

## Analysis

### Item 40: Department of Revenue

#### Corporate Activities Tax Implementation Costs (General Fund)

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**Analyst:** John Borden

**Request:** Increase General Fund by \$928,177 and establish 15 permanent positions (1.21 FTE) for the Corporate Division and the implementation of the Corporate Activities Tax.

**Analysis:** The Legislature in 2019 enacted HB 3427, a comprehensive education funding solution for K-12. The funding mechanisms included the establishment of a Corporate Activity Tax (CAT) on the Oregon commercial activities of businesses. The tax is \$250 plus 0.57% on taxable Oregon commercial activities above \$1 million, including a subtraction equal to 35 percent of the greater of input costs or labor costs. Proceeds from the tax, after the payment of the Department of Revenue's (DOR) administrative costs, will support investments in education. There is anticipated to be statutory (technical) modifications to the CAT during the legislative session in 2020.

Since the end of the legislative session in 2019, DOR has revised the number of businesses eligible to pay the tax from an estimated 450,000 to 650,000 due to the original estimate excluding Schedule E rental income taxpayers, as rental income was only later determined to be a commercial activity.

The CAT is effective for the tax year beginning January 1, 2020. Taxpayers are to begin quarterly payments April 30, 2020. The first annual tax return is due April 15, 2021. DOR states that the agency will not be imposing any penalties or interest for the tax year 2020 as long as the taxpayer files a return by April 15, 2021 and pays at least 80% of the tax due each quarter. Businesses subject to the tax are required to register each calendar year beginning in 2020 and are subject to a \$100 penalty per month up to \$1,000 for failure to register.

#### Revenue Estimate

The CAT is estimated to generate \$1.6 billion in revenue for the 2019-21 biennium less the cost of a reduction of personal income tax rates of \$311 million as well as other changes in HB 3427 which affected the existing General Fund revenue stream for a net revenue gain of \$1.2 billion before the Department of Revenue's (DOR) administrative costs. For the 2021-23 biennium, gross CAT revenue is estimated to be \$2.8 billion less the cost of a reduction of personal income tax rates of \$699 million for net revenue of \$2.1 billion before DOR's administrative costs, according to the most recent Department of Administrative Services Office of Economic Analysis revenue forecast (December 2019). According to DOR, the "department does not have an accurate way to estimate revenue flow for a brand new program..."

#### HB 5047 Legislatively Adopted Budget (DOR Tax Administration only)

The primary budget authority for implementing the CAT was provided in HB 5047 (2019), the budget companion measure to HB 3427. DOR's 2019-21 legislatively adopted budget for CAT totals \$2.8 million General Fund, \$1 Other Funds, and 38 positions (9.29 FTE). DOR's initial one-time start-up costs, through April of 2020, are funded with General Fund, which is prior to the availability of CAT revenue. Thereafter, DOR's administrative costs will be funded by Other Funds from CAT revenue

(see Joint Interim Committee on Ways and Means Item #41). There is no statutory requirement that CAT revenues repay DOR's General Fund start-up costs.

The adopted budget established the *Corporate Division* as a separate and unique program within DOR for the tracking of budget and expenditures. Objectively identifying DOR's CAT budget and actual expenditures is of importance in order to forecast the amount of net revenue transfers to the Fund for Student Success.

The adopted budget funded: (a) administratively establishing the program; (b) taxpayer communications; (c) customer service; (d) initial payment processing; and (e) staff for information technology, accounting, and human resources. In addition, \$700,000 General Fund was appropriated to modify DOR's integrated tax system (GENTAX) for the new tax, including: configuration and testing of registration; financials; revenue accounting; case workflow; Revenue Online; and electronic payment processing. An additional \$300,000 General Fund was included for ongoing operation and maintenance costs of GENTAX plus another \$165,000 General Fund for independent quality assurance oversight of the implementation.

Of note is that auditing of CAT tax returns will begin in the spring of 2021 pending approval of DOR's Other Funds request. Activities related to filing enforcement, appeals, and collections will begin with the 2021-23 biennium, pending the approval of additional resources. Also, for the 2021-23 biennium, the General Fund will be phased-out of the agency's budget and any ongoing costs will be funded with Other Funds (CAT revenue).

#### Corporate Activities Tax Implementation Status Report (December 2019)

While DOR has been successful in implementing a number of new large tax programs, including recreational marijuana tax and transportation taxes, the CAT is a more significant challenge for the agency given that CAT is an entirely new type of tax program. It is difficult to ascertain from DOR reporting the actual status of the scope, schedule, and budget of the CAT implementation. In general, the project appears to be slightly behind schedule, out-of-scope, and over budget.

DOR states that the agency's original implementation strategy was based on delaying key facets of the implementation until after the outcome of a possible special election, which then changed when the ballot measure to overturn the CAT did not materialize. This then advanced DOR's implementation schedule. In addition, a contract amendment with FAST Enterprises, the GENTAX or Core Systems Replacement vendor, has experienced multiple delays and the contract has yet to be finalized. DOR has had to undertake business registry work internally thereby reducing the amount needed for the GENTAX contract amendment. As of the date of this analysis, a GENTAX contract amendment has yet to be finalized.

Given the abridged timeframe for implementing the CAT, DOR has, primarily through a non-competitive process, chosen to use existing staff in various non-CAT tax programs to initiate the CAT program. Eventually, permanent staffing will replace temporarily assigned positions.

With the assignment of temporary positions noted, the financial management practices of DOR continue to be of concern for the following reasons:

- DOR has not been properly charging most CAT expenses to the General Fund appropriation established for the program by the Legislature, which makes independent verification of CAT expenses in the state's budget and financial system impossible.
- Of the 38 legislatively authorized positions for the CAT program, 35 positions remain vacant; however, 18 of these positions have funding that starts on February 1, 2020 or later.

DOR's letter makes no reference to non-CAT programs being charged CAT expenses. There was no mention of why this is being done, its impact in dollar terms by division, its operational impact on each division, and any potential negative impact on especially state General Fund revenue generation. There was also no mention when these financial management irregularities will be resolved (i.e., expenditure corrections and positions being expensed under the Corporate Division). Any argument that state systems are the cause of these issues lacks merit, as such systems allow for the proper coding of both new and existing position costs.

#### Supplemental Request – General Fund (January 2020)

DOR is requesting retroactively supplemental funding in the amount of \$928,177 General Fund for additional startup costs and advancing the start date of 15 permanent positions (1.21 FTE). The supplemental funding is for the following activities: (a) administrative support establishing the program; (b) customer service; (c) initial payment processing; (d) information technology; and (e) position funding above second step (DOR is asking for an exception to the standard second step budget authority granted newly established positions).

In addition, newly requested positions are based on the compensation structure determined by the conclusion of recent collectively bargained agreements and associated administrative decisions for non-unionized employees. The Legislature, however, has yet to make a formal decision on the funding of the compensation plan.

#### Recommendation

The Legislative Fiscal Office recommends the following supplemental funding actions, which are based on discussions with DOR to budget appropriately the resources needed for the Corporate Division and the implementation of the CAT.

For Personal Services, authorize the following position actions, which are funded at an average of step 8 due to the experience of staff hired and pay equity issues. These costs are also based on the current compensation plan:

- Program Administration: One permanent full-time Principal Executive Manager E (0.31 FTE)
- Manage Call Center staff: One permanent full-time Principal Executive Manager C (0.08 FTE)
- Technical customer support: Three permanent full-time Tax Auditor 2 (0.08 FTE)
- Business registry: One permanent full-time Office Specialist 2 (0.05 FTE)
- Paper Payment processing: Three Seasonal Part-Time Office Specialist 2 (0.04 FTE)
- Document imaging: One Seasonal Part-Time Office Specialist 1 (0.04 FTE)
- Customer Service: One Limited Duration Public Service Representative 3 (0.17 FTE)
- Customer Service: One Limited Duration Public Service Representative 4 (0.17 FTE)
- Project Management: One Limited Duration Information Systems Specialist 6 (0.13 FTE)
- Legislative Policy: One permanent full-time Operations and Policy Analyst 4 (0.08 FTE)

For DOR's Corporate Division, the total supplemental cost is \$387,375 General Fund and the establishment of 14 positions (1.16 FTE). Personal Services costs total \$673,072, the associated Services and Supplies costs is a reduction of \$298,046, and Capital Outlay costs totals \$12,348. For the Corporate Division, \$365,274 associated with the Attorney General line-item is shifted from General Fund to Other Funds. For the Core Systems Replacement Project, given the delay in the GENTAX contract amendment for the CAT, \$1.165 million General Fund can be shifted to Other Funds.

Lastly, a total of \$567,052 in General Fund and \$111,364 in Other Funds can be disappropriated across the Administration, Personal Tax and Compliance, Business, Information Services, and Marijuana Divisions due to Corporate Division CAT expenditures being inappropriately charged to these divisions.

The combined total of the recommended actions is a reduction in General Fund of \$1.3 million, an increase in Other Funds expenditure limitation of \$1.4 million (for a total funds increase of \$74,234) and the establishment of 14 positions (1.16 FTE).

**Legislative Fiscal Office Recommendation:** The Legislative Fiscal Office recommends that the Joint Interim Committee on Ways and Means recommend including the following in a budget reconciliation bill during the 2020 legislative session, as one-time General Fund appropriation(s), for the Corporate Activities Tax:

- Increase the General Fund appropriation for the Corporate Division by \$387,375 and increase the Other Funds expenditure limitation by \$365,274, and authorize the establishment of 14 positions (1.16 FTE).
- Reduce the General Fund appropriation for the Core Systems Replacement by \$1,165,000 and establish an Other Funds expenditure limitation in the amount of \$1,165,000.
- Reduce the General Fund appropriation for the Administration Division by \$28,559 and reduce the Other Funds expenditure limitation by \$7,592.
- Reduce the General Fund appropriation for the Personal Tax and Compliance Division by \$287,641 and reduce the Other Funds expenditure limitation by \$5,870.
- Reduce the General Fund appropriation for the Business Division by \$122,072 and reduce the Other Funds expenditure limitation by \$62,885.
- Reduce the General Fund appropriation for the Information Services Division by \$128,780 and reduce the Other Funds expenditure limitation by \$20,964.
- Reduce the Other Funds expenditure limitation for the Marijuana Division by \$14,053.

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Department of Revenue  
Pearson

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**Request:** Appropriate \$928,177 General Fund and establish 15 positions (1.21 FTE) for the Corporate Division.

**Recommendation:** Consider the request during the 2020 Legislative Session.

**Discussion:** The Department of Revenue (DOR) is requesting \$928,177 General Fund and 15 additional positions (1.21 FTE) in its Corporate Division. House Bill 5047 (2019) established a budget for DOR to collect the Commercial Activity Tax (CAT) approved in the Student Success Act. This Act required the establishment of a new Corporate Division within DOR. House Bill 5047 provided nearly \$4.0 million General Fund, 22 permanent positions, and 16 limited duration positions.

This request reflects a need for General Fund if the Legislature chooses not to transfer funds between existing appropriations. There may be opportunities to shift funding between appropriations, which would reduce the need for additional General Fund and preserve more funding for needs elsewhere in the statewide budget.

The reason for this request compared to the original budget approved in the 2019 Legislative Session is due to implementing CAT earlier than expected after opponents announced they would not pursue a referendum. The DOR began to receive questions from taxpayers and customer service representatives answered them. Staff budgeted in divisions, other than the Corporate Division, worked on accelerating the communications strategy and amending the GenTax vendor contract for modifications to implement the new tax. Because existing long-term employees worked on CAT implementation, personal services expenses are higher than the fiscal impact statement prepared during the 2019 Legislative Session, which assumed new hires at a lower compensation range. This use of existing resources to implement CAT earlier is another reason to explore adjusting existing appropriations before considering additional General Fund.



# Oregon

Kate Brown, Governor

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December 9, 2019

The Honorable Senator Betsy Johnson, Co-Chair  
The Honorable Senator Elizabeth Steiner Hayward, Co-Chair  
The Honorable Representative Dan Rayfield, Co-Chair  
Joint Interim Committee on Ways and Means  
900 Court Street NE  
H-178 State Capitol  
Salem, OR 97301-4048

## **REPLACEMENT**

Dear Co-Chairpersons:

### **Nature of the Request**

The 2019 Legislature passed the Corporate Activity Tax (CAT) program through House Bills (HB) 3427 and 2164. During the 2019 session, funding was approved for initial start-up costs anticipated through April 30, 2020 and the Department of Revenue was asked to make another request during the 2020 session. The department is requesting additional General Fund to cover greater than anticipated implementation costs necessary through April 30, 2020.

### **Agency Action**

The department is currently working to implement the CAT program using the resources provided. The CAT program is a new tax that will impact businesses with over \$1 million of commercial activity in Oregon. Implementation activities will continue through the 2019–21 biennium. Implementation activities include, but aren't limited to, developing administrative rules, creating forms and instructions, generating web content, information system development, project management, communicating with potential subject taxpayers, etc. The provisions of the law require businesses to register, make quarterly tax payments, and file an annual tax return.

The department's initial request was limited to resources believed to be necessary before the first tax payments were due and subsequent expenses would be paid with a portion of receipts from required quarterly payments. At that time, the department was under the assumption there would be a referral to voters in January 2020 to either affirm or reject the new tax. The timeframe planned for many activities, including availability of technical systems, communications, and hiring, was predicated on not beginning until after the outcome of an election was known.

Once a referendum referral was withdrawn, and the deadline for other referrals passed without additional filings, potential taxpayers and interest groups demanded information on the new tax. In response, the department changed its implementation and communication strategy and accelerated timelines for both communication and program implementation activities. That also means costs for these activities are being incurred sooner than originally expected.

When there was potential for a referral, planned communication activities were minimal prior to February. Broad based informational letters weren't scheduled to begin until February and March, after the tax would potentially be affirmed by voters. With new timelines, those broad based communications began in November 2019. This in turn led to a volume of calls and emails regarding the new tax to be received before expected. The department has been able to handle the

increased volume thus far, however the change in communication strategy will require the department to shift resources from other programs to handle the increased workload.

There are two parts to this request:

1. Funding for additional resources used during initial implementation through April 30, 2020.
2. Funding for positions previously requested to begin on or after May 1, 2020 that must now start before that time.

1. Additional resources for earlier than planned activities.

The first part of the request relates to the costs for additional resources for taxpayer assistance, IT development time, additional oversight for the project, program management positions, and higher salary steps than were previously provided. Additional staff are needed to provide adequate taxpayer assistance with inquiries starting earlier than when there was a possible referral. Our communication plan has changed considerably, and all timelines were accelerated. This has led to an increase in taxpayer contacts, as well as stakeholder feedback from the roadshow indicating the need for information about the new tax as soon as possible. The department requests additional funding for call center staff time and technical assistance from tax auditors to address earlier than expected inquiries.

The amount of time it's taking to amend our contract with the vendor for our core system has required the department to take on development activities for phase 1 of the project, including development of letters, registration, and payments. The department has taken steps to use department IT staff rather than vendor staff, and reprioritized other work. Although this is an additional cost to this project, the department will realize General Fund savings allocated for this vendor work in the Core Systems Replacement appropriation.

In November 2019, it became obvious the department needed more project management resource for such a large project. A more experienced overall project manager has been brought on. The previous project manager will focus part time on requirements for the state's stage gate process and IT tasks. Initially, it was thought that an existing department program manager would have capacity to take on the initial implementation activities in addition to their current workload. However, the new program has become a full-time job given the extensive outreach, communication, and workload. The department requests funding specific to this project management position in order to provide effective management oversight to the CAT program.

Due to accelerated program activities, the majority of the incumbent program manager's time has been spent on CAT, therefore, 75 percent of their salary will be added from the beginning of the program, July 1, 2019, through December 2019.

Finally, the department requests additional funding related to staff being hired at higher salary steps than the initial fiscal was approved for. The standard for fiscal impacts is to use salary step 2. When hiring experienced internal staff, and with the impact of pay equity, most staff are hired at higher steps and this is reflected in the request.

Position	Total Positions	Monthly salary with OPE	Months	Total Salary
Additional resources used during initial implementation				

Public Service Reps		5,545		9,649
Office Specialist 1		6,112		\$7,640
Information Systems Specialist		11,691		\$20,049
Project Manager		12,327		\$36,805
Principal Executive/Manager E		10,468		\$62,808
Employees hired above step 2				\$387,619
<b>Total Personal Services costs</b>				<b>\$524,569</b>
IT Expendable Property				\$92,400
<b>Total Services and Supplies costs</b>				<b>\$92,400</b>
Office Furniture and Fixtures				
<b>Total Capital Outlay costs</b>				
<b>Total expenditures</b>				<b>\$616,969</b>

## 2. Early hiring of necessary staff.

The second part of the request is for hiring staff sooner than planned to handle the additional workload caused by advancing the communication timeline and the desire from stakeholders to have information as soon as possible. The department requests position authority for two managers earlier than originally planned. The program manager (PEME) is needed in January 2020 so focus can be given to new and existing programs. Position authority for an additional first-line manager (PEMC) is needed to assist with onboarding of new staff that are starting in February and March 2020. The program currently has one full-time first-line manager. However, this position needs to focus on the policy and system development staff and processes. The department also requests position authority for three tax auditor twos (TA2) in March 2020 to focus on higher-level technical taxpayer assistance than call center staff can provide. This will allow auditors from other programs to focus on those programs, existing CAT policy staff to focus on implementing the new tax, as well as provide better assistance to the public. The first CAT payments will be received before CAT revenues are available to pay expenses so additional resources are needed in the department's processing center in order to process the first quarter's payments, an increase in their workload.

Position	Total Positions	Monthly salary with OPE	Months	Total Salary
Moving position starts dates up				
Principal Executive/Manager E	1	13,155	4	\$52,619
Principal Executive/Manager C	1	10,209	2	\$20,417
Tax Auditors 2	3	9,862	2	\$59,170
Data Entry Operator	3	5,456	2	\$32,734
Office Specialist 1	1	5,626	1	\$5,626
Office Specialist 2	4	6,011	2	36,064



Public Service Rep 3	1	6,011	2	\$12,021
Public Service Rep 4	1	7,218	2	\$14,435
<b>Total Personal Services costs</b>				<b>\$233,086</b>
Instate Travel				\$519
Out of State Travel				\$5,040
Employee Training				\$1,933
Office Expenses				\$1,869
Telecommunications				\$3,504
Data Processing				\$735
Attorney General				\$3,747
Expendable Property				\$665
IT Expendable Property				\$49,500
<b>Total Services and Supplies costs</b>				<b>\$67,512</b>
Office Furniture and Fixtures				\$10,610
<b>Total Capital Outlay costs</b>				<b>\$10,610</b>
<b>Total expenditures</b>				<b>\$311,208</b>

These requests taken together will allow for better customer service, more efficient processing of the first payments, adequate management of staff hired in early 2020, better oversight of the project, and continued implementation in order to meet the timelines set by the legislation. In order to fully implement and administer the CAT program the department requires the resources outlined in this request.

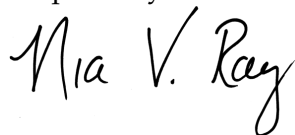
#### Action Requested

The department requests that the legislature approve the funding necessary to support the implementation activities of the CAT program through April 30, 2020 by appropriating additional General Fund by \$928,177 and establishment of 15 positions, 1.21 FTE.

#### Legislation Affected

Allocation of \$928,177 to supplement the appropriation established by chapter 612, Section 1 (5), Oregon Laws 2019 (enrolled HB 5033) made to the Department of Revenue, Corporate Division for the 2019–2021 biennium.

Respectfully submitted,



Nia Ray, Director  
Oregon Department of Revenue