

Department of Revenue					
	2015-17 Actual	2017-19 Legislatively Adopted	2017-19 Legislatively Approved *	2019-21 Current Service Level	2019-21 Governor's Budget
General Fund	185,042,400	188,533,904	194,469,572	204,875,450	200,411,318
Other Funds	125,282,327	124,776,501	129,934,422	123,681,615	58,273,914
Total Funds	310,324,727	313,310,405	324,403,994	328,557,065	258,685,232
Positions	1,083	1,007	1,079	1,024	1,031
FTE	1,023.35	933.85	961.67	969.22	974.04
* Includes Emergency Board and administrative actions through December 2018.					

Program Description

The Department of Revenue (DOR) administers the state's income tax and property tax programs, although property taxes are primarily managed and collected by counties. The tax programs the Department administers generate approximately \$21 billion, or 96%, of General Fund revenue, through a combination of personal income, corporate income and excise, estate, tobacco, gift, and other taxes. DOR also administers recreational marijuana tax as well as several property tax relief programs. DOR recently began administering various transportation packages taxes and a Heavy Equipment Rental Taxes. DOR also has made changes required by the Federal Tax Cuts and Job Act tax reform and the state decoupling from that tax [SB 1528 and SB 1529 (2018)]. Finally, DOR completed a multi-biennia information technology project entitled the Core Systems Replacement project, which installed GENTAX, the agency's core tax management application.

The Other Funds revenue is derived from administrative charges to various tax, fee, assessment, collections, and other programs. The County Assessment Function Funding Assessment account also helps pay for a portion of state and local property tax assessment and taxation functions.

CSL Summary and Issues

The 201-21 current service level budget for the agency \$328.6 million total funds (1,024 positions/969.22 FTE). The CSL is \$4.2 million, or 1.3%, more than the 2017-19 legislatively approved budget of \$324.4 million. Full-time equivalents decreased by 55 positions (7.55 FTE). There are no noted differences between DAS and LFO CSL calculations. DOR, however, neglected to include a revenue shortfall package for the Property Tax Division, discussed in more detail below. Additionally, the budgetary structure of the agency was change through a series of base budget (Administrative Services and Information Technology Divisions) and technical adjustments (Collections Division) and a revenue clearing house program was established. These changes will make comparisons to the prior biennium more difficult; however, the changes may be seen as an improvement.

The General Fund Debt Service was increased by \$693,675 for the roll-up costs of previously issued debt, bringing the total CSL Debt Service cost to \$16.4 million. The CSL phases-out of \$17.5 million total funds in one-time investments, some of which includes: (a) ongoing maintenance and support of GENTAX (\$3.6 million); (b) GENTAX implementation and Article XI-Q bonds for GENTAX (\$1.1 million General Fund and \$9.7 million in Other Funds); (c) construction projects to build out DOR's marijuana cash handling space in their building (\$1.1 million Other Funds); (d) outcome-based management system contract (\$350,000); (e) Phase 1 of the Processing Center Modernization project (\$892,812); and (f) comprehensive external audit (\$150,000). The CSL includes \$1.2 million total funds increase for previously unbudgeted State Treasury fees, as part of a DAS-approved CSL exception. Other CSL changes include standard adjustments for contractually approved compensation plans, vacancy factor, mass transit taxes, PERS pension obligation bond assessments, inflation on services and supplies, Attorney General line-item, professional services, and rent. The CSL includes a variety of technical adjustments to realign budget line-items among various divisions for better costing of expenditures, which has a net-zero impact across the agency.

Policy Issues

There are a number of preliminary budget issues that the Co-Chairs budget will need to consider beyond which the agency may have additional requests.

Revenue Shortfall in Property Tax Division (\$1.1 million General Fund and <\$398,369> Other Funds; 0 positions/2.57 FTE): The Division has been in a chronic and systemic revenue shortfall that has remained unaddressed since 2004. A continued revenue shortfall in the PTD's County Assessment Function Funding Assistance may require General Fund backfill. Compounding these financial problems has been a series of errors in the department's budget submissions, including one in 2016 that left 23 positions funded at 0.88 FTE instead of 1.00 FTE. PTD continues to hold positions vacant, which ultimately has a revenue impact to state and local governments. Rectifying the PTD's funding and financial management issues should be of primary focus this session. ***This request was included in the Governor's budget.***

Property Valuation System (\$0): DOR has the statutory responsibility for developing real market values for approximately 4,450 industrial and 500 central assessment companies across the state, whose value is in excess of \$1 million. The state undertakes this work on behalf of counties, which are the taxing authority and through DOR's appraisal efforts collect \$600 million in property tax revenue on over \$50 billion in taxable value, according to the agency. DOR's current property tax administration relies on a roughly 15-year-old legacy "system" comprised of non-integrated applications, and internally developed databases, spreadsheets, and paper files to manage property valuations. After a failed attempt to implement a new system, DOR submitted no 2019-21 budget request to re-authorize the PVS project; however, the Legislature may itself want to reconsider this project due to its importance. ***No funding was provided in the Governor's budget.***

Post-Core Systems Replacement Project Implementation Costs (\$7.2 million General Fund and \$622,445 Other Funds; five positions/5.00 FTE): Contrary to reports to the Legislature, there is evidence that GENTAX remains to be fully and optimally configured. ***This request was partially funded in the Governor's budget (\$4.4 million General Fund and \$352,321 Other Funds).***

- DOR is requested Level 2 support for GENTAX in 2019-21, down from Tier 3 support in 2017-19.

- Five on-site software vendor staff to maintain to accelerate the configuration work that remains to be done in GENTAX, address the backlog of change requests, and ensure that knowledge transfer to agency staff continues (\$1.7 million);
- Two DOR Operations and Policy Analyst 3 positions who serve as business analysts;
- One DOR Principle Executive/Manager E position to serve as DOR's overall project manager;
- Two DOR Training and Development Specialist 1 positions.

Increase Printing and Postage (\$2.0 million General Fund and \$418,766 Other Funds): DOR is requesting additional printing and postage costs that have resulted from increasing the volume of taxpayer mailings with the implementation of Gentax. The necessity and value of these mailings and why electronic communications are not more actively being pursued is unclear. **No funding was provided in the Governor's budget for this request.**

Risk and Compliance (\$1.5 million General Fund and \$130,703 Other Funds; five positions/5.00 FTE): This request is for one position to work in the agency's Disclosure Office managing incidents where agency staff have disclosed confidential information and to make a variety of upgrades to the physical security of the agency's headquarters and three positions to restore the agency's three information security positions transfer to the Department of Administrative Services by Senate Bill 90 (2017) and to add a position to manage Gentax user access. **No funding was provided in the Governor's budget for this request.**

Financial Institution Data match (\$166,029 General Fund and \$29,299 Other Funds): SB 254 requires financial institutions to participate in a data match program DOR by comparing a list of delinquent debtors with the names of account holders. Budget authority is required to pay required fees to banks for their participation. Approximately 75.0 percent of banks and credit unions doing business in Oregon have signed agreements to participate in this service, with more agreements coming. It is unknown whether the program will reach its revenue estimate of \$1.7 million General Fund during 2017-19 or \$7.0 million General Fund in 2019-21 biennium. **This request was included in the Governor's budget.**

Increase Fraud Detection (\$746,081 General Fund and \$15,226 Other Funds; four positions/4.00 FTE): DOR would like additional resources to adjust the fraud module in Gentax and to review and audit returns that are flagged for review. After investments in the Gentax application and more specifically a fraud application and services, DOR continues to struggle with how to differentiate fraudulent returns from legitimate returns and how best to optimize CSR data analytic module that was in addition to the GENTAX application (Thomsen Reuters). **No funding was provided in the Governor's budget for this request.**

Processing Modernization Project (\$780,007 General Fund and \$67,826 Other Funds): Processing Center processes all incoming paper returns, payments and correspondence and deposits all payments. This project replaces the DOR's obsolete scanners with new scanners that are integrated with Gentax. After an initial failed attempt to complete this project, which adversely impacted the 2016 tax season, the PCM project was re-authorized by the Legislature in 2017. PCM completed successfully Phase 1 and decommissioned the legacy scanners most at

risk of failure. Phase 2 will be completed by August 2019 and Phase 3 will be completed in August 2020. The project is on schedule, within scope, and a budget overage is being managed by the agency. ***This request was funded in the Governor's budget.***

Processing Center Staffing for Statewide Transit Tax (\$1.5 million Other Funds; 11 positions/11.00 FTE): The Processing Center is requesting permanent resource to continue to handle the increased volume of paper returns and correspondence due to the new statewide transit tax. Limited duration resources were provided in February of 2018 and then phase-out of the agency's budget. The state has a joint electronic payroll tax form with the Department of Employment that could be modified to accommodate this work rather than continue to rely upon a manual processing method. ***This request was funded in the Governor's budget.***

Heavy Equipment Rental Tax (HERT)(\$876,361, Other Funds; three positions/1.50 FTE): DOR requires resources to continue the implementation of HERT; however, the implementation of HERT has been called into question due to the amount and timing of the cashflows necessary to support the startup and ongoing administrative costs of DOR. DOR's 2019-21 agency request budget does not include an associated policy package. ***This request was added in the Governor's budget.***

State and Local Lodging Tax Auditing (\$220,871 Other Funds; one positions/1.00 FTE): DOR is requesting resources to audit the state and local lodging taxes. ***This request was funded in the Governor's budget.***

Marijuana Program/Income Tax Auditing (\$474,361 Other Funds; four positions/4.00 FTE): DOR is asking for resources to audit marijuana tax returns and the income tax returns of license marijuana businesses. There is a high risk of non-compliance in this cash-driven industry. ***This request was funded in the Governor's budget.***

Outcome-Based Management Assessment (\$769,100 General Fund and \$57,697 Other Funds; two positions/2.00 FTE): DOR is requesting resources to implement an outcome-based management system. DOR only recently contracted with Deloitte to assist with developing and implementing the system. This is a placeholder request whose cost is likely to be substantially higher than the current estimate. ***This request was only partially funded in the Governor's budget.***

Payments to Counties: This request shifts Other Funds expenditure limitation totaling of \$70 million for the CAFFA and Senior Deferral program to revenue transfers. This is a budget policy decision whether to budget pass-through payments to local governments as revenue transfers or as a budgeted special payment. This is a budgetary policy decision that the Legislature should consider in the context of the larger state budget and the consistent application of the policy across state agencies. ***This change was approved in the Governor's budget.***

Customer Service (\$244,880 General Fund and \$4,4997 Other Funds; one positions/1.00 FTE): DOR is requesting one position to serve as the agency's overall customer service coordinator. The customer service function is decentralized throughout the agency as well as

somewhat geographically. The centralization of DOR's customer service function within the agency should be considered. **No funding was provided in the Governor's budget for this request.**

Policy Packages: The above budget issues are not entirely inclusive of DOR's agency request budget, which includes 14 policy packages totaling \$15.5 million General Fund and \$3.2 million Other Funds (36 positions/38.57 FTE). An additional policy package reduces Other Funds expenditure limitation by making pass-through payments to local governments a revenue transfer(s). Of note is that DOR mis-calculated all policy package positions at 1.00 FTE rather than allowing for a three-month hiring period (0.88 FTE). This overstates the cost of the packages.

The Governor's budget funds DOR at \$258.7million total funds, or \$70 million below, and seven additional positions (4.82 FTE) above, current service level. General Fund was reduced by \$4.5 million. Other Governor's adjustments that were not previously mentioned include:

- Eliminates all funding for Nonprofit Homes for the Elderly Program (\$3.4 million General Fund). Under the NPH, counties grant a property tax exemption to qualifying nonprofit corporations that provide housing to individuals age 62 or older who are within certain income limits. Through this program, payments are also made to local governments in lieu of property taxes on certain tax-exempt housing for the elderly. The nonprofit entity passes the property tax exemption on to eligible tenants in the form of reduced rent.
- Eliminates six positions (9.00 FTE) in the Personal Tax and Compliance Division that perform filing enforcement and tax processing (\$2.7 million General Fund)
- Eliminates four positions (4.00 FTE) in the Business Division that perform customer service (\$396,521 General Fund and \$349,174 Other Funds)
- Eliminates \$1.3 million General Fund and five positions/3.87 FTE, as well as unneeded contract support for scanners (\$428,400), in the Information Technology Services Division
- Eliminates inflation on most services and supplies accounts, increases the vacancy factor by five percent, eliminates long-term vacancies, and adjusts DAS and AG charges.
- Adds an 070 Revenue Shortfall package for the Property Tax Division (<\$969,223 Other Funds>; one position/3.78 FTE)
- Fund shifts one General Funded Collections Division position to Other Funds (\$190,154)
- Adds a Legislative Concept 576 that reduces the early filing discount on commercial and industrial properties from three to two percent on July 1, 2020 producing \$15 million in 2019-21 and \$33.2 million in 2021-23. This new source of funding would be used for grants to counties, distributions through CAFFA, with \$3.2 million being for the Property Tax Division (seven positions/5.00 FTE)
- Adds six positions (2.00 FTE) to implement a new Employer Responsibility Assessment that was created to fund the Oregon Health Authority (\$326,853 General Fund). DOR apparently will be in-charge of levying, or at least collecting, an assessment on certain employers who do not meet threshold health care contributions on behalf of their workers.

Other Significant Issues and Background

There are a number of significant issues facing the Department of Revenue.

Legislative Session Concerns (2017): DOR came under significant Legislative criticism during the Legislative Session in 2017 for a myriad of issues related to the agency's operations, including financial management, human resources practices, information technology, customer service, employee engagement, and collections. Nine budget notes required the agency to examine its operating practices and report back to the Legislature. The legislative approach was to seek independent validation of the concerns identified by the Legislature. The Department of Administrative Services, Secretary of State Audits Division, and a private audit firm provided this validation through a series of reports and audits. With clear problem definition, the onus shifts to DOR and DAS to propose to the Legislature comprehensive solutions to remedy the systemic issues within the agency. For DOR to be successful, the Information Technology Services Division and the Research, Finance, Internal Audit, Human Resources, and Project Management sections must be operating at much higher levels of focused performance. Lastly, the performance of the agency must be quantitatively-based and measurable.

Audits and Reviews: The Secretary of State Audits Division has conducted a number of audits that either directly or tangentially impacted the agency. Completed audits include: Statewide Audit, Core Systems Replacement Audit; a review, rather than a formal audit, looked at Core Systems Replacement and then the County Assessment Function Funding Account. An external audit, as directed by budget note, was recently completed. Audits currently in-process include a "Organizational Cultural" audit.

Operations: Operationally, DOR is due much credit for this biennium for successfully implementation of federal and state tax law changes and simultaneously successfully implementing a variety of new and complex state taxes as well as the consolidation of the state's collection function. This underscores a dichotomy that exists between agency operations and vital supporting services.

Statewide Collections (SB 1067): The Legislature also passed a law moving receivables statewide to DOR. DOR moved Other Agency Accounts into a new division and the Legislature approved funding for a Collections Division Administrator. DOR, by budget note, is still required to submit a feasibility study for consolidating the agency's remaining collections functions (e.g., Personal Tax and Compliance Division and the Business Divisions) in the new Collections Division.

Working Capital Requirement: DOR has been relying upon General Fund to cash flow Other Funded program operations. The standard practice, which DOR has not adopted, is that each Other Fund revenue stream must be self-supporting, including any cash flow needed to pay for DOR administrative expense.