

**REDUCING LOST REVENUE AND IMPROVING PERFORMANCE
AT THE DEPARTMENT OF REVENUE**
ADDING EFFECTIVENESS BACK TO EFFICIENCY



STACEY E. PICKERING
STATE AUDITOR

A report from the Performance Audit Division

#129

March 12, 2012

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**Office of the State Auditor
Stacey E. Pickering**

March 12, 2012

J. Ed Morgan
Commissioner of Revenue
Mississippi Department of Revenue
PO Box 22828
Jackson, MS 39225

Commissioner Morgan,

I am pleased to present to you my Performance Audit Division's report #129, entitled "*Reducing Lost Revenue and Improving Performance at the Department of Revenue: Adding Effectiveness Back to Efficiency.*" I hope the information in this report will be helpful to you in your efforts to increase collection of legally owed taxes. One issue this performance audit report notes is that the Mississippi Department of Revenue is operating in a highly efficient manner. The report includes a chart showing the levels of various types of tax collections compared to the Department's budget that illustrates this point clearly.

As you and I have talked over the last several months, I am very aware of the impact of too few resources on an agency with such specialized skills as your auditors, investigators, analysts, etc. have. Having skilled experienced staff in sufficient numbers is vital to being effective.

As one of the very few agencies responsible for generating the revenue that fuels the many services and activities of State government, I believe it is important to recognize the seriousness of the issues facing your agency. You and your staff have been concerned for some time about the growing tax gap—the taxes owed to the State that are not being paid. I hope the section in the report where we analyzed the impact of the tax gap in Mississippi are meaningful in creating a picture of the long-term and short-term impacts of these losses on both the government and on the taxpayers who are properly paying what they owe.

Finally, the section of the report showing what other states have done over the last two decades when faced with similar situations will provide you with many ideas for solutions to closing the tax gap. Numerous states recognized that it was not only a federal issue. Some states, such as Minnesota, have worked for more than a decade to understand how and why the problem is occurring as well as what they can do about it.

I would like to commend your staff for their professionalism, efficiency, helpfulness, and patience as they provided valuable information and insights to my staff throughout this project. Again, I hope that you find this report and its recommendations beneficial as you go forward. Please do not hesitate to call me if I can be of further assistance.

Serving Mississippi together,

Stacey E. Pickering
Mississippi State Auditor



**Office of the State Auditor
Stacey E. Pickering**

***Reducing Lost Revenue and Improving Performance at the Department of Revenue
Adding Effectiveness Back to Efficiency***

*A Performance Audit Report
Executive Summary*

#129

March 12, 2012

In November 2011, the Department of Revenue (DoR) contracted with the Mississippi Office of the State Auditor (OSA) to conduct a Performance Audit to determine the major reasons for the agency's reduced effectiveness in collecting all taxes legally due in the State. They asked OSA to analyze their main operations to determine the most significant areas affecting their ability to meet their mission.

To accomplish the objectives of the audit, OSA identified major issues by reviewing DoR operations, appropriations, and staffing over time. In addition, OSA reviewed information from other state revenue agencies to find out how efficiently and effectively they were operating.

The DoR is the primary agency for collecting the majority of the State's revenue and its functionality is imperative to the State's everyday operation. Compared to other states' ratio of agency funding to tax collections, Mississippi has been very efficient in maintaining certain operations.

On the other hand, two of their biggest concerns are how to provide appropriate taxpayer assistance and how to close or eliminate the growing tax gap that exists. Very quickly, OSA realized that several issues were negatively affecting the DoR's capacity to fulfill its mission. Due to appropriation cuts and staff losses over the years, both customer service and collections have had diminished capacity.

Their customer service capability has suffered from a lack of staff and technology over time. The DoR does not have enough staff to answer all the requests that come into the agency in a timely manner, especially not during tax "season." They try to monitor phone and internet inquiries, but they only capture a portion due to technology limitations. In 2009, DoR divisions were only able to respond to 67% of the calls they received, and in 2010, that percentage dropped to 65% overall. Some divisions at

DoR can reach up to an answer rate of more than 90%, but some areas are well below 50%. The limitations DoR faces are a direct result of staffing and, to some extent, technology.

The main mission of the DoR is tax administration, which includes collection and enforcement among other areas. They are responsible for ensuring that legally owed taxes are paid in a timely manner to the State. When individuals and businesses fail to pay, under-pay, or misreport their taxes, they create a tax gap—the difference between what is owed and what is actually paid. Part of what DoR does, through audits, investigations and other means is identify those individuals and businesses that are not

*OSA estimates that Mississippi's Tax Gap—
funds owed to the State but not paid—may be as
high as \$624 million per year.*

*The Mississippi Department of Revenue, facing
staffing and funding shortages is currently unable to
lessen the growing tax gap and help the State get
additional dollars that would help the Legislature
mitigate the budget crisis.*

paying properly.

Mississippi is facing a growing tax gap. Reasons for the growing tax gap may be as innocent as not understanding the complex tax code or as illegal as intentional misreporting. OSA has estimated that the gross tax gap for the State may be as high as \$624 million for the last fiscal year. While they know it exists and they have identified several hundred million owed, they do not have the resources—specifically funding and staff to decrease the current tax gap.

Other states that have tried to understand and reduce the tax gap have kept statistics about how much extra they were able to collect for every dollar of additional resources the state gave them (see page 11). Based on efficiencies at the DoR and OSA's analysis, OSA estimates that for every dollar in additional funds for auditing, investigating, and enforcement the State provides DoR they will be able to collect at least \$9. For example, if the Legislature gave an additional \$5 million to DoR, and they were able to hire additional staff, they would probably see a return on investment of approximately \$45 million from the tax gap.

Lack of sufficient funding, staffing, and technology



have hindered DoR's productivity. While OSA finds that DoR is highly efficient, morale issues also hinder their effectiveness. Even though staff seem to know that the current administration is working hard to solve many existing problems, morale is not high at DoR. Reduced staffing compounded with a high turnover rate, non-competitive salaries, and poor working conditions all have a negative impact on morale.

Former employees cite location and salary as two of the main reasons that they left. Loss of experienced staff has many negative implications. Not only do new staff have to be trained—which takes them out of the field, they are less experienced and therefore, less productive. New employees need more oversight and assistance, which detracts from more experienced employees completing their own tasks. Training is also necessary. Currently DoR does not have enough staff in areas to allow much time off for training. In addition, certain areas have very few, if any, support staff, leading to professional staff doing routine clerical work instead of audits, investigations, etc. Fewer staff means fewer audits completed, fewer taxpayers assisted, fewer investigations opened, etc.

OSA does not consider the current location of DoR—temporary for the past 15 years—to be a professional workplace for auditors, analysts, accountants, and others. It is a large metal warehouse building, more suitable for storage than for complex and expensive computer systems and professional staff. It is hot in the summer and cold in the winter. In addition, it is prone to safety and security issues that can affect customers as well as the employees. It is located in a rural area that has had several “near misses” with tornadoes and other natural disasters. There is no truly safe location in the building in case of a severe weather event. When economic developers bring clients to Mississippi to meet, the DoR must go to meetings elsewhere, because other State agencies do not consider it an appropriate facility to show potential clients. OSA believes that the DoR facility certainly contributes to morale and turnover issues.

The Legislature gave DoR bonding authority to upgrade technology. Some of the systems still in operation today are close to 40 years old. Many systems are not integrated in any way. DoR has spent several years planning a new computerized tax system that would allow customers to access their records on-line and would streamline and standardize the entire tax administration process.

The new MARS system, which will provide web-based taxpayer portals for all major tax areas, saw its first systems come online in October 2011. In each of the next four years, a new segment will open up to the public via the internet. With this new system, the Legislature should be aware that there would be maintenance costs after the first several years. DoR has done well to maintain the many systems they have for so long. Many of them have been very costly and problematic and have been in use for almost forty years. MARS is a chance for the taxpayers of the State to get more information faster and provide a

streamlined, integrated system that makes the DoR more effective as well.

OSA raised many questions during the performance audit. This report will answer those questions and highlight some of the most critical areas affecting DoR operations. It also contains recommendations to the Department as well as to the Legislature to help increase effectiveness within the agency. There is no doubt that the DoR is tackling the issue of the tap gap, but there are other core responsibilities of the department such as:

- Customer service;
- Privilege and other business licenses;
- Regulation of the Wholesale Distribution of Alcoholic Beverages;
- Enforcement of the Local Option and Prohibition Laws;
- Ensuring Equitable Statewide Property Appraisal; and
- Administration of Motor Vehicle and Title Law

Many of the agency responsibilities go unnoticed by the Legislature, Governor, and the public. Much of what the agency does, which is either underfunded or not funded at all, is legislatively mandated. While collections, compliance, and enforcement are essential core responsibilities of the agency, there are additional duties the agency has that can impact the State such as the property tax appraisal system and the Economic Development Incentive Verification process. Ultimately, while each of these services is important to the effective operation of the tax system, the cost to do them properly detracts from other tax compliance and enforcement efforts.

However, without sufficient funds, DoR cannot be effective because the agency lacks necessary resources it needs to operate properly. Insufficient resources for the DoR mean they may be unable to:

- Find non-compliant taxpayers;
- Assist taxpayers who need help;
- Enforce existing tax laws;
- Recruit and retain qualified personnel;
- Invest in technology and maintain equipment that benefits the citizens and the State; and
- Concentrate on revenue generating activities.

One thing is clear, without enforcement and education for taxpayers, the tax gap will likely continue to grow larger, and the State will see an increase in tax fraud. The DoR is the front line of defense for both taxpayer education and compliance efforts. Without the proper resources, the DoR cannot be effective in its efforts to enhance voluntary compliance, educate taxpayers, and enforce non-compliance. With sufficient resources, the State will see better collections, more revenue, more compliance, and taxpayers may be spared additional tax increases elsewhere. The next page provides a summary of OSA priority recommendations for the DoR.

Summary of Priority Recommendations

1 Regarding the Shortage of Skilled Staff: *OSA recommends the DoR ask the Legislature and the Legislative Budget Office to review their analysis of current DoR funding and assign resources based on current agency needs, personnel, and revenue generating activities. OSA believes the shortage of both professional staff and support service staff is severely limiting the agency's ability to collect the taxes owed thus reducing the \$520,000,000 - \$624,000,000 Tax Gap. (Page 15)*

2 Regarding the Loss of Personnel: *OSA recommends DoR should gather salary information for similar positions in the public and private sector in Mississippi. They should use this as well as the other states' information to create a plan with recommendations for more competitive salaries and career ladders for their professional analysts, auditors, investigators, etc. to improve the retention of knowledgeable staff. Retaining knowledgeable staff is imperative to sustaining the 9 to 1 return on investment proven by the DOR. They should present this plan to the State Personnel Board for approval. (Page 14)*

3 Regarding Workplace Location, Morale, Safety, and Productivity: *OSA recommends the DoR continue to work with the Legislature to find a more appropriate facility to house the agency, which is safer, more secure, and more appropriate to the job of tax collection. The state does not want to risk any delay in depositing revenue or losing vital information due to situations caused by the current facility. (Page 17)*

4 Regarding Tax Collection and Compliance: *It is the OSA's recommendation that DoR requests the Legislature to consider the continued upgrade and maintenance of technology projects so that the DoR can sustain the level of revenue collection that the state and local governments must have to function. These include the Motor Vehicle Title/Registration Network, the scanning and imaging systems, remote work capabilities, telecommunications, etc. (Page 16)*

5 Regarding Performance Measures Related to Customer Service: *OSA recommends the DoR formulate a long-term plan to focus on customer service and Voluntary Compliance. This would include the upgrade and maintenance of their telecommunications and internet systems to increase the number of phones being monitored as well as better monitoring and logging of internet assistance requests. It would also include funding a Voluntary Tax Compliance Division within the agency that would be better able to serve the taxpayers of Mississippi and reduce the number of compliance issues and the Tax Gap. These performance measures are valid and reliable; and can be expanded. (Pages 7 and 17)*

6 Regarding Legislative Mandates and Agency Resources: *OSA recommends a review of the current legislation and mandates of the DoR before allocating additional duties and responsibilities to the agency that don't match with the agency's mission of collecting revenue. Such a review may aid DoR in decisions about the elimination of unnecessary areas and increases or enhancements to more critical areas. It may also help identify laws that need to be modified or eliminated to make DoR operations more effective and efficient. (Page 6)*

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**Office of the State Auditor
Stacey E. Pickering**

***Reducing Lost Revenue and Improving Performance At the Department of Revenue
Adding Effectiveness Back to Efficiency***

A Performance Audit Report

#129

March 12, 2012

Introduction

Efficiency, the “accomplishment of, or ability to accomplish a job with a minimum expenditure of time and effort,”¹ is something the Mississippi Department of Revenue (DoR)² has done well over the last decade, if one considers their limited resources and their mission. Efficiency, however, is only one-half of what is necessary to have a high performing organization. The other half is effectiveness, which, in most cases, requires adequate resources.³ Without a balance of efficiency and effectiveness, performance suffers or money is wasted.

In November 2011, the Department of Revenue contracted with the Mississippi Office of the State Auditor (OSA) to conduct a Performance Audit to determine the major reasons for reduced effectiveness in collecting all taxes legally due in the State. In an effort to more specifically define the problem facing the DoR—a problem that directly affects the State’s revenue—they asked OSA to analyze the main areas of operations to determine the most significant areas affecting their ability to meet their mission.

Part of any performance audit requires the review and analysis of relevant governing documents and financial data. To that end, the OSA requested and received the DoR’s financial data for the last decade. OSA also reviewed and analyzed strategic plans, internal risk assessment documents, policies and procedures, statutes, and other governing documents. A thorough review of more than a decade of financial and personnel data shows the DoR is attempting to properly operate and function according to these guidelines even though they have very limited resources and chronic funding problems. Over the last two decades, funding and staffing have declined as Mississippi’s business, industry and individual populations have grown. Inversely proportional resource to requirement ratios prevent any organization from reaching their maximum potential.

Performance Audit staff also reviewed audit findings from OSA’s Financial and Compliance Agency audits. OSA notes that, within its resources and limitations, the DoR appears to be trying to take corrective action for identified deficiencies through technology and system upgrades, requests for additional personnel, training, etc.

“The same is true of revenue collection. Raising taxes during an economic downturn slows recovery and puts an unfair burden on Mississippi’s taxpayers, but we cannot let tax cheats deprive the state of revenue it is owed already. I propose increasing the budget of the Tax Commission, so it can hire additional auditors to collect money the state is already owed.”

*-Haley Barbour,
Former Governor of MS*

¹ Dictionary.com

² Formerly known as the Mississippi State Tax Commission Senate Bill 2712, enacted during the 2009 Legislative Session but was not effective until July 1, 2010, reorganized the Mississippi Tax Commission by creating the Department of Revenue to conduct most of the administrative functions formerly conducted by the State Tax Commission

³ The degree to which something is successful in producing a desired result; success:



QUICK FACTS

2011 Population: 2,978,512

2011 Individual Income
Taxpayers: 1,241,698
Taxes paid \$1,780,577,764

2011 Corporate Income
Taxpayers: 69,287
Taxes paid \$510,383,344

2011 Business Sales
Taxpayers: 78,318
Taxes paid \$2,645,990,929

2011 All Other Taxes
collected by DoR:
\$1,806,944,169

DoR employees: 674
DoR budget: \$50,786,563

In its review of data and information, OSA notes that the DoR is in agreement with previous financial audits. They appear to be trying to focus on corrective action for identified deficiencies. The OSA Financial Audit findings included segregation of duties issues (lack of staff), lack of internal and system controls (aging systems), lack of documentation (limited administrative/clerical support), and lack of audit trails. DoR has identified all of these as serious issues in its risk assessment document and in its five-year strategic plan. OSA found that management recognizes the problems that multiple aged systems, potential human errors, system bypasses, and overrides, lack of adequate document logs and trails, and similar issues can cause to effective tax collections for the State. Therefore, OSA recommends the DoR continue to address the deficiencies identified in the Financial and Compliance audits through policy and procedure changes, additional internal controls, and system changes.

This report will highlight some of the most critical areas affecting DoR operations and will summarize OSA’s conclusions. It also contains recommendations that will help the DoR increase effectiveness and may ultimately aid them to increase revenue collections for the State significantly. However, this report does not address the adequacy, relevance, need for, or the fairness of any tax, but rather it seeks to address the growing issue of uncollected revenue based on the Department of Revenue’s operations.

Background

In 2010, Mississippi ranked 33rd of the fifty states in total taxes collected compared to its population.⁴ Tax collections fund government services. When tax collections fall, government cuts or eliminates services or else they raise taxes to make up for the shortfall. The DoR is the primary agency for collecting the majority of the State’s revenue. Compared to other States ratio of funding to collections, Mississippi has done an extremely good job. The agency has launched several initiatives to enhance collections and cut costs, despite constant and chronic underfunding and personnel losses. Their biggest concerns are how to provide appropriate taxpayer assistance and how to close or eliminate the tax gap that exists. They, like the federal government and numerous other states, have realized that tax avoidance, underreporting, non-filing, etc. have a complex negative impact on government revenues and services as well as on the individual taxpayers.

THE TAX GAP

The tax gap is something governments do not think about in times of plenty. However, as a poor economy takes hold and revenue collections fall, a gap in tax collections of 10-15% or more becomes quite noticeable. Mississippi is seeing the tax gap’s negative impact now. The DoR, in asking for the performance audit to help identify ways to mitigate the tax gap, recognizes the problem as well.

A simple definition of the tax gap is the difference between what is legally owed to a government and what is voluntarily paid to the government. Beyond that, the issue becomes far more complex. Issues such as which taxes have a gap, how the tax gap is calculated, and what can be done about it are the basis of studies, articles, policy, law, legislative and congressional hearings, and even court cases. The term “tax gap” and its analysis only date back to the early 1980s when the IRS first began considering taxpayer non-compliance as a serious issue. Tax avoidance has and always will exist, but as a government studied issue, it is still relatively new. Prior study had focused on the “underground” or “shadow” economy in the US.

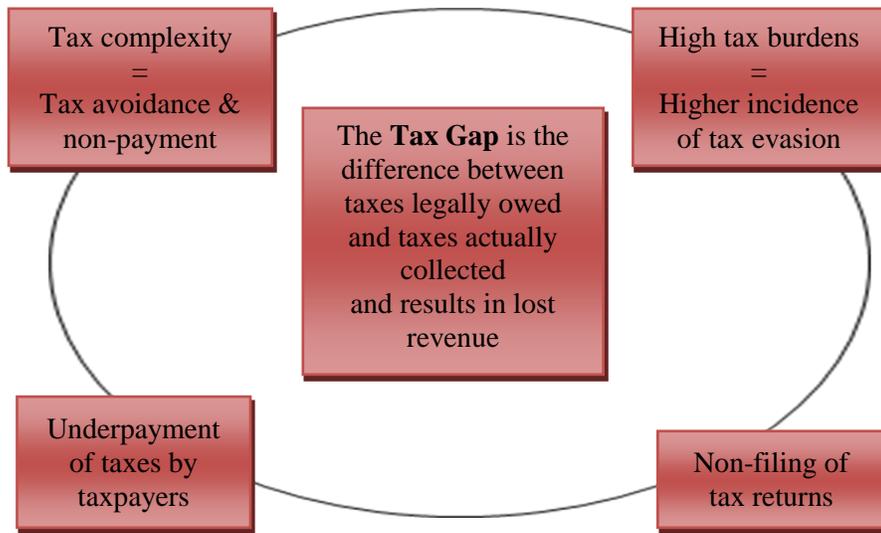
THE TAX GAP

*The difference between
what is legally owed
to the government*

and

*what is voluntarily paid to
the government*

⁴ U.S Census Bureau 2010: States ranked by states total taxes collected



Growth of the Tax Gap. The tax gap at the federal and state level has grown tremendously over the last 20 years. Many believe this growth is due to increasingly complex tax codes, a blurring of the distinction between an individual and a business, and a loss of fear of the penalties associated with non-compliance. The last issue has been tied to growing knowledge that the federal IRS has lost 36% of its enforcement and auditing force over the last 20 years, and the knowledge that states have often relied on federal information to help them with enforcement.

Mississippi is no different. Over the past thirty years, the DoR has seen more cuts to personnel and budgets than they have seen level funding. At the same time that their

budgets were shrinking, the “net tax gap” (total remaining uncollected after enforcement) has been growing. The federal net tax gap grew from \$290 billion to \$385 billion just between 2001 and 2006. OSA analysis shows that Mississippi is likely not much different regarding the growth of the tax gap. Over the last decade, the numbers of businesses and individuals have increased and the amount of revenue has increased—but not always proportionately. Other states that have studied this have seen similar results, and while there are complex reasons to explain the data, most have implemented many programs to mitigate the tax gap.

Who Creates the Tax Gap? When most people hear about the tax gap, they think, “tax cheats.” Evidence has shown though, that the gap between what is owed and what is paid is not just caused by individuals and businesses trying to cheat on their taxes. The complexity of state and federal tax laws is often blamed for a portion of the tax gap. When the tax rules get more complicated, taxpayers can get confused. Recent studies by the Government Accountability Office (GAO) have shown that even professionally trained tax preparers make mistakes when filing returns. Those who try, but fail, to understand their tax obligations may make inadvertent errors, or just give up and not file. The Mississippi Department of Revenue understands this and has been continually seeking ways to better educate and assist taxpayers. In fact, customer service and education is one of the primary areas that the Department has been trying to improve. However, there are those who hide behind the complex tax code as a means to pay less than what they owe. The DoR is also aware of this problem and seeks to mitigate tax cheating through enforcement and investigative actions.

In its June 6, 2012, report on the federal tax gap—now estimated to be about \$450 billion per year—the IRS calculated that approximately 84% of the tax gap came from intentional or accidental underreporting of tax obligations; 10% came from intentional or accidental underpayment of taxes owed; and just 6% came from non-filing. Interestingly, because taxpayers that have mandatory withholding (ex. W-2 at a job) are more likely to report their earnings accurately, the IRS estimates that only 1% of all wage and salary income was misreported. However, income or payments subject to little or no reporting were misreported 56% of the time. This most recent IRS report provides additional useful information about high-risk populations and non-compliance. According to the August 1994, GAO report *IRS Can Better Pursue Non-compliant Sole Proprietors*, self-employed and sole proprietors, especially those paid in cash, misreport 54% of their actual income on average by either underreporting it or by claiming deductions, credits, and exemptions to which they are not entitled.

WHO IS THE TAX GAP?

- 84% under reporters
- 10% under payers
- 6% non-filers

The IRS estimates only 1% of wage and salary income is misreported each year.

Self-employed and sole proprietors tend to misreport approximately 54% of their actual income, on average.

Payments for goods and services with little or no reporting requirements are misreported 56% of the time.



What is the Impact of the Tax Gap? Generally, most experts (scholars, economists, tax analysts, etc.) agree that a tax gap has both present and future impacts:

- It affects the public by reducing the availability of current government services;
- It increases the amount others have to pay through offsetting tax increases when programs aren't cut;
- It can result in an increase in future borrowing to continue services;
- It lessens the ability to repay existing debt;
- It erodes confidence in the voluntary tax system; or
- It can be some combination of these things depending on political will and severity of the problem.

Mississippi's Potential TAX GAP

- OSA estimates between \$520 million and \$624 million total Tax Gap
- In FY 2011, through audit and enforcement efforts, the DoR was able to collect more than \$141 million of unpaid taxes
- In FY 2011, the DoR was also able to identify \$284,898,687 in unpaid taxes that for which they could file asset liens.

The IRS has calculated that—at the federal level—the average annual additional tax burden put on those who report accurately and timely is about \$2,200 per individual or entity.⁵ Put another way, the average taxpayer is paying \$2,200 more in taxes each year to cover just a portion of those who do not report properly. The tax gap still exists, but taxes increase or new taxes are created to make up the shortfall.

Mississippi's Tax Gap. Based on IRS calculations and its review of similar research from other states, OSA believes Mississippi's compliance rate is still probably close to the IRS' 85%. This is also an indication that a majority of the State's taxpayers are honest and want to pay their taxes. Just the same, there are business owners and individuals who avoid paying their obligation in taxes. Based on methodologies used in other states, OSA estimates that the income tax gap may be conservatively as high as 10-12% of all sales, use, and income taxes paid in Mississippi.

If the Mississippi tax gap for sales, use, personal income, and corporate income taxes alone (the total of these taxes in FY 2011 was \$5,201,326,589) were between 10-12%, then there are between \$520 million and \$624 million in underreported, underpaid, or non-filed taxes. OSA took into account the known or identified tax gap in its assessment. Through enforcement and compliance actions, the DoR was able to recover more than \$141 million in FY 2011. In the same fiscal year, the agency identified \$284,898,687 in unpaid taxes for which they could file asset liens. This information, added to the methodologies other states are using to estimate the tax gap (known and unknown dollars) was the basis of the OSA estimate. However, OSA recommends that the DoR review the various methodologies used in other states and develop their own system to calculate the tax gap. Their access to more detailed taxpayer information will allow them to determine the Mississippi tax gap more accurately. As part of this audit, OSA will provide research from numerous other states.

Mitigating the Tax Gap. States have spent the last two decades trying various methods to calculate and reduce the tax gap. Some have followed in the footsteps of the IRS, using whistleblower reward programs and technological enhancements for enforcement and compliance. Others have tried tax amnesty programs. Almost universally, states and the federal government have determined that more audits of low-risk, generally compliant populations is not effective as is the identification and pursuit of non-filers and targeted audits of high risk populations that do file taxes.

Generally, without spending more on enforcement and only being more effective with existing resources, the states and federal governments are able to shrink the tax gap by between 2-5%. While the idea of amnesty programs, whistleblower reward programs, increased enforcement, technology solutions, etc. are all appealing to reduce the tax gap and burden on compliant taxpayers, they are not currently realistic possibilities in Mississippi because all of these solutions require resources—sufficient numbers of trained employees, technology, and funds—that the DoR simply does not have at this time.

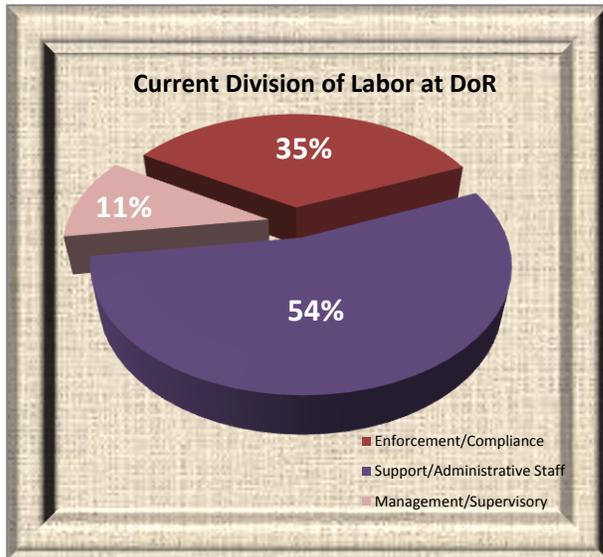
⁵ IRS National Taxpayer Advocate, OMB Watch. *Bridging the Tax Gap: The Case for Increasing the IRS Budget*. 2008



THE CURRENT STATE OF THE DEPARTMENT OF REVENUE

OSA systematically reviewed DoR staffing data as far back as 1982. Today, with 674 filled positions, there are 84 fewer workers within the agency than a decade ago. Since 1982, there are 321 fewer PINS appropriated and 339 fewer positions filled. The lack of funding has not only impacted employee numbers, but has resulted in a larger tax gap, reduced services and assistance to the public, and, until recently allowed for few technology improvements to support the vast number of revenue-generating activities.

While many Mississippi government entities complain of underfunding and shortage of highly skilled staff, there are only a very few whose critical mission is tied to the revenue generation, collection, and management that keeps Mississippi government functioning—The Department of Revenue, the Department of Treasury, the Department of Finance and Administration, and the Department of Audit.



The current division of labor at DoR appears to be weighted in favor of support and administrative staff. However, the support/administrative staff functions include all of the people who process returns, title requests and replacements, license renewals, prepare reimbursements, research and handle records requests and registrations, do all of the data entry, mailings, printing, and generally work with the public. They handle motor vehicle registrations, they process withholdings, the work in the Alcoholic Beverage Control (ABC) Division, and, internally they handle shipping receiving, accounting, computer operations, network services, etc. Even the Support/administrative functions are fairly specialized in many cases. They are generally the first voice that a taxpayer hears or the person a taxpayer works with

when trying to complete a transaction or ask a question. However, even though it appears that there are a significant number of them when compared to all DoR employees, the areas of enforcement and collections (revenue officers) have almost no support or clerical staff.

Enforcement and compliance staff includes the attorneys, the four criminal investigators, ABC enforcement agents, statewide revenue agents, auditors and analysts, and appraisers. Administration theory suggests that optimal supervisor to staff ratio—known as “span of control” depends on the type of work. The more routine and repetitive the work, the larger the span can be. The more autonomy, independence and open-ended the work is the smaller the span should be. For example, a span of control for investigators’ supervisors should be smaller than for the division that handles routine records requests. Currently, DoR operates with a 10:1 supervisory ratio on average. However, it appears that DoR has strategically placed its management staff to best manage the resources it has. In an organization like DoR, a smaller span for certain divisions should be a target goal. Too large a span of control can seriously impact operations by causing “bottlenecks” of workflow, decisions, and communication. Too small of a span creates too many managers. Additionally, OSA finds that, unlike many large state agencies, DoR has a good communication process amongst its management and supervisors. If the DoR can begin to build its workforce from within and promote those experienced employees with management skills who also know what it takes to do the jobs their subordinates have, then the effectiveness and performance should increase over time. This will mean they have to reduce their turnover rate and increase staff positions, both of which require assistance from the Legislature.

In its review of operations compared to funding and resources, OSA finds that DOR’s effectiveness in the above listed areas is primarily affected by insufficient resources. The areas OSA identified as most deficient in resources, but which should have the



most positive impact of tax collections, are the investigators, auditors, and revenue officers. OSA finds that DoR should study all its governing statutes, other laws, mandates, and existing programs to look for redundant, inefficient, or ineffective areas of operation that could be targeted for elimination, modification, or enhancement.

Because DoR has funding and employment limitations, the responsibilities listed above are not always done as effectively as in the past. One area suffering the most from this is investigators and revenue officers for tax collections in business and individual income. *OSA recommends a review of the current legislation and mandates of the DoR before allocating additional duties and responsibilities to the agency. Such a review may aid DoR in decisions about the elimination of unnecessary areas and increases or enhancements to more critical areas. It may also help identify laws that need to be modified or eliminated to make DoR operations more effective and efficient.* Understanding the duties of the DoR will help the Legislature make informed decisions regarding the roles and importance of the agency.

Core Responsibilities

Probably the most thought of responsibility of the Mississippi Department of Revenue is Tax Administration. It includes processing returns, depositing funds, issuing refunds, and distributing payments to the State General Fund and other units of local government. The area of tax administration also includes issuance of permits and other regulatory duties. In addition to Tax Administration, the DoR's other core responsibilities include:⁶

- Wholesale Distribution of Alcoholic Beverages
- Compliance Collection and Enforcement
- Enforcement of the Local Option and Prohibition Laws
- Ensure Equitable Statewide Property Appraisal
- Administration of Motor Vehicle and Title Law

The DoR has many responsibilities that may go unnoticed by the Legislature, Governor, and the public. Much of what the agency does, which is either underfunded or not funded at all, is legislatively mandated. While collections, compliance, and enforcement are essential core responsibilities of the agency, there are additional duties the agency has that are also beneficial to the State as a whole. While they are not specifically core responsibilities, OSA has found that enforcement of the "Unfair Cigarette Sales" Law and tax incentive verification for business and industry are two other important areas for the DoR.

ALCOHOLIC BEVERAGE CONTROL (ABC)

Wholesale Distribution of Alcoholic Beverages. The Alcoholic Beverage Control (ABC), a unit within DoR, is tasked with regulating the dispensing of alcoholic beverages in Mississippi. Since 1966, ABC liquor distribution has contributed over \$2 billion to the State Treasury. "Sales increased by 2.4% over the prior year reaching \$263 million," according to recent DoR data. Those sales generated more than \$92 million in sales tax, liquor tax, and profit transfers to the state treasury. ABC has an enforcement system, which requires investigative and permitting functions to be in place to enforce State laws. Without sufficient staff, enforcement is limited.

Other States' Favored Methods of Collection Enforcement:

- Written notices/bills
- Field Officer collections
- Installment agreements
- Offers in compromise agreements
- Liens against assets
- Seizure/sale of property
- Garnishments
- Collection agencies
- Credit Bureau Reporting
- Various State license or permit denials, suspension, or revocation
- State tax refund offsets
- Credit card program for delinquent taxes

⁶ Mississippi Department of Revenue 2011 Annual Report, Fiscal year ending June 30, 2011



COLLECTION AND COMPLIANCE

The DoR collects the State's taxes, processes returns, completes and distributes tax refunds, deposits bank transactions, and distributes tax payments to local governments. Annually, with 674 employees, the DoR manages tax returns and payment information for more than 1.5 million taxpayers.⁷ This is a tremendous growth in taxpayers from twenty years ago—almost twice as many—that DoR manages with far fewer personnel and less average years of experience. In 1990 for example, when the technology and IT systems in place today were relatively new, the State Tax Commission had 973 employees. However, there were only 799,000 individual taxpayers and 41,475 corporate taxpayers; not to mention a much simpler tax code with far fewer exemptions, incentives, etc. then there are today. It is far more difficult for the DoR to maintain the same level of operation that it had 20 years ago.

In its 2011 Risk Assessment document, the DoR describes one of its primary goals is "...to reduce non-compliance through identification and collection of non-paid tax liabilities. Failures are threats to the State's revenue." Through such enforcement efforts, the DoR was able to conduct 4,700 field audits and 6,500 office audits, resulting in approximately \$135 million in unpaid taxes being assessed. However, there are still uncollected revenues not being found by the existing personnel due to sheer volume of cases. The DoR reviewers and analysts also prevented more than \$6 million in fraudulent individual income tax returns from being issued. In many cases, compliance personnel are able to catch businesses and individuals who do not comply with tax laws and who avoid paying taxes.

Nationally, current research shows a growing segment of individuals and businesses that are avoiding paying taxes. On the other hand, many taxpayers get the process correct. The agency refers to this as voluntary taxpayer compliance. The DoR also recognizes the importance of keeping voluntary taxpayers paying. To that end, their position is to keep this bracket of taxpayers by offering training, seminars, and providing resources. However, limited resources prevent the extensive implementation and use of taxpayer education other tools to improve compliance.

To aid in increased compliance, it is the OSA's recommendation that DoR requests the Legislature to consider funding a Voluntary Tax Compliance Division within the agency that would be better able to serve the taxpayers of Mississippi. With additional staffing in other areas, this division could be both internal and external information and training source for tax compliance issues.

Non-Revenue Generating Activities

This section is about activities the Department of Revenue has responsibility for, but which are not producing any special fund revenue for the agency.

Enforcement of the Prohibition and Local Option Laws. ABC enforces these laws as well. Its purpose is to enforce the local option laws of the State with a focus to reduce alcohol consumption by minors. Agents of this unit train permit holders and their employees on state prohibition law to enhance knowledge on and to lessen underage access to alcohol and beer. The DoR receives no revenue from these services. These services are currently paid for from the agency's general fund appropriation. OSA recommends that DoR request the Legislature to repeal the Prohibition and Local Option law or amend it to impose a fine and/or surcharge on those persons or entities

⁷ Mississippi Department of Revenue 2011 Annual Report, Fiscal year ending June 30, 2011, reports an outline of the six core responsibilities



that break this law. OSA further recommends that the Legislature authorize the DoR to use the proceeds of this fine to test compliance and to enforce this law more effectively. This would be similar to the \$25.00 surcharge assessed on individuals who receive a Driving Under the Influence violation.

PROPERTY TAX

Ensure Equitable Statewide Property Appraisal. The DoR is required to provide a consistent evaluation of property values to ensure equitable ad valorem tax rates. Therefore, educational and support services are provided to the State’s 82 counties. The DoR receives no revenue from local governments for this service. Again, these services are currently been paid for from the agency’s general fund appropriation. The cost of these and other Property Tax Division services, such as mailings, customer service, etc., amounted to \$2,892,877 in fiscal year 2011.

Motor Vehicle and Title Laws. The DoR manages the statewide Tag and Title computer network, which is accessible to the State’s 82 counties and law enforcement. As a courtesy to the counties, the agency prints renewal notices for each registered motor vehicle in the State. Currently, the DoR does this at no charge to the counties. The printing of notices and managing of the network is time consuming and costly to the agency. At present, it costs the agency \$72,000 to print renewal notices and \$700,000 to maintain the network annually. To cover some of the cost to administer these laws more effectively, OSA recommends DoR assess a fee of up to \$1.00 to the counties for each renewal notice printed. In FY 2011, the agency issued 875,000 new titles; 66,000 new tags for big trucks and government vehicles; printed 2.6 million renewal notices for license plates; and disbursed \$4.2 million from the sale of specialty plates, all without being able to mitigate the costs. In evaluating this program, OSA finds this is a valuable resource for counties and taxpayers, yet it consumes scarce resources that could be better used on tax compliance efforts.

“In its current form, Mississippi’s Unfair Cigarette Sales law requires large amounts of staff time to investigate complaints and the “meeting the competition’s price” clause makes staff efforts to assess penalties virtually impossible.”

-PEER, 2010 Review of the Department of Revenue’s Enforcement of the Mississippi’s “Unfair Cigarette Sales Law”

ENFORCEMENT OF THE UNFAIR CIGARETTE SALES LAW

MS Code §75-23-25 states; *The State Tax Commission shall prescribe, adopt and enforce rules and regulations relating to the administration and enforcement of the Unfair Cigarette Sales Law.* Additional enforcement responsibilities include answering taxpayer questions, receiving complaints, and performing price checks on cigarettes to ensure retailers are not selling below minimum prices. According to an October 2010, PEER report, the agency had one (1) employee whose primary responsibility was to enforce this law to approximately 7,500 licensed retail cigarette outlets and 145 licensed wholesalers. At this time, there is still only one (1) employee responsible for the enforcement of this law. PEER also stated, “Enforcement efforts are of necessity a complaint-driven process rather than proactive monitoring process.” Currently, the individual assigned to this and several other duties only responds to complaints. This employee does not actively enforce the law other than through whistleblower and complaint processes. To sum this up, the Mississippi’s Unfair Cigarette Sales law enforcement division needs additional staff to investigate complaints and to make determination on the assessment of penalties for violators. OSA recommends that DoR pursue Legislative appropriation for this division to provide additional staffing.

ECONOMIC DEVELOPMENT INCENTIVE VERIFICATION

Mississippi, like many states, provides business taxpayers with numerous incentive programs. To receive the incentives, business may have to employ a certain number of people on a regular basis. Initial employment verification of qualified business or industry is another responsibility of the DoR. The agency has to work closely with the State’s other agencies, such as the Mississippi Development Authority, Mississippi Employment Security Agency, and OSA Bond Monitoring Division, as well as the



companies applying for the incentives to be efficient and effective in this verification process.

In the past several years, Mississippi has recruited or preserved business relations with more than 20 industries, through jobs incentives. For each net new full-time job created, achieved, and maintained, the agency issues tax credits to certain qualified businesses and industries. The DoR determines job creation/maintenance by comparing the average annual employment level from the previous year with the average of the current year. If there are increases in the job total, then the employer qualifies for a tax credit. Currently, the agency has two employees from the Policy Department who split their time on other duties and who work with several other employees from different areas that do the same. To do the minimum verification work for this area of DoR costs the agency more than \$100,000 per year. It is imperative that this verification process is true and actual because millions of dollars in taxpayer funds are tied to job creation and maintenance in Mississippi. Mandating that businesses and the Mississippi Development Authority provide certain information and data to the DoR would make the entire process more efficient. OSA recommends that the Legislature and/or the Mississippi Development Authority (MDA) require that each time a new business or industry enters into a contract with the State, the business or industry should submit a certified and warranted total number of employees in place as of the effective date of the contract, or at the time of the approval of the incentives by the Legislature or MDA, whichever is more appropriate. This list should include each employee's name and a unique identification number and should be made available to both the DoR and the OSA Bond Monitoring Division.

Ultimately, while each of these services is important to the effective operation of the tax system, the cost to do them properly detracts from other tax compliance and enforcement efforts.

Implications of Underfunding

When an agency is allocated a sufficient amount of funds, the agency is able to operate effectively. Measuring sufficiency is a complex issue. However, without sufficient funds, the agency runs the risk of not being as effective because it lacks necessary resources it needs to operate properly. An insufficient appropriation for the DoR means they may be unable to:

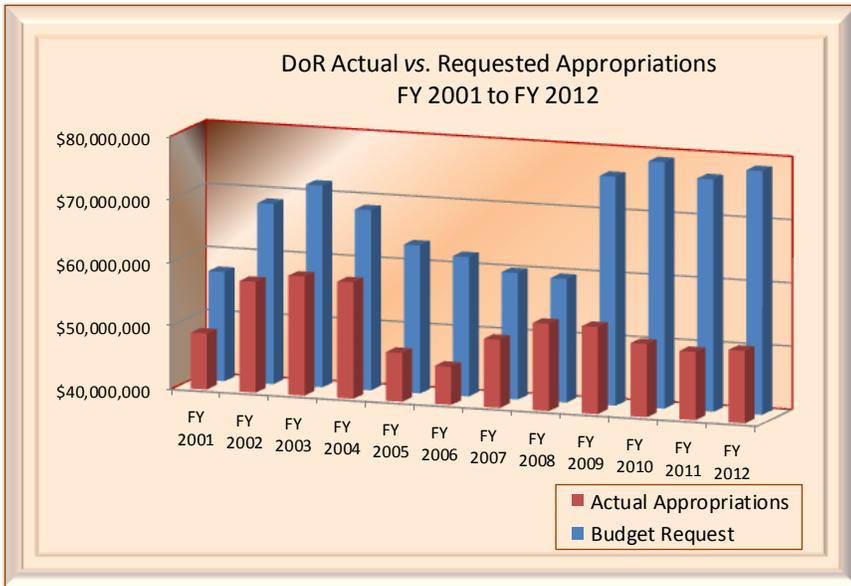
- Stop the tax gap from increasing—that is, they may be unable to prevent revenue loss due to non-compliance, which shorts the State from funding other agencies it deems “critical” or “priority” agencies;
- Provide effective customer service, which can lead to increased non-compliance with tax laws;
- Enforce existing tax laws;
- Recruit and retain qualified personnel;
- Provide necessary training and career ladders for personnel; and
- Purchase and maintain necessary equipment and systems needed to effectively operate the agency.

“The not so well kept secret of State tax administration is that their efforts to ensure compliance tend to be underfinanced, weak on staffing and technology, and thus hard put to catch many cheaters.”

-Institute for Wisconsin's Future, 2009 report, “Investing in Revenue”



Like many agencies primarily funded from the State’s General Fund, sufficient funds provided through the Legislative appropriation process are vital to the DoR’s ability to effectively carry out its mission. The Legislature has numerous pressures on it to provide higher funding to more popular, more visible, or what the public often perceives as the more “critical service” agencies. Unfortunately, agencies that generate significant amounts of revenue for the Legislature to appropriate do not always received funding priority.



Source: Mississippi Department of Revenue Data⁸

The DoR has tried to ensure that its budget requests have been realistic and uninflected over the past several years. They believe they have used sound methods to produce their request, including meaningful performance measures. For the past 11 years, appropriations for the DoR have fallen short of budget requests, although recently, the DoR did receive Legislative authority to use bond money for upgrades to decades old computer hardware and software systems. Further, the Legislature has been positive about aiding them in relocating to a safer, more functional facility.

Gaps between budget requests and actual appropriations are shown on the chart above. In the past 11 years, funds appropriated to the DoR have averaged 18% less than what has been requested. This has led to loss of personnel, many of whom were experienced, and a reliance on computer software and systems as much as forty years old.⁹ Based on analysis and comparison to other states, the OSA believes these are the contributing factors to the undetected tax non-compliance as well as a growing amount of uncollected tax.

One of several key requirements of a true PBB system requires understanding the needs of an agency and its current effectiveness with revenues it has been given. Another key component of such a budgeting system is to understand the agency’s benefit to the State.

In the past few months, the concept of using a Performance Based Budgeting (PBB) system to aid in annual appropriations has been gaining momentum. One of several key requirements of a true PBB system requires understanding the needs of an agency and its current effectiveness with revenues it has been given. Another key component of such a budgeting system is to understand the agency’s benefit to the State. The DoR’s functionality is imperative to the State’s everyday operation. Lack of funds inhibits the DoR from effectively pursuing revenues owed to the State—revenues that fund education, mental health, social services, healthcare for the poor, and other “priority” funding areas. OSA has determined the DoR is operating at a high efficiency, and with increased funding this could balance that efficiency with greater effectiveness, which would allow for:

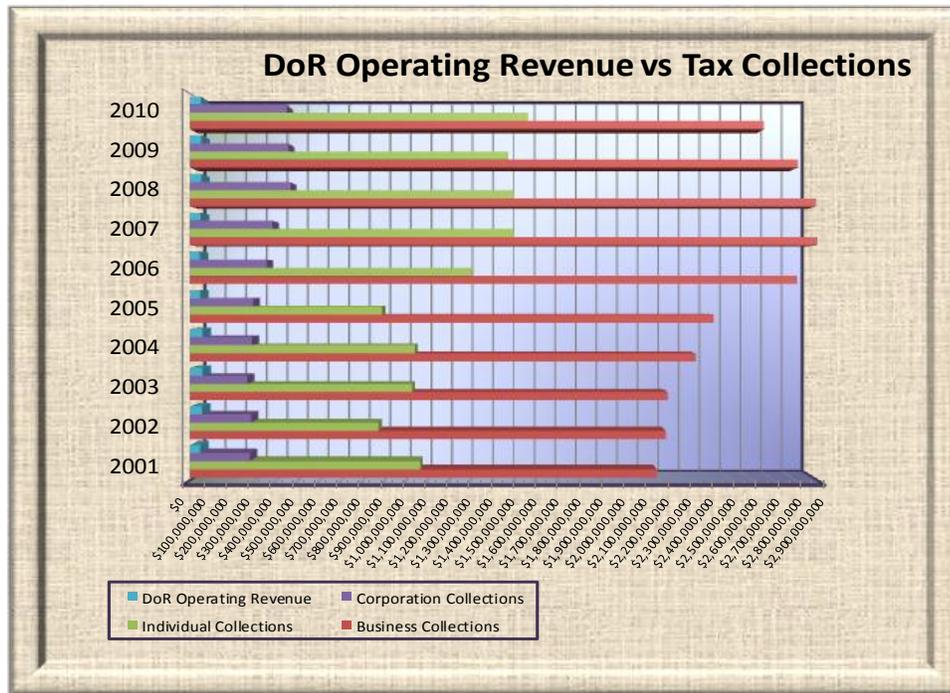
- Performing more audits through increasing audit staff;
- Retaining more experienced auditors, revenue officers, and investigators;
- Developing more ways of finding non-compliant tax payers;
- Enhancing taxpayer education to help increase the voluntary compliance;
- Increasing tax collection efforts by having more collection staff; and
- Investing in more advanced taxpayer friendly stable, modern, and secure technology.

⁸ This graph does not include a \$27 million pass through appropriation to beef up the Motor Vehicle Ad Valorem Tax Reduction Fund. These amounts show the appropriated amounts primarily used for DoR for operations.

⁹ DoR Appropriation Analysis



The Chart below shows just how efficient the DoR has been over the last decade. Similar charts from other States do not show such an efficient ratio of budget to collections. With additional funds and a plan to increase compliance and enforcement activities, DoR should be able to recover more unpaid taxes for the State.



The table below illustrates comparative rates of return on increased enforcement spending from other states. The table uses available data from OSA research efforts to determine what other states were doing about this situation over the last decade. Some states have continued the additional funding to maintain a higher level of compliance, while others only considered these pilot programs or chose to discontinue the additional funding.

Comparative Return on Investment From Compliance Efforts				
State	Year	Additional Funds	Additional New Revenue from Compliance Efforts	Return On Investment (ROI)
Idaho	2003	\$926,000	\$12,000,000+	13 to 1
Kansas	2002	\$6,000,000	\$54,000,000	9 to 1
Kansas (2 nd Year)	2005	\$1,440,000	\$15,000,000	10.4 to 1
Minnesota	2003	\$10,300,000	\$97,200,000	9.4 to 1
Washington	2009	\$10,700,000	\$67,800,000	6.3 to 1
New Mexico	2009	\$5,000,000	\$29,000,000	6 to 1
New Mexico (2 nd Year)	2010	\$5,000,000	\$45,000,000	9 to 1
Mississippi	2013 (projected)	\$2,000,000	\$18,000,000	9 to 1
Average ROI				9 to 1

** This chart shows that for each extra new dollar devoted to new compliance efforts, these states were able to recover additional un-remitted taxes owed to the state.*



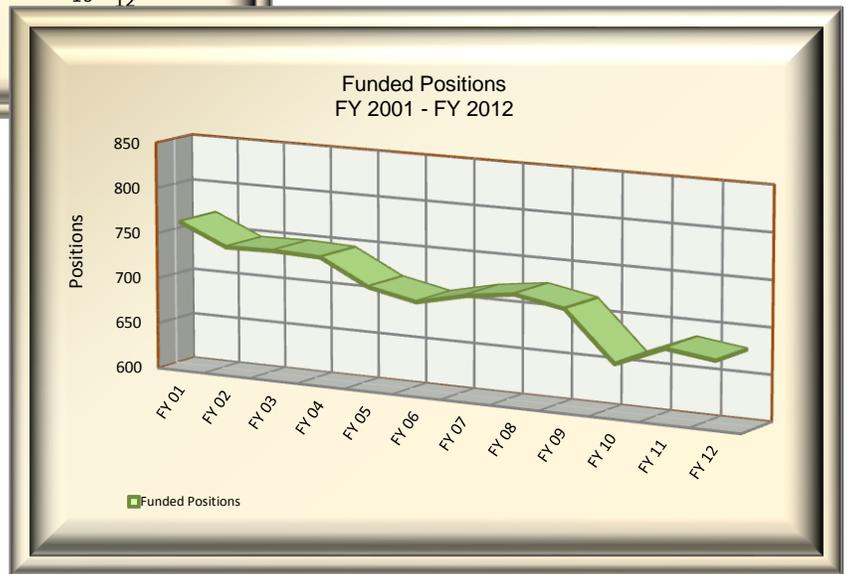
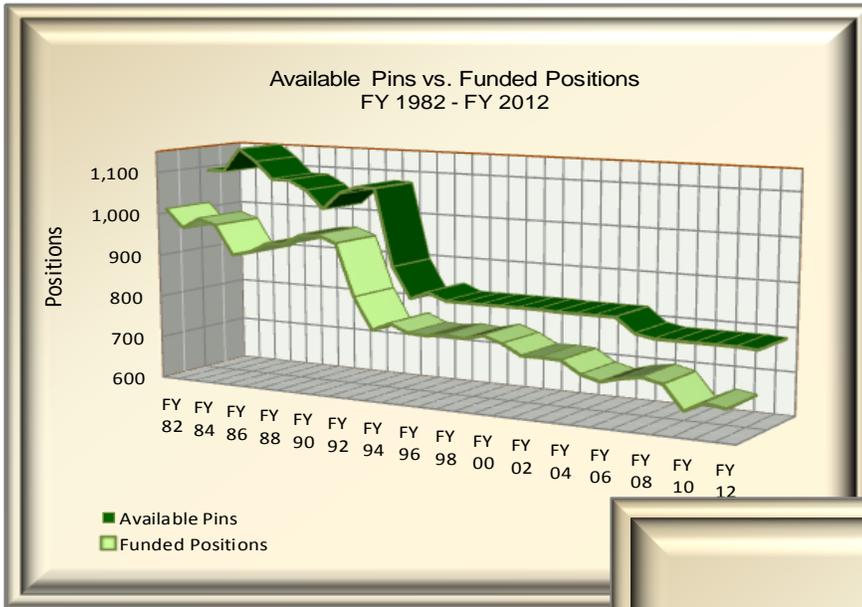
LACK OF TOTAL PERSONNEL

Currently, DoR has 674 employees, but 11 years ago, they had 765 and at one point in the last 30 years, DoR had more than 1,100 employees. According to the DoR, one reason for part of the decline in staff is that in the early 1990s a division, Weight Enforcement and Oversized Permits contained approximately 120 employees who were transferred to the Mississippi Department of Transportation. Nevertheless, there are half as many employees as there were three decades ago.

The staffing trend over the last decade represents significantly fewer positions, including 14 fewer revenue officers and 20 fewer auditors collecting revenue for the State. The following two charts illustrate the decline in staffing.

Compounding the loss of funded PINS is the added high turnover rate. Many of the current employees are eligible for retirement or have less than five (5) years of experience. Staff losses will have a negative effect on an organization's effectiveness.

While management is working to correct this in several ways, it is important to note that



salaries for job classifications at the DoR are not competitive with similar job classifications at a number of other State agencies, the private sector, the federal government, or with surrounding states. While employees leave for various reasons—morale, pay, flexibility, other working conditions, etc.—in the government tax auditing profession, salary generally plays a large role in where people choose to work.

The high turnover rate and fewer professional staff generally results in fewer audits and investigations completed in any given year. These audits require unique skills and require extensive hours of work, observation, and analysis to complete. At a time when many other states were providing their Revenue Departments with funds to improve operations, Mississippi lagged behind. Even with the added capability to file certain types of taxes electronically, the amount, types of information, and associated workload increased at a similar rate, outpacing the staffing levels.



The DoR has several different groups of tax auditors—In-House Auditors, Foreign Auditors, Field Auditors, and IFTA/IRP Auditors. Each set of individuals monitor certain aspects of the tax system. The basic description of the auditor’s process is to receive and review potential audit leads, schedule an audit with the taxpayer, determine taxability of an audit, interview the taxpayer, and summarize the completed audit.

Currently, in-house auditors have an inventory of 65,886 federal audits to review that have the potential to generate tax revenue for the State. On average, DoR auditors are only able to complete 8,300 assessments annually (12%). This 12% generated about \$37 million in unpaid taxes last year. With additional auditors and support staff, the number of audits will increase, thus generating more funds for the State through the recovery of unpaid taxes.

Furthermore, the DoR only has four (4) investigators. Their duties range from conducting interviews and serving subpoenas to preparing case files to present to the district attorney. They work cases in state and across the nation, although with no support staff and limited travel funds, many potential cases are never opened. Currently, there is a known multi-State tax scheme worth millions to the State, but there are no sufficient resources to handle the workload. The investigator position is crucial and has a great need for technology, training, and support staff.

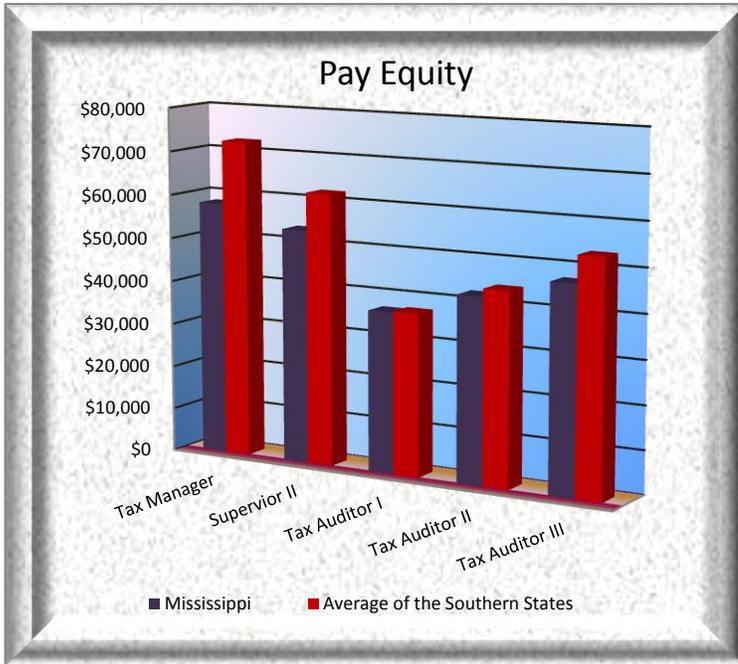
A long-term lack of funding and insufficient staffing has resulted in loss of effectiveness at the DoR.

The agency has close to half the staff it had 30 years ago, yet the population of the State has almost doubled, and the number of businesses has grown.

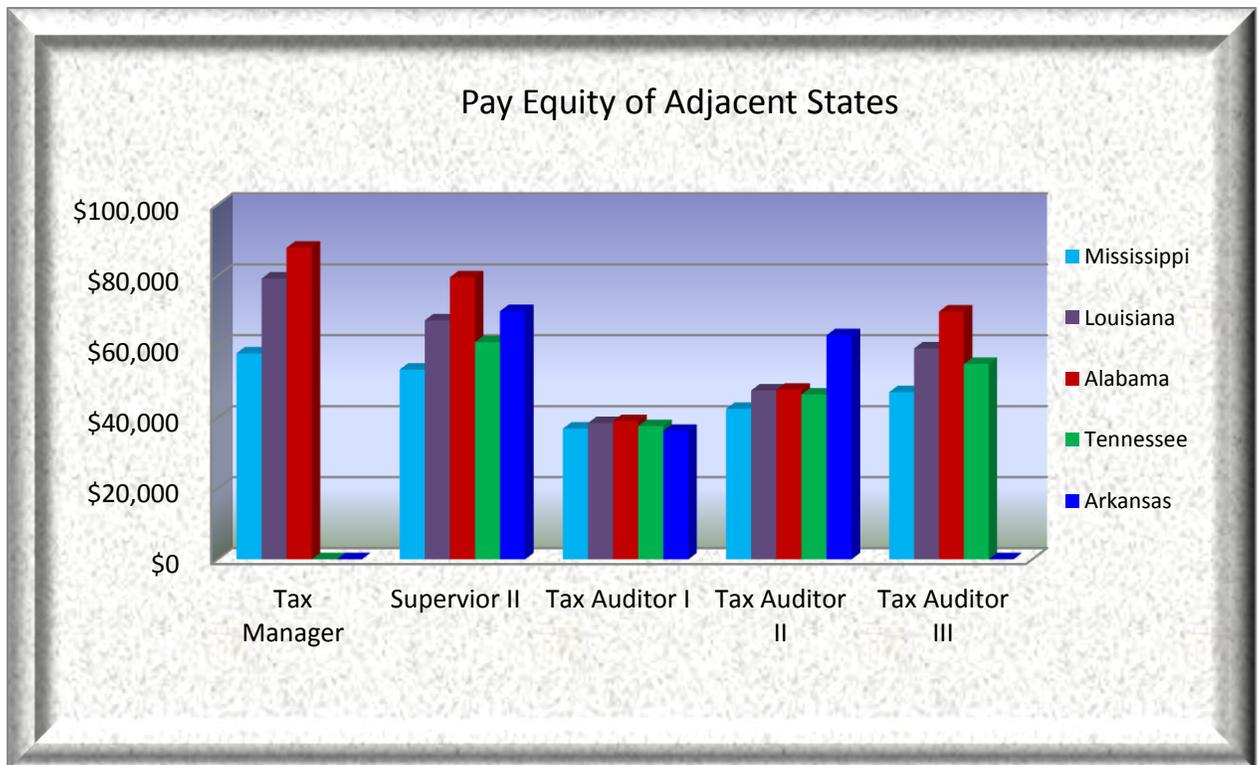
The performance audit analysis shows that these two areas—auditing and investigations—do not have sufficient support staff. Currently, most auditors and investigators spend a significant portion of their time completing routine clerical duties instead of being able to focus on the specialized work they are hired to do. When they do not do the clerical work, they risk financial and compliance audit findings about lack of controls. OSA notes that in addition to authorizing extra PINS (with no parallel funding appropriation), the Legislature did approve the DoR to realign certain of their professional staff (revenue officers), but to date they have not provided the additional funding.

Shortage of Skilled Staff. Even if DoR could hire all of the employees they need to increase enforcement and customer service, they will still have fewer remaining experienced staff. Fewer remaining experienced and knowledgeable staff makes mentoring and in-house training more difficult. Retaining skilled employees poses a great strain on any agency’s ability to operate in the most efficient manner. Continuous staff training builds on the experience they have. Constantly training new hires is not only time consuming, but inefficient. These new employees are not able to work as efficiently as their more experienced co-workers are and often, and, as they get enough experience to work more independently, they tend to leave for a higher paying job elsewhere.

A less experienced employee’s need for assistance and supervision also detracts from the ability of current staff to complete their own work. Study after study shows that, especially in poor economic times, certain taxpayers who realize that the State is conducting fewer audits will try to take advantage of the voluntary tax system. The more this tax evasion occurs, the further the understaffed, undertrained agency loses effectiveness. Ultimately, the greater the tax gap and the greater the loss of revenue, then the greater the likelihood of taxes being raised on others to make up the shortfall.



A key factor in retaining skilled staff is competitive salaries. During a review of other states, OSA analysis showed that, with the exception of the Tax Auditor I, salaries in Mississippi for tax auditors and directors do not meet the average salary for the region. The charts to the left and below show how Mississippi pays less than the Southern state average for various positions. Similarly, when compared to adjacent states, Mississippi does not have equivalent salaries in most cases. Neighboring state Alabama is paying as much as \$30,000 more for the same positions. *OSA recommends DoR should gather salary information for similar positions in the public and private sector in Mississippi. They should use this as well as the other States information to create a plan with recommendations for more competitive salaries and career ladders for their professional analysts, auditors, investigators, etc. They should present this plan to the State Personnel Board for approval.*



The DoR management, at present, cannot afford the loss, or even long-term absence (for training) of its experienced professional staff. Each new loss is challenging, given the department, which had 1,013 PINS in 1982, and has dropped steadily over time, with only 674 funded positions remaining. While training is very important, a current shortage of highly skilled, experienced staff makes finding time for it very difficult. For staff to go to training, they must set aside their workload, since there are no other personnel that can take on the extra work. While they are in training, they are not doing their work. The lack of training has a negative impact on the agency's effectiveness, but taking the time to train without enough additional professional staff



can result in decreased agency function, a smaller knowledge base, and subsequently, an increase in revenue loss.

Two of the recent financial audit findings were about segregation of duties and audit trails. These will continue to be recurring audit findings at the agency while they do not have staff in certain positions. One of the issues the OSA Performance Audit staff verified through review of job functions is many professional staff have no backup in case of illness or other event that takes them away from the office. Another observation from OSA's review of staffing levels at the DoR is that there is very little opportunity for cross training, even though a number of areas overlap by necessity. Staffing is low enough in some areas there is just no other person who can do a certain job.

For example, the DoR is required to perform several legislatively mandated functions for other state agencies and local governments related to distribution of taxes. Most of these services generate no revenue for DoR, but they take up a significant amount of time and other resources at the agency. The work performed requires many man-hours. Further complicating matters, the traditional approach to strategic staffing is often ineffective and unattainable. Specifically, the DoR is an agency that builds experience from within because its work is so specialized that it requires a more intricate knowledge of Mississippi tax law, the collection process, and distribution rules. ***OSA recommends the DoR ask the Legislature and the Legislative Budget Office to review their analysis of current DoR funding and assign resources based on current agency needs, personnel, and revenue generating activities. OSA believes the shortage of both professional staff and support service staff is severely limiting the effective operations of the agency as well as their ability to collect taxes owed.***

TECHNOLOGY UPGRADES—THE SOLUTION TO AGING AND INADEQUATE SYSTEMS
MARS. In an effort to improve its quality of service, the DoR began implementing the Mississippi Automated Revenue System (MARS) during fiscal year 2011. With approximately \$30 million in Bond funding authorized by the Mississippi Legislature, The DoR designed this 5-year project to completely replace decades old, multiple incompatible computer and software systems at the agency and support the large volume of transactions and payments made to the agency. When it is finally complete—in about four (4) years—it will also integrate MOST of the DoR's tax programs into a single comprehensive system. MARS will provide enhanced services for taxpayers through TAP—the “taxpayer portal,” where they will have online access to their tax records and other information. In the near future, the DoR will also need to replace the aging Title Registration Network that combines the 82 counties vehicle title and registration information. That system was once the premier system in the country is now outdated and ready to be replaced.

This system has rollout dates set over a five (5) year period, which began October 24, 2011 with the following tax areas:

- Corporate Income and Franchise
- Pass-Through Entities
- Gaming
- Insurance Premiums
- Finance Privilege
- Beer Excise
- Tobacco Excise
- Beer and Tobacco Permits



The first of five MARS rollouts went live October 24, 2011.

Future MARS rollouts include:

- October 2012, Individual Income and Withholding
- October 2013, Sales and Use Taxes (special city, county, and other taxes)
- October 2014, Miscellaneous Taxes (Severance, regulatory, etc.)
- October 2015, Alcoholic Beverage Taxes

As DoR implements this new technology, they plan to manage each phase to assure quality control. Their new system will require employee training, which is now underway. The training required will temporarily remove employees from the current skeletal staff and from revenue-generating activities to gain the knowledge and skills needed to manage the system. Although the new MARS system has already made significant improvements in taxpayer compliance, *OSA recommends that the Legislature continue appropriations to finalize the system over the next four years, and provide maintenance for the new system once it is in place. Additionally, sufficient staff levels are necessary to ensure proper system operation.*

LOCATION, SAFETY, AND MORALE

In fall of 1996, the DoR moved out of the Woolfolk Building (state property) to its current location, which was presumed to be temporary housing for the agency. Over the years, very few changes have been made to this facility to accommodate the long-term needs of the agency. The facility is an un-insulated, unreinforced metal warehouse building. There are potential safety and health issues at the facility. Temperatures that cannot be regulated uniformly—or even within normal ranges at times—flooding, live animal incursions, etc. all contribute to less than ideal working conditions.

The Mississippi Department of Revenue was “temporarily” moved to a metal warehouse building in 1996.

They are still there more than 15 years later.

DoR reports that it is working with the Legislature to find a safer, more secure and appropriate facility to house them.

Safety issues for both employees and visitors should be of major concern to the State. The OSA observed that there are no safe areas for visitors and employees to go to in case of tornadoes or other natural disasters. Further, if an emergency occurs and visitors must move to a more central location in the current metal building, there is no guarantee that taxpayers’ confidential information can be protected.

Employee turnover has a direct impact on agency revenue collection and effectiveness. Working conditions in the current location may also be contributing to the high turnover rate. The current location is not a secure or even safe facility compared to most professional government offices. It also has environmental problems that may be affecting the productivity of employees. Poor working conditions are may also affect morale.

Low morale is another common factor in a high turnover rate. Conversely, a high turnover rate can also add to low employee morale. When co-workers leave, those left behind often see more work for them, training new people, hiring new people at the same or higher salaries, but with less expertise and fewer skills, etc.—all of which can lead to low morale. Low morale may also stem from overworked employees who have increased workloads and responsibilities due to a lack of a trained workforce and support staff, regardless of the turnover rate.

People tend to leave an organization when they are unhappy with salary, working conditions, job requirements, etc. Studies have consistently addressed turnover rates among the new generation of employees based on job dissatisfaction. Younger workers today enter the workplace expecting jobs where the work environment is satisfying.



Clients considering Mississippi as a place to build a business will need to meet with DoR officials. It is very important the State present itself in the best possible light in a professional setting that demonstrates the importance of the agency's function. The building housing the main office of the DoR is insufficient as a professional workplace. Based on information from the DoR, the agency general condition meeting with potential economic development clients are never held at their warehouse building, but instead are held at another State agency. A professional office facility also communicates to employees their importance to the State, helps to create pride in employees' work, improves employees' morale, and can play a role in setting a high standard for work performance. ***OSA recommends the DoR continue to work with the Legislature to find a more appropriate facility to house the agency, which is safer, more secure, and more appropriate to the job of tax collection.***

DoR made over \$2.2 billion in transfers to local governments and special funds. \$378 million dollars was returned to over 300 of local governments from sales tax. Another \$57 million was diverted to 65 cities and counties for special levies.

The OSA, after reviewing existing conditions, finds the DoR should have governmental support, appropriate dollars for operation, and the proper technology and facilities to protect and house the employees and visitors. These support measures can aid in improvement of morale and productivity. The same measures can contribute to fiscal stability and ensure a system of operation that is reliable and safe.

CUSTOMER SERVICE AS A MAJOR AREA OF CONCERN

The DoR is the vehicle through which citizens of the State receive information and training regarding the Mississippi tax system.

The DoR management believes that customer service is extremely important. They look at their physical location, internet presence, and telephone capabilities as three customer service areas they want to improve to increase taxpayer education to help increase voluntarily compliance.

Even though it is an uncompensated area that can take a significant portion of time away from auditing and compliance activities, DoR knows that good customer service can lead to better overall compliance with State's tax laws. Research from the federal and state level shows that when a customer cannot reach the appropriate area to receive tax help, they tend to give up and not file taxes appropriately if they file at all.

In fact, the DoR has created very meaningful performance measures to monitor telephone related customer service. The agency realizes from analysis of their own performance measures they need to improve in this area. They monitor many of their telephone systems and the internet to determine how many requests for assistance that DoR receives. Of those monitored in FY 2009 and FY 2010, they:

- Received 1,037,388 (FY 09) and 1,101,816 (FY 10) calls,
- Answered 697,946 (FY 09) and 715,913 (FY 10) of those calls,
- Were unable to answer 33% (FY 09) and 35% (FY 10) of calls due to a lack of resources and time, and
- Received over 13,000 hits to the "Contact Us" section on the DoR webpage in one month.

The DoR knows there are many unmonitored field office phones, as well as other phones at the agency headquarters that do not go through the main switchboard. These phones also receive a high volume of taxpayer requests for assistance. The DoR does not currently have an effective method of capturing those unmonitored phone calls.

After data review and analysis, ***OSA recommends the DoR formulate a long-term plan to upgrade their telecommunications and internet systems to increase the***



number of phones being monitored as well as better monitoring and logging of internet assistance requests. These performance measures are valid and reliable; however, they need to be expanded. This plan should also include methodology to determine additional staffing needed to manage the volume of calls and other types of assistance requests received by the DoR staff. Additionally, OSA recommends that until DoR can expand its automated information request monitoring system, they design a short-term plan to have employees that receive calls on unmonitored phones record basic information about calls they receive and the outcome or result of their assistance to the taxpayer. Such a temporary manual system can help supplement existing performance measure to better help the agency and the Legislature understand the information needs of the taxpayer. This information could be reported quarterly to add to other monitoring reports to help A) improve existing DoR performance measures and to B) gather statistics about additional staffing needs based on volume of calls and time allocated.

Each of the following areas can create incremental improvement in effectiveness and productivity:

- Sufficient staffing levels;
- Training;
- Salary competitiveness;
- Adequate and appropriate facilities; and
- Functional and integrated IT systems.

Delinquent Tax Collections

The Bureau of Collection is an enforcement division charged with collection of delinquent taxes. Revenue Officers, processors, and analysts are responsible for the collection of final assessments for all taxes, contacting delinquent accounts, investigating new and closed businesses, answering taxpayers' questions, and delivering liens and garnishments. The Processors and Analysts also have a number of other significant job duties in addition to handling tax liens, including answering taxpayer questions.

DoR currently has approximately 19 Processors and Analysts in the Collections Bureau who support the 44 Revenue Officers across the State. In FY 2011, there were 207,643 new liens that could have been filed in local counties and which represented \$284,898,687 in uncollected taxes. Of those liens, which must all be manually processed and filed in the counties, the DoR was able to enroll (or register) 96,608, with 114,969 remaining unenrolled for the fiscal year. In the first six months of FY 2012, the DoR has already identified more than \$207.5 million (or, 79,203 items) in new liens that need to be filed. So far, they are averaging 46.53% filed. However, for each lien filed, counties charge the DoR between \$5 to \$7. Even if the DoR had enough staff, the cost to file the liens at the local level would have amounted to approximately \$1.3 million or more.

Put another way, at current staffing levels, working year round on only tax liens, the 19 Processors and Analysts would **each** have to prepare 10,929 liens per year (or, 42 per day), and **each** of the 44 Revenue Officers would have to file 4,719 liens per year (or, 18 per day) in counties across the State. OSA has estimated that to make this a more manageable process and to maximize the number of liens filed for delinquent taxes, the DoR needs approximately 19 more Processors and Analysts, and 20 more Revenue Officers. Ultimately, more staff and at least \$1.3 million for fees in FY 2011 would have helped the State process liens to recoup almost \$285 million in taxes. This effort

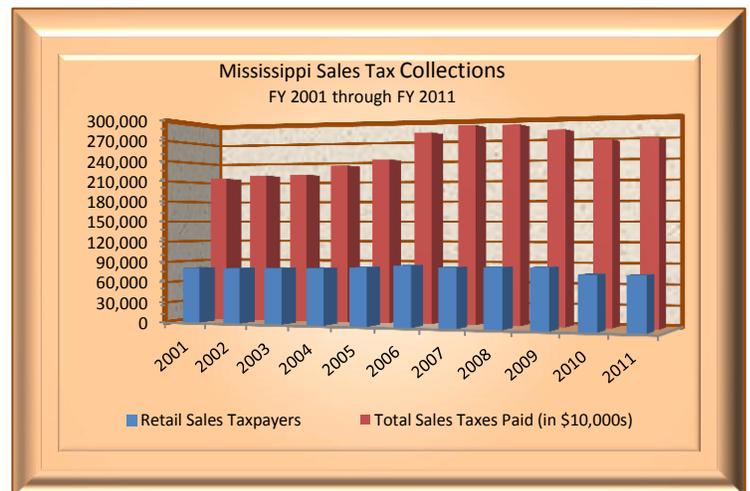
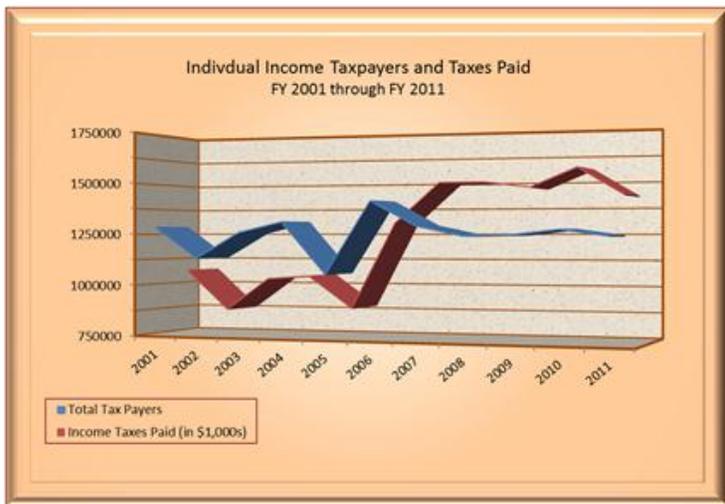


would not include the other normal workload these staff must undertake. Currently, DoR only has enough staff to realistically work on about 35 liens per day in house and revenue officers can usually work on an average of 9 to 10 liens per day. Because this is not even the equivalent of being able to process 50% of the new liens that should be filed each year, OSA recommends the DoR present a request to the Legislature for sufficient staffing levels in this division to help it increase its tax lien filings by at least 50%, in order to significantly increase the number of liens being filed on delinquent State taxes owed.¹⁰

OSA further recommends that the DoR research various ways the \$5 to \$7 filing fee for each item could be eliminated and the various ways that the filing process could be streamlined at, perhaps, a State level. A central filing solution would also aid the revenue officers who could then be freed up to work on additional uncollected or delinquent revenue.

There are trend analysis methods that can aid in determining whether individuals and businesses, may be under-reporting or not reporting their legally due taxes. By looking at individuals, or businesses, etc. as unique groups and comparing their sales or purchases over time to the total numbers in those groups, a graph of the entities and the taxes paid should parallel one another closely. Even with a bad economy where many individuals are losing their jobs and businesses are closing, if the types of businesses and the average income do not change significantly, then the trends should continue to parallel each other. When the number of taxpayers grows, but the amount being collected declines, this may be an indication of a growing tax gap. While such a situation can occur due to unemployment and a downturn in the economy, it can also be an indication that tax avoidance is occurring. DoR should conduct trend analysis by business or industry type as well as for individuals to test for the possibility of tax under- or mis-reporting.

The following two charts show the comparison trends of total taxpayers compared to total taxes paid for individual income and sales tax collections. Currently, the DoR does not have enough staff or technology to complete the necessary analysis that would allow them to determine what the causes are and where they should focus their resources. Even if they could conduct the analysis, they do not have enough officers, auditors, and investigators to follow through with the volume of work they would have.



¹⁰ The actual percentage of unfiled liens at the end of FY 11 was 55.85%



Other Revenue Departments & the Tax Gap

By reviewing other states' methodologies and results for comparative purposes, OSA has concluded that while more revenue was coming in, it is possible that Mississippi's tax gap was also growing. With growing a growing economy (before 2008), a growing tax gap is less noticeable. Once the economy started to decline, the tax gap makes the funding problems of the government more apparent. Along with the IRS, the states of Wisconsin, Minnesota, New York, and several others spent time over the last decade studying the increasing tax gap in their states and trying to correct the problem.

During their examination of data, the leadership of the Department of Revenue realized that the State was owed far more than what was being collected. They requested that, as the OSA conducted its performance, that it also review other states to see if any of them had faced similar situations. OSA finds that Mississippi is facing a common situation. The difference is that only a few other states have been active in understanding why and how it is happening and what can be done about it. Below are summaries of other states.

MINNESOTA

The Minnesota Department of Revenue first began studying the issue of a tax gap in state income collections in 1996. This and their 2007 study of sales and use tax remittances are the most often cited by other states. Unlike the IRS methodologies, Minnesota's focuses on State issues and strategies. They also completed a 2009 study of the cigarette sales tax gap. They spent more than a year and millions of dollars to determine that in 1996, the state had an income tax gap of \$101 million. Their 2007 survey results showed a \$423.6 million tax gap. They have implemented a number of strategic solutions that are reducing the tax gap. Some of their strategies required legislative action while others were merely administrative, such as redirecting resources.

A March 2006 Performance Audit of the Minnesota Department of Revenue's collection and compliance resulted in the following findings and recommendations¹¹:

- Individuals owe, but do not pay, an estimated \$600 million in Minnesota income tax annually. For the sales and use tax, this Minnesota "tax gap" is about \$450 million.
- In addressing the income tax gap, the Minnesota Department of Revenue has made significant progress targeting non-filers but not underreported self-employment income.
- The department is not effectively using some important information that would help identify noncompliance.
- On average, income, sales, and use tax audits yielded \$5 to \$7 per dollar spent in fiscal year 2005, not counting revenue gains that may occur later because of better voluntary compliance.
- However, some of the department's audit programs find little noncompliance, and these resources could be redirected to more productive audits.
- Many taxpayers who file returns with a balance due or who owe taxes after an audit do not pay on time. This tax debt totaled over \$450 million in 2005.
- Although the department has increased annual debt collections, many of its collection practices are inefficient.
- Taxpayers who call or write with questions often do not get prompt responses, and the department does not do enough to ensure that taxpayers get correct answers.

¹¹ March 2006. <http://www.auditor.leg.state.mn.us/ped/pedrep/taxcomp.pdf>, accessed January 30, 2011.



- Minnesota has significant tax compliance problems, and the state needs to strengthen its ability to detect and deter noncompliance.

Recommendations:

- The Department of Revenue should improve its tools for identifying noncompliant taxpayers. To help, the Legislature should require employers to file wage reports in a common electronic format.
- The department should (1) make better use of performance data to evaluate audit projects and (2) modify or reduce resources in those that are unproductive.
- The department should simplify the steps involved in pursuing debt collection cases and put more emphasis on collecting high-dollar debts.
- The department should improve the quality of assistance provided to taxpayers who call or write with tax compliance questions.

Before the State made a significant change to the model they used for tax collection in Minnesota (funding, staffing, approach), they were able to catch about 4,000 tax cheats a year. In just the first year of their new approach (more funding and more staff), they were able to identify an additional 20,000 individuals who owed \$73 million. By 2009, using their new technology, funds and employees, they had opened another 24,000 investigations. Between 2003 and 2008, Minnesota's DoR had collected an additional \$900 million through increased audit and enforcement activities. Finally, between FY 2001-2003, an investment of \$10 million yielded \$97 million in additional revenue for the State. Between FY 2003 and 2005, \$12 million in additional DoR enforcement and compliance funding helped recover approximately \$92 million additional dollars. Between FY 2005 and 2007, \$17 million additional funds for DoR resulted in almost \$115 million extra revenue for the State.

Minnesota emphasized auditing, combined corporate reporting, more sophisticated technology. The State Legislature supported their efforts through funding and staffing authority and the State's revenues improved significantly without the necessity of raising taxes.

INDIANA

In 2005, they identified an expected tax gap of \$600 million. They chose a short-term solution, by using a tax amnesty program from September 15 to November 15, 2005. The State considered the two-month program a success and was able to collect approximately \$103 million.

OREGON

In 2005-2006, Tax Fairness Oregon (TFO), an advocacy group that attempts to close tax loopholes and increase collection enforcement in Oregon, took up the tax gap issue. The organization assumed that Oregon had the same estimated tax gap percentage (16.3% in tax year 2001) as the federal government and they estimated that their state tax gap is approximately \$1.5 billion per year on a \$6 billion collection total. They did not provide their methodology in their paper; however, OSA believes they erroneously assumed that Oregon's tax gap matches the federal tax gap, not taking numerous other factors including licensing requirements, types of taxes, etc. into account. The federal government only uses personal and corporate income taxes in its estimates. Their report advocates sharing information with the IRS in a reciprocal manner to find tax evaders. They mention the fact that in 2005, California added \$1 billion to their tax enforcement efforts and were able to collect an additional \$700 million in taxes owed to the State. As of 2011, Oregon has only been able to pass piecemeal legislation to correct their tax gap. One success was a 2009 pilot program that cross-referenced tax compliance with professional and occupational licenses and which lead to increased collections. Other ideas that they advocate and which OSA believes have merit are increased funds for enforcement and listing individuals and entities that are delinquent



in their taxes on the Department of Revenue website, something a number of other states have employed.

IOWA

In a 1999 report stated the Iowa Department of Revenue collected \$5.9 billion annually. They contracted with a company that provided them with integrated technology solutions (much like Mississippi is doing with MARS). The system they purchased replaced mainframe applications and 20 disparate systems that could not communicate. The Iowa Department of Revenue wanted to focus more on customer service and education, audit and collections, and document processing. Between 2000 and 2003, they were able to improve compliance by about 10% per year and collect an additional \$35 million from the 2.9 million population. They were able to pay for the new system using the authority under the State's innovative funding mechanism called the Performance-Based Procurement Law.

IDAHO

A 1996 Performance Audit, "Estimating and Reducing the Tax Gap in Idaho," estimated the tax gap for just individual income and sales and use tax was \$244.8 million. In 1995, the Idaho Tax Commission had a \$19.8 million operating budget and collected \$1.5 billion in tax revenue for the State. The performance audit stated they were unable to make a corporate income tax gap calculation. The report further calculated the "collectible" portion of that tax gap to be \$46.9 million through systemic changes and improved collection practices.

In 2009, the Idaho Tax Commission issued a report that estimated their net (after enforcement activities) annual tax gap to be between \$250 million and \$352 million using three different methods, all three of which only consider various types of income taxes. The State's total revenue from taxes used in the calculation \$3.16 billion. Using the same formula from the 1996 performance audit, the tax commission's estimate was \$299 million annually. Using their own estimate based only on averaging results from completed audits, they estimated \$250 million. Using the IRS' methodology, which also only considers income taxes, they estimated the State's tax gap was \$352 million. They also calculated the average return on investment to be 13 to 1 for enforcement collections. Finally, they pointed out that the multiplier effect on revenue collections to budgeted collection efforts is actually stronger in reverse. The more the agency is cut the more cases are dropped due to lost resources, the greater the tax gap becomes.

GEORGIA

In 2006, Georgia State University conducted a study "Tax Collectability and Tax Compliance in Georgia." Fiscal Research Center Report #133. They did not actually try to estimate their tax gap, but generally point out the likelihood and causes of its severity. They "consider the question" of how large the tax gap is in Georgia. Since GA relies on the federal adjusted gross income as the basis for its income taxes, the report notes the personal income tax gap may have been 18%.

CALIFORNIA

In 2006, the California State Comptroller issued a strategic report providing information and recommendations about the State's tax gap. Their goal was to address the causes using "soft" approaches along with increased enforcement measures. Soft approaches included taxpayer education, reminders, and other ways to increase taxpayer confidence and compliance. They developed short- and long-term goals they believed were achievable. The short-term goals were more enforcement related and allowed them to begin closing the current gap and collecting unpaid revenue. Long-term, the State wanted to change taxpayer attitudes and increase compliance. Their short-term solutions included:



- Conducting more audits;
- Focusing on high risk preparers;
- Reviewing Independent Contractors more closely;
- Using more data sources to detect non-filers; and
- Focusing on potential business non-filers.

In addition to more taxpayer education and assistance, the long-term goals also included requiring some additional information from business taxpayers and increasing criminal prosecutions.

In the 2006 report, they estimated the tax gap in California was approximately \$6.5 billion per year, or 11% of their total expected collections (Almost the State of Mississippi's entire general fund budget). Between 2004 and 2006, their VCI (Voluntary Compliance Initiative) efforts collected \$1.4 billion. One of the "soft-hard" combination tactics they used was to use a tax amnesty right before implementing new penalties. This effort recouped \$4.8 billion. The total additional investment over this two year period was \$13 million. These two programs brought an additional 175,000 individuals and businesses into compliance and into the tax system.

In 2010, California estimated a \$6.5 billion tax gap. In the last few years, California has spent approximately \$1 million per year to collect \$700 million in unpaid taxes through enforcement. Also in 2010, the State introduced legislation to provide for a reward program to encourage whistleblowers to report tax fraud and tax evasion.

NEW YORK

In 2002, the New York State Department of Taxation and Finance published a report about income tax compliance. This income tax study estimated the State had \$2.84 billion in uncollected taxes. They also used three different methods for calculations—The IRS method, the Minnesota method, and the Idaho approach. They calculated that underreporting accounted for \$2.3 billion and they estimated the non-filer tax gap to be \$516 million. This represents a 13% tax gap. The report estimated that \$500 million recoverable through regular enforcement efforts. The current appropriated PINS are not enough to replace existing employees upon retirement. Additionally, the agency's budget allocations and legislatively mandated hiring freezes have not allowed for effective operation. This fact alone hinders the agency's ability to compete with the private sector, other states, and employee interest. Employee turnover has a direct impact on agency revenue collection and effectiveness.

WISCONSIN

In 2009, the Institute for Wisconsin's Future released their report, "Investing in Revenue: How Wisconsin Can Profit by Using the Minnesota Model for Closing the Tax Gap." They note that evidence suggests Wisconsin's Department of Revenue is very efficient and effective as is, but "the not so well kept secret of State tax administration is that their efforts to ensure compliance tend to be underfinanced, weak on staffing and technology, and thus hard put to catch many cheaters."

Their report focuses on comparisons between what Minnesota has done to accomplish its goals and how Wisconsin has fared during the same time. In many ways, the two states share much in common—demographics, economy, etc. In FY 2002, both states had similar funding and staffing in their revenue departments. Their economies and populations were similar, yet within 5 years of implementing changes to their tax administration processes, Minnesota far outpaced Wisconsin. See the summary chart below:



Growth between 2002 and 2007	Minnesota	Wisconsin	Difference
Personal Income growth	27.5%	24.3%	3.2%
Gross Domestic Product growth	28.4%	23.2%	5.2%
Tax collection growth	34.5%	22.6%	11.9%

Minnesota was able to increase their revenue through collection efforts—not through tax increases or changes. The Wisconsin report points out that they placed emphasis on collection, compliance, and enforcement, rather than on increasing taxes on businesses and individuals. They also compare Minnesota’s DoR staffing to Wisconsin’s. Between FY 2002 and FY 2009, Minnesota’s DoR staffing grew from 1,108 to 1,429. During the same time, Wisconsin’s DoR went from 1,200 employees down to 1,020. Minnesota’s DoR budget went from \$99 million to \$146 million at the same time Wisconsin’s grew from \$92 million to \$107 million.

As OSA noted in this report, staffing, and funding play a tremendous role in both voluntary compliance and enforcement collections by the State Department of Revenue. The Wisconsin report has drawn a clear picture of just how much positive impact such funding and staffing at the Department of Revenue can have on revenue for the State.



Conclusion

OSA's objective in conducting this performance audit was to determine what factors had the greatest negative impact on the Mississippi Department of Revenue's ability to find and collect tax revenue legally and properly owed to the State, provide better customer service and education, and provide other legislatively mandated services.

The agency, with an annual operating budget between \$45 million and \$58 million over the last decade, has several equally serious issues that should be addressed through legislative action. While the DoR has managed to be very efficient, staffing shortages, non-competitive professional salaries, budget cuts, an inappropriate location, and continuing technology needs are all factors affecting the agency's effectiveness. From a high of over 1,100 employees at a time when there were fewer than 800,000 income tax filers and less than 50,000 businesses, to a low of 674 employees when there are over 1.5 million total taxpayers, the DoR does not have enough resources to handle the customer service needs or the growing tax gap effectively in Mississippi.

The above issues are contributing to a very high turnover rate. New employees average less than five years of experience because they frequently leave after a short period for a higher paying job elsewhere in State, local, or federal government or in the private sector. Location, morale, workload, and lack of support staff for auditing areas all contribute to the high turnover rate as well.

Much of the auditing, analysis, and investigative work of the DoR is highly specialized. Training is only available on the job. Knowing tax laws, understanding processes, etc. cannot be learned elsewhere. Professional employees need training, but because there are so few that handle the current workload, when they leave there is no one they can turn their work over to.

Under its current leadership, the DoR recognizes that there are millions of dollars in taxes owed to the State, but which are going uncollected each year. They are not considered new taxes or tax increases, but past due taxes owed by individuals or businesses. By collecting these owed taxes, DoR may help alleviate some of the budget stress the Legislature faces. Additionally, by improving existing tax collections, there may be less need to increase taxes or to create new ones.

One thing is clear, without enforcement and education, the tax gap will likely continue to grow larger. When there is a poor economy and the taxpayer does not fear being caught, DoR faces a higher risk of tax cheating. Additionally, when there is an extremely complex tax system and the taxpayers cannot get the help they need, they may make mistakes or choose give up and to not file at all. The DoR is the front line of defense for both taxpayer education and compliance efforts. Without the proper resources, the DoR cannot be effective in its efforts to collect revenue, educate taxpayers, and enforce non-compliance.

Granted, before any implementation is done there has to be attention given to the root of the issue. This is the need of additional resources for the DoR to continue to enhance government responsiveness, accountability, and capability through tax collection. With the DoR financial and employment short falls, the responsibilities and statutory requirements of the agency are not always as effective as they should be. With assistance from the legislature and the development of long- and short-term plans, the DoR can improve its effectiveness, bring more dollars to the State Legislature, and help alleviate some of the budgetary stress facing the State today.



Appendix 1

Agency Response



— DEPARTMENT OF —
REVENUE
STATE OF MISSISSIPPI

OFFICE OF THE COMMISSIONER

March 2, 2011

Stacey E. Pickering, State Auditor
Office of the State Auditor
501 North West Street
Suite 801
Jackson, MS 39201

RE: Performance Audit Findings

Dear Mr. Pickering:

We received your Performance Audit Management Report, *"Reducing Lost Revenue and Improving Performance at the Department of Revenue: Adding Effectiveness Back to Efficiency."* Thank you and your staff for the thorough analysis of our roles, responsibilities and completion of our duties.

Staff and I appreciate your acknowledgment that this Department "is operating in a highly efficient manner." Please allow me to say that I totally concur; the Department of Revenue *is* operating efficiently. I further agree with your comment that this agency could operate more *effectively* if properly funded.

The Department of Revenue provides the most requisite function in all of state government, that is collecting the revenues necessary to fund government services. Without adequate funding, we have been unable to perform at an optimal level. And, without the efforts of this agency, there would be no one to teach our kids, maintain our roads, protect our natural resources, protect our homes and families, boost economic development, guard our prisons, and do countless other things for us every single day. The money we collect provides all these services, and others critical to our everyday lives and well-being.

The answer is really very simple. If the Department of Revenue receives the funds needed to operate at an effective level, then the return on that investment will then be available for funding these important government services.

Again, thank you for your insight, observations and validation of our work processes and procedures.

Respectfully,

J. Ed Morgan
Commissioner of Revenue



Appendix 2:

Purpose, Scope, and Methodology

PURPOSE

The purpose of this engagement is to provide an independent, outside review of the impact of changing demographics and reduced DoR resources on revenue collection efforts. It will also provide recommendations to improve the efficiency and effectiveness of revenue collections at the DoR. At a requested of the agency, the Office of the State Auditor conducted a Performance review related to reduce revenue collections affected by appropriations, lagging technology, lower employment numbers, and other mitigating factors.

SCOPE

To identify major relationship areas in the collection of revenues by determining: how much revenue was been collected in the State; the need for a new facility to house the agency to provide better security and safety for its employees; the future need for an emergency plan, the reasons for low employee morale; the need for training and retaining experience personnel; and the loss of PINS caused by decreases in appropriations.

METHODOLOGY

In conducting this review, the OSA evaluate and analyze data components to determine the impact of changing dynamics of population, businesses, and the DoR resource allocations used to collect revenues. In addition, the OSA utilized the DoR standard program evaluation procedures, laws that governs the agency, audit reports from PEER and the Financial and Compliance Division of the OSA, trends in appropriation, the agency strategic plan, and other states departments of revenue websites.



Appendix 3:

Additional, Non-Priority Recommendations for DoR

Regarding prior audit deficiencies: *The OSA recommends the DoR continue to address the deficiencies identified in the Financial and Compliance audits through policy and procedure changes, additional internal controls, and system changes. (page 2)*

Regarding OSA's estimate of the potential Tax Gap in Mississippi: *OSA recommends that DoR review the various methodologies used in other states and develop their own system to calculate the tax gap. (page 4)*

Regarding the enforcement of the Prohibition and Local Option laws: *OSA recommends that DoR request the Legislature to repeal the Prohibition and Local Option law or amend it to impose a fine and/or surcharge on those persons or entities that break this law. OSA further recommends that the Legislature authorize DoR to use the proceeds of this fine to test compliance and to enforce this law more effectively. (page 7)*

Regarding administration of Motor Vehicle and Title laws: *To cover some of the cost to administer these laws more effectively, OSA recommends DoR assess a fee of up to \$1.00 to the counties for each renewal notice printed. (page 8)*

Regarding administration of Unfair Cigarette Sales law: *OSA recommends that DoR pursue Legislative action to either totally repeal this law or for an appropriation for this division to provide additional staffing. (page 8)*

Regarding tax incentive verification under State Economic Development laws and program agreements: *OSA recommends that the Legislature and/or the Mississippi Development Authority (MDA) require that each time a new business or industry enters into a contract with the State, the business or industry should submit a certified and warranted total number of employees in place as of the effective date of the contract, or at the time of the approval of the incentives by the Legislature or MDA, whichever is more appropriate. (page 9)*

Regarding additional call logging for customer service information: *OSA recommends that until DoR can expand its automated information request monitoring system, they design a short-term plan to have employees that receive calls on unmonitored phones record basic information about calls they receive and the outcome or result of their assistance to the taxpayer. Such a temporary manual system can help supplement existing performance measure to better help the agency and the Legislature understand the information needs of the taxpayer. (page 18)*

Regarding DoR requirement to file tax liens with the counties: *Currently, DoR only has enough staff to realistically work on about 35 liens per day in house and revenue officers can usually work on an average of 9 to 10 liens per day. Because this is not even the equivalent of being able to process 50% of the new liens that should be filed each year, OSA recommends the DoR present a request to the Legislature for sufficient staffing levels in this division to help it increase its tax lien filings by at least 50%, in order to significantly increase the number of liens being filed on delinquent State taxes owed. (page 19)*

Regarding the cost to DoR to file tax liens in the counties: *OSA further recommends that the DoR research various ways the \$5 to \$7 filing fee for each item could be eliminated and the various ways that the **filing** process could be streamlined at, perhaps, a State level. (page 19)*



Appendix 4:

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