Legislative Fiscal Bureau
One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873
Email: fiscal.bureau@legis.wisconsin.gov • Website: http://legis.wisconsin.gov/lfb

May 27, 2015 | Joint Committee on Finance | Paper #560

Additional Auditor Positions
(DOR -- Tax Administration)

[LFB 2015-17 Budget Summary: Page 381, #1]

CURRENT LAW

The Department of Revenue (DOR) is statutorily authorized to supervise, administer, and enforce state tax laws. Under this authority, DOR administers a number of auditing programs. In state fiscal year 2013-14, DOR collected $246.3 million through its desk (in-office) and field (on-site) auditing programs with an average annual staffing level of 290 front-line auditors, excluding support or managerial positions. The Attachment to this document includes a description of the types of auditing programs and associated annual average front-line audit staff for each program in 2013-14.

GOVERNOR

Provide $11,810,500 GPR in 2015-16, $13,605,100 GPR in 2016-17, and 102.0 GPR positions annually to increase auditing activity and to improve tax collections. Estimate increased state tax revenues of $31,500,000 in 2015-16 and $82,000,000 in 2016-17 from the additional auditing activity associated with those additional positions.

DISCUSSION POINTS

1. As noted, DOR collected $246.3 million by imposing assessments, denying or reducing refunds, and from issuing letters requesting collections through its auditing programs with an annual staffing level of 290 front-line auditors in 2013-14. These collection amounts represent average revenues of approximately $850,000 per auditor. According to the administration, the additional auditor positions recommended by the Governor would include 87 front-line audit staff,

seven managers, and eight support positions. The estimated revenues from the Governor's recommended increase in auditing staff reflect average revenue of $940,000 per front-line auditor in 2016-17, the first full year in which the new auditors would be phased in. The estimated revenues per front-line auditor from the additional positions estimated by the administration are about 11% higher than generated by DOR's current auditing activity.

2. The budget bill would provide DOR with the additional position authority and funding necessary to support additional auditing activity. However, the bill does not specify how those positions would be allocated to administer the law. DOR has provided the following information regarding how the 102.0 GPR positions would be utilized.

Sales/Use Tax Nexus Auditors. Eight Revenue Tax Specialist 1 positions would be provided for sales/use tax nexus investigation. According to the administration, nexus investigation is relatively straightforward and DOR expects that persons hired for these positions could be trained and working at their full capacity by the early part of 2016. DOR estimates that these positions would generate revenues of $6.0 million in 2015-16 and $8.0 million in 2016-17 (approximately $1.0 million per auditor, annually). As compared to current similar auditing positions, the Department indicates that experienced auditors performing nexus investigations generated approximately $2.3 million per FTE in 2013-14.

Traveling Sales/Use Tax Auditors. Sixteen positions, including one Revenue Management Supervisor, five District Auditors, and 10 Large Case Auditors, would be provided to support sales/use tax investigations outside Wisconsin. The administration notes that significant underreporting of sales/use taxes has been associated with businesses headquartered outside the state, in part, because such businesses have never been subject to a Wisconsin audit. From 2011-12 through 2013-14, DOR administered a pilot program related to this type of auditing that asked existing staff to volunteer to travel and audit out-of-state entities, as would be the primary function of these positions. The Department reports that the pilot program produced average collections of between $1.0 million and $3.8 million per FTE. DOR's estimate assumes that the 15 front-line auditors would generate revenues of $7.5 million in 2015-16 and $15.0 million in 2016-17 (approximately $1.0 million per auditor, annually). The Department notes that over 26,000 of the current 172,000 sales tax registrants have customer account addresses outside Wisconsin. Nearly 1,500 out-of-state registrants have reported tax liability in excess of $100,000.

Large Case Auditors. Thirty-one positions, including three Revenue Management Supervisors and 28 Large Case Field Auditors, would be provided to support large corporate income/franchise tax audits. According to DOR, the audits would primarily focus on determining nexus and apportionment for members of combined groups. The Department states that corporate audits dealing with apportionment among members of a combined group require additional training time as compared to other types of audits. DOR does not expect that these additional auditors would generate any revenues until after January 1, 2016. The three manager positions would focus on supervising new staff, rather than income generating activities from direct auditing activities.

Large case corporate tax auditors in 2013-14 generated approximately $2.2 million per FTE position. Currently, large case auditors engage in both corporate apportionment audits and large case sales/use tax audits, whereas the new positions would focus only on corporate returns. Such auditors generally require approximately two to four years before they are fully productive, and the new auditors that would be added under the bill are expected to be less-experienced. DOR has recently experienced a number of retirements and resignations among audit staff, reducing the number of experienced auditors that could be reassigned to large corporate audits. As a result, DOR estimates that the 28 front-line positions would increase state tax revenues by approximately $9.0 million in 2015-16 and by $29.0 million in 2016-17 (approximately $1.0 million per auditor).

Small Corporations/Pass-Through Auditors. Thirty-nine positions, including three Revenue Management Supervisors and 36 Revenue Auditor 3 positions, would be provided to conduct audits of small C corporations, tax-option corporations, and partnerships. These positions would provide a new auditing focus to dedicate staff only on audits of small pass-through entities. Similar to the large case auditor positions described previously, audits of small pass-through entities are complex and require additional training before such positions can become revenue generating. The Department does not anticipate revenues to be generated from these positions until after January 1, 2016. The three manager positions would manage the new staff, rather than engage in income generating activities from direct auditing activities.

This new focus for auditing activity is proposed because the Department's experience with corporate field audits shows a higher level of noncompliance involving individuals receiving pass-through income from small C corporations, tax-option corporations, and partnerships. DOR notes that corporate office auditors averaged about $960,000 per auditor, and field auditors that perform audits of both small and large corporations averaged about $1.26 million in 2013-14. The Department anticipates that the new positions would generate revenues somewhere between these amounts once fully productive (after approximately four years). DOR estimates that the additional positions would generate $9.0 million in 2015-16 and $30.0 million in 2016-17 (approximately $830,000 per auditor, annually).

Non-Audit Support Positions. With the addition of 87 front-line auditors and seven managerial positions, certain non-revenue producing staff are provided under the bill to support the additional revenue producing staff. Specifically, four Revenue Field Auditor 8 positions, three Tax Resolution Officers, and one Revenue Administrative Manager would be provided under the bill. The revenue field auditor positions perform data analytics and audit selection to provide auditors with information identifying potential businesses/persons for audit. The tax resolution officers handle appeals and resolve cases before such appeals and cases result in costly legal proceedings. Tax resolution officers are typically provided at a ratio of one position for every 30 front-line auditors. The tax resolution officers would not be hired until July 1, 2016, when the additional auditors are expected to begin finishing audits that might be appealed. The revenue administrative manager position would be provided to manage and oversee additional positions that would be created under the bill.

3. As noted previously, the estimated increase in revenues under the bill from each additional auditor is 11% higher than the revenues associated with current front-line audit staff. However, DOR has stated that corporate audits, followed by sales/use tax audits, generally generate the most tax revenue per auditor. Because the additional auditors would focus primarily on corporate and sales/use tax audits, it is not unreasonable to assume that the added positions would

generate revenues in excess of the current average for all auditing staff. It is anticipated that the new auditors would include some individuals that have auditing experience, but most of the new employees are anticipated to have a minimal amount of auditing experience. DOR states that the revenues associated with the new positions were estimated to be somewhat lower than the revenues generated in 2013-14 by more experienced auditors that participated in the pilot program to account for the difference in auditing experience. Given the information and methodology presented by the Department for estimating additional state tax revenues generated from the recommended additional positions, the estimates do not appear unreasonable.

4. It should also be noted that other states that have recently expanded compliance and enforcement activity have shown relatively strong revenue gains. Specifically, the State of Minnesota has engaged in sizable expansions in its number of auditors in recent years. From 2004-05 to 2006-07, Minnesota's Revenue Department expanded its full time employment of auditors engaged in direct compliance and enforcement activity from 608.4 FTE to 707.5 FTE (99.1 FTE growth) and generated increased estimated compliance revenues of $45.8 million, annually, or approximately $460,000 in revenue growth per FTE. Minnesota's Revenue Department further expanded the number of direct compliance and enforcement employees to 816.3 FTE (108.8 FTE growth) and generated increased estimated compliance revenues of $135.1 million in 2008-09, or approximately $1,240,000 in revenue growth per FTE in that year. As compared to Minnesota, the administration's estimates appear reasonable considering that: (a) the per front-line employee estimate of $940,000 annually falls within the range of per employee revenue growth experienced in Minnesota; and (b) the new positions at the Department would focus on corporate income/franchise tax audits and sales/use tax audits, which DOR states are the two most effective audit types. It should also be noted that the number of auditors engaged in compliance and enforcement activities in Minnesota is significantly higher than the number of front-line auditors employed in Wisconsin. The reported revenue growth associated with Minnesota's expansion of auditors adds evidence to DOR's belief that the expansion of 87 front-line auditor positions would generate the estimated revenues in excess of expenditures associated with those new positions.

5. According to DOR, the Department continuously recruits auditors to address normal turnover of audit staff. Auditors are generally hired in groups to facilitate training. The largest recent recruitment and hiring of audit staff occurred on January 26, 2015, when 42 auditors were hired to fill positions vacated by incumbent staff. An additional 15 revenue agents were hired shortly thereafter beginning February 9, 2015. DOR believes that current managerial staff could be repurposed for a short period of time to assist with an enhanced recruitment effort beyond its normal recruitment efforts, beginning immediately after passage of the budget bill. DOR states that it would: (a) expand its current recruitment efforts and advertise immediately following enactment of this provision; (b) require applications to be submitted by July 13; (c) conduct interviews from July 20 through August 7; (d) make job offers between September 8 and September 18; and (e) have those employees begin work on October 5.

6. It could be argued that the pool of potential auditor candidates may not be sufficient to support recruitment or hiring efforts of the magnitude proposed under the budget, particularly if the recruitment focused only on candidates located in the Dane County region. The proposed recruitment and hiring schedule would require a recruitment class nearly 150% larger than DOR's

largest (42) hiring of audit candidates in recent years. The Department has not engaged in a recruitment effort of the size proposed under the bill to expand the number of audit related positions in recent years. However, DOR states that it is confident that its ongoing recruitment efforts can be quickly expanded to recruit, hire, and train auditor candidates under the timeline described above. While some of the hired staff, such as the eight sales/use tax investigators proposed under the bill, would likely be located at the central Madison office, the corporate and out-of-state sales/use tax auditors would likely be located in larger cities in close proximity to airports to facilitate travel for on-site field audits. DOR currently maintains office space in Milwaukee, Chicago, and Minneapolis. The Department states that the location of field auditors would depend, in part, on where those auditor candidates currently reside. For instance, if a large pool of eligible candidates were to be hired from Minneapolis, it is likely that DOR would expand its office space in that city rather than relocate those people to another city. Because DOR would be making recruitment efforts in larger cities (rather than only in the Madison metropolitan area) with larger labor pools, the Department's recruitment and hiring plan appears plausible.

7. An argument could be made that, based on the experience in Minnesota, additional funding and authorized positions to hire additional auditors beyond the number recommended by the Governor would result in additional state tax revenues above the cost of the additional positions. However, the Department has expressed some concerns with further expansion of auditing activity. DOR states that the auditors recommended by the Governor were based on an analysis of pilot programs related to the specific functions described previously. In addition, certain practical concerns related to the Department's availability of office space, adequate training capacity, as well as managerial and administrative Departmental support, could result in additional administrative costs per position (such as requiring additional office space or having to delay training due to a lack of adequate persons able to train a larger group of auditors) from a significantly larger expansion of authorized auditors and associated funding.

8. While the administration's estimates do not appear unreasonable, the proposed expansion of the audit staff would be significantly larger than previous, similar initiatives in Wisconsin, and the revenues produced from the new stiff could differ from the estimates. If the Joint Committee on Finance (JFC) were to approve the Governor's proposal, the Committee could choose to require DOR to prepare a report to be delivered to JFC, annually, that provides information regarding state tax revenues generated from the additional positions. JFC could choose to require the annual report to include estimated total expenditures related to the positions added under the budget bill. As noted previously, certain types of auditing functions are more complex, such as large case apportionment audits of combined groups, and require several years of experience before an auditor might be considered to have reached full productivity. The annual report could be required no later than six months following the close of each state fiscal year from 2015-16 through 2019-20. The annual report would better inform the Committee of what revenues might be generated from future proposals that may seek to expand the number of state auditors employed by the Department.

ALTERNATIVES

1. Approve the Governor's recommendations.

2. In addition to Alternative 1, require DOR to submit an annual report to JFC within six months following the close of the state's fiscal year. Specify that the report would be required for state fiscal years 2015-16 through 2019-20. Specify that the report must contain information regarding the actual or estimated amounts of state tax revenues generated by, and expenditures associated with, the additional full-time auditor positions authorized under the 2015-17 biennial budget act.

3. Deny the Governor's request. Delete $11,810,500 GPR in 2015-16, $13,605,100 GPR in 2016-17, and 102.0 GPR positions annually that would have been provided to DOR's collection of taxes -- general program operations appropriation. Reduce estimated state tax revenues by $31,500,000 in 2015-16 and $82,000,000 in 2016-17.

ALT 2	**Change to Bill**	
	Funding	Positions
GPR	- $25,415,600	- 102.00
GPR-REV (Tax)	- $113,500,000	

Prepared by: Sean Moran
Attachment

ATTACHMENT

Department of Revenue 2013-14 Auditing Programs and Staffing Levels

Program Name	Key Program Activities	Average Auditing Staff
District Field Audit	Conducts field audits of individuals and small to mid-sized business as assigned. Auditors are trained in, and may be assigned to, audits involving individual income tax, sales/use tax, corporate income/franchise tax, and pass-through entities.	88
Large Case Field Audit	Conducts field audits of large businesses. Auditors are trained in both sales/use taxes and corporate income/franchise taxes and may be assigned to cases for either or both taxes. The Department has begun dedicating some large case auditors to combined corporate income/franchise tax returns.	41
Central Income Tax Office Audit	Examines individual income tax returns, earned income tax credit claims, and homestead tax credit claims to verify that refunds are correct before they are released to individuals. Conducts individual income tax audits via correspondence, including follow-up on federal audit reports from the Internal Revenue Service. Processes claims for refunds and closing certificates for fiduciaries. Performs desk audits for pass-through entities and specific issues identified from analysis of data outside of the filed return.	91
Central Business Tax: Corporation/Pass Through Office Audit	Assists business with filing income/franchise tax returns for corporations and pass-through entities and examines such returns that are being processed to verify completeness and accuracy before a refund is issued. Performs desk audits of corporations and pass-through entities based on specific issues identified from analysis of data outside of the return. Certain staff also perform individual income tax office audit functions.	17
Central Business Tax: Sales Tax Office Audit	Reviews and verifies claims for refunds of sales/use taxes. Identifies and corrects errors in motor vehicle registrations. Requests taxpayers to voluntarily pay the tax based on referrals from field audit staff or information received from other sources.	11
Central Business Tax: Excise	Registers taxpayers for excise taxes, such as motor fuel and tobacco. Conducts both field audits and desk audits.	13
Central Business Tax: Nexus	Handles requests for voluntary disclosure and identifies businesses that should be filing taxes in Wisconsin but that currently do not.	11
Computer Audit Specialists	Generates statistical samples for field audits. Maintains technology platforms used for conducting audits and analyzing results. Facilitates the use of electronic records to automate the audit process.	11
Program Development	Selects cases for potential audit. Coordinates WINPAS automation efforts. Develops and implements training for audit staff and develops and monitors performance metrics.	7
Total:		290