

2014

Oregon Department of Revenue
Licensee Tax Compliance
HB 2871 (2013 Regular Session)

Executive Summary
February 2014



Introduction

This report describes the department's progress in implementing the pilot project related to licensee tax compliance as authorized by House Bill 3082 (section 2, chapter 576, Oregon Laws 2009).

It includes evidence gathered during the pilot project from 2009 through 2010, as well as follow-up data on licensee compliance that was gathered in December 2013.

Based upon the evidence gathered during the pilot project we saw an improvement in compliance rates among licensees when we were actively monitoring their tax compliance and reporting back to the agencies with which we partnered. When we did a follow-up study (December 2013) to re-measure the compliance of the original participants we saw the compliance rates return to near their pre-pilot project levels.

It appears that licensee sanctions are most effective when licensees are continually educated about tax compliance and are aware that their license may be in jeopardy if they are not in compliance.

Background

The 2009 Legislature enacted House Bill 3082, which authorized us to develop and implement a pilot project that required licensees to demonstrate tax compliance as a condition of receiving or renewing a license. The bill authorized us to conduct this pilot project with up to three licensors. While only three boards fully participated (license was in jeopardy if non-compliant) we also worked with an additional six boards in more of an educational manner (license was not in jeopardy if non-compliant.) We reported our findings on the pilot project to the 2011 Legislature.

Results of the Pilot Project

There were 6,137 licensees from the three participating boards included in the pilot project. The below chart shows the results of our first baseline compliance check in early of 2010, the tax compliance check as of December 2010, and a recheck of our baseline as of December 31, 2013.

| Name of Board | Baseline % Compliant | Dec 2010 % Compliant | Dec 2013 % Compliant |
|--|-----------------------------|-----------------------------|-----------------------------|
| Oregon Mortuary and Cemetery Board—Preneed Salespeople | 84.2% | 91.1% | 86.1% |
| Board of Tax Practitioners—Licensed Tax Consultants | 96.2% | 99% | 97% |
| Board of Tax Practitioners—Licensed Tax Preparers | 94.9% | 96.1% | 94.2% |
| Construction Contractors Board—Residential Limited Contractors | 86.5% | 91.6% | 87.6% |

Recommendation

Based upon the evidence we gathered during the pilot project, there appears to be value in having a licensee tax compliance requirement. The highest levels of compliance were observed when we were actively working with the boards and their licensees, as well as providing educational materials related to being in tax compliance as requirement to obtain or renew a license. In order to maintain the high levels of compliance we saw in our 2010 measurement we would need to commit resources to this project long term.

We are currently contracted with FAST enterprises to replace our aging computer core systems. This will be our primary focus as an agency over the next few years. Pursuing a large project around licensee tax compliance would require additional resources, that, at present we are dedicating to this major IT initiative. We also believe that our new core systems may open up new compliance tools that will allow us to achieve higher compliance rates than we currently experience—based upon feedback we've received from other states.

We recommend allowing the original pilot project described in House Bill 3082 to sunset, and perhaps revisit a licensee tax compliance program in the future, after our core systems are implemented. This will allow us the opportunity to examine our compliance strategies in light of emerging technology and weigh the benefits of a licensee tax compliance program along with other tools that may improve compliance.

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Based upon the evidence gathered during the pilot project we saw an improvement in compliance rates among licensees when we were actively monitoring their tax compliance and reporting back to the agencies with which we partnered. When we did a follow-up study (December 2013) to re-measure the compliance of the original participants we saw the compliance rates return to near their pre-pilot project levels.

It appears that licensee sanctions are most effective when licensees are continually educated about tax compliance and are aware that their license may be in jeopardy if they are not in compliance.

Discussion of collateral compliance

The tax system has relied upon imposing monetary penalties as a consequence for non-compliance. However there is some disagreement on the effectiveness of monetary penalties as a tool to improve compliance rates. Collateral sanctions are used in many areas of the law, most often in the criminal context when a convicted criminal gets a prison sentence but also is prevented from enlisting in the military, serving on a jury, receiving a commercial driver's license among other sanctions. Some discussion is occurring in the states and at the federal level related to whether collateral sanctions for non-compliance with tax laws are appropriate. Under federal law, "...the failure to pay taxes owed may result not only in civil and criminal penalties, but also in the loss of the ability to obtain federal employment, apply for Federal Housing Authority mortgages, enter contracts with the federal government, and hold U.S. passports." (Source: Joshua Blank, *Collateral Compliance*, September 2013).

Some individuals who are habitually delinquent or not in compliance do not consider monetary tax penalties as a loss great enough to come into compliance because they expect the penalty and consider it a cost of doing business. Licensee sanctions may be superior to monetary sanctions in that they provoke 'loss aversion' especially when associated with a government-provided benefit to which people feel entitled. Additionally, licensee sanctions are less likely to be hidden from the public or the licensee's peer group. This may provide additional motivation to remain in tax compliance.

Licensee Tax Compliance Fosters Equity

We presented a report on tax compliance to the 2009 Oregon Legislature. Among other things, it highlighted a lack of fairness and equity among businesses when some but not others comply with tax laws.

"When businesses don't pay their taxes, they have more cash available for business needs. This is especially true for employers who withhold income taxes from their employees' wages, but fail to send them to the department or hold on to them longer than allowed by law. Business owners who pay their fair share of taxes (including unemployment, workers' compensation, and transit taxes) and pay payroll withholding taxes on time are at a disadvantage; they must make enough income

from their businesses to cover these business expenses. Business owners who do not pay their taxes or who do not pay payroll withholding taxes on time can bid lower for certain jobs and have an unfair competitive edge in the marketplace.” (2009 *Report on Personal Income Tax Compliance in Oregon*)

Lack of third-party verification

The professional licensee population typically has a lower percentage of third-party withholding verification, which leads to lower tax compliance rates. In our 2009 *Report on Personal Income Tax Compliance in Oregon* we address this issue as a risk to tax compliance. The report said in part, “According to a report from the Government Accountability Office, those subject to substantial information reporting and withholding are 99-percent compliant, whereas self-employed individuals who are subject to little or no information reporting and withholding are 46-percent compliant.” Since a greater percentage of professional license holders are self-employed—and not subject to third-party verification of income and withholding—a licensee tax compliance requirement may improve compliance rates.

Progress implementing the pilot project

The 2009 Legislature enacted House Bill 3082, which authorized us to develop and implement a pilot project that required licensees to demonstrate tax compliance as a condition of receiving or renewing a license. The bill authorized us to conduct this pilot project with up to three licensors. While only three boards fully participated (license was in jeopardy if non-compliant) we also worked with an additional six boards in more of an educational manner (license was not in jeopardy if non-compliant.) We reported our findings on the pilot project to the 2011 Legislature (*Appendix A*).

The following three boards participated in the pilot project:

- Mortuary and Cemetery Board (Small—2,153 licensees total, we checked compliance on 260 licensees that applied for new or renewed licenses.)
- Board of Tax Practitioners. (Medium—4,598 licensees total, we checked compliance on all 4,598 licensees at the request of the board. They were very interested in understanding the level of tax compliance of their licensees, due in part, to the nature of their work—tax preparation.)
- Construction Contractors Board (Large—40,292 licensees total, we checked compliance on 1,279 licensees that were applying for new licenses or renewing.)

Evidence gathered during the Pilot Project

The participating licensee’s tax compliance was measured at the following intervals:

- Baseline compliance, Jan/Feb 2010. This was our initial compliance check of the participating licensees. No information about the project had been shared with licensees, and no licenses were in jeopardy of non-issue, or non-renewal.
- December 2010 compliance check. This measurement of compliance was taken after we shared educational materials and notified the boards of non-compliant licensees. Non-compliant licensees were in jeopardy of not obtaining or renewing their license.
- December 2013 compliance check. We re-measured the participating licensees to determine if there was a long-term impact of our pilot project.

| Name of Board | Baseline % Compliant | Dec 2010 % Compliant | Dec 2013 % Compliant |
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The overall compliance rate of the three boards combined was 93.47%. The original compliance rate of the licensees when we checked in early 2010 was 93.12%. As we worked closely with the participating boards—by educating licensees, and the boards withholding licenses, an increase of compliance was observed, as it rose to 96.38% over all.

Based upon the evidence we gathered during the pilot project, there appears to be value in having a licensee tax compliance requirement. The highest levels of compliance were observed when we were actively working with the boards and their licensees, as well as providing educational materials related to being in tax compliance as requirement to obtain or renew a license. In order to maintain the high levels of compliance we saw in our 2010 measurement we would need to commit resources to this project long-term.

Recommended Methods to expand the pilot project

We believe that there is value in continuing to study licensee tax compliance and expanding the pilot project authorized by House Bill 3082 however there are a few things that could be accomplished to maximize the effectiveness of such a requirement, if one were to be implemented. Consider the following information:

- While gathering information for this report we initially relied on Oregon’s licensee webpage (www.licenseinfo.oregon.gov). This site (hosted by Secretary of State) lists 114 agencies, boards, and commissions in Oregon that issue 1,198 different license types. This site contains general information about the type of licenses and requirements for obtaining them. However, when we contacted individual agencies to verify the licensee data (types of licenses offered and number of license holders) we found that the information listed on the website was incomplete, inaccurate, and outdated. If licensee compliance were expanded in the future—it would be helpful to have up-to-date information. We believe that the site will be updated regularly due to 2013 HB 2643 that takes effect January 1, 2014 and requires licensors to update the site by September 1 each year.
- In order to leverage technology we recommend a licensee compliance requirement be implemented with the ability to issue online tax compliance certificates. We would make tax compliance certificates available through a web-based, self-service tax-compliance-check program which we already know is supported by our new core system replacement.

Factors bearing on expanding the pilot project

We are currently contracted with FAST Enterprises to replace our aging computer systems. This will be our primary focus as an agency over the next few years. Pursuing a large project around licensee tax compliance would require additional resources, that, we currently are

dedicating to this major IT initiative. We also believe that our new core systems may open up new compliance tools that will allow us to achieve higher compliance rates than we currently experience—based upon feedback we’ve received from other states.

We recommend allowing the original pilot project described in House Bill 3082 to sunset, and to revisit a licensee tax compliance program in the future, after our core systems are implemented and after licensee databases are updated. This will allow us the opportunity to examine our compliance strategies in light of emerging technology and accurate licensee information, and weigh the benefits of a licensee tax compliance program along with other tools that may improve compliance.

Appendix: HB 3082

House Bill 3082

Licensee Tax Compliance Pilot Project

Final Report



www.oregon.gov/dor

January 2011

January 31, 2011

To the Members of the Seventy-sixth Legislative Assembly:

Enclosed is the Department of Revenue's report detailing the findings and conclusions of Licensee Tax Compliance Pilot Project. Chapter 576, Oregon Laws 2009 authorized the Department of Revenue to conduct a pilot project to determine the effectiveness of requiring tax compliance as a condition for occupational and professional licensing.

Elizabeth Harchenko, Director
Department of Revenue

Introduction

Chapter 576, Oregon Laws 2009 (Enrolled House Bill 3082), authorized the Department of Revenue to conduct a pilot project to determine the effectiveness of requiring tax compliance as a condition for occupational and professional licensing.

Pilot project overview

The department focused on personal income tax compliance (excluding withholding tax) for tax years 2006, 2007, and 2008 and worked with three licensing boards: the Mortuary and Cemetery Board, the Construction Contractors Board, and the Board of Tax Practitioners. Each board supplied the Department of Revenue with a selected list of licensees who would be renewing their licenses during the project period.

The department mailed information about the pilot project to every specified licensee. We also notified those licensees who were not in compliance that they would have to file tax returns or make arrangements to pay past-due taxes in order to renew their licenses. At the beginning of the project, 422 of the 6,137 licensees we contacted were not in compliance.

The department posted project information on our website, included it in the letters and brochures sent to licensees, and recorded it on our telephone messaging system. In addition to helping licensees resolve their compliance issues and answering questions, we assigned a dedicated employee to act as a liaison to assist each of the licensing boards.

Results

There were 6,137 licensees from the three participating boards included in the pilot project. Of those licensees, 422 were noncompliant as of our first baseline compliance check in early 2010.

As of December 31, 2010:

- 311 licensees paid \$449,974 in past-due taxes.
- 365 past-due tax returns had been filed.
- Refunds worth \$83,290 had been issued.
- Refunds worth \$11,709 had been denied. The returns were filed more than three years after the year the return was due.
- 104 payments plans had been set up.
- Approved payments plans have been set up to collect an additional \$208,072.
- 25 licenses have been suspended or not renewed.
- The number of noncompliant taxpayers was reduced to 218.

Conclusions

Although the sample we used was small, the results indicate that making tax compliance a condition for professional or occupational license renewal can be an effective tool. We

recommend that the pilot project be continued with a larger licensee population to better measure the effect of a compliance requirement and to assess the effect it might have on other tax programs.

The department also researched what other states are doing and found that some states have implemented successful tax compliance requirement processes for licensees, state employees, and state contractors. At least one state has created a Tax Compliance Certificate process in which licensees obtain a certificate online, which is a required part of their license application.

Oregon licensing boards issue approximately 1 million professional and occupational licenses. Before we can advise the legislature on the value of a tax compliance requirement, we also need to determine the implementation cost.

Next steps

The department believes that there is value in continuing the pilot project to include a larger, more diversified licensee population. We will also expand the pilot to include other tax programs covered in HB 3082 to evaluate the effectiveness of a tax compliance requirement for those tax programs.

This first phase of the pilot project has allowed us to set up effective and efficient internal processes, create partnerships with the licensing boards, and create open lines of communication with licensees. We recommend that the legislature take no action at this time, and that we report to the Seventy-seventh Legislative Assembly on the results of our continued study.

If you would like additional information on the results of the first phase of the pilot project, please contact the Director's office.