

2016

Oregon Department of Revenue

Presentation to the Interim Joint Committee on Ways & Means Subcommittee on General Government

Responses to Questions from Committee Members

February 10, 2016



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Department of Revenue

Response to questions

Do you have a graphic representing your estimate of nonfilers?

The most recent work produced by the department relating to the personal income tax gap is represented in a budget note presented to the Ways and Means General Government Subcommittee in January 2014, titled *Compliance with Oregon's Personal and Corporate Tax Programs, Sources of Noncompliance and Discussion of Tax Gap*. The graphic below shows estimates for all sources of noncompliance for tax year 2010. The nonfiling gap was estimated at \$133 million.

Oregon Personal Income Tax Gap Estimate TY 2010	
(\$ Millions)	
Tax Return Line Item Misreporting by Visibility Category	
Substantial Information Reporting and Withholding ¹	\$67
Substantial Information Reporting ²	\$62
Some Information Reporting ³	\$291
Little or No Information Reporting ⁴	\$905
Tax Credits	\$122
Adjustment due to GAO Findings	-\$199
Total Misreporting Gap	\$1,247
Nonfiling Gap	\$133
Underpayment Gap	\$155
Gross Tax Gap	\$1,536
Voluntary Withholding Payments not Claimed on	
Timely Returns	-\$250
Other Receipts Beyond Reported Tax	-\$148
Net Tax Gap	\$1,137
Net Tax Gap as % of True Liability	17.8%

¹Includes wages & salaries

²Pensions & annuities, unemployment compensation, dividend income, interest income

³Deductions, exemptions, partnership/S-Corp income, capital gains, alimony income

⁴Nonfarm proprietor income, other income, rents & royalties, farm income, adjustments

Source: Oregon Department of Revenue Research Section

Our enforcement revenue collected includes payments from nonfilers generated through our variety of enforcement activities. For Fiscal Year 2013, we collected \$36 million through our personal income tax filing enforcement activities. For more detailed information on enforcement revenue or tax gap estimates, please see *Compliance with Oregon's Personal and Corporate Tax Programs, Sources of Noncompliance and Discussion of Tax Gap* on our website or on OLIS.

How is lien priority determined when debts are assessed by the department and the IRS at the same time (tiebreaker)?

Based on our agreement with the IRS, priority is determined based on the assessment date, not the date(s) either party files a lien notice or warrant or executes their levy or garnishment.

When two or more debts are assessed on the same date, levy or garnishment

payments are split proportionally based on the debt amount. In situations involving parties other than just the department and the IRS, such as bankruptcies, insolvency proceedings, or federal estate and gift tax liens, priority is determined by federal and state laws.

How do you distribute accounts to private collection firms (PCFs)? How many accounts did you distribute to each firm? What was the value of those accounts? What's the effectiveness of each firm?

Before assigning debt to a PCF, we rank them based on criteria including recovery rates and customer service feedback. We then assign debt in a tiered method; giving the most debt to the top ranked firm and proportionally less to each of the lower ranked firms.

The chart below shows how much debt was assigned to each of the firms in the last seven years. It shows the number of debts we sent to each firm during those fiscal years and the combined value of those debts.

Fiscal year	Professional Credit Services (PCS)		Account Control Technology (ACT)		Premiere Credit (PNA)	
	# of debts	Value of debt (millions)	# of debts	Value of debt (millions)	# of debts	Value of debt (millions)
2009	11,700	\$14.1	10,200	\$24.9		
2010	10,400	\$12.4	11,200	\$22.5		
2011	21,000	\$23.8	21,200	\$36.2		
2012	20,500	\$35.2	21,400	\$37.5		
2013	22,100	\$42.2	17,000	\$39.9		
2014	11,800	\$25.3	10,200	\$21.8	2,000	\$3.7

Calculating the effectiveness of each firm is challenging. Even when an account is assigned to a PCF, payments may be received by the firm, by the department, or through an offset process.

The Department of Revenue chooses firms from the statewide contract administered by the Department of Administrative Services (DAS). If a PCF hasn't applied, qualified, and contracted with DAS, we can't make use of their services. Currently, there are 12 firms on the statewide contract to choose from.

What is the internal review process for accounts being considered for write-off or cancellation?

Currently, we evaluate debts manually using the criteria shown below to determine if they qualify for write-off or cancellation. Each debt that qualifies is marked for further review. Depending on the balance of the debt, up to three people review the debt before it's written off or cancelled. The third level of review is always performed by a section manager or administrator.

Write-off (ORS 293.240)

1. No assets located in three years.
2. No payments received in three years.
3. No correspondence received in three years.
4. Taxpayer not deceased.
5. No liabilities older than seven years.

Cancellation (ORS 305.155)

1. Delinquent seven or more years.
2. All reasonable efforts to collect have been made.
3. Taxpayer can't be located or is deceased.
4. Tax is wholly uncollectible.

We'll soon be using a feature in GenTax that will make it easier and more efficient to identify and assign debt that may qualify for write-off or cancellation. We'll still use our current additional review process before making final determinations on any debt.

Is anyone, DAS, DOR, or anyone else, analyzing the performance of the private collection firms? Does a division at DAS or somewhere else look at that?

The PCFs evaluate the debt they receive from us to determine how they want to attempt collection. We don't specifically monitor what action each firm has taken on every debt that is assigned. However, it is in their best interest to collect on everything they can. Each PCF is compensated based on a percentage of the debt they are able to collect. We do not know if a division at DAS monitors the activity suggested in this question for all PCFs under their contract. The Legislative Fiscal Office's Liquidated and Delinquent Debt report does some analysis of collection rates of private collection firms.

What were the audit procedures for the Business Energy Tax Credit and why were auditors unable to follow up?

In 2011, the U.S. Tax Court issued decisions concluding that the sale of a nonrefundable state tax credit resulted in taxable capital gain for the seller. Subsequently, the IRS issued a Chief Counsel Advice affirming that the proceeds from the sale of a state tax credit was in fact considered a capital gain for tax purposes.

Since Oregon's definition of taxable income is tied to federal taxable income, when new information arises at the federal level, the Department of Revenue has an obligation under ORS 305.170 to alert the Legislature. We do that in various ways, one being contacting the Legislative Revenue Office (LRO), which provides staff for committees related to revenue.

After being alerted to these federal developments by staff, our legislative liaison reached out to the Governor's Office in late 2011 to determine what steps to take to notify the Legislature. The Governor's Office felt it was appropriate to alert LRO of the IRS's position. Over the next few months, we worked with LRO and the Governor's Office to make it clear that our interpretation of the law was that the gain from the sale was taxable. LRO agreed with that interpretation. Following those conversations, the Governor's Office authorized a bill draft that would allow a subtraction from Oregon income for the capital gain reported on the federal return. This bill was introduced in February of 2013.

In April 2012, given the possibility that the Legislature would take up the issue of the taxability of gain from the sale of state tax credits, the department's director, Jim Bucholz, asked audit programs to hold off on undertaking a project pertaining to the Business Energy Tax Credit (BETC). A project consists of focused audits on a specific area with a high potential for mistakes or where there have been a number of mistakes in the past. At that time, a few auditors were interested in starting a BETC project. They suspected significant capital gains resulting from the sale of BETCs were going untaxed. Director Bucholz also instructed that if an auditor discovered the issue in the normal course of an audit on another issue to include proposed adjustments related to BETC.

The only instruction was to not run a project specifically focused on the sale of state tax credits. The reason he chose to do that was the pending work by the Legislature that may very well have changed the state's position on the taxability of the gain. If the Legislature chose to change the

way we taxed gains from the sale of state tax credits, we'd have to go back and revisit those audits and reverse the adjustments previously made.

In order to ensure the best use of staff resources during this period, we continued to audit for other issues in accordance with our resource allocation plan that we discussed with the committee. Ultimately, we wanted to avoid doubling efforts for both staff and taxpayers and to use our audit resources as efficiently and effectively as possible.

The Legislature considered the bill addressing the issue in 2013, but didn't pass it. We interpreted their inaction on the bill to mean they agreed with the department following the federal tax treatment, and the director lifted the hold on BETC-focused audit projects.

At that time we created a plan to begin an audit project on the sale of BETC credits, which began at the end of 2013. These audits resulted in an adjustment rate of approximately 60 percent. That means in about 40 percent of audits, taxpayers correctly reported the gain as taxable income. As we explained in our February 10 testimony, we strive to have an audit adjustment rate that averages at least 85 percent. However, we have found audits on the sale of BETC to be less resource intensive than others. Therefore, we continue to select audits of BETC and other transferable credits as a part of our audit resource allocation plan.

The information regarding the consideration taken during the Legislative process is the same information we provided to the Secretary of State in 2015. They issued a letter indicating they were satisfied with the reasons that the department gave for deciding to wait until the Legislature had opportunity to consider the issue of the taxability of gain from the sale of tax credits.