Estimating and Reducing the Tax Gap in Idaho

December 1996

Office of Performance Evaluations
Idaho State Legislature

Report 96-06

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In July 1996, the Joint Legislative Oversight Committee directed the Office of Performance Evaluations to estimate the state's "tax gap," the difference between the amount of taxes paid to the state and that which is legally due. The committee also requested that we evaluate the Tax Commission's efforts to reduce the gap through its tax enforcement efforts.

I respectfully submit our completed evaluation for your review and consideration. We estimate that the state's tax gap for individual income tax, corporate income tax, and sales and use tax totals $245.8 million. Tax Commission efforts have reduced this gap, although the cost of identifying and collecting unpaid tax makes full collection unlikely. Based on the methodologies available, we estimate that an additional $46.9 million could be collected through increased efforts and improved use of Tax Commission resources.

Our report includes eight recommendations to improve Tax Commission enforcement efforts, including changes to staff assignments, analysis of revenue collection patterns, and tracking of forgiven tax. Together, these recommendations could generate a minimum of $3.3 million in additional revenue each year. Due to the limited scope of our evaluation, our findings and recommendations do not provide a comprehensive review of the agency's operations.

Also, you asked us to examine whether it was necessary to have four commissioners oversee the Tax Commission. We found that it is not uncommon for state tax collection agencies to be overseen by a commission, which helps disperse power and balance political affiliation. While other management configurations are possible, our analysis of two possibilities did not reveal clear gains for Idaho's agency.

We appreciate the cooperation we received from Tax Commission staff and officials throughout our evaluation.

This report was written and researched by Dan Kern and Beth Harris, with the assistance of Jason Hancock (intern) and the entire Office of Performance Evaluations staff.

Respectfully submitted,

Nancy Van Maren

Table of Contents

List of Figures and Tables

Estimating and Reducing the Tax Gap in Idaho

Executive Summary

In July 1996 the Joint Legislative Oversight Committee requested a performance evaluation of the State Tax Commission's efforts to identify and collect unpaid taxes. They asked for an estimate of the tax gap, whether collection efforts could be improved, and whether four commissioners are necessary to manage the Tax Commission.

The four member constitutionally established Tax Commission administers collection of Idaho's 19 taxes and manages staff in the state's tax collection agency. In fiscal year 1995, the Tax Commission oversaw collections of $1.5 billion with a budget of $19.8 million.

Under a voluntary system of taxation, the state depends upon its citizens to compute, report, and remit taxes due at the times and in the manner prescribed by law. Complete compliance will never be achieved because of:

- Unintentional misapplication of the tax laws;
- Financial inability of some taxpayers to pay taxes due;
- Fraud committed by taxpayers who file tax forms containing false information; and
- Willful noncompliance of those who do not file tax forms.

Complete compliance with tax laws will never be achieved due to intentional and unintentional taxpayer errors.

Our evaluation focuses on the efforts of the Tax Commission's Division of Audit and Collections to identify and collect unpaid tax revenue. We limited our calculations and review of collection efforts to the three taxes that in 1995 accounted for 86.1 percent of the total tax revenue collected by the Tax Commission: individual income tax, sales and use tax, and corporate income tax.

We focused our evaluation on individual and corporate income taxes and sales and use tax.

The Tax Gap

The gross tax gap is the amount of taxes that are due to the state that are not paid voluntarily and on time. We estimated the tax gap in Idaho for individual income tax, sales and use tax, and corporate income tax. We adjusted these amounts to account for revenues obtained through Tax Commission audit, discovery, and collection efforts.

The Tax Commission may be able to collect an additional $46.9 million annually for the period evaluated.

We estimated that Idaho might collect an additional $19 million in individual income tax revenue and at least $27.9 million in sales and use tax revenue annually. We were unable to determine the additional revenue that could be collected from corporate income tax. At a minimum, with different or increased enforcement efforts, we estimate the Tax Commission could potentially collect an additional $46.9 million annually for the three taxes. The methods used to estimate the tax gaps for the three taxes were based on current research and methodologies and are different for each tax. The estimates for each tax cover different time periods due to the particular method used and the most current available data.

The largest contributor to the state's tax gap is sales and use tax ($120.1 million), followed by individual income tax ($111.2 million), and corporate income tax ($13.5 million).

Individual Income Tax

Based on tax year 1994 data, the estimate of the gross individual income tax gap is $111.2 million. The Internal Revenue Service (IRS) estimates that 30 percent of the federal gross income tax gap is feasible to collect, in recognition of the resources needed to collect small amounts of tax from many individual taxpayers. Using IRS estimates of actual collections, we estimated that the Tax Commission collected approximately $14.4 million of Idaho's tax gap. Estimating that $33.4 million of the $111.2 million gap is collectible, this leaves a potential $19 million in collectible revenue.

Sales and Use Tax

We estimated the gross sales and use tax gap for calendar year 1995 at $120.1 million. We assumed a minimum of 30 percent could be collected. Audit efforts and a portion of collection efforts generated $8.1 million, leaving a minimum amount that could be collected for the year analyzed of $27.9 million.

Corporate Income Tax

The estimate of the average annual gross corporate income tax gap between tax years 1992 and 1994 is $13.5 million. The Tax Commission collected an average of $9 million through its audit efforts alone, leaving $4.5 million uncollected. We were unable to determine if any of this remaining amount would be feasible to collect.

Improving Tax Collection Efforts

The Tax Commission uses various methods to collect all taxes due, including written notices, computer assisted calling, installment agreements, and seizures of real and personal property. We found these methods similar to those used in other states. We evaluated the cost-effectiveness of several of these methods in Idaho, and reviewed data and interviewed staff to identify areas where the process of identifying and collecting unpaid tax could be improved.

Identifying taxpayers who do not file is a cost-effective method to increase tax revenue.

The Tax Commission relies primarily on two methods to increase collection of taxes not submitted voluntarily or timely: audits of taxpayer filings to correct errors and detect abuse, and identification of taxpayers who do not file the appropriate forms within the prescribed time limits, a process known as "discovery." We found that identifying taxpayers who do not file is a more cost-effective method to increase revenue collection than auditing those who do file. The Discovery Bureau identified $14.37 in potential revenue for every budget dollar expended in fiscal year 1996 compared to $6.68 for the Income Tax Audit Bureau and $3.97 for the Sales and Use Tax Audit Bureau.

An internal shift of four staff members could generate an additional $1.4 million each year.

However, we found the Tax Commission devoted more resources to auditing than to identifying nonfilers. The number of staff assigned to the Discovery Bureau has been approximately one-half that assigned to each audit bureau, and the annual budget has been approximately one-third. We recommend the Tax Commission devote more resources to the discovery of taxpayers that have not filed tax forms. We estimated that shifting four staff from the Sales and Use Audit Bureau to discovery efforts could generate as much as $1.4 million in additional revenue each year.

To evaluate the allocation of enforcement resources among the four bureaus, we asked Tax Commission staff to provide us with

such information as the number of audit employee hours worked, number of cases and dollar amount of deficiency adjustments per year, dollar amounts billed, and the amounts turned to collection agencies. We found the Tax Commission does not regularly collect and analyze information on the performance of the bureaus within the Audit and Collections Division to assess productivity and review resource needs. Reviewing agency performance measures can highlight productive areas for additional resources, help weigh the allocation of resources among various objectives, and signal when remedial steps need to be taken. We recommend that the State Tax Commission compile and review established performance measures quarterly.

Targeted audit selection could help use limited staff resources more effectively.

Because there are insufficient staff resources available to audit all possible taxpayers, targeted audit selection can effectively use limited staff resources to increase tax revenue. We learned the Tax Commission does not select sales and use tax audits based on criteria that would systematically identify those cases where additional taxes are most likely due. We determined that audits of certain industries had higher recovery rates per hour than others. For example, fiscal year 1994 audits of one industry recovered $582 per hour compared to $0 per audit hour for another. We recommend the Sales and Use Tax Bureau analyze audit results to develop selection criteria that will increase the likelihood of taxpayer assessments.

Managed audits allow taxpayers to conduct their own reviews. Expanding this program could generate an additional $2.4 million in tax revenue annually.

In 1995 the Tax Commission introduced a new program in which taxpayers can conduct their own sales and use tax audits in an effort to improve collection of Idaho's use tax on items purchased out of state. The audits are supervised by Tax Commission staff and managed by student interns. These "managed audits" are a cost-effective method to identify unpaid sales and use tax. Tax Commission staff reported a gross return of $275 per hour for managed audits compared to $167 per hour for the Sales and Use Tax Audit Bureau. Currently the program is limited to three interns at the Boise office. We recommend the Tax Commission consider expanding the managed audit program to the five field offices, which could generate estimated revenue of $2.4 million annually.

Tax Commission officials told us they use data from other state agencies to identify unreported taxable activity. One such source is a list supplied by the Division of Purchasing of all in-state and out-of-state vendors registered to do business with Idaho agencies. However, use of this list is restricted to manual

searches of 6,000 vendor names and data. We found the process could be streamlined through better communication between state agencies. Staff at the Office of the State Controller told us complete data for over 80,000 vendors could be searched, sorted, and downloaded to Tax Commission computers. We recommend the Tax Commission obtain vendor information electronically to speed up data searches and aid in enforcement activities.

Some Tax Commission efforts could be improved through better communication between state agencies.

The Taxpayer Services unit promotes taxpayer education and is a component of Tax Commission enforcement efforts. To accommodate a 59.4 percent increase in taxpayer calls from January 1 to April 15, 1996, Tax Commission officials shifted one to two auditors per day from Audit and Collections to Taxpayer Services. We estimated this shift resulted in potential lost tax revenue of $112,525 to $225,050 during the tax season, based on an average audit return rate of $1,500 each day. We recommend the Tax Commission discontinue the diversion of auditors to Taxpayer Services and consider hiring additional temporary staff as needed to meet the increased workload during tax season. Use of part-time personnel could save an estimated $13,500 in salary costs, as well as allow audit efforts to continue.

Taxpayers may appeal the amount of additional taxes they are charged as the result of an audit. In many cases, this process begins with an informal redetermination hearing conducted by the Tax Commission, with further appeals made through the state court system. During the informal appeals process, Tax Commission officials are authorized by rule to compromise an original tax determination based upon doubt as to liability, doubt as to collectibility, and extreme hardship of the taxpayer. However, the Tax Commission does not maintain records of these discretionary adjustments. The average annual adjustment rate for the tax years 1992 through 1994 was 31 percent for corporations and 15 percent for sales and use tax. We recommend the adjustment amounts be recorded to provide benchmarks for the Tax Commission to gauge agency performance and provide public confidence that the tax laws are administered without prejudice.

Tax Commission officials are authorized to adjust a tax determination, but presently do not maintain records of these adjustments.

In 1993 the Tax Commission installed a computer-assisted calling system to be used in the collection of permit-based taxes, such as sales and use tax. We observed an increase of 18.5 percent in telephone collections over the previous year with an average increase of 6.6 percent in subsequent years. We also noted an increase of 91.7 percent in the number of collection calls made in

1994 over the number of calls made in 1991. Although we were unable to determine whether the increases were entirely due to the use of computer-assisted calling, the system appears to have improved phone collection efforts. As a result, we recommend the Tax Commission examine the potential benefits of expanding the use of the computer-assisted telephone calling to include collection of other state taxes.

While other states appear to have similar structures to their tax collection agencies, those we surveyed employed an executive director, while Idaho does not.

Tax Commission Governance

The Idaho Constitution as amended created a bipartisan State Tax Commission of four members to supervise property tax assessments. Idaho Code later expanded the Tax Commission's responsibilities to include the assessment and collection of all taxes, made the commissioners full-time salaried state employees, and designated the chairman as the administrative head.

We surveyed ten other tax collection agencies to compare with Idaho's governance structure and administrative costs. We learned that half of the surveyed agencies use a commission to govern their state's tax collection agency. We also learned that all ten agencies have an executive director while Idaho does not. Commissioners in Idaho are the lowest paid of any full-time commissioner or director.

We could not determine clear monetary or managerial gains from restructuring the present Tax Commission structure.

Idaho Tax Commissioners oversee individual taxes, but tax commission staff are organized by functional area. Although this could lead to staff confusion about reporting lines, relationships among commissioners and upper agency management appear to be clear.

We compared the cost and managerial effectiveness of Idaho's governance structure to two alternatives suggested by the surveyed agencies. Our analysis did not reveal any clear monetary or managerial gains from restructuring the present Tax Commission's governance structure.

Summary of Report Findings and Recommendations

1. The gross tax gap for individual income is $111.2 million. *Page 12.*

2. Approximately $33.4 million of Idaho's individual income tax gap potentially could be collected. *Page 12.*

3. The average net individual income tax gap is $96.8 million. *Page 13.*

4. In 1994, approximately $9.7 million in interstate mail order use tax was due but not paid to the state. *Page 15.*

5. The gross sales and use tax gap is $120.1 million. *Page 15.*

6. The abuse and misuse of resale certificates in Idaho resulted in approximately $26.3 million in uncollected taxes. *Page 16.*

7. The net sales and use tax gap for calendar year 1995 is $112 million. *Page 16.*

8. The annual gross corporate income tax gap between tax years 1992 and 1994 is $13.5 million. *Page 18.*

9. Between tax years 1992 and 1994, the annual net corporate income tax gap was $4.5 million. *Page 18.*

   - **We recommend the Tax Commission further refine our tax gap calculation methods as feasible and adopt improved methods as they become available. *Page 19.***

10. Identifying taxpayers who do not file is a more cost-effective method to increase revenue collection than auditing those who do file. *Page 22.*

11. The Tax Commission devotes more resources to auditing returns than to identifying those who do not file. *Page 24.*

    - **We recommend the Tax Commission devote more resources to the discovery of taxpayers that have not filed tax forms. *Page 25.***

12. The Tax Commission does not regularly collect and analyze consistent and comparable information on the performance of the bureaus within the Audit and Collections Division to assess comparative productivity and review resource needs. *Page 26.*

    - **We recommend the Tax Commission compile and review established performance measures quarterly.** ***Page 27.***

13. Currently, the Tax Commission does not select cases for sales and use tax audits based on criteria that would systematically identify those cases most likely to provide a return. *Page 29.*

    - **We recommend the Sales and Use Tax Audit Bureau analyze audit results to develop selection criteria that will systematically devote audit resources to candidates with the highest likelihood of return.** ***Page 30.***

14. Managed audits are a cost-effective method to identify unpaid sales and use tax. *Page 31.*

    - **We recommend the Tax Commission consider expanding the managed audit program to the Tax Commission's five field offices.** ***Page 31.***

15. The process of identifying businesses that owe income taxes could be streamlined through better communication between state agencies. *Page 33.*

    - **We recommend the Tax Commission obtain state vendor information electronically for use in enforcement activities.** ***Page 34.***

16. The seasonal diversion of auditor resources to Taxpayer Services is costly and unnecessarily reduces audit and discovery productivity. *Page 34.*

    - **We recommend the Tax Commission discontinue the diversion of existing professional resources during the tax season and consider hiring additional temporary staff as needed to accommodate the increased workload in Taxpayer Services.** ***Page 35.***

17. The Tax Commission does not maintain records of the discretionary adjustments made to an auditor's determination of deficiency as a result of the informal hearing process. *Page 38.*

    - **We recommend the Tax Commission maintain records of discretionary adjustments to deficiencies and report the figures for all adjustments in the annual report.** ***Page 39.***

18. The Tax Commission's Collections Bureau uses collection procedures similar to those used in other states. *Page 40.*

- **We recommend the Tax Commission examine the potential benefits of expanding use of the automated calling system to other taxes and report its conclusions to the 1998 Legislature.** ***Page 43.***

19. The Legislature has exercised broad discretion in defining the role and responsibilities of the tax commissioners. *Page 46.*

20. Tax collection agency governance by a commission is not unusual, but all ten agencies we surveyed have an executive director while Idaho does not. *Page 47.*

21. Idaho's current governance structure appears to be as cost-effective as that of other states. *Page 49.*

22. We were unable to determine any clear monetary or managerial gains from restructuring the Tax Commission's governance structure. *Page 53.*

Introduction
Chapter 1

In July 1996, the Joint Legislative Oversight Committee requested a performance evaluation of the State Tax Commission's efforts to identify and collect unpaid taxes in Idaho. Members requested that we estimate the current gap between the amount of taxes owed to the state and the amount paid voluntarily and timely. They questioned whether the commission's efforts to reduce the gap could be improved, and whether four tax commissioners were necessary to manage the State Tax Commission's operations.

Legislators requested an estimate of the current tax gap and an evaluation of Tax Commission efforts to reduce it.

To respond to the committee's questions, we asked:

- What was the estimated amount of taxes owed but not paid in the most current fiscal period? What were the sources of unpaid tax?
- How successful are the State Tax Commission's present methods to identify and collect unpaid taxes?
- What additional steps, if any, could the State Tax Commission take to reduce the amount of unpaid taxes?
- Could the State Tax Commission be restructured to achieve financial or managerial gains? How does the Tax Commission's governance structure compare to that of other states' tax collection agencies?

Methods

To complete our evaluation, we interviewed three tax commissioners and Tax Commission officials and staff. We reviewed methodologies used by the federal government and other states to estimate gaps for various taxes. We analyzed financial data on the amounts of taxes assessed and collected by the Tax Commission and estimated the amounts not reported and not yet collected in Idaho. Finally, we contacted other states to

learn what tax identification and collection methods they use and how the governance structures for their tax collection agencies are organized.

Individual and corporate income taxes and sales and use tax together made up 86 percent of Tax Commission collections in fiscal year 1995.

Idaho Code provides for the state collection of 19 different taxes, as listed in Figure 1.1.

We limited our calculations and review of collection efforts to the three taxes that make the largest contributions to the state general fund: individual income tax, sales and use tax, and corporate income tax. The Tax Commission concentrates enforcement resources on these taxes.

As shown in Table 1.1, together these taxes provided 86.1 percent of the total revenue collected by the Tax Commission in fiscal year 1995, the most recent year for which data were available.

Although motor fuels taxes accounted for 11 percent of total revenue, we did not review motor fuels enforcement practices or include motor fuels in our tax gap calculation for two reasons.

Table 1.1: Total Revenue Collections by the State Tax Commission, Fiscal Year 1995

Source	Revenue[a] (in millions)	Percent of Total Revenue
Individual Income Tax	$601.1	39.6%
Sales Tax	574.0	37.8
Motor Fuel Taxes	160.8	10.6
Corporate Income Tax	132.0	8.7
Other[b]	49.5	3.3
Total	**$1,517.4**	**100.0%**

[a] Amount after refunds.
[b] This category includes other taxes such as cigarette, tobacco, beer, wine, and travel and convention taxes.

Source: 1995 Annual Report, Idaho State Tax Commission.

Figure 1.1: State Taxes Established

§ 23-1319	Requires the Tax Commission to collect tax of $0.45 per gallon on **wine**.
§ 47-332	Requires the Tax Commission to enforce collection of the 2 percent tax on the market value of **oil or gas** produced in Idaho, also called the severance tax.
§ 63-411	Requires the Tax Commission to assess and collect property tax on **private railroad car companies**.
§ 63-2400	Sets excise taxes of $0.25 per gallon on **gasoline fuel** (63-2405) and **special fuels** (diesel, compressed gases, natural gas and hydrogen) (63-2416), $0.055 per gallon on **aviation gasoline** (63-2408) and $0.045 per gallon imposed on **jet fuel** (63-2408).
§ 63-2500	Imposes taxes of $0.28 per pack on **cigarettes**, and 40 percent of the wholesale price on other **tobacco products**.
§ 63-2700	Establishes license tax of one-half mill per kilowatt hour on **electricity** production from water power.
§ 63-3000	Imposes tax ranging from 2 percent to 8.2 percent on taxable **individual income,** and a tax of 8 percent on taxable **corporate income**.
§ 63-3400	Transfers collection responsibility to the Tax Commission for: • **beer** tax of $0.15 per gallon (23-1008); • **mine license** tax of 2 percent of value of ores extracted (47-1201); and • **transfer and inheritance** (estate) tax computed at federal rates (14-402).
§ 63-3600	Imposes tax of 5 percent on **retail sales**.
§ 63-4200	Imposes taxes on **illegal drugs** by weight and dosage, including marijuana and other controlled substances.
§ 67-4718	Requires the Tax Commission to collect a 2 percent tax on **hotel/motel room sales**, including campground spaces.
§ 67-4917C	Authorizes auditorium districts to contract with the Tax Commission for the collection of hotel/motel room sales tax. Currently, the Tax Commission collects a 4 percent tax for the **Boise auditorium district**.

Note: The county revenue sources of property taxes, forest land and product taxes, mine profits tax, resort county sales tax, and certain license fees are also governed by Title 63. As county revenues, these taxes are outside the scope of this evaluation.

Source: IDAHO CODE, citation numberings effective January 1997.

First, the revenues from these taxes are distributed directly to specified accounts, such as highway maintenance, bridge inspection, and waterways improvements, rather than to the general fund.[1] Second, statutory restrictions on the distribution and sale of fuel make Tax Commission audits for point of sale fraud straightforward and effective.

Tax System in Idaho

Idaho's tax collection agency is overseen by a four member, bipartisan commission.

The Idaho Constitution created a bipartisan State Tax Commission of four members to supervise state and county property tax assessments.[2] Idaho Code expanded the Tax Commission's responsibilities to include the assessment and collection of all taxes.[3] As shown in Figure 1.2, Idaho Code also:

- Established the Department of Revenue and Taxation to consist of the State Tax Commission and the Board of Tax Appeals;
- Authorized the Tax Commission to organize itself and administrative units under its control for efficient operation;
- Enumerated the taxes imposed in the state and set their rates; and
- Created a "taxpayers' bill of rights" to protect the confidentiality of taxpayer information and prevent the Tax Commission from engaging in intimidating revenue collection practices.

Title 63 was recodified during the 1996 legislative session. Citation numberings in this report are effective January 1, 1997.

Each of the four tax commissioners oversees administration of certain taxes. However, since 1978 Tax Commission staff have been organized into functional areas, rather than along tax lines, as illustrated in Figure 1.3. Idaho Code designates the commission chairman as the administrative head of the Tax Commission and permits the chairman to delegate personnel and

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1 IDAHO CODE §§ 63-2412 and 63-2418 (1996).
2 Article VII, Section 12.
3 IDAHO CODE § 63-101 (1996).

Figure 1.2: Statutory Provisions Governing Revenue Collection Efforts of the State Tax Commission, Effective January 1, 1997

Collection Authority

§ 63-105	Defines State Tax Commission powers and duties, including the assessment and collection of all taxes, the duty to ensure that statutory penalties are enforced, and the duty to recommend changes to tax law "to facilitate assessment and collection of taxes in the most economical and efficient manner."
§ 63-3038–§ 63-3078	Enumerates collection and enforcement procedures for income tax; also applied to other taxes. Among its options, the Tax Commission may examine records, charge interest, assess penalties, file for liens and foreclosures, institute any court action, and seize and sell property.
§ 63-3700	Enacts Multistate Tax Compact to assist in the determination and collection of tax from multistate taxpayers and to avoid duplicate taxation.
§ 63-4000	Enumerates a Taxpayers' Bill of Rights, which limits the acquisition and communication of taxpayer information, prohibits harassment or abuse of taxpayers by revenue officers, defines and prohibits unfair practices in collecting unpaid taxes, and assigns civil liability to the Tax Commission for revenue officers who violate the provisions of the section.

Additional Code sections establish taxes and set criminal penalties for tax avoidance:

§ 23-1319	§ 63-3000
§ 47-332	§ 63-3400
§ 63-411	§ 63-3600
§ 63-2400	§ 63-4200
§ 63-2500	§ 67-4718
§ 63-2700	§ 67-4917C

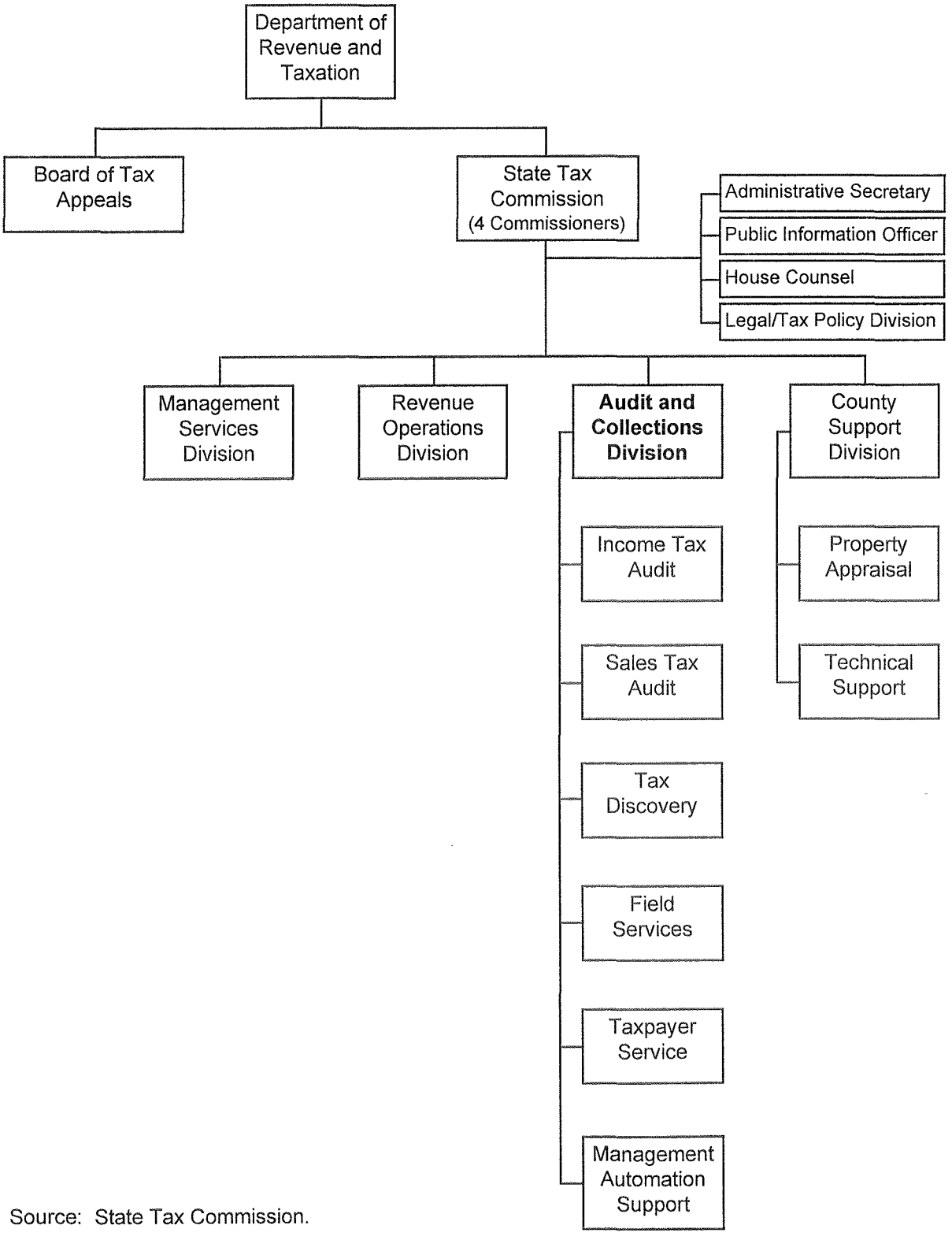
Note: The county revenue sources of property taxes, forest land and product taxes, mine profits tax, resort county sales tax, and certain license fees are also governed by Title 63. As county revenues, these taxes are outside the scope of this evaluation.

Source: IDAHO CODE, citation numberings effective January 1997.

budgetary responsibilities.[4] The division of managerial authority by the commissioners and its implications for tax law administration will be discussed in Chapter 4.

[4] IDAHO CODE § 63-102(4) (1996).

Figure 1.3: Organization of the Department of Revenue and Taxation, February 1996



Source: State Tax Commission.

Under a voluntary system of taxation, citizens compute, report, and remit the taxes due the state at the times and in the manner prescribed by state and federal tax laws. Given the importance of voluntary compliance, the Tax Commission emphasizes taxpayer education on reporting requirements. However, interpretations of tax requirements may still vary, and taxpayers may appeal tax assessments as well as Tax Commission audit decisions. Complete compliance with the tax laws is not achieved due to:

- Unintentional, undetected misapplication of the tax laws by some citizens;
- Financial inability of some citizens to pay taxes;
- Fraud by citizens who file false forms to avoid full taxation; and
- Willful noncompliance of those who do not file tax forms.

Noncompliance results in a gap between the amount of taxes owed and the amount the state receives, the "tax gap."

Avoidance, misunderstanding, and conflicting interpretations of tax laws create a gap between the taxes owed and revenue received.

Identifying and Collecting Unpaid Taxes

The Tax Commission's mission is "to provide courteous, quality services and to administer the state's tax laws in a fair, timely, and cost-effective manner to benefit Idaho and its citizens." The Tax Commission encourages voluntary compliance through education and by maintaining the resources necessary to detect abuse and enforce compliance. The Tax Commission relies primarily on two methods to increase collections: audits of taxpayer filings to correct errors and detect abuse, and investigation to identify non-filers and unreported taxable activity, a process known as "discovery." In fiscal year 1995, individual income tax, sales and use tax, and corporate income tax audit and discovery efforts generated $25.7 million in state revenue. Figure 1.4 summarizes the areas of taxpayer noncompliance and the methods used by the Tax Commission to address each area.

The Tax Commission works to increase collections through education and discovery of abuse.

Our evaluation focuses on the efforts of the Tax Commission's Division of Audit and Collections to identify and collect unpaid tax revenue.

Figure 1.4: Sources of Noncompliance and Related Tax Commission Efforts to Improve Revenue Collections, 1996

		Collection Efforts			
Sources of Non-Compliance	Taxpayer Education	Appeals	Audit	Discovery	Collections
Accidental reporting error	✓		✓		
Ignorance of tax law	✓		✓	✓	
Interpretation of tax law	✓	✓	✓	✓	
Intentional avoidance of tax law			✓	✓	✓
Inability to pay		✓			✓

Source: Interviews with Tax Commission officials and staff.

The Tax Gap
Chapter 2

The gross tax gap is the difference between tax revenue that is remitted and that which would be remitted if all tax laws were adhered to. It is the amount of true tax liability for a given tax year that is not paid voluntarily or timely. The net tax gap is the gross tax gap adjusted by the amounts identified and collected through the State Tax Commission's enforcement efforts.

The tax gap is the difference between the taxes due the state and those actually paid.

The tax gap is a measure of taxpayer noncompliance. It does not include:

- Taxpayers who are not required to file a return because of low incomes, and businesses that have no sales;
- Tax liability on income from illegal activities, such as drug sales and the illegal sale of weapons. The tax resulting from these activities is hard to estimate and enforce; and
- Penalty and interest charges on unremitted taxes. If compliance increased, the state would benefit from the remittance of additional taxes, not from penalty and interest charges.

Some portion of the tax gap will always exist due to the cost of enforcement. Although the Internal Revenue Service (IRS) estimates that only 30 percent of the federal gross income tax gap is collectible, states may be able to improve on this figure given their access to local information.

The Tax Commission encourages voluntary compliance through education, service, and simplified tax laws and forms. Recovering more of the tax gap than what is currently discovered and collected would require different or increased efforts. Increased efforts would likely increase equity among taxpayers, as a greater number of taxpayers would contribute their portion of the tax burden. However, beyond a certain level, unpaid taxes become more expensive to collect than the revenue they generate.

The Tax Commission encourages voluntary compliance with tax laws through education, service, and simplified tax laws and forms.

At this point it makes greater economic sense to *not* collect the taxes due. While states and the federal government agree that this point of diminishing marginal returns exists, it is difficult to determine because the revenue generated through increased enforcement does not yield a net gain to the state. The cost of enforcement is a known cost to the Tax Commission's budget, whereas the revenue the investment generates does not return to the Tax Commission's budget, and some fraction of it is dispersed before reaching the general fund.

We calculated Idaho's tax gap for individual income tax, sales and use tax, and corporate income tax.

Tax Gap Calculations

We calculated Idaho's tax gap for individual income tax, sales and use tax, and corporate income tax. These taxes have accounted for 94 percent of general fund revenue each fiscal year since 1993. In fiscal year 1995, 47.7 percent of general fund revenue came from individual income tax, 37.7 percent from sales and use tax and 8.7 percent from corporate income tax.

We used the most reliable and current data available to make the tax gap calculations for the different taxes. As a result, the estimates are for slightly different time periods. In addition, the methods used to calculate the various tax gaps differed based on the best data available and current research. A summary of these calculations and the time periods they cover are included in Table 2.1.

At a minimum, with different and increased enforcement efforts, the Tax Commission could potentially collect an additional $46.9 million.

We estimated that Idaho might collect an additional $19 million in income tax revenue and at least $27.9 million in sales and use tax revenue. We were unable to determine the additional revenue which could be collected from corporate income tax. At a minimum, with different and increased enforcement efforts, the Tax Commission could potentially collect an additional $46.9 million.

Individual Income Tax

The tax rate on individual income in Idaho ranges from 2 percent to 8.2 percent depending on income. Individual income includes wages, salaries, self-employment income, and other taxable income from business and non-business sources. The revenue collected from individual income tax for fiscal year 1994 was $563.6 million.

Table 2.1: Summary of Current Tax Gap Estimates

Gross Tax Gap: Calculation of taxes due to the state that were not paid voluntarily or timely.

Net Tax Gap: Gross tax gap calculation minus Tax Commission enforcement efforts.

Potentially Collectible: Estimate based on IRS estimate that 30% of the federal gross income tax gap is collectible.

Remaining Potential: Calculation of 30% of gross tax gap minus Tax Commission enforcement efforts.

	Estimate Year	Gross Tax Gap	Net Tax Gap	Potentially Collectible	Remaining Potential
Individual Income	TY 1994	$111.2 million	$96.8 million	$33.4 million	$19.0 million
Sales and Use	CY 1995	$120.1 million[a]	$112.0 million	>$36.0 million[b]	>$27.9 million
Corporate Income	Ave. TYs 93–95	$13.5 million	$4.5 million	>$4.1 million[c]	$0[d]
Approximate Total		**$244.8 million**	**$213.3 million**		**>$46.9 million[e]**

[a] Includes only a portion of the amount attributable to abuse and misuse of resale certificates.
[b] No other states have determined what percent of the sales and use tax gap is feasible to collect. This 30% estimate is too conservative for sales tax, and not conservative enough for use tax.
[c] Underestimates the amount collectible, as Idaho collected 67% of the gross for this period from audit efforts alone.
[d] We were unable to determine if any additional portion of the net could be collected for corporate income.
[e] At a minimum, the Tax Commission could potentially collect this amount with different and increased efforts.

Source: Office of Performance Evaluations calculations using most current available data.

For individual income tax, noncompliance can result from:

1. Underreporting and nonreporting of taxable income by taxpayers who file returns.
2. Overstating deductions by taxpayers who file returns.
3. Unintentional errors by taxpayers in completing their returns.
4. Taxpayers failing to file the required tax returns.
5. Nonpayment or underpayment by taxpayers who file returns.

According to IRS estimates of the federal gross individual income tax gap for 1992, 76.7 percent of the gap results from underreporting income, overstating deductions, and math errors. Those who do not file returns account for 14.5 percent of the gap and underpayment accounts for 8.8 percent.

For tax year 1994, the gross tax gap estimate for individual income is $111.2 million.

We calculated the gross individual income tax gap in Idaho due to all reasons using tax year 1994 data.[1] We estimate that based on tax year 1994 data:

- **The gross tax gap for individual income is $111.2 million.**

For individual income tax, federal adjusted gross income is used to determine liability for both federal and state taxes. As a result, issues that affect taxpayer compliance at the federal level also affect Idaho. Therefore, we used the federal gross individual income tax gap estimate to determine an estimate for Idaho's gap.

To use the most recent, comparable federal and state figures available, we inflated federal gross individual income tax gap estimates for 1992 to 1994 values.[2] This resulted in a *federal* gross individual income tax gap estimate of $103.1 billion. The portion that could be attributed to federal returns from Idaho was $342.3 million (.332 percent).

An estimated $33.4 million of Idaho's individual income tax gap potentially could be collected.

We adjusted the 1994 federal gap attributed to Idaho returns by 32.5 percent due to Idaho's lower individual income tax rate. This resulted in our estimate of the gross individual income tax gap for tax year 1994 of $111.2 million. A summary of these calculations are included in Figure 2.1.

As noted previously, the IRS considers 30 percent of the federal gross income tax gap to be feasibly collectible. According to this assumption, we estimate that:

- **Approximately $33.4 million of Idaho's individual income tax gap potentially could be collected.**

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[1] A tax year is the year for which the tax is due.

[2] We assumed the growth in the federal estimates of underreporting, nonfilers and underpayment from 1988 to 1992 reasonably characterized the growth from 1992 to 1994.

Figure 2.1: Calculation of Idaho's 1994 Gross Individual Income Tax Gap

1.	Estimate of the 1994 federal gross individual income tax gap.	$103.1 billion
2.	Percentage of federal individual income tax liability due to Idaho returns.	x .332%
3.	Amount of the federal individual income tax gap attributable to Idaho.	$342.3 million
4.	Idaho taxes income at a different rate than the federal government. Therefore, we applied the percentage of Idaho individual income tax liability to federal individual income tax liability due to Idaho returns.[a]	x 32.5%
5.	Estimate of Idaho's 1994 gross individual income tax gap.[b]	**$111.2 million**

[a] We assumed Idaho's individual income tax gap is proportional to its share of the federal individual income tax gap.

[b] We assumed: (1) state compliance patterns and federal compliance patterns are not significantly different; and (2) the state gross individual income tax gap increases at the same rate as the federal gross individual income tax gap.

Source: Office of Performance Evaluations calculations based on IRS and State Tax Commission data.

Further, the IRS estimates that it actually collects between 11 and 15 percent of the federal gross individual income tax gap annually through various enforcement activities. Applied to Idaho's estimated gap of $111.2 million, we would expect that between $12.2 and $16.7 million of the $33.4 million gap has been collected as a result of Tax Commission efforts. In fiscal year 1994, Tax Commission audit efforts alone resulted in collections of $4.5 million; we were unable to determine actual amounts collected as a result of additional Tax Commission efforts. Therefore, we used the IRS estimated average rate of 13 percent ($14.4 million) to estimate:

- **The average net individual income tax gap is $96.8 million.**

The net tax gap is the gross tax gap adjusted by the amounts identified and collected through the Tax Commission's enforcement efforts.

We estimate that Tax Commission efforts have reduced the individual income tax gap for tax year 1994 to $96.8 million.

We estimate that for tax year 1994, an additional $19 million in individual income tax would be feasible to collect.

Further, we adjusted the amount that is potentially collectible to account for the estimate of actual collections. The result is the estimate of the remaining amount that could be collected. Using current data, we estimate this amount to be $19 million.

Sales and Use Tax

Sales tax is paid at the time goods are purchased and is remitted by retailers to the State Tax Commission. Retailers in Idaho must obtain a seller's permit from the Tax Commission, collect the tax on goods sold, and remit tax revenues to the Tax Commission each month.

Use tax is a tax on goods that are purchased for use in Idaho, but for which sales tax was not paid at the time of purchase. For example, use tax is due on items purchased out of state and brought into the state for use in Idaho and on items purchased through mail order companies. Use tax is also due when the sales tax paid for goods was less than Idaho's rate and the goods are intended for use in Idaho. The state's sales and use tax rates are currently set at five percent. The revenue collected from sales and use tax for fiscal year 1995 was $574 million.

Idaho Code lists 37 exemptions to the sales and use tax.

Idaho Code lists 37 exemptions to the sales and use tax. These exemptions apply when a buyer or industry is exempt, or when the goods purchased are for an exempt use or for resale. To make an exempt purchase, a buyer must provide a sales tax exemption or resale certificate to the permit holder. A complete list of exemptions is included as Appendix A.

Sales and use tax noncompliance results from:

1. Underreporting and nonreporting of taxable sales.
2. Failure of individuals and businesses to remit use tax.
3. Misuse or abuse of exemptions and resale certificates.

We calculated the effect of sales and use tax noncompliance in Idaho for calendar year 1995.[3] We first grouped fiscal year 1994 audit results by the annual amount of tax paid. We determined

[3] We identified four states that have attempted to measure their sales and use tax gap. Three of the four states relied on historical results of audit and discovery efforts in their estimates. In 1982, Idaho's State Tax Commission estimated the sales and use tax gap using this method.

how many audits in each group showed a deficiency, and how much was recovered by the audit. Assuming the same rate for unaudited returns, we applied these percentages to all calendar year 1995 sales and use permit holders. We then reduced the estimate to account for audit cases in which refunds were made to the permit holder and further reduced the estimate to account for penalty and interest.[4] This resulted in an estimate of $110.4 million.[5]

However, this estimate does not include revenues lost as a result of noncompliance with use tax on mail order sales. We reviewed existing data on the amount of this effect.[6] We found:

- **In 1994, approximately $9.7 million in interstate mail order use tax was due but not paid to the state.**

For 1994, an estimated $9.7 million in interstate mail order use tax was due but not paid to the state.

This amount could be added to the sales and use tax gap to produce a new total. Accordingly, we estimate that for calendar year 1995:

- **The gross sales and use tax gap is $120.1 million.**

For calendar year 1995, we estimate the gross sales and use tax gap is $120.1 million.

Use tax on mail order sales, like other use taxes, is particularly difficult to enforce. It relies on taxpayer-initiated calculations, reporting, remittance, and taxpayers' understanding of how the use tax applies. Currently, the chair of the State Tax Commission is chairing a task force sponsored by the Multistate Tax Commission which, among other topics, is exploring means for increasing the collection of tax on interstate mail order sales.

Further, this estimate does not include the full effect of abuse or misuse of exempt sales in Idaho. Tax Commission staff explained that some permit holders claim all of their purchases as exempt, regardless of the intended use. For example, a restaurant

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4 Based on information provided by Tax Commission staff, we assumed an average annual interest rate for the period used for the estimate of 5.2 percent and an average annual penalty rate of 3 percent.

5 This figure may overstate the true sales and use tax gap because cases selected for audit were expected to yield a return, and the tax gap calculation is a multiple of audit returns. However, we were unable to quantify this effect.

6 "Taxation of Interstate Mail Order Sales 1994 Revenue Estimates," Advisory Commission on Intergovernmental Relations, SR-18, 1994, p. 6.

may buy tax exempt food for resale, but use some of the food in their home. Some of the misuse is intentional and some is due to ignorance. We calculated the effect of this based on estimates derived from a recent study in another state.[7] We found that in calendar year 1995:

- **The abuse and misuse of resale certificates in Idaho resulted in approximately $26.3 million in uncollected taxes.**

The portion of this estimate due to noncompliance with tax law is already included in the gross tax gap estimate and should not be added twice. The remainder, due to inappropriate use of exemptions, could be added to the tax gap estimate. However, we could not determine the percent attributable to either case.

An estimated $36 million of Idaho's sales and use tax gap potentially could be collected.

It is difficult to determine how much of the gross sales and use tax gap calculation is collectible. The estimate of 30 percent collectibility applied to the individual income tax gap is likely too conservative for sales tax collections and not conservative enough for use tax collections. In addition, none of the states that measured their sales and use tax gaps has addressed what percentage would be feasible to collect. However, assuming that a minimum of 30 percent could be collected, we estimate that at least $36 million could be collected.

We estimate Tax Commission efforts have reduced the sales and use tax gap for 1995 to $112 million.

However, we calculated a net sales and use tax gap using what is known about the effect of Tax Commission efforts for the years on which the gross estimate is based. Sales and use tax audit and discovery efforts generated almost $8 million in revenue for fiscal year 1995. Statutory write-offs and collections from collection agencies further reduced the gap by $106,774. Combined, these efforts reduced the $120.1 gross sales and use tax gap by 6.7 percent. Although additional enforcement efforts also decreased the gap, data were not available to calculate their effect. We expect that the additional percent reduction would be small. Therefore, we estimate:

- **The net sales and use tax gap for calendar year 1995 is $112 million.**

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[7] "Report on the Sales Tax Exemption for Resale Purchases," Interim Report, House Committee on Finance and Taxation (Florida), July 1994.

We reduced the minimum amount that could be collected, $36 million, by what the Tax Commission had already identified and collected in their efforts, $8.1 million, to determine the remaining amount that could be collected. For calendar year 1995, we estimate this amount to be at least $27.9 million.

For sales and use tax, we estimate that an additional $27.9 million is feasible to collect.

Corporate Income Tax

The corporate tax rate in Idaho on taxable income is eight percent. The revenue from corporate income tax for fiscal year 1994 was $87.9 million. In Idaho, approximately 80 percent of corporate income tax revenue comes from corporations that do business in both Idaho and other states. The remaining 20 percent comes from corporations that do business only in Idaho.

As with individual income tax, corporate income tax noncompliance results from underreporting taxable income, overstating deductions, unintentional errors, not filing required returns, and underpaying amounts due. Some reasons for noncompliance are not as prevalent among corporations as among individuals.

To account for variation, we estimated the corporate income tax gap using figures averaged for tax years 1992 through 1994.

To account for recent tax law changes and variability in returns over time, we calculated the effect of corporate income tax noncompliance in Idaho using data averaged for tax years 1992 through 1994. Because of their different contributions to total corporate tax revenue, we calculated the gap for multistate corporations and Idaho corporations separately. For each group, we assumed a constant rate and applied the average rate of deficiency identified to the amount of unaudited revenue.[8]

We found that, between tax years 1992 and 1994, the annual gross corporate income tax gap was $20.5 million. This gap represents the total annual amount due to the state that was not remitted voluntarily or timely. However, it overstates the actual gross corporate income tax gap.

Through the appeals process, a deficiency may be adjusted as a result of consideration of new evidence, auditor error, or interpretation of the law. The adjusted deficiency is the assessed

[8] Although audits of corporations are not selected completely at random, it is likely that the tax gap calculation is not overstated because selection is not directly related to the amount of the possible deficiency.

Between tax years 1992 and 1994, we estimate the annual gross corporate income tax gap is $13.5 million.

amount due. Assessments equal anticipated revenue. Based on the data we used, the adjustments reduced the deficiencies identified by 29 percent for multistate corporations and 47 percent for Idaho corporations. After accounting for these reductions, we estimate:

- **The annual gross corporate income tax gap between tax years 1992 and 1994 is $13.5 million.**

The IRS estimates 30 percent of the federal gross income tax gap is feasible to collect. However, Tax Commission audit efforts alone recovered an average of $9 million per year for tax years 1992 through 1994. Accounting for these efforts, we found:

- **Between tax years 1992 and 1994, the annual net corporate income tax gap was $4.5 million.**

Tax Commission audit efforts alone recovered an average of $9 million per year between tax years 1992 and 1994.

This calculation could be further reduced by other enforcement efforts, collections, statutory write-offs, and compromise. However, we were unable to calculate these amounts, but anticipate the additional reduction would be relatively small. We were also unable to determine whether any additional portion of the gross corporate income tax gap potentially could be collected.

Conclusions

We estimated the tax gaps using current methodologies and the most current data available. The estimates are reasonable, but in each case they could be further refined with better data and additional resources. Should the Tax Commission or the Legislature wish to make more regular calculations of the gaps, the following should be considered.

Individual Income Tax

The estimate for the gross individual income tax gap could be refined by:

- Examining Idaho income tax returns to determine the line items that contribute most to the state gap and the proportion of income they represent. The IRS, as well as several states, have found that line items contribute differentially to the tax gap.

And:

- Using the 1996 estimates of the federal gross individual income tax gap when they become available. The IRS estimates the tax gap every four years. We used data from 1992, the last year for which an estimate was available.

The net individual income tax gap could be improved by adjusting for the amount of collections, statutory write-offs, and compromises attributable to individual income tax.

The tax gap estimates could be further refined with better data and additional resources.

Sales and Use Taxes

The gross sales and use tax gap estimate could be improved if the data used resulted from randomly selected audits. The gap is likely overstated, as it was calculated using data from audits that were selected because the taxpayers were expected to be out of compliance. The net sales and use tax gap estimate could be improved by accounting for the amounts of sales and use tax collections that are compromised and the amount paid through payment plans.

Corporate Income Tax

The estimate of the gross corporate income tax gap could be improved if it were based on a sample of randomly selected audits. We believe the selection process did not significantly affect the size of the tax gap estimate; calculating the gap based on random audits would confirm or refute this assumption. In addition, the net corporate income tax gap could be improved by adjusting for the amount of collections, statutory write-offs, and compromises attributable to corporate income tax.

In our review of Idaho Code, we learned that one of the responsibilities of the Tax Commission is to assist the executive and legislative departments in the analysis of tax measures.[9] As a result, should the Legislature request future calculations of the tax gap:

We recommend the Tax Commission further refine our tax gap calculation methods as feasible and adopt improved methods as they become available.

[9] IDAHO CODE §63-105(3) (1996).

Improving Tax Collections
Chapter 3

In requesting this evaluation, the Joint Legislative Oversight Committee asked if the Tax Commission's efforts to identify and collect unpaid taxes could be improved. We interviewed Tax Commission officials and staff to learn about commission operating procedures and analyzed Tax Commission financial data to gauge agency performance. We also examined recent Government Accounting Office (GAO) reports that compared collection methods used by different states.

This chapter includes eight findings and recommendations that resulted from our efforts to identify how the Tax Commission could improve operations. However, given the complexity of the administration of the three taxes we considered and project time constraints, these findings and recommendations do not provide a comprehensive review of the agency's operations.

Finding I: Discovering nonfilers generates more revenue than auditing taxpayers.

The Discovery Bureau identifies those who do not file returns within legal time limits.

The Tax Discovery Bureau in the Audit and Collections Division identifies in-state and out-of-state taxpayers who do not file the appropriate forms or report their tax liability within legal time limits. Those who do not file contributed an estimated $16.1 million to the gross individual income tax gap in tax year 1994. According to Tax Commission staff, the primary causes of nonfiling are taxpayer ignorance of filing requirements and willful disregard for the tax laws.

Discovery Bureau staff use several methods to locate those who do not file, including:

- Examination of the results of federal audits provided to the Tax Commission by the Internal Revenue Service (IRS);

- Verification of income reported by Idaho taxpayers on their federal returns;
- Data exchanges with other state agencies such as the Department of Employment, the Division of Purchasing, and state agencies that issue licenses and permits; and
- Review of newspapers and periodicals to identify unreported business activity.

Identifying taxpayers who do not file tax returns is a more cost-effective method to increase total revenue than auditing those that do.

After identifying a nonfiler, Tax Commission staff notify the taxpayer of the omission and request that the taxpayer file the appropriate returns for the periods identified. We found:

- **Identifying taxpayers who do not file is a more cost-effective method to increase revenue collection than auditing those who do file.**

The Discovery Bureau identified more revenue per unit than other audit efforts in tax years 1994 through 1996 according to two measures. First, the Discovery Bureau identified $14.37 in potential revenue for every budget dollar in fiscal year 1996, as shown in Table 3-1.1.[1] In contrast, income tax audits identified $6.68 in potential revenue for each budget dollar and sales and use tax audits identified $3.97 in potential revenue for each budget dollar during the same period.

In fiscal year 1996, the Discovery Bureau processed 639 cases per staff, compared to 20 in Sales and Use Audit and 32 in Income Tax Audit.

Second, Discovery Bureau staff have identified 2.5 to 5.5 times more potential revenue than sales and use audit staff during the past three fiscal years, as shown in Table 3-1.2. Tax Commission staff told us income tax audits identified more potential revenue per staff in 1995 due to the selection of cases to audit and higher than typical staff turnover in discovery.

Tax Commission officials explained two possible reasons for these differences. First, Discovery Bureau staff do not examine taxpayer records in-depth. As a result, discovery staff can process more cases in a shorter period of time than auditors in income tax or sales and use. According to Tax Commission figures, the Discovery Bureau processed 639 cases per staff in fiscal year 1996, compared to 20 cases per staff in the Sales and Use Audit

[1] Actual revenue collected may be less than that identified, due to taxpayer appeals and, in some cases, the state's inability to collect.

Table 3-1.1: Deficiencies Identified Per Budgeted Dollar, Fiscal Years 1994–1996

	1994	1995	1996
Discovery Bureau	$16.66	$13.53	$14.37
Individual and Corporate Income Tax Audit Bureau[a]	$7.05	$9.15	$6.68
Sales and Use Tax Audit Bureau[b]	$2.13	$2.17	$3.97

[a] Among others, includes deficiencies identified for inheritance and mine license taxes, and revenue from unclaimed property.
[b] Among others, includes deficiencies identified for sales and use, motor fuels, and miscellaneous taxes.

Source: Office of Performance Evaluations analysis of Tax Commission data.

Table 3-1.2: Deficiencies Identified Per Staff, Fiscal Years 1994–1996

	1994	1995	1996
Discovery Bureau	$613,514	$497,037	$592,975
Individual and Corporate Income Tax Audit Bureau[a]	$398,136	$627,341	$457,570
Sales and Use Tax Audit Bureau[b]	$108,492	$128,322	$244,068

[a] Among others, includes deficiencies identified for inheritance and mine license taxes, and revenue from unclaimed property.
[b] Among others, includes deficiencies identified for sales and use, motor fuels, and miscellaneous taxes.

Source: Office of Performance Evaluations analysis of Tax Commission data.

Bureau and 32 cases per staff for the Income Tax Audit Bureau during the same period.

Second, the Discovery Bureau may determine more deficiencies per taxpayer than either of the audit bureaus. This is because a taxpayer who does not file a return will usually not file for several periods and the resulting tax liability includes penalties and interest for each period. As a result, "discovered" liabilities are higher than those determined in an audit. However, sufficient data were not available for us to verify this reason.

More Tax Commission resources are assigned to auditing returns than to identifying those who do not file.

Nonetheless, we found:

- **The Tax Commission devotes more resources to auditing returns than to identifying those who do not file.**

The Discovery Bureau was separated from the Income Tax Audit Bureau in 1993. Each year since the bureau was created, the number of staff assigned to discovery efforts has been approximately one-half that assigned to each audit bureau. Similarly, the annual budget for the Discovery Bureau has been approximately one-third that of each audit bureau. Table 3-1.3 compares staffing and budget allocations for the three bureaus for fiscal years 1994 through 1996.

Table 3-1.3: Staff and Budgets for Discovery and Audit Staff by Bureau, Fiscal Years 1994–1996

	1994		1995		1996	
	Number of Staff	Budget	Number of Staff	Budget	Number of Staff	Budget
Discovery Bureau	17	$ 626,068	18	$ 661,177	17	$ 701,694
Audit Bureaus						
Individual and Corporate Income Tax Bureau	35	$1,976,848	35	2,398,395	34	2,329,011
Sales and Use Tax Audit Bureau	40	$2,029,189	40	2,349,630	39	2,383,314

Source: Office of Performance Evaluations analysis of Tax Commission data.

To increase cost-effective use of Tax Commission staff:

We recommend the Tax Commission devote more resources to the discovery of taxpayers that have not filed tax forms.

Given the performance of current staff, it is likely that additional staff would generate more revenue than required to fund their positions. However, additional resources could be added to discovery efforts without requiring new funding. The Tax Commission could shift staff from another bureau, such as sales and use auditing, which provides comparatively less return on investment. As illustrated in Table 3-1.4, we estimate an internal shift of four staff could generate approximately $1.4 million in additional revenue each year.

Table 3-1.4: Effect of Internal Shift of State Tax Commission Resources

	Number of Staff (1996)	Increase (Decrease) in Deficiencies Identified	Net Gain
Current:			
From: Sales and Use Audit	40		
To: Discovery	17		
Shift of two staff:			
From: Sales and Use Audit	38	($488,136)	
To: Discovery	19	$1,185,950	
Total			$ 697,814
Shift of four staff:			
From: Sales and Use Audit	36	($976,272)	
To: Discovery	21	$2,371,900	
Total			$ 1,395,628

Note: We assumed that returns and clerical requirements per staff remain the same.

Source: Office of Performance Evaluations analysis of Tax Commission data.

Although relatively less lucrative, we acknowledge that the Sales and Use Tax Audit Bureau should retain resources to continue its efforts. An audit presence is important in deterring fraud. However, the identification of taxpayers that do not file returns should also deter fraud and promote taxpayer voluntary compliance.

Finding II: The Tax Commission does not regularly measure revenue returns in terms of resources invested.

The Tax Commission does not currently collect the data to compare bureau performance.

To further evaluate the allocation of enforcement resources, we asked Tax Commission staff to provide information on the performance of the four bureaus within the Audit and Collections Division. We asked for information such as the number of audit employee hours worked, number of cases and dollar amount of deficiency adjustments per year, dollar amounts billed, and amounts turned over to collection agencies. We found:

- **The Tax Commission does not regularly collect and analyze consistent and comparable information on the performance of the bureaus within the Audit and Collections Division to assess comparative productivity and review resource needs.**

The Tax Commission did not maintain some of the information we requested on a bureau level, or, in some cases, at the division level. All bureaus independently monitor employee performance to some extent. However, the data bureaus maintain are not comparable across bureaus. Without this information, Tax Commission management cannot adequately monitor agency performance and assess the distribution of resources.

Reviewing agency performance would help in evaluating the allocation of resources and signal when remedial steps should be taken.

As our analysis in Finding I illustrates, reviewing measures of the performance of agency efforts can highlight productive areas for additional resources, help weigh the allocation of resources among various objectives, and could signal when remedial steps need to be taken. Regular review of established performance data would also assist the Tax Commission in meeting related responsibilities to "investigate the effectiveness and adequacy of the revenue laws" and to recommend to the Governor and the Legislature changes to the tax laws "to facilitate assessment and

collection of taxes in the most economical and efficient manner."[2] Accordingly:

We recommend the Tax Commission compile and review established performance measures quarterly.

We contacted the Federation of Tax Administrators and two other states to identify useful performance measures for state revenue agencies. Comparison of performance between states is difficult due to differences in each state's taxes, population base, taxation and collection philosophies, and economic health. However, we learned of a 1995 study conducted by Delaware's Division of Revenue to determine the uniformity of performance measures used by seven surveyed states. According to the study results, no state had developed a means of measuring voluntary compliance. However, each state had a system in place to evaluate the operation of its tax administration based on measures of the timeliness and accuracy of filings. Measures of the performance of enforcement activities focused on dollars realized, cases worked, audit success rates, and collection analysis.

States struggle with measuring voluntary compliance. However, states track the effect of enforcement activities to monitor agency efforts and resource needs.

The number of measures each state tracked varied significantly. For example, one state had over 500 performance measures that were computed and analyzed every month by a staff of four working part-time on the project. Another state reported using only fifteen measures to monitor agency performance.

We reviewed the measures used by these states to monitor their enforcement activities. We determined that a limited number of measures would improve management of the Audit and Collections Division in Idaho. Figure 3-2.1 provides some examples of the types of measures the Tax Commission could consider for their enforcement efforts.

During preliminary review of our findings, Tax Commission officials told us the agency is developing two computer software systems to improve management information. The first is an upgrade of the Taxpayer Management System that should be completed in December 1996, and the second is development of an Assignment Reporting and Tracking system. According to

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[2] IDAHO CODE §§ 63-105(3) and (10). Citation numberings effective January 1, 1997.

Figure 3-2.1: Suggested Performance Measures for the Tax Commission's Audit and Collections Division

Measure	Computation
1. Deficiencies per staff	$ amount deficiencies/# of staff (by bureau)
2. Return on investment	$ amount of deficiencies/$ amount of budget (by bureau)
3. Audits per staff	# of audits/# of staff (by bureau)
4. Percent of audits appealed	# of audits appealed/# of total audits (by bureau)
5. Percent of appeals sustained	# of audits sustained/# of audits appealed (by bureau)
6. Percent of deficiencies collected	$ amount of deficiencies collected/$ amount of total deficiencies (by bureau)
7. Percent of deficiencies adjusted	$ amount of deficiencies adjusted/$ amount of total deficiencies (by bureau)
8. Percent collections voluntarily remitted	$ collected voluntarily/$ total tax dollars collected
9. Percent written-off	$ amount of annual write-off/$ amount of total deficiencies
10. Collections per staff	$ amount of collections/# of collections staff

Source: Office of Performance Evaluations selection of measures used by states reviewed.

Tax Commission officials, the systems will provide data on employee caseloads and enforcement results for staff in field services, discovery, and audit efforts. While these systems may respond to the management needs we identified, we did not review them and therefore cannot make this determination.

Tax Commission officials emphasize equity in the administration of tax laws.

Finding III: Limited enforcement resources could be used more effectively.

Tax Commission officials told us they attempt to maintain equity in their audit process. As a result, they maintain resources to audit all taxes, rather than auditing only those that would likely produce returns. However, staff resources are insufficient to audit all taxpayers. To identify candidates for sales and use audits, the Tax Commission provides employees a list of 11 referral reasons as shown in Figure 3-3.1.

Figure 3-3.1: Examples of Reasons for Referring a Candidate for Sales and Use Tax Audit

a. Referrals from other sections such as Compliance, Tax Discovery Unit, Income Tax

b. A large refund request

c. Spin offs from other audits performed

d. Taxpayer complaints

e. Industry audits

f. Geographic location audits

g. Three-year rotation

h. Contractors with job sites located in Idaho

I. Out of state business with Idaho sites

j. Activity to or from bordering states

k. Newspaper/magazine article

Source: Quoted from Idaho State Tax Commission Sales Tax Audit Manual, June 1988, section 200.

Tax Commission staff told us that most candidates are referred for a sales and use tax audit because a permit holder has been identified in a related audit as likely being out of compliance. To select audit cases from the number of referred candidates, Tax Commission officials told us they consider the cost of an audit, the opportunity to educate taxpayers, and the probability of determining noncompliance.

We acknowledge the need for the equitable enforcement of tax laws. At the same time, it is important to use limited resources effectively. We found:

Limited resources should be used effectively.

- **Currently, the Tax Commission does not select cases for sales and use tax audits based on criteria that would systematically identify those cases most likely to provide a return.**

Tax Commission staff do not routinely rely on audit selection criteria designed to produce the greatest tax revenue returns.

To determine whether the Tax Commission's current efforts used resources in the most cost-effective manner, we compared the number of sales and use tax audits conducted in fiscal year 1994 with the revenue generated according to volume of sales, and identified the most productive categories of taxpayers in 1994. We learned that for fiscal year 1994, the Tax Commission had audited a larger percentage of those businesses in categories that: (1) had been most likely to owe taxes to the state; and (2) had produced the greatest return.

While in fiscal year 1994 the Tax Commission's selection process focused resources on likely candidates, staff do not systematically rely on criteria designed to repeat this selection in the future. For example, while preparing our estimate of the tax gap, we determined that audits of certain industries had higher audit recovery rates per hour than others. Fiscal year 1994 audits on one industry recovered $582 per audit hour, compared to $0 per audit hour for another industry. Analyzing audit results according to industry types could identify particular reasons for noncompliance, and aid in compiling audit industry profiles to use in the selection of productive candidates in the future.

The Sales and Use Tax Audit Bureau has recently acquired new software that will allow them to incorporate the industry code and other information about businesses when selecting audit candidates. Therefore:

We recommend the Sales and Use Tax Audit Bureau analyze audit results to develop selection criteria that will systematically devote audit resources to candidates with the highest likelihood of return.

Managed audits allow taxpayers to conduct their own reviews, assisted by trained Tax Commission interns.

Finding IV: Expanding the managed audit program could increase revenue returns.

In 1995, the Tax Commission introduced a new program in which some taxpayers conduct their own sales and use tax audits. Under this program the Tax Commission instructs the taxpayer on filing requirements, shows him or her how to conduct the audit, then reviews the final results for accuracy. To encourage participation in these voluntary audits, the Tax Commission waives the penalty for not filing a sales and use tax return, typically assessed at 25 percent of the deficiency identified in the audit. The Tax

Commission also waives the five percent penalty for negligence. However, the taxpayer is still responsible for interest charges computed on any unpaid tax balance. In July 1996, the Tax Commission began using local university accounting interns part-time to manage the self-audits.

To date, the Tax Commission has focused the managed audit program on dental and medical professionals. While their services are exempt from sales tax, the equipment and goods they purchase from out of state vendors are subject to use tax. This includes expensive medical equipment, which can otherwise be overlooked. Based on the program's performance to date, we found:

- **Managed audits are a cost-effective method to identify unpaid sales and use tax.**

Interns are paid a wage of $7.50 per hour. Tax Commission staff reported that in the four months since beginning their efforts, the interns have spent an average of 6.7 hours to complete each audit, and have generated a gross return of $275 per hour. We compared this return to the amount of deficiencies identified per hour by the Sales and Use Tax Audit Bureau. In fiscal year 1996, this bureau identified an average of $167 per hour invested, approximately 61 percent of the managed audit return.[3]

To date, managed audits have proven 65 percent more lucrative than other sales and use audits.

Six audits have been completed and forty-eight are in progress. Tax Commission officials report that interns are particularly well-suited to use tax audits, which focus on simple compliance questions such as where goods were purchased and whether the tax was paid. Further, the potential for these audits is significant: the Tax Commission estimates there are over 2,600 medical professionals in Idaho, and any other service-based businesses would qualify. Currently the program is limited to the Boise office and uses only three student interns. Therefore:

We recommend the Tax Commission consider expanding the managed audit program to the Tax Commission's five field offices.

[3] Neither hourly return calculation includes costs for necessary clerical support.

Table 3-4.1: Anticipated Returns Under Expanded Managed Audit Program

	Number of Interns	Hours Per Week	Return Per Hour[a]	Annual Return
Expanded Program				
Coeur d' Alene	2	17	$184	$325,312
Lewiston	2	17	$184	$325,312
Twin Falls	2	17	$184	$325,312
Pocatello	2	17	$184	$325,312
Idaho Falls	2	17	$184	$325,312
Subtotal				**$1,626,560**
Current Program				
Boise	3	17	$275	$ 729,300
Total Estimated Managed Audit Return				**$2,355,860**

[a] We assumed new interns would take 10 hours to complete each audit rather than 6.7 as under the current program, to account for necessary training requirements. This reduced the return per hour.

Source: Office of Performance Evaluations calculations of Tax Commission data.

At current rates, adding two interns to each field office could generate an additional $1.6 million annually.

Field offices are located in Coeur d'Alene, Lewiston, Twin Falls, Pocatello, and Idaho Falls. Each community has a college or university in the proximity from which to draw accounting interns.

We estimated the net revenue two interns in each location could generate based on the performance of current interns. As Table 3-4.1 shows, ten additional interns could generate a total annual return of $1.6 million.[4] Added to ongoing Boise efforts, the managed audit program could generate total returns of nearly $2.4 million if interns worked year round. Further, we considered the increased requirements on audit supervisors in the field

[4] We estimate that future managed audits would initially require more time to complete, due to intern training requirements. Tax Commission staff estimate that interns require approximately 136 hours of training to manage a self audit with little supervision.

offices for necessary training requirements and additional audit supervisory time. While it is possible that the time required to supervise the interns could detract from other field office activities, the Boise program has shown that higher returns should offset the effect of any decreased collections effort.

Finding V: Automation could improve identification of unreported income.

We asked Tax Commission officials what data they collected from other state agencies to identify unreported taxable activity. Commission officials told us they rely on many sources, including a list of all in-state and out-of-state vendors registered to do business with Idaho state agencies. Currently, however, this source is used very little by Tax Commission staff as they must manually search the alphabetical list of 6,000 names to match with taxpayer numbers.

The identification of businesses that owe taxes could be improved through better communication between state agencies.

We found:

- **The process of identifying businesses that owe income taxes could be streamlined through better communication between state agencies.**

The Division of Purchasing currently provides the vendor list to the Tax Commission. However, due to limitations of their computer software, the division cannot provide the taxpayer number that the Tax Commission needs to more easily review the list.

We considered other options to simplify this process for the Tax Commission and learned that a custom vendor list containing federal employment identification numbers, state sales tax permit numbers, vendor names, addresses, and annual payments could be obtained from the Office of the State Controller. The information could be downloaded to Tax Commission computers and used to electronically match vendor data with filed tax returns. While the list currently supplied by the Division of Purchasing contained just over 6,000 vendor names, a staff member in the Office of the State Controller told us there are over 80,000 registered vendors in their database. This more comprehensive list of vendors may be sorted to meet the Tax Commission's selection criteria. Therefore:

We recommend the Tax Commission obtain state vendor information electronically for use in enforcement activities.

Tax Commission officials told us information from other agencies could also aid in identifying unpaid tax, but that legal restrictions and staff limitations often hindered their access. Time constraints prevented us from fully evaluating the Tax Commission's efforts to use other state information sources.

Finding VI: The diversion of internal resources during tax season is inefficient.

The Tax Commission's Taxpayer Services Bureau is charged with promoting taxpayer education and voluntary compliance with the state's tax laws. Staff answer taxpayer questions by phone and in person and provide forms and explanatory pamphlets upon request.

The diversion of auditor resources to taypayer services during the tax season reduces tax revenue by as much as $112,525 per auditor.

Tax Commission staff reported that between January 1 and April 15, 1996 the number of calls received by Taxpayer Services increased by 59.4 percent from the number of calls handled during the rest of the fiscal year. To accommodate this increased activity, in 1996 Tax Commission officials shifted one or two auditors each day from the Audit and Collections Division to Taxpayer Services. However, we found that:

- **The seasonal diversion of auditor resources to Taxpayer Services is costly and unnecessarily reduces audit and discovery productivity.**

On average, auditor efforts identified $1,500 in deficiencies per day during fiscal year 1996. Over the course of the 75 work days of the tax season, each auditor could identify an average of $112,525. By these calculations, two auditors would have generated $225,050 in potential revenue during the period they were shifted to assist with taxpayer services.

In addition, we compared 1996 average annual salaries for auditors in the Audit and Collections Division with those for individuals providing taxpayer assistance. Auditors earned an average of $42,430 per year, while those in taxpayers assistance earned an average of $30,283 per year (or $14.56 per hour). Further, an agency official told us that part-time staff are hired

during the tax season to supplement efforts in Taxpayer Services. They are hired at rates between $7.50 and $10.75 per hour which is lower than the average of $14.56 per hour for full-time staff.

Taxpayer assistance promotes voluntary compliance, an important component of the Tax Commission's enforcement efforts. Therefore:

We recommend the Tax Commission discontinue the diversion of existing professional resources during the tax season and consider hiring additional temporary staff as needed to accommodate the increased workload in Taxpayer Services.

The use of the same number of temporary staff could save an additional $13,529 in salary costs.

Assuming two part-time staff are hired at the maximum hourly rate, the Tax Commission could save $13,529 in salary costs as well as generate $225,050 in potential revenue with this adjustment during the tax season. The Tax Commission should consider whether this would prove cost effective in field offices as well.

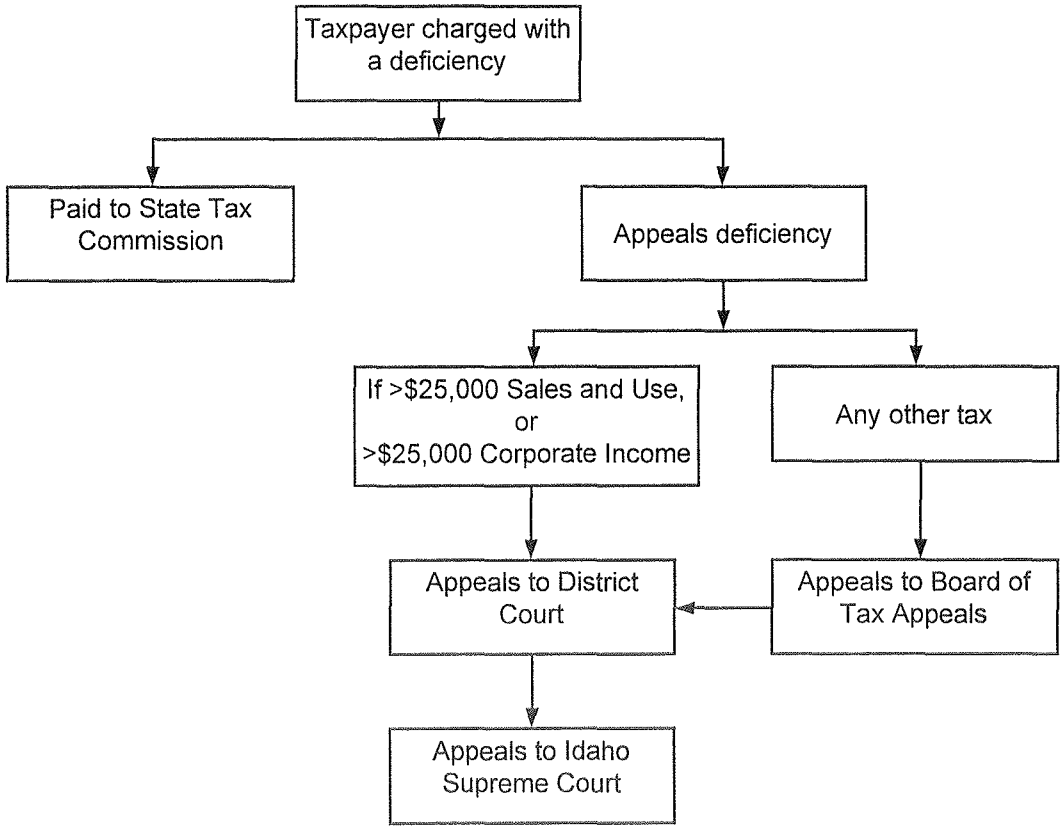
Finding VII: The Tax Commission does not record discretionary adjustments to taxes due.

An audit determines the amount of additional taxes that are due, called a "deficiency," or the amount that should be refunded. The taxpayer then has 63 days to protest the deficiency by petitioning the Tax Commission for an informal redetermination hearing. Beyond this hearing the taxpayer may appeal to the Board of Tax Appeals or the state court system, depending on the tax and the amount involved. Figure 3-7.1 shows the progression of a deficiency through the appeals process.

The Tax Commission is authorized by Administrative Rule to make discretionary adjustments to the amount of taxes a taxpayer owes.

In some cases, the appeals process is used to resolve disputes over the interpretations of tax law. In other cases, it provides the Tax Commission the opportunity to consider unique circumstances not clearly provided for in law, or evidence not considered in the initial audit. Auditor judgment is involved in the determination of a deficiency. As Figure 3-7.2 shows, Tax Commission judgment is also involved in the adjustment to the deficiency at two points in the appeals process: informal redetermination hearings and collection.

Figure 3-7.1: Taxpayer Appeals Process

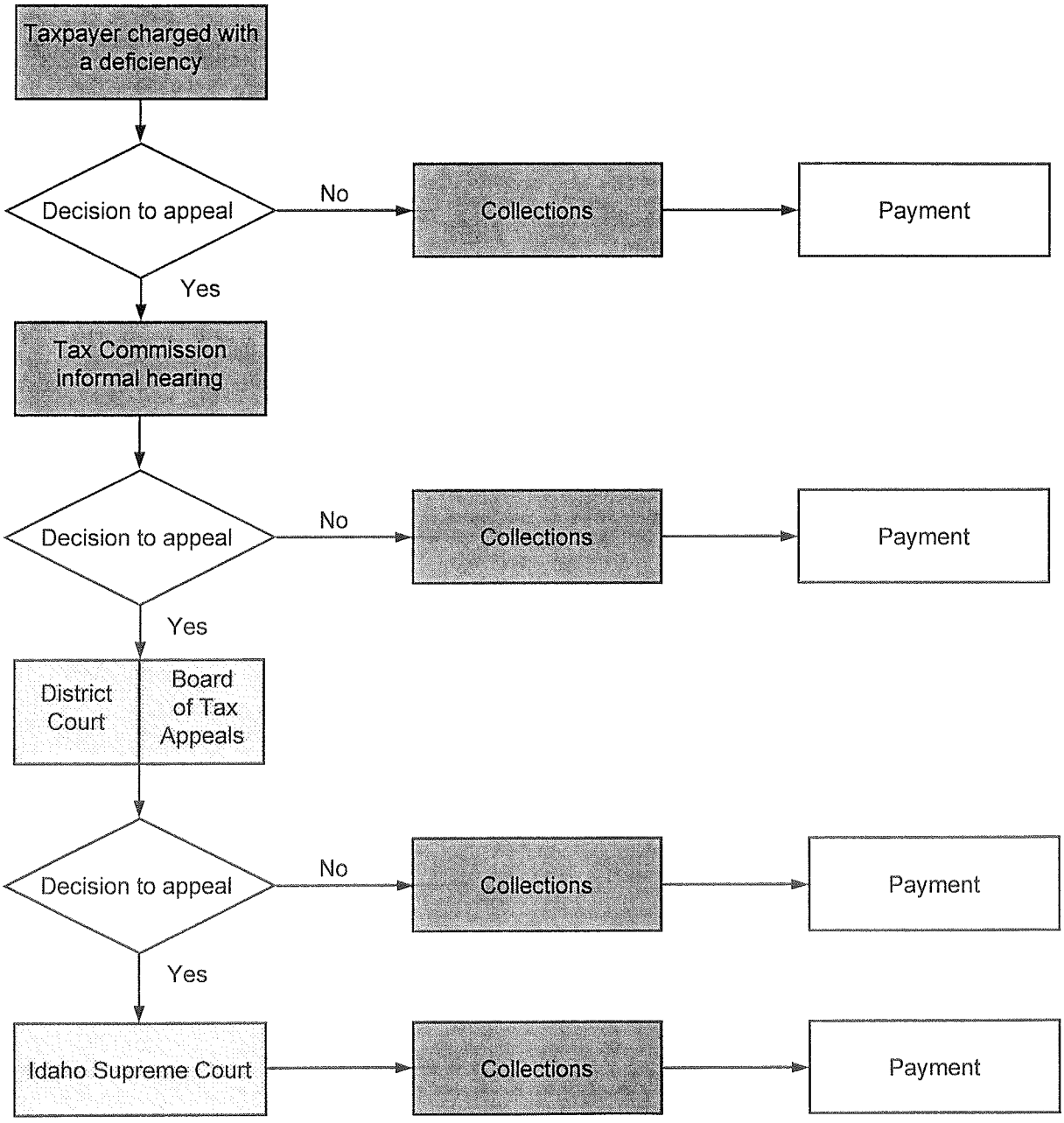


Source: State Tax Commission documents.

Appeals may result in two types of adjustments to the deficiency amount determined. *Non-discretionary* adjustments occur when facts are clarified to change the taxpayer's liability. For example, a taxpayer may provide conclusive additional documentation that was unavailable when the deficiency was originally determined. *Discretionary* adjustments are compromises as defined in Administrative Rule.[5]

[5] Idaho Administrative Code, July 1, 1996, Vol. 8, IDAPA 35.01.01.112.01.

Figure 3-7.2: Discretionary and Non-Discretionary Adjustments During the Tax Appeals Process, 1996



Non-discretionary application of law only

Discretionary and non-discretionary adjustments possible

Source: Interviews with Tax Commission officials and staff.

> "The State Tax Commission may compromise any case relating to the tax liability, penalties, or interest of any person at any time. Any such liability will be compromised only upon one or all of the following three (3) grounds:
>
> a. Doubt as to liability.
> b. Doubt as to collectibility.
> c. Extreme hardship of the taxpayer."

In practice, the Tax Commission has delegated the authority to make adjustments of up to $5,000 to audit supervisors. Bureau Chiefs or their equivalent in field offices may make adjustments of up to $10,000, while a division administrator may make an adjustment of up to $20,000. Adjustments involving amounts between $20,000 and $50,000 must be made by the commissioner with authority over that tax. Adjustments greater than $50,000 must be made by a tax commissioner after consultation with at least two other commissioners.[6]

The Tax Commission does not record discretionary adjustments to taxes due.

Tax Commission staff track the amount of deficiencies determined in agency audits. Further, the Tax Commission monitors adjustments and statutory write-offs by the Collections Bureau. In fiscal years 1994 through 1996, these partial Tax Commission adjustments and write-offs for all taxes averaged 1.8 million. However, we found:

- **The Tax Commission does not maintain records of the discretionary adjustments made to an auditor's determination of deficiency as a result of the informal hearing process.**

Due to limitations of the data available, we could determine the amounts adjusted by informal redetermination hearings for sales and use tax and corporate income tax only. We calculated the average annual adjustments to deficiencies for sales and use tax in fiscal years 1993 through 1995. The average annual deficiency determination for these years was $14.0 million. The average annual recoveries were approximately $11.95 million, an adjustment rate of 15 percent.

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[6] Prior to October 23, 1996, adjustments greater than $20,000 were made by the commissioner with authority over that tax.

Also, as discussed in Chapter 2, average annual multistate corporate income tax deficiencies for tax years 1992 through 1994 were $11.4 million with recoveries of $8.2 million, an adjustment rate of 29 percent. For Idaho corporations, average annual deficiency determinations equaled $1.5 million during these years, and recoveries totaled $0.8 million, an adjustment rate of 47 percent. Overall, the average adjustment rate for corporate income tax in tax years 1992 through 1994 was equal to 31 percent. As these examples illustrate, adjustments can significantly reduce the amounts determined to be deficient.

Adjustments can significantly reduce the amounts determined to be deficient.

In our review, we learned that some states monitor the amount of adjustments to deficiencies to evaluate auditor performance. This information also provides an indication of overall agency performance. Monitoring the discretionary adjustments to deficiency determinations could:

- Help assess auditor performance in non-discretionary cases by revealing misapplication of tax law;
- Identify unclear areas of law;
- Help executive and legislative policymakers and the public understand the actual tax burden under current law;
- Provide benchmarks to gauge Tax Commission performance; and
- Increase public confidence that the tax laws are applied without prejudice.

Monitoring adjustments can help gauge agency performance and increase public confidence that the tax laws are applied without prejudice.

Therefore:

We recommend the Tax Commission maintain records of discretionary adjustments to deficiencies and report the figures for all adjustments in the annual report.

The amount of deficiencies that have been determined, adjusted, collected, and written off should be monitored to evaluate the audit process and the effectiveness of Tax Commission enforcement activities.

Finding VIII: The Tax Commission's computer-assisted calling program appears to increase revenue.

Most Tax Commission collection efforts appear consistent with those used in other states.

We examined recent Government Accounting Office (GAO) reports that compared the effects of various state delinquent tax collection methods.[7] We learned that:

- **The Tax Commission's Collections Bureau uses collection procedures similar to those used in other states.**

In 1994 the GAO surveyed tax administrators in all 50 states to determine commonly used tax collection methods and assess their effectiveness. The survey requested that tax administrators describe how frequently they used a set of 15 methods to collect each of four taxes. As Figure 3-8.1 shows, Idaho currently uses all but 3 of the 15 methods the states reported using for income or sales and use tax.

GAO's survey also asked tax administrators to comment on the effectiveness of seven selected methods. As Figure 3-8.2 shows, written bills and installment agreements were the most frequently used and effective of the seven methods, while credit card programs and collection agencies were judged least effective. Automated telephone calling systems were considered effective by 90 percent or more of the respondents, but were used in fewer states. Automated systems increase staff efficiency by dialing lists of pre-programmed numbers, then forwarding completed calls to staff for action. Seventeen states in the GAO survey reported using a computer-assisted calling program. Idaho's computer assisted dialing system, called VoiceLink, is limited to collection of permit-based taxes, such as sales and use and motor fuels. While 14 of 17 states reported using their systems for sales and use tax collection, 13 states indicated they also used the program to collect individual or corporate income taxes, or both. Twelve states said they used it for the collection of employment taxes.

Computer-assisted callings systems can increase staff efficiency.

[7] GAO/GGD-93-67, New Delinquent Tax Collection Methods for IRS (May 1993); and GAO/GGD-94-59FS, State Tax Administrator's Views on Delinquent Tax Collection Methods (February 1994).

Figure 3-8.1: Methods Used to Enforce Collections for Three Taxes in Surveyed States

	Individual Income Tax (n=34)		Corporate Income Tax (n=38)		Sales and Use Taxes (n=39)	
Method	Number of States Using	Idaho	Number of States Using	Idaho	Number of States Using	Idaho
Written notices, bills	33	✓	36	✓	36	✓
Telephone demands using computer-assisted calling system	13	✓	10	✓	14	✓
Field office collections	29	✓	32	✓	33	✓
Installment agreements	33	✓	35	✓	36	✓
Offers-in-compromise agreements	27	✓	26	✓	27	✓
Levies of financial assets	31	✓	33	✓	35	✓
Seizure/sales of real and/or personal property	27	✓	30	✓	32	✓
Garnishments	29	✓	24	✓	31	✓
Collection agencies in-state	17		15		16	
Collection agencies out-of-state	28	✓	28	✓	26	✓
State tax liens	33	✓	35	✓	37	✓
Reporting to credit bureaus	2		1		1	
License or permit denial, suspension, or revocation	14		22		32	✓[a]
State tax refund offsets	32	✓	33	✓	32	✓
Credit card programs for delinquent taxes	11		8		5	

[a] Idaho revokes sales and use permits and liquor licenses only.

Source: *State Tax Administrators' Views on Delinquent Tax Collection Methods*, GAO, February 1994.

Figure 3-8.2: Collection Methods Found Effective in Other States, 1994

	Individual Income Tax		Corporate Income Tax		Sales and Use Taxes	
Method	Number States Responding	Number States Finding Effective	Number States Responding	Number States Finding Effective	Number States Responding	Number States Finding Effective
Installment agreements	31	31	32	28	35	34
Written bills	32	30	33	27	34	33
Automated telephone calls	12	12	10	9	14	13
Field Office Collections	27	19	31	23	33	32
Enforcement programs involving licenses and permits[a]	13	10	18	12	29	25
Collection agencies	28	14	24	6	27	12
Credit card programs for delinquent taxes	9	2	6	-	4	-

[a] Includes license or permit denial, suspension, or revocation.

Note: Idaho may be included in the responding states.

Source: *State Tax Administrators' Views on Delinquent Tax Collection Methods*, GAO, February 1994.

Idaho's system became operational in January 1993. We reviewed the amount of sales and use tax collected through telephone efforts in 1992 and subsequent years. With the same number of staff in both time periods, Tax Commission telephone collections increased 18.5 percent the year the system became operational. Collections have increased on average 6.6 percent each year since that time. Also, in 1991, staff made 14,532 calls, while in 1994, they made nearly twice this number, or 27,862. However, the Tax Commission did not maintain data on the number of calls in the fiscal years before and after system

implementation (1992 and 1993), so we were unable to determine whether the increase in calls and collections was due entirely to VoiceLink.

In GAO's report, states that use computer assisted systems cited benefits such as a 40 percent increase in revenue collections (one state), a 25 to 1 return on dollars invested (one state), and collections ten times higher than the amount collected in the field (one state).

The computer-assisted calling program appears to have improved collections, but definitive data were not available.

Idaho's VoiceLink system originally cost $180,000 to purchase and install. According to the Tax Commission's preliminary calculations, it would cost approximately $106,000 to expand the system to collect all state taxes. However, this calculation assumes current staff would be shifted to VoiceLink collections and no new staff would be added.

The full extent of the costs and benefits of expanded VoiceLink capabilities have not been calculated. However, because it appears the state may benefit from increased automated dialing capabilities:

We recommend the Tax Commission examine the potential benefits of expanding use of the automated calling system to other taxes and report its conclusions to the 1998 Legislature.

Governance of the State Tax Commission

Chapter 4

In requesting an estimate of the state's tax gap, the Joint Legislative Oversight Committee asked whether it was necessary to have four full-time individuals managing the Tax Commission. We reviewed the authority of the Tax Commission and compared Idaho's structure to a sample of other states.[1] We evaluated whether the governance structure appears cost-effective and establishes clear lines of management for the Tax Commission staff.

To respond to the committee's concerns, we asked:

- Under what authority is the State Tax Commission created?
- How are other state tax collection agencies governed?
- What functions do State Tax Commissioners perform?

We reviewed the Idaho State Constitution, Idaho Code, and legislative committee minutes to determine the responsibilities of the State Tax Commissioners. Also, we interviewed three Idaho State Tax Commissioners and Tax Commission staff. We surveyed tax collection agencies in nine other states for information to compare with Idaho's agency governance structure.

The State Tax Commission was created in the Idaho Constitution.

Constitutional and Legislative Authority

The Idaho Constitution as originally drafted created the State Board of Equalization to perform duties as prescribed by law.

[1] We surveyed seven western states, one state with a tax structure similar to Idaho's, and one state that had done a tax gap analysis: Arizona, California, Minnesota, Montana, Nevada, Oklahoma, Oregon, Utah, and Wyoming. This totals ten agencies because California has two agencies with tax administration responsibilities.

Idaho Code directed this board, comprised of the Governor, Secretary of State, Attorney General, State Auditor, and State Treasurer, to "equalize the valuation of property throughout the state."[2] The Board existed until 1944, when a constitutional amendment replaced it with a State Tax Commission of four members appointed by the Governor. Like the Board of Equalization, this commission is charged with performing those duties prescribed to it by the Legislature.

The Tax Commission consists of four individuals appointed by the Governor.

Although the State Tax Commission is created in the Constitution, we found:

- **The Legislature has exercised broad discretion in defining the role and responsibilities of the tax commissioners.**

In 1945, the Legislature created the Department of Revenue and Taxation and directed the State Tax Commission to manage its operations. The first powers and duties granted to the Tax Commission focused primarily on the equalization and collection of property taxes.[3] In 1969, the Legislature created the Board of Tax Appeals within the Department of Revenue and Taxation.[4] However, the State Tax Commission does not govern its operations.

In 1967, the four commissioners became full-time, salaried state employees with managerial responsibilities over the tax collection agency.

Since 1945, Idaho Code has been amended to add to the list of commissioner responsibilities. In 1967, commissioners became full-time, salaried state employees, each with managerial responsibilities over specific "departments of taxation."[5] According to our review of legislative committee minutes, Legislators wanted to ensure that staff members had clear lines of reporting authority, even though authority was dispersed amongst four commissioners. In 1974, legislation made the chair of the commission the chief executive officer and administrative head of the Tax Commission, responsible for "all personnel and budgetary and/or fiscal matters of the state tax commission."[6]

Twice the Legislature has chosen not to change the number of commissioners or their status as the agency's administrators. In

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2 Political Code of State of Idaho, 1901, p. 441.
3 1945 Idaho Sess. Laws, ch. 69, pgs. 87–93.
4 Idaho Code § 63-3801 (1996).
5 Idaho Code § 63-102 (1996).
6 1974 Idaho Sess. Laws, ch. 19, pgs. 525–528.

1974, the Department of Revenue and Taxation was not included in a codified list of those executive departments to be headed by an executive director.[7] In 1978, the Legislature rejected a recommendation by the Governor's Committee on Taxation to make the Tax Commission an odd-numbered board responsible only for setting policy and appointing administrative staff to oversee the agency.[8]

Organization and Cost-Effectiveness of Governance Structure

Organization

Past Legislatures have been concerned that lines of responsibility be clearly established for Tax Commission staff. We compared Idaho's governance structure to that of the states we surveyed and reviewed the structure to better understand the managerial relationships between commissioners and their staff. We found:

- **Tax collection agency governance by a commission is not unusual, but all ten agencies we surveyed have an executive director while Idaho does not.**

Agency oversight by a commission offers the advantage of dispersing power and balancing political affiliation to better ensure unprejudiced administration of state tax policy. At the same time, executive directors can assume daily personnel and budget duties, freeing commissioners to focus on tax policy development and application.

Oversight by a commission offers the advantage of dispersing power and balancing political affiliation in the administration of tax laws.

Half of the ten tax collection agencies we surveyed are overseen by commissions. As Table 4.1 shows, in Idaho's Tax Commission and three other agencies, commissioners serve full-time; in the remaining two, commissioners serve part-time. Governors appoint commissioners in Idaho and all surveyed states except California.[9] Commissioners in the states we surveyed

[7] 1974 Idaho Sess. Laws, ch. 40, pgs. 1072–1074.

[8] "Idaho Taxes: Comparative Analysis, Evaluation and Recommendation," Governor's Committee on Taxation, September, 1978, p. 9.

[9] The part-time commissioners at California's Franchise Tax Board are full-time elected officials who serve ex officio on the Franchise Tax Board and, in one instance, on the State Board of Equalization.

Table 4.1: Governance Structure of Tax Collection Agencies, by State, 1996

	Governed by Commissioners	Number of Commissioners	Employ a Director(s)
Arizona			✓
California			✓
Board of Equalization	✓	5	✓
Franchise Tax Board[a]	✓	3	✓
Idaho		**4**	
Minnesota			✓
Montana			✓
Nevada[a]	✓	8	✓
Oklahoma	✓	3	✓
Oregon			✓
Utah	✓	4	✓
Wyoming			✓

[a] Commissioners serve part-time.

Source: Office of Performance Evaluations survey results.

All other tax collection agencies we studied employed an executive director.

serve fixed terms ranging from three to six years; Idaho's commissioners serve a six-year term.

Unlike Idaho, all surveyed agencies employ a full-time director. Directors in surveyed agencies all serve at the pleasure of either the governor (six agencies) or the commission (four agencies). In Idaho, the legal responsibility for the day-to-day operation of the Tax Commission is given to the commissioners, with most management responsibilities given to the chair of the commission or his designee.[10]

[10] IDAHO CODE § 63-102(4).

The tax commissioners told us they have organized themselves to have primary responsibility for specific taxes. In this capacity, they advise on matters of tax policy and make determinations on taxpayer appeals for the taxes they oversee. Similarly, commissioners in each of the five states with commissions advise on policy matters, and, in all but one part-time commission, hear taxpayer appeals.

Tax Commissioners have organized themselves to have primary responsibility for specific taxes, while staff are organized by function.

At the same time that the commissioners are organized to exercise authority over specific taxes, Tax Commission staff are organized under functional areas, such as the Management Services Division and the Audit and Collections Division, as described in Chapter 1. While this divergence could lead to staff confusion about reporting lines, relationships among commissioners and upper agency management appear to be clear.

As shown in Figure 4.1, three division administrators, and the staff under them, report to only one commissioner. Only one division administrator reports to more than one commissioner. This administrator oversees the identification and collection of all taxes, thus affecting the responsibilities of all commissioners. He is jointly hired by the commissioners and reports to all four depending on the issue. Importantly, this arrangement eliminates the need to create duplicative functional areas by tax.

Reporting relationships among commissioners and upper agency management appear to be clear.

We did not systematically interview staff below the division administrator level to fully assess the efficiency of the Tax Commission's management of its staff.

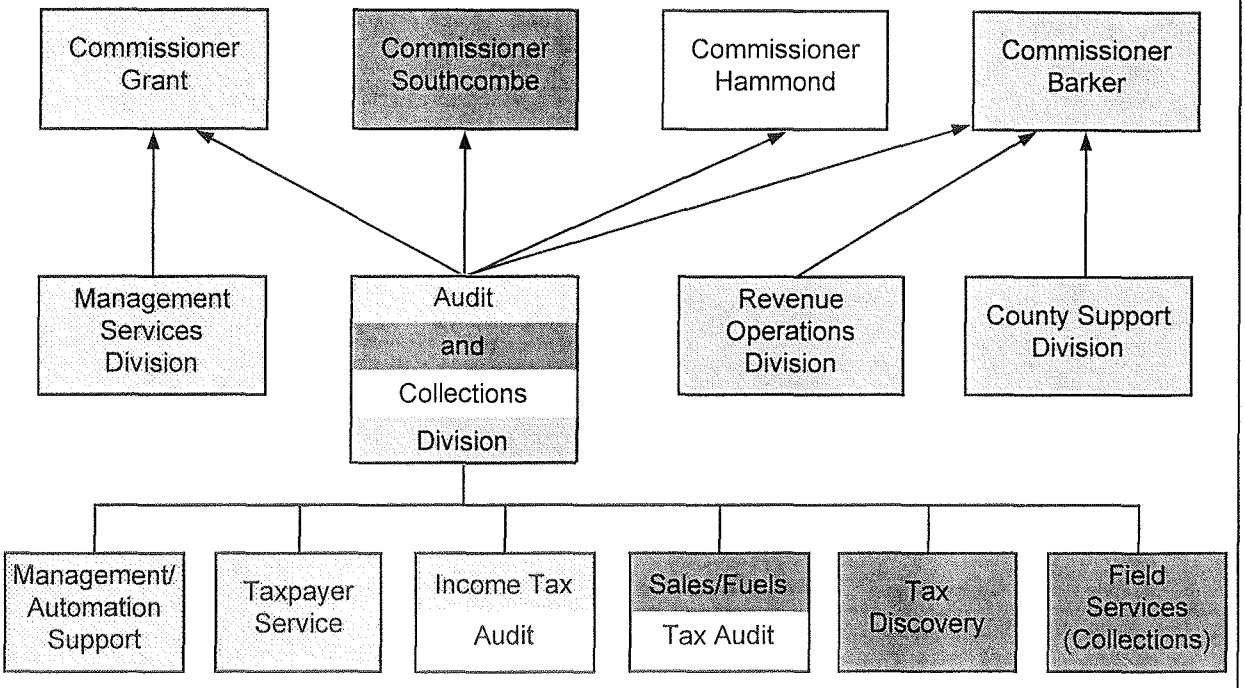
Cost-Effectiveness

We confined our assessment of cost-effectiveness to the salaries of top administrative officials. We did not ask agencies to provide work load data or to report the percentage of time spent on different tasks. Based on this review:

- **Idaho's current governance structure appears to be as cost-effective as that of other states.**

Annual salaries for full-time commissioners ranged from $55,000 (Idaho) to $95,052 (California). Not all commissioners in California reported receiving a salary for their work on the commission, but part of the salaries of elected officials serving ex officio should be associated with their statutory duty of governing the tax collection agency. Part-time commissioners in Nevada

Figure 4.1: Reporting Relationships From Staff Functional Areas to Commissioners, 1996



Source: Office of Performance Evaluations analysis of Tax Commission documents.

Idaho's governance structure appears as cost-effective as those in other states.

receive a per diem. Directors' salaries ranged from $56,000 (Montana) to $103,872 (California).

To compare the costs of administering a tax collection agency, we calculated total salaries for the top administrative responsibilities in each state, including all commissioners, agency directors, deputy directors, and division administrators in the states that had them. We compared these total salaries to the agency's total budget and state's gross revenue for the same fiscal year.

As Table 4.2 shows, in fiscal year 1995 Idaho ranked third in the percent of agency budget devoted to administrative staff and fifth in the percent of total state tax revenue devoted to tax collection oversight. Because we included the same administrative layers in

our calculations for all agencies, comparative administrative costs for larger agencies that rely on additional administrative layers are not fully included. As a result, Idaho's ranking in this analysis may be inflated.

Alternative Governance Structures

To determine if there would be monetary benefits under an alternative governance structure, we compared Idaho's current

Table 4.2: Administrative Salary Costs in Survey States, 1996

Administrative Salaries as Percent of Total Agency Budget

Rank	State	Percent
1	Wyoming	4.7%
2	Nevada	4.2%
3	**Idaho**	**2.3%**
4	California[a]	1.8%
5	Utah	1.8%
6	Montana	1.1%
7	Arizona	1.1%
8	Oregon	.8%
9	Oklahoma	.7%
10	Minnesota	.6%

Administrative Salaries as Percent of Total State Tax Revenue

Rank	State	Percent
1	Wyoming	.065%
2	Montana	.050%
3	Utah	.030%
4	Nevada	.025%
5	**Idaho**	**.023%**
6	Arizona	.010%
7	Oklahoma	.010%
8	Oregon	.009%
9	California[a]	.009%
10	Minnesota	.006%

[a] We averaged total salary data for the two tax administration agencies in California.

Source: Office of Performance Evaluations survey of other states' tax collection agencies.

We compared Idaho's current governance structure with two alternatives we found in other states.

structure to two alternatives found in the states we surveyed. First, we compared the current structure with that under a part-time commission and a full-time director. Under this scenario the four tax commissioners would become part-time to advise on matters of tax policy and the disposition of cases in dispute. A full-time director would be hired to oversee agency operations. Also, a deputy director would be hired to meet the demands of full-time agency administration.[11] As shown in Table 4.3, the potential salary savings of this alternative is $5,000 per year. This net effect would vary using alternative salary assumptions.

[11] The Legislature currently establishes salaries for the state tax commissioners. Director and deputy director salaries would likely be established by the Idaho Personnel Commission. The salaries used here are based on increases made to salaries currently being paid to State Tax Commission staff.

Table 4.3: Potential Cost of Alternative Governance Structure, Alternative A

	Number	Full-Time or Part-Time	Salary	Total
Current				
Commissioner	4	Full	$55,000	$220,000
			Total	$220,000
Alternative[a]				
Commissioner	4	Part	$15,000	$60,000
Director	1	Full	$90,000	$90,000
Deputy Director	1	Full	$65,000	$65,000
			Total	$215,000

[a] Director and deputy director salary estimates are based on increases to current Tax Commission staff salaries.

Source: Office of Performance Evaluations analysis.

Second, we compared the current structure with that under a full-time commission and a full-time director. Under this scenario the tax commissioners would continue full-time at their current salary levels, advising on matters of tax policy and making determinations on appeals. A full-time director would be hired to perform administrative functions for the Tax Commission. As shown in Table 4.4, the potential cost of this alternative is $90,000 per year more than under the current structure. This net effect would vary using alternative salary assumptions.

We did not determine clear benefits from restructuring the present Tax Commission structure.

Based on this limited review:

- **We were unable to determine any clear monetary or managerial gains from restructuring the Tax Commission's governance structure.**

Table 4.4: Potential Cost of Alternative Governance Structure, Alternative B

	Number	Full-Time or Part-Time	Salary	Total
Current				
Commissioner	4	Full	$55,000	$220,000
			Total	$220,000
Alternative[a]				
Commissioner	4	Full	$55,000	$220,000
Director	1	Full	$90,000	$90,000
			Total	$310,000

[a] Director salary estimate is based on an increase to current Tax Commission staff salaries.

Source: Office of Performance Evaluations analysis.

Appendix A
Sales and Use Tax Exemptions

63-3622.	Exemptions, Exemption certificates, Penalties.
63-3622A.	Prohibited taxes.
63-3622B.	Out-of-state contracts.
63-3622C.	Motor fuels subject to tax.
63-3622D.	Production exemption.
63-3622E.	Containers.
63-3622F.	Utilities.
63-3622G.	Heating materials.
63-3622H.	Home yard sales.
63-3622I.	Literature.
63-3662J.	School, church, and senior citizen meals.
63-3662K.	Occasional sales.
63-3662L.	De minimis sales.
63-3662M.	Liquor sales.
63-3662N.	Prescriptions.
63-3662O.	Nonprofit organizations.
63-3662P.	Purchases shipped out-of-state by a common carrier.
63-3662Q.	Out-of-state shipments.
63-3662R.	Motor vehicles and used mobile homes.
63-3662S.	Radio and television broadcasting equipment.
63-3662T.	Equipment to produce certain newspapers.
63-3622U.	Funeral services.
63-3622V.	Bullion.
63-3622W.	Irrigation equipment and supplies.
63-3622X.	Pollution control equipment.
63-3622Y.	Taxation of aerial passenger tramways and snowgrooming and snowmaking equipment.
63-3622Z.	Sales by Indian tribes.
63-3662AA.	Exemption for official documents.
63-3662BB.	Research and development at the INEL.
63-3662CC.	Railroad rolling stock.
63-3662DD.	Parts for railroad rolling stock.
63-3662EE.	Purchases for the federal special supplemental food program for women, infants and children (WIC).
63-3662FF.	Purchases made with federal food stamps.
63-3662GG.	Aircraft.
63-3662HH.	Production exemption shall not apply to sales regarding recreation-related vehicles.
63-3662II.	Money-operated dispensing equipment.
63-3662JJ.	Logging exemption.
[63-3662KK.]	Incidental sales by religious corporations or societies. [Effective until January 1, 1997.]
63-3662KK.	Incidental sales by religious corporations or societies. [Effective January 1, 1997.]

Source: Idaho Code (1996).

Response to the Evaluation

For The People of Idaho

STATE TAX COMMISSION

800 Park Blvd. Plaza IV • Boise, ID • 83722

November 25, 1996

Nancy Van Maren
Director
Office of Performance Evaluations
STATEHOUSE MAIL

Dear Nancy:

The State Tax Commission would like to preface its comments to the Tax Gap Estimate Report by expressing appreciation to the Office of Performance Evaluations for its efforts in producing this report.

We worked closely with OPE analysts over a period of four months and acknowledge their hard work and dedication. Given the complexity of our agency and the issues being addressed, as well as the compressed time frame in which the report had to be produced, we believe the end product is one for which your office can be justifiably proud. We hope our remarks will be received in the spirit in which they are offered. They are not intended to be overly critical of the report or the project in which we were pleased to participate, but are presented as additional "food for thought" for the Joint Committee on Legislative Oversight.

Overview:

It appears to us the focus of the report and its recommendations seem to emphasize maximization of revenue from enforcement activities. We sincerely appreciate the support for our enforcement efforts as it is expressed in the report. We believe, however, a single-minded emphasis on maximizing enforcement overlooks the need to support and encourage voluntary compliance. We believe this approach also fails to give adequate consideration to the need to maintain balance and equity in our overall system of tax administration. This, in our judgment, would tend to drive citizens away from the system and help foster the tax protest movement.

Voluntary compliance is the cornerstone of our tax system. We depend upon it to produce the vast majority (97% for FY 96) of the tax revenue received by the State Tax Commission. The tax gap estimate in this report demonstrates there is additional revenue which might be realized. Since the goal of our efforts should be to maximize overall revenue, a response to the tax gap needs to focus on increasing revenue from voluntary compliance as well as revenue which comes from enforcement activity.

Various studies have shown that one key to improved voluntary compliance is a strong enforcement program. One such study of federal tax compliance performed by the California Institute of Technology (CIT) in the late 1980's concluded reduced IRS audit emphasis from a 2.5% coverage level in 1976 to 1.1% in 1986 produced a huge reduction in voluntary compliance, even during a period when tax rates were reduced. This study estimated, if 1976 audit coverage rates had been maintained, total federal revenue collected for tax year 1985 would have been $47.43 billion higher. The study finds that $43.46 billion (93%) of this total would have resulted from better voluntary compliance caused by the deterrent effect resulting from the greater level of audit coverage. Only $4 billion of this would have been the direct result of audit activity.

The results of the CIT study generally confirm the recommendation of the OPE report that an effective enforcement program is critical to voluntary compliance. But, to be effective, enforcement must also be balanced and equitable. The proposals for shifting staffing from sales tax audit to tax discovery because nonfiler work produces more dollars in measurable enforcement revenue for each dollar spent (Recommendation I) or targeting specific industries for audit enforcement (Recommendation III) merit additional consideration, but we are concerned there may be corresponding adverse impacts on revenue. The effects on equity and voluntary compliance of such shifts have not been fully evaluated. The suggestion that a shift of sales tax staffing to nonfiler work "should also deter fraud and promote voluntary compliance" is probably true. We are again concerned, however, this fails to consider the potential impacts on the balance and equity of our enforcement efforts (critical ingredients of voluntary compliance) relating to registered sales/use tax accounts.

In addition to the need for maintaining enforcement which is balanced and effective, and a tax system which is fair and equitable, voluntary compliance depends on a level of simplicity and public understanding of compliance requirements which enables people to comply voluntarily. Since we realize voluntary compliance is such a huge part of any effective system of tax administration, much of our effort, even that focused primarily on enforcement, is devoted to educating taxpayers so future compliance is improved. We feel we have received very explicit direction from both the Legislature and the Governor in this regard. Over the past several years (generally those years covered by this review), the Tax Commission has intentionally placed expanded emphasis on educating the taxpayer. As a result of this, and because tax law,

technology, the complexity of inter-taxpayer relationships, and a more service oriented economy have made audits more difficult and time consuming, clarifying compliance requirements during the audit process is more important than ever. If we reduce audit staffing in one bureau or target specific industries to the exclusion of others in our audit work, there may be reductions in voluntary compliance which exceed the increased enforcement revenues we realize from the shift.

This report makes several recommendations which are intended to increase the revenue generation capacity of our enforcement programs. We generally agree with them, particularly those which suggest making additional funding available for taxpayer service and expanding the automated phone collection system. We also support recommendations to increase nonfiler staffing and to expand use of interns in the managed audit project (if the results of our pilot effort prove as successful as they appear to be now), but not necessarily if these expansions require shifts from other activities. We are encouraged by the suggestion that additional information sources, such as the state vendor list, should be made available to us in an electronic format, but caution that using this information effectively will require additional systems development and possibly additional staffing.

Missing from this report are ideas which will permit meaningful long-term improvement in our enforcement capabilities. However, we do realize the time frame in which we were operating prevented a more in-depth analysis and the development and discussion of such ideas. We believe if anything more than piecemeal progress in reducing the tax gap is going to occur, fundamental long-term commitment to understanding its causes and seeking to overcome them is necessary. We believe the best opportunity for enhancing long-term enforcement effectiveness will come from a comprehensive re-engineering of our enforcement functions. Such an effort will require a substantial commitment from agency management and staff as well as from others who serve in leadership roles within state government.

Responses to Specific Findings, Conclusions and Recommendations:

Finding I:

While it is clear additional resources devoted to nonfiler work would be productive, it is not clear these resources should be redirected from existing audit work. Voluntary compliance, which obviously produces the vast majority of the state's revenue, demands a perception on the part of those who comply that the tax

system is equitable and those who do not comply will be caught. If we divert staffing from one of the audit groups to discovery, we reduce the influence on voluntary compliance which results from our audit efforts. That may still be a wise thing to do, but we have to recognize the impact it may have on voluntary compliance which results from the education and perceptions of equity which are produced by our audit programs.

Another factor which may have been overlooked by the suggestion to shift audit staffing to discovery activities is the difference in classification and job qualifications which exists between audit and nonfiler positions. While it is possible to shift resources when positions become vacant or go through a lay-off process, Personnel Commission rules prohibit our simply moving auditors into nonfiler enforcement because qualification requirements and pay levels are not the same. A preferable option from our perspective would be to add staffing to our nonfiler bureau without reducing it in our audit programs. This would, of course, require an increase to our appropriation.

Finding II:

While our systems do not presently capture data which provide us with consistent or in-depth performance information across bureau lines, we do monitor employee work efforts and believe the success of our management practices and business judgment is reflected in the recoveries set forth in this report. Further, we have two significant software development projects in process. These will markedly improve the information we have available to manage cases while they are in progress as well as to provide detailed or summary information about cases when they are completed. The first of these is an update to our core Taxpayer Management System (TMS). It is scheduled to be completed in December. With the changes being made in this system, reports available to Field Services will provide much better information about individual employee caseloads and collection results. The other system being developed is our Assignment Reporting and Tracking (ART) system. It will enable the audit and discovery programs to more easily manage inventories, to monitor progress on cases being worked, and to more comprehensively and consistently report results.

Our current and planned efforts to monitor and evaluate performance demonstrate we understand the importance of assessing productivity and modifying plans to make resource utilization more effective. We have, however, always avoided, and are presently prohibited by the Taxpayer Bill of Rights from using dollars

produced as a measure of employee performance. We do not believe in a "dollars-at-any-cost" approach to tax enforcement. We believe we are following gubernatorial and legislative direction in our efforts to 1) promote voluntary compliance, 2) maintain balance and equity in our tax administration policies, and 3) emphasize quality and education in our enforcement programs.

Finding III:

As we noted above, voluntary compliance requires a balanced audit approach . . . one that maintains a degree of equity and a perception that any taxpayer may be the subject of an audit. We believe our enforcement efforts should emphasize more than just a numbers game. In fact, during the past three or four years in particular, our enforcement personnel have spent a much greater portion of their time trying to explain the requirements and otherwise educate taxpayers so they can more effectively comply. This is consistent with direction we have received from the Legislature and the Governor. We believe the emphasis on education in our audit and collection efforts is responsible to some degree for an increase in revenue throughout this period from voluntary compliance.

While we are not oblivious to the need to select cases which have a significant potential for unreported tax, we believe our enforcement should focus on taxpayers from all industries who may have such potential.

With our recent acquisition of ACL software and the opportunity it provides to scrutinize the characteristics of businesses in our sales/use tax database, we believe we will be able to select even better audit candidates (not just by their industry code), taking into account all of the information in our database.

Finding IV:

We agree the managed audit program holds a lot of promise. Thus far, our experience with this concept is limited to the pilot effort we began in July of this year. Expanding its use to other parts of the state and employing the concept of using interns in a similar way in other enforcement programs appears to be a great idea; however, it is already clear it will be feasible only where the issues being addressed are relatively simple. Broader use of interns will also require resources we do not now have.

Finding V:

We also agree there is potential for a greater degree of computer matching which could provide useful information to our nonfiler and audit programs as well as offsets against our accounts receivable for entities who receive payments for goods or services from the state. In addition to the state vendor list (which would be useful if we could identify businesses by EIN and volume of business done with the state), we could benefit from use of occupational license information, information which discloses the details of real estate transactions, and receipt of information from the Secretary of State which identifies businesses operating within the state. Legislation would be necessary to make much of this kind of information available to the Tax Commission. Making effective use of new information sources such as these may also require additional staffing or a shift from some of our current activities.

Finding VI:

The substance of this finding and recommendation is the basis for a decision unit which is contained within the agency's FY 98 budget request. We have asked for three new permanent positions and $20,000 for hiring temporary staffing during the annual tax season when permanent employees would not be able to keep up with the demand we receive for taxpayer service. Even with this additional complement of staffing, other collection and audit staff will be impacted during the tax season, especially in our five field offices. Additional staffing in those offices could also be provided by interns if the necessary funding were available.

Finding VII:

We remain uncertain what is intended by this finding and recommendation. In our opinion, maintaining records of discretionary adjustments would not convey meaningful or useful information and the numbers could easily be misunderstood and misused. The statistics in and of themselves would not convey, for instance, whether the notice of deficiency (NOD) was excessive, whether the taxpayer provided additional information, or whether there were issues being litigated. The finding and recommendation also assume the starting point, the NOD, establishes a tax liability. The NOD amount is not necessarily a part of the tax gap this report is attempting to measure. In fact, a tax liability is not determined until the conclusion of the taxpayer's appeal. The state does not have the "right" to receive tax dollars proposed in a deficiency until after the tax liability is legally assessed.

This cannot occur until all of the taxpayer's opportunities for administrative or judicial review have fully expired. Timing differences between the date of the NOD and the date final collection of the assessed tax liability occurs will also significantly skew statistics and further impair their meaning and usefulness.

Finding VIII:

We can comply with this recommendation. Expansion of the system for use in collecting other taxes will, as pointed out, require additional funding.

Conclusion:

We have enjoyed participating in this study to identify Idaho's tax gap. We believe the report conveys interesting and meaningful information to the Governor and the Legislature which should prove helpful in determining the future direction of tax administration in Idaho.

Sincerely,

Coleen Grant

Coleen Grant
Commissioner

Completed Performance Evaluations

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