

Analysis

Item 41: Department of Revenue

Corporate Activities Tax Implementation Costs (Other Funds)

Analyst: John Borden

Request: Increase the Other Funds expenditure limitation by \$9,636,926 and establish 75 permanent full-time positions (32.71 FTE) for the Corporate Division and increase the Other Funds expenditure limitation by \$2,513,500 for the Core Systems Replacement program.

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 Oregon 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 #40). 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).

Supplemental Request - Other Funds (January 2020)

The agency is requesting increasing Other Funds expenditure limitation by \$9.6 million and establishing 75 permanent full-time positions (32.71 FTE) for the Corporate Division and increasing Other Funds expenditure limitation by \$2.5 million for the Core Systems Replacement program. 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 bargaining 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 appropriately budget the resources needed for the Corporate Division and the implementation of the CAT. Personal Services are recommended to be funded at an average of step 8 due to the experience of staff hired and pay equity issues and based on the current compensation plan.

The following costs represent DOR's funding need from May 1, 2020 to June 30, 2021 or that portion of this biennium to be funded with Other Funds from CAT revenues. Of note is that of the total number of positions (77), 52 were previously authorized by the Legislature, if the Legislature approves all the positions being established as part of DOR's General Fund request (Item #40).

- Program Administration: One permanent full-time Principal Executive Manager E (0.58 FTE); one permanent full-time Principal Executive Manager D (0.58 FTE); three permanent full-time Operations and Policy Analyst 3 (1.75 FTE); one limited duration Operations and Policy Analyst

3 (0.58 FTE); three permanent full-time Operations and Policy Analyst 2 (1.75 FTE); one limited duration Operations and Policy Analyst 2 (0.58 FTE); and one permanent full-time Office Specialist 2 (0.04 FTE).

- Audit Function: One permanent full-time Principal Executive Manager D (0.42 FTE); one permanent full-time Principal Executive Manager C (0.58 FTE); seventeen permanent full-time Tax Auditor 2 (4.67 FTE) two permanent full-time Operations and Policy Analyst 3 (0.75 FTE).
- Processing Center: One seasonal Office Specialist 1 (0.21 FTE); three seasonal Office Specialist 2 (0.63 FTE); six seasonal Data Entry Operators (0.75 FTE); one seasonal Office Assistant 1 (0.08 FTE); and one Operations and Policy Analyst 2 (0.29 FTE).
- Suspended Return Reconciliation: Seven permanent full-time Administrative Specialist 2 (4.08 FTE) and three limited duration Administrative Specialist 1 (1.75 FTE).
- Information Technology Services: One permanent full-time Information Systems Specialist 8 (0.58 FTE); one permanent full-time Information Systems Specialist 7 (0.58 FTE); one limited duration Information Systems Specialist 6 (0.58 FTE); one permanent full-time Information Systems Specialist 4 (0.58 FTE); one permanent full-time Operations and Policy Analyst 3 (0.58 FTE); four limited duration Operations and Policy Analyst 3 (1.67 FTE); and two limited duration Training and Development Specialists (0.84 FTE).
- Project Management (Information Technology Services): One limited duration Information Systems Specialist 6 (0.58 FTE).
- Communications: One permanent full-time Public Affairs Specialist 2 (0.58 FTE).
- Accounting and Disbursements: One permanent full-time Accountant 3 (0.58 FTE).
- Customer Service: One limited duration Public Service Representative 4 (0.58 FTE); four limited duration Public Service Representative 3 (2.33 FTE); and two permanent full-time Public Service Representative 3 (1.17 FTE).
- Human Resources: One permanent full-time Human Resources Analyst 2 (0.58 FTE).
- Legislative Policy: One permanent full-time Operations and Policy Analyst 4 (0.58 FTE).

Personal Services also includes \$100,000 in budgeted overtime costs, which includes Other Payroll Expenses. Services and Supplies totals \$2.4 million for standard costs plus \$625,000 in one-time postage and \$65,000 in one-time costs for an Oregon State University training contract plus an additional \$266,037 in Attorney General line-item costs. Capital Outlay totals \$302,945 Other Funds for the one-time cost of office furniture and fixtures.

In addition, the Core Systems Replacement Project totals \$2.465 million, which includes an additional \$2 million to modify DOR's integrated system (GENTAX) for the new tax, including: configuration and testing of registration [which due to the contract delay are being undertaken in-house by DOR]; financials; revenue accounting; case workflow; Revenue Online; and return processing, audit, collections, filing enforcement, and appeals. An additional \$300,000 Other Funds was included for ongoing operation and maintenance costs of GENTAX plus another \$165,000 Other Funds for independent quality assurance oversight of the implementation. These figures supplement the previously approved \$1.165 million in GENTAX costs bringing the overall total to \$3.63 million.

The combined total of the recommended actions is an increase in Other Funds expenditure limitation of \$12.1 million and the establishment of 18 permanent full-time positions and seven seasonal positions (7.25 FTE). The 2021-23 biennial costs are estimated to be \$19.2 million Other Funds and 67 positions (61.63 FTE)

Legislative Fiscal Office Recommendation: The Legislative Fiscal Office recommends that the Joint Interim Committee on Ways and Means recommend including an increase of \$9,619,595 in the Other Funds expenditure limitation and authorizing the establishment of 18 permanent full-time positions (6.42 FTE) and seven seasonal positions (0.83 FTE) for the Department of Revenue Corporate Division; and establishing an Other Funds expenditure limitation in the amount of \$2,465,000 for the Core Systems Replacement project, as a one-time expense; in a budget reconciliation bill during the 2020 legislative session for the Corporate Activities Tax.

41
Department of Revenue
Pearson

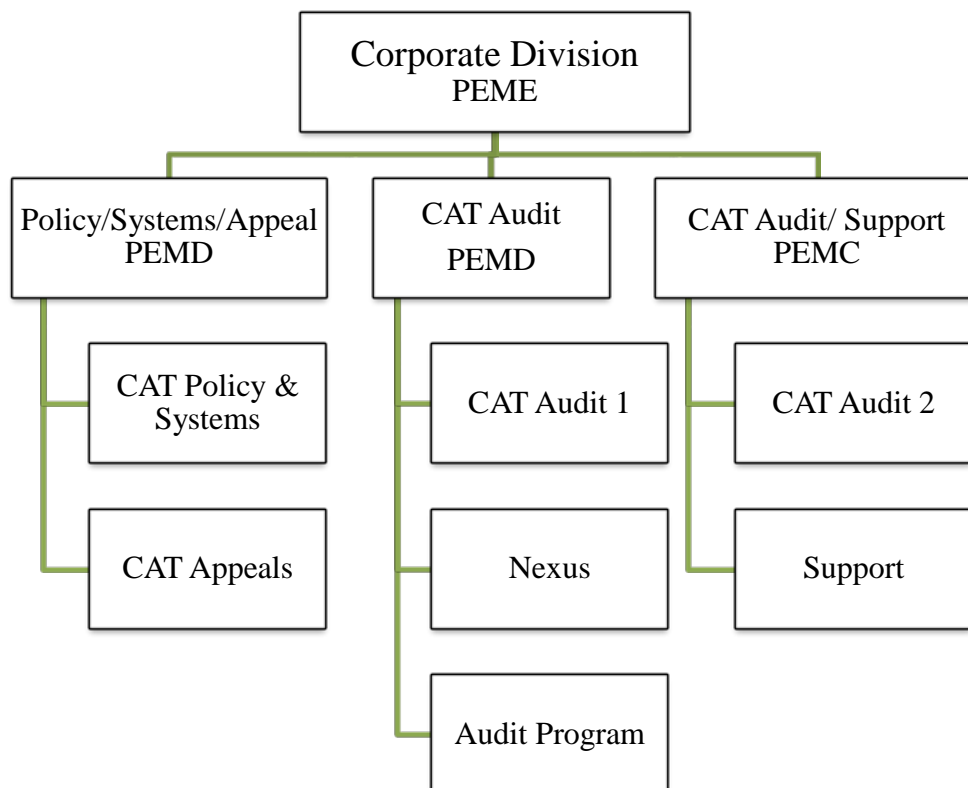
Request: Increase Other Funds expenditure limitation by \$12,150,426 and establish 75 positions (32.71 FTE).

Recommendation: Consider the request during the 2020 Legislative Session.

Discussion: The Department of Revenue (DOR) is requesting a \$12,150,426 Other Funds expenditure limitation increase and 75 additional positions (3.21 FTE) into its Corporate Division. In the 2019 Legislative Session, House Bill 5047 established a budget for DOR to collect the Commercial Activity Tax (CAT) approved through the Student Success Act. This Act required the establishment of a new Corporate Division within the Department. House Bill 5047 provided nearly \$4.0 million General Fund, 22 permanent positions and 16 limited duration positions for startup costs through April 30, 2020. The budget report for House Bill 5047 states:

The Legislature in 2020 may provide additional resources for the remainder of the biennium, which would be funded from gross corporate activities tax proceeds. The costs for May 2020 to June 30, 2021 is estimated to total \$9.5 million Other Funds (corporate activity tax) and an additional 30 positions (18.33 FTE).

The request includes \$6.8 million for Personal Services, \$2.5 million for Services and Supplies, and \$0.3 million for Capital Outlay. Personal Services includes 51 permanent (24.63 FTE) positions, 15 limited duration (6.75 FTE) positions, and nine seasonal permanent (1.33 FTE) positions. The planned organizational structure for the division follows:



The request differs from the fiscal impact statement by hiring staff sooner, paying staff at a higher step, adding a part-time clerical support position and information technology desktop support position, changing a business analyst from limited duration to permanent for ongoing support of the GenTax system, adding training, postage, a list-serve service, travel for outreach to businesses, and allocating departmental overhead to the new division.

DOR will seek the review of the Department of Administrative Services Chief Human Resources Office for the position requests, which should be available at the start of the 2020 Legislative Session. Refinements to the request may be proposed.



Oregon

Kate Brown, Governor

Department of Revenue
955 Center St NE
Salem, OR 97301-2555
www.oregon.gov/dor

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 through April 30, 2020 and the Department of Revenue was asked to make another request during the 2020 session. The department is requesting additional Other Funds limitation for implementation and administration costs for the remainder of the 2019–21 biennium from revenue attributable to the CAT per the provisions of the law.

Agency Action

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

Ongoing administrative activities include operational, policy, and analytical support; customer service; return processing and account resolution; information systems support, maintenance, and annual configuration changes; compliance activities to identify non-compliant taxpayers; communications, human resources, and financial services support; postage and printing; employee travel and training; legal representation for appeals and policy decisions; and other costs associated with the ongoing administration of a large broad-based tax program.

Initially, the department only requested the resources necessary to pay for expenses incurred before the first tax payments were due. The department was asked to make an additional request for Other Funds during the 2020 session. The initial request was also based on the high likelihood of a referral to voters in January 2020 to either affirm or reject the new tax. If there was a referral in January, implementation strategy and activity would have been different. For instance, initial educational letters would not have been sent to potential taxpayers. The ability for businesses to register for CAT would not have been released in December 2019 ahead of the potential vote. Now that implementation activities have begun knowing there won't be a referral, there is a greater overall need for resources and for some to start earlier in the biennium than originally planned.

The original request included extending resources requested for the initial implementation and administration as well as the following:

- Tax auditor positions starting February 1, 2021 to begin auditing for compliance with the provisions of the CAT program.
- Audit technical support positions starting October 1, 2020 to build the audit system, develop case selection techniques, and train auditors on provisions of the CAT program.
- Conference officer and filing enforcement positions starting July 1, 2021 to handle internal appeals and identify businesses who are not filing CAT returns.
- Two first-line managers to oversee audit, appeals, and call center staff and participate in program management.
- Funding for correspondence sent to taxpayers through the return processing, audit, filing enforcement, and appeals processes.
- Collections staff will begin during the 2021–23 biennium and will be included in a future request.
- Resources required by the processing center related to increases in received mail, processing quarterly tax payments, processing annual tax returns, keying data not captured accurately, correcting tax return information to allow processing, and to work with external vendors to test forms and maintain the front-end system for returns and payments.
- One accounting position starting April 1, 2020 to account for quarterly payments and distributions as well as reconciling accounts.
- One-time costs for Fairfax, the external vendor for front-end processing systems, to update their system for CAT forms.
- One-time costs for Fast, the external vendor for GenTax, to configure the system for processing returns, auditing, filing enforcement, collections, and accounting functions.
- One-time cost for a quality assurance vendor.
- Ongoing costs to pay for necessary maintenance of this additional configuration in GenTax.
- One-time costs for public service announcements to educate impacted parties and reach a broad audience.

This request is modified from the Other Funds fiscal impact statement submitted during session in the following ways:

- Higher salary steps are requested for staff already hired above salary step two. All other new or unfilled positions are requested at higher salary steps to account for changes made by pay equity and recent experience with the steps at which positions have been filled.
- Additional request for training dollars to allow more efficient and effective training of all new staff including call center staff, administrative staff, auditors, and collectors.
- Hiring three tax auditors sooner than originally planned in order for them to assist taxpayers with technical questions that cannot be answered by administrative staff. Due to the increased timeframe for sending educational letters the agency is experiencing a higher volume of requests from stakeholders than anticipated with the later implementation schedule.
- Hiring additional call center staff sooner than anticipated due to the increase in calls related to expanded and accelerated communications being sent to businesses.

- Hiring two managers sooner than planned to manage the program itself as well as call center and audit staff, which will allow the current manager to focus on administrative rules, policy, forms, and systems staff as well as stakeholder communication.
- Additional request for printing and postage to account for a larger number of potential businesses that may be subject. This will allow more informational letters to be sent explaining when a business is and is not subject to the new tax. During the 2019 Legislative session estimates were made for the upper bound of businesses that could be subject to the CAT of around 450,000. Since that time, the department has found that there are at least 200,000 more businesses reporting individual income tax on Schedule E of Form OR-40, that are potentially subject to CAT.
- An additional part-time position in the processing center that will work with the front-end return and payment capture systems and vendors. This position was requested in the original fiscal, however it was a one-time or limited-duration position. The need in this area is annual, therefore the position should be a permanent part-time employee.
- An additional clerical support position for the program area. Previously no clerical support was requested, however, there is a need for general clerical support for the new program and staff with distributing correspondence, assisting with phone calls, and other clerical tasks.
- An additional position to provide IT desktop support to agency employees. This is necessary as the current resource level is at maximum capacity. The number of new employees, phone lines, and computers requested in relation to the CAT requires this addition.
- Change one Business Analyst (OPA3) position from limited-duration to permanent for ongoing support of changes and maintenance of the GenTax system. The CAT is a major new program containing unique requirements. This position will support the GenTax system related to the program by responding to needed changes in the system and working with developers regarding those changes as well as testing to ensure the changes are accurate.
- Additional request for a list-serve service that will be used by the new tax program to effectively communicate with external stakeholders and taxpayers. This is needed because the system currently used by the state enterprise does not allow new lists to be added. For the CAT program, DOR is currently manually tracking interested stakeholders, which now numbers over 2,000. The list-serve service will make this process more efficient and allow staff to focus on implementing and administering the CAT.
- Additional request for travel expenses in order to provide additional outreach and education within the state. During the initial implementation period in late 2019, the department reached out to stakeholders through an in-state roadshow, video conference calls, and phone conference calls with stakeholders located both within and outside of Oregon. During this outreach, one of the main themes was that impacted parties saw a need for more in-person education and training as implementation continues. This outreach will include gathering feedback on administrative rules, educating taxpayers on the requirements of the new tax, and sharing new updates about the implementation activities.
- Recognition that in addition to direct expenses to implement and administer the CAT program, the new program will also share in the agency overhead costs that are associated with all programs.

The department is making two requests to support implementation and administration of the CAT program. This request contains resources that are needed from May 2020 through July 2021. The other request which is in a separate letter is for additional General Fund needed during the early implementation period, July 1, 2019 through April 30, 2019. In order to fully implement and administer the CAT program the department is requesting the following resources.

These additional resource costs are summarized in the table below:

Position	Total Positions	Total Salary & OPE
Accountant 3	1	\$132,532
Administrative Specialist 1	3	\$271,280
Administrative Specialist 2	7	\$707,375
Data Entry Operator	6	\$98,203
Human Resource Analyst 2	1	\$107,666
Information Systems Specialist 4	1	\$125,814
Information Systems Specialist 6	1	\$146,369
Information Systems Specialist 7	1	\$159,805
Information Systems Specialist 8	1	\$179,524
Office Assistant 1	1	\$9,768
Operations & Policy Analyst 2	5	\$567,550
Operations & Policy Analyst 3	11	\$1,375,248
Office Specialist 1	1	\$78,770
Office Specialist 2	4	\$241,231
Public Affairs Specialist 2	1	\$155,373
Principal Executive/Manager C	1	\$142,915
Principal Executive/Manager D	2	\$284,935
Principal Executive/Manager E	1	\$184,166
Public Service Representative 3	6	\$504,870
Public Service Representative 4	1	\$101,052
Tax Auditor 2	17	\$1,104,512
Training & Development Specialist 1	2	\$133,978
TOTAL PERSONAL SERVICES COSTS		\$6,812,936
Instate Travel		\$ 29,509
Out of State Travel		\$ 201,595
Employee Training		\$ 127,272
Office Expenses		\$ 636,272
Telecommunications		\$ 112,868
Data Processing		\$ 23,654

Publicity & Publications	\$	57,429
Attorney General	\$	620,070
Facilities Rental	\$	474,122
Agency Program Related S&S	\$	10,000
Expendable Property	\$	21,406
IT Expendable Property	\$	168,036
Total Services and Supplies costs		\$2,482,233
Office Furniture and Fixtures	\$	341,757
Total Capital Outlay costs		\$341,757
Total expenditures		\$9,636,926

In order to update data capture and tax administration systems, and potential quality assurance services, the department is requesting the following resources to be paid to vendors.

Professional Services	\$213,500
IT Professional Services	\$2,300,000
Total Vendor Services and Supplies costs	\$2,513,500

Action Requested

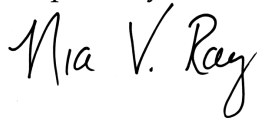
The department requests that the legislature approve the funding necessary to support the implementation and ongoing administration of the CAT program by increasing Other Funds limitation by \$12,150,426 and establishment of 75 positions, 32.71 FTE.

Legislation Affected

Increase Other Funds expenditure limitation established by Chapter 612, section 2(6), Oregon Laws 2019 (enrolled HB 5033) for the Department of Revenue, Corporate Division by \$9,636,926 for the 2019–2021 biennium.

Increase Other Funds expenditure limitation established by Chapter 612, section 2(10), Oregon Laws 2019 (enrolled HB 5033) for the Department of Revenue, Core Systems Replacement by \$2,513,500 for the 2019–2021 biennium.

Respectfully submitted,



Nia Ray, Director
Oregon Department of Revenue