600 tons of steel
30,000 sq. ft. of exterior glass
14,000 cubic yards of concrete
123 miles of electrical wiring
10 miles of piping
450 tons of ventilation ductwork
20,000 light bulbs

Winning Partnerships “not just in the state tax business anymore”

The Minnesota Department of Revenue does more than just collect taxes on behalf of the state. It also offers collection services for other units of government.

Minnesota Collection Enterprise

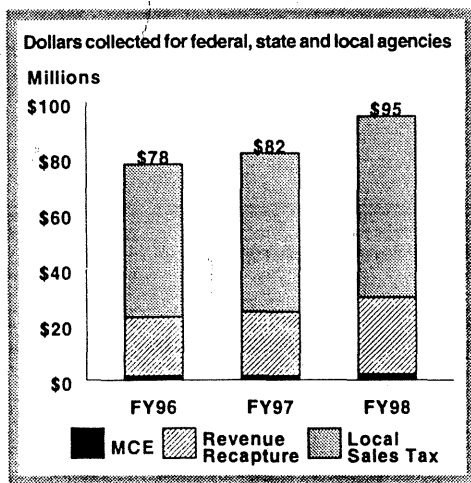
The Minnesota Collection Enterprise (MCE)—a unit of the Revenue Department based in Ely, Minnesota—was created in 1994 to provide low-cost collection services for state agencies and courts. Currently, 30 state agencies and three district courts are MCE clients. Each year around \$1.5 million in non-tax debt is collected; in 1998, that figure reached \$2.18 million. Our goal is to collect \$11 million in non-tax debts for 1999. Using MCE’s professional collection services enables these public entities to focus their resources on their primary mission.

Revenue Recapture

The Revenue Recapture program was established by the Minnesota Legislature in 1980. The program enables governmental units to collect money owed them by applying the debtors’ tax refunds to the amount of the debt. In 1998, this program served 550 agencies and collected \$27.5 million.

Local Option Sales Tax

The department also collects local option sales taxes on behalf of cities and counties throughout the state. After a local tax is approved by the state legislature and local citizens, the department works with city or county officials to notify taxpayers and to develop a tax administration agreement. In FY98, we collected over \$65 million in eight local option sales taxes. Two more local sales taxes will take effect in FY99.



The Minnesota Collection Enterprise won the 1998 Partnership Minnesota award for Government Administration for its proficiency in debt collection.

Business performance: our 1998 results

Our performance measures are linked to our goals for tax compliance, customer satisfaction, operational excellence, and employee learning and growth. These goals are an integral part of our department's strategic plan and serve as the framework for

determining how well we are performing on a year-by-year basis. This summary section describes the measures we are using to mark our progress in achieving our vision and mission.

Goal 1: Tax Compliance

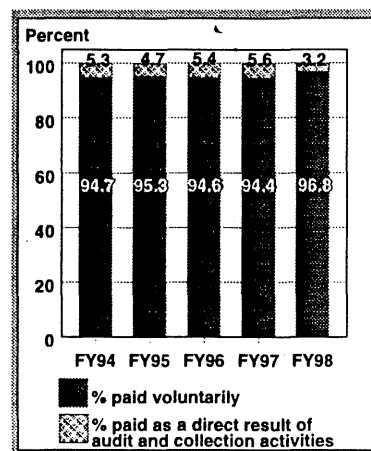
*Everyone is
paying what is
owed, no
more, no less.*

Goal 1: Tax Compliance

Because voluntary compliance is the foundation for our state's revenue system, we need to know how well our customers understand their responsibilities to file and pay their taxes. Our role is to help them "do their taxes right."

In recent years, about 95 percent of receipts have come via voluntary compliance (chart, right). This first measure reminds us that our primary task is to support and improve voluntary compliance using a balance of sound policy,

education, service, feedback, and progressive enforcement.



The "Tax Gap." Another important tax compliance measure is the difference between what should be reported and what is actually paid and received. This "tax gap" is notoriously difficult to measure. However, through sample audits, we have studied compliance levels for both sales and use tax in various industries (below). While sales tax compliance has generally been quite good, use tax compliance has always been more difficult to

achieve. (Minnesota use tax is due when a taxable item is purchased outside the state for use here.) We have conducted similar studies for our personal and corporate income taxes and are continuously seeking to improve our measurements in this area.

The percentage of tax dollars reported correctly in sample populations.

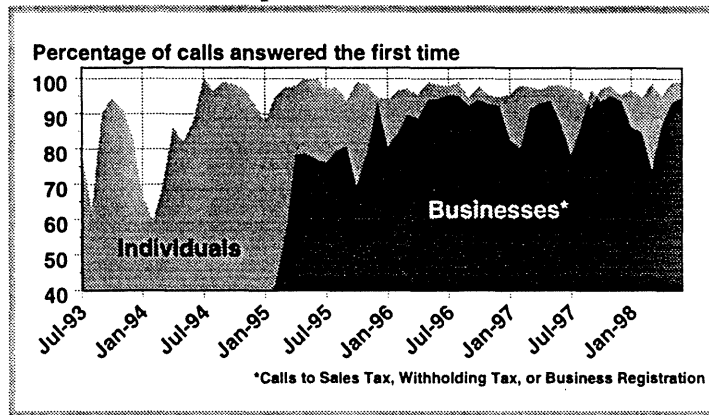
	FY	Sales		Use	
		Large*	Small	Large	Small
Banking	1993	99%	94%	79%	16%
Dentists	1996	96%	92%	30%	35%
Medical Doctors	1996	98%	76%	63%	13%
Other Health	1996	92%	88%	2%	5%
Accountants	1997	100%	84%	91%	17%
Cable TV	1997	99%	99%	85%	16%

*Large/small categories determined by the amount of Minnesota withholding tax remitted annually. Size break varies by industry.

Goal 2: Customer Satisfaction

Phone service. We practice good customer service because it is the right thing to do. Most important, it helps taxpayers understand what they need to do in order to comply with the laws. We know that if people can't reach us when they have questions, they're more likely to make errors. Our goal is for people to reach us the first time they call. After working to improve our phone service for over four years, we are now able to answer 95 percent of individual income tax calls the first time, and we are close to that level for our business

tax customers (chart, below). We have added interactive voice response technology, shifted staff during peak periods, and made more people available for more hours to answer questions. Our goal for all phone service over the next two years is targeted at 98 percent for individuals and 90 percent for businesses.

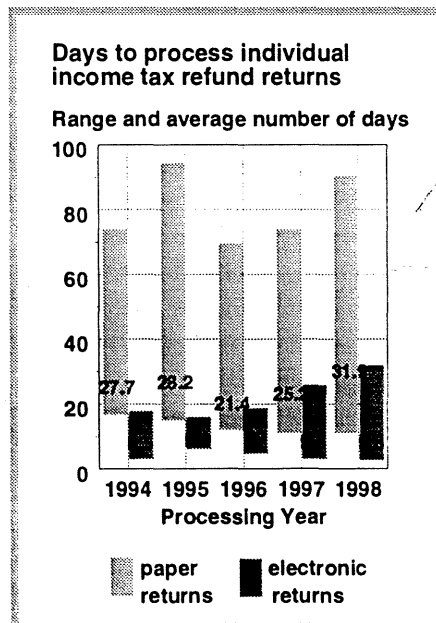


Goal 2: Customer Satisfaction

Taxpayers are satisfied because they are treated like customers and we deliver services that meet their expectations.

Fast refunds. Our customers also expect prompt service when it comes to returning the money we owe them—their refunds. To help people get their refunds as fast as possible, we encourage electronic filing. On average, it takes 10 days or less for a refund on an electronically filed return, while refunds on paper returns take about a month, and can take much longer if filed during peak busy times (chart, at right).

“Painless” audits? Another way to measure our customers' satisfaction is simply to ask them what they think. We do this in several ways, one of our strongest measures being our Audit Quality Survey. For example, since 1992, over 90 percent of those responding to the audit survey sent by the Sales and Use Tax Division have agreed that



their needs were met during the audit process. While audits will always be a fact of life, we want to do everything we can to minimize the burden they place on taxpayers.

Goal 3: Operational Excellence

The revenue system is fair, efficient, reliable, competitive, and understandable.

We work toward making Minnesota's revenue system fair, efficient, reliable, competitive, and understandable. As chief administrators of the system on

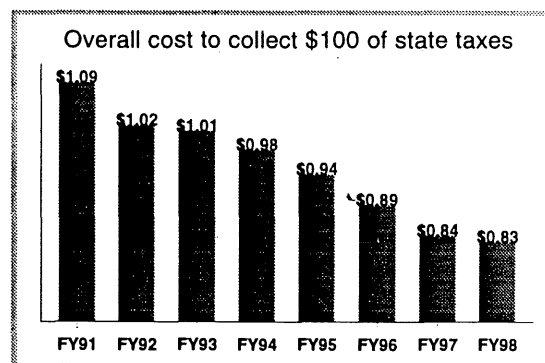
behalf of Minnesota and its citizens, it is our responsibility to ensure its reliability and efficiency.

Goal 3: Operational Excellence

Our first broad efficiency measure is our cost to collect \$100 in taxes (at right). Since 1991, this figure has declined almost 25 percent, from \$1.09 to \$.83 for FY98.

This steady decline reflects two factors: the sustained growth in tax receipts over the past eight years, and a flat department budget over the same period. Furthermore, the decreasing cost to collect state taxes means that more of each tax dollar paid can go directly to fund the

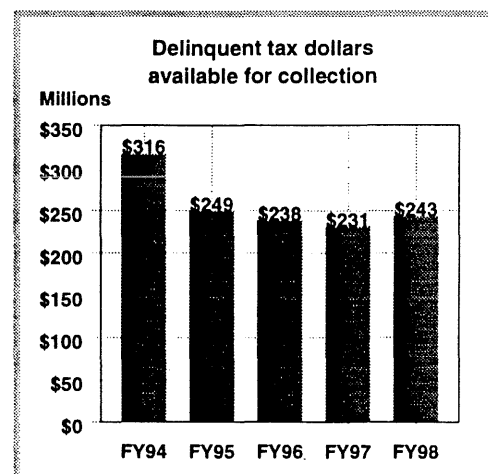
public services for which it is intended.



Our second measure of efficiency is our ability to deposit receipts, i.e., how quickly we get the state's money in the bank. Minnesota benefits by earning interest as soon as possible. For the last two years, we have been able to deposit at least 80 percent of the dollars received by the next business day, and in FY98 we reached our goal of 85 percent. The growing use of electronic funds transfer (which now accounts for 70 percent of all dollars processed) was in large part responsible for this improvement.

A final measure of efficiency is our ability to collect delinquent taxes—our Accounts Receivable.

In the last five years, the total dollars available for collection (either by our collection division or by the private firms under contract to collect on the state's behalf) have dropped from \$316 to under \$250 million (see below). Our goal is to further reduce this amount to \$200 million in the next two years.



Our employees are our greatest asset. Computer systems, office facilities, and tax forms and instructions are important, but in the end, tax admin-

istration is done by people. It is essential for us to create and sustain a work environment that leads to satisfied and productive employees.

Goal 4: Employee Learning and Growth

The Department of Revenue's employees work in over 120 different jobs, from tax collectors and tax specialists to management analysts and computer programmers.

Approximately 55 percent are women; most—95 percent—are represented by unions. Close to 10 percent are members of one or more ethnic or racial minorities.

Stability is a key characteristic of our workforce; the average length of service is 15 years. However, dramatic changes are only a few years away: 40 to 50 percent of us will be eligible for retirement by 2003.

It's our responsibility to help our current workforce adapt to new technologies, gain new skills, and develop new products and services, as well as to recruit and retain the next generation.



Revenue's 1,200 employees are located in 15 Minnesota and 9 national offices.

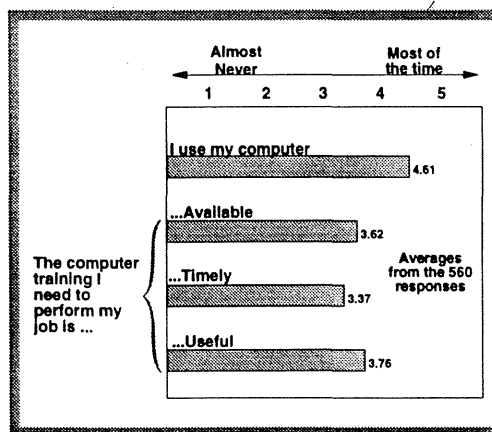


Goal 4: Employee Learning and Growth

Employees receive the support and training they need to effectively perform their work.

Employee satisfaction. Since 1989, we have surveyed employees on important areas such as work challenge, opportunity to learn, training, management support, and resources. In 1997, we replaced the paper-and-pencil survey with electronic "Pulse Taker" e-mail surveys to gather employee feedback quickly and frequently.

One recent Pulse Taker asked about computer training (responses at right). Of the 560 employees who responded, the majority rely heavily on computers to perform their work. While available training was generally felt to be useful,



responses to the other questions made it clear that we must do more to ensure that training is also available when employees need it.

Looking Ahead: 1999 and Beyond

Income tax re-engineering: building a better tax system

Our income tax system, with 3 million taxpayers and \$5 billion in annual receipts, affects the lives of every citizen. However, this vital component of our public finance system is supported by outdated business practices and old, fragile computer systems. As a result, our ability to provide good service to our customers and policymakers is substantially limited.

The existing income tax system.

The business practices and computer systems that make up our current system are nearly 30 years old; that makes it a real dinosaur, in terms of information technology.

For example, it can take 70 days for a return to be entered and available for use, in spite of the fact that only 10 minutes or less of actual work time is required.

It can take us three years to identify

errors made by taxpayers on their returns and to contact them.

It's not just a matter of replacing the old with something more efficient; the current system is at risk, depending as it does on hardware and software that is old and fragile.

There are estimated to be hundreds of millions of dollars in unpaid income tax annually, mostly due to unreported income.

As a result, our operating costs for processing routine transactions are too high, we are unable to meet the increasing demand for electronic filing, and, most important to our mission, our ability to achieve compliance is seriously limited. It is easy to see that the performance of the Minnesota income tax system needs dramatic improvement.

Designing a better system. We have begun a redesign of the following key business processes in the income tax system: taxpayer identification, filing and paying, and compliance. Cross-functional teams drawn from across the agency—aided by the appropriate technology—are at work designing new approaches that will enable us to reach significantly better performance levels for taxpayers and the state. We expect to finalize design and begin initial implementation during 1999, with implementation continuing over the coming years.

The image shows a tilted view of a Minnesota Department of Revenue Individual Income Tax 1998 form. The form is filled out with various numbers and text, including sections for personal information, deductions, and credits. The form is tilted at an angle, making it difficult to read the specific details, but the layout and structure are clearly visible.

Managing technology for the next millennium

Our emphasis on good customer service and operational excellence requires us to rely heavily on modern information technology. Three of the major business technology issues we now face are:

Obsolete computer systems.

Large parts of some of our computer systems are obsolete and face the immediate risk of failing. Over the years, these computer systems have been asked to handle an increasing number of complex transactions, at a greater speed and with a greater degree of expected accuracy, yet our recent assessment showed that many of the systems with the highest business value were in the poorest technical condition. As a result, we are undertaking a major re-engineering of our income tax system and are planning for similar projects (but on a smaller scale) that will ensure our continued ability to meet the needs of our customers and the state's revenue system.

Increasing cost of maintaining information systems and retaining information systems (I/S) staff.

While our dependence on technology grows, the costs for information systems increases, and is expected to reach 30 percent (over \$20 million) of our budget by the year 2000. Similarly, we continue to experience increases in our cost to attract and retain the qualified I/S staff needed to maintain and upgrade or replace our obsolete technology. To help meet these challenges, we have invested available money from other parts of our budget; this move has af-

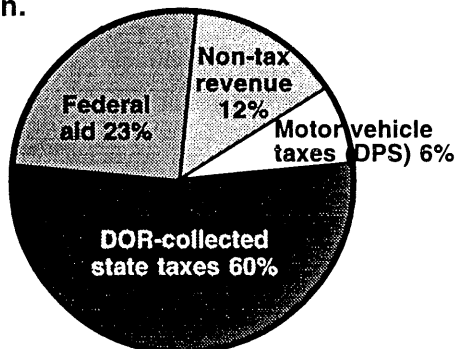
fectured our ability to meet other needs, including our taxpayer service and compliance activities.

Moving beyond Y2K: Year 2000 readiness disclosure. Since 1996, we have been involved in a state-wide effort to deal with "Y2K" problems—the so-called "millennium bug" affecting computer business applications that use only two digits to designate the year. Since 1987, all of the Department of Revenue's new business application systems have been designed to include a four-digit year in all date fields. However, some of our older systems dating back to the 1960s have required extensive Year 2000 compliance modifications. We have analyzed close to 300 applications, over 100 different software tools, and several thousand computer programs written in many diverse programming languages. We are working to ensure that state revenues are timely and accurately processed, and we expect no interruption of service resulting from the coming change.

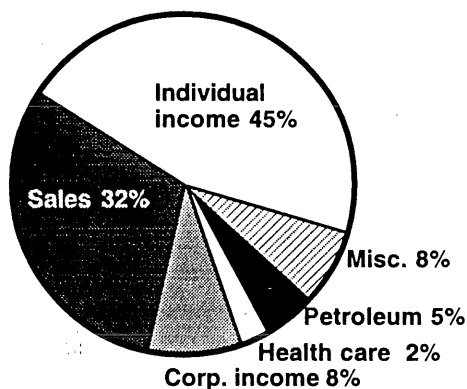


The Minnesota Department of Revenue *at a glance*

Minnesota's revenue from all sources is \$17 billion.

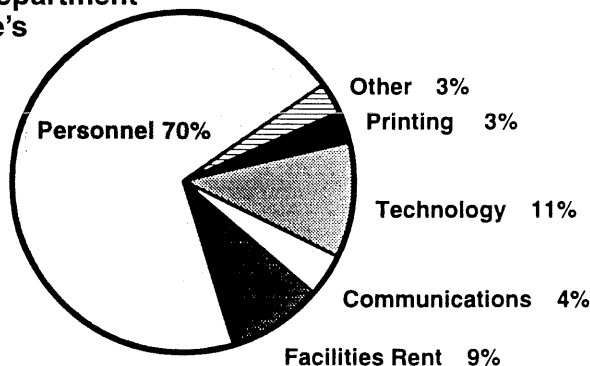


Of that amount, the Department of Revenue collects \$10 billion, or 60%.



The department administers 28 taxes.
Cost to collect \$100 of taxes: 83¢

How the Department of Revenue's budget is allocated:



1,231 employees work at 24 locations—
15 in Minnesota, 9 elsewhere

1998 telephone tax help:

900,000 individual income tax calls,
72,000 sales and use tax calls

4,250 visitors to the Revenue web site per week

5.7 million pieces of mail received per year

How to contact us:

General Information
(651) 296-3781
1-800 652-9094

TDD/TTY: contact
MN Relay Service at
1-800-627-3529

Web site:
www.taxes.state.mn.us

MinnesotaCare tax, 1992

1990

Hazardous waste tax, 1983

1970

Sales tax, 1967

1950

Cigarette tax, 1947

1930

Gift tax, 1937
Liquor tax, 1934
Income tax, 1933

Fuel tax 1925

1910

Mortgage tax, 1907
Inheritance tax, 1905

1890

Iron ore tax, 1881

1870

Premium tax on insurance companies, 1872

1850

State Board of Equalization, 1860

Statehood, 1858

Property tax, 1849