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↻ Designates that this item is a change item

MINNESOTA · REVENUE

January 27, 2009

To the 2009 Legislature:

On behalf of Governor Pawlenty, I am pleased to submit the Department of Revenue's recommendation for the 2010-11 biennial budget. This budget consists of \$246,318,000 from the State's General Fund and \$8,482,000 from other funds, a decrease of 1.6 percent from the 2008-09 biennial base budget. This decrease is primarily due to the operating budget reductions recommended by the Governor, offset by funding to complete the Integrated Tax System project that began in FY 2008.

Focus on Core Functions

The Department will continue to focus on its mission of "making the revenue system work well for Minnesota". To advance this mission, the Department carries out these core functions:

- ◆ providing taxpayers with the services and information they need to meet their filing and paying obligations, including forms and instructions and telephone assistance;
- ◆ processing returns and payments, issuing refunds and managing taxpayer accounts;
- ◆ auditing to resolve discrepancies, discourage tax evasion and identify patterns of noncompliance;
- ◆ enforcing the tax laws for those who do not comply voluntarily; and
- ◆ identifying and recommending improvements to the revenue system.

The Governor's budget recommendation ensures that citizens have the services they need to fulfill their tax obligations and have the confidence that the tax system is fair to all citizens.

Major Challenges Ahead

In the 2010-11 biennium, the Department will continue to face five major challenges:

1. replacing the Department's outdated computer systems with a fully functional integrated tax processing system. This includes transitioning 28 tax types to the new system and decommissioning many computer sub-systems and applications;
2. eroding state revenues due to globalization of the economy and changes in technology and demographics, as well as the growing threat of federal preemptions of states' tax authority;
3. aggressive challenges to the state tax laws by businesses and individuals;
4. an aging workforce and the loss of institutional knowledge through retirements; and
5. delivering services to a vastly more diverse population, some of whom have limited English speaking skills.

Operating Budget

The Department will – as it has in the past – direct its funds to improve filing and paying systems for citizens and businesses, increase revenues through expanded compliance, and deliver services at lower costs. This is being achieved by:

1. transforming tax filing and paying from high-cost paper processes to cost-saving electronic transactions that also increase the speed, accuracy and ease of transactions for taxpayers.
2. creating web-based self-service systems to enable taxpayers to get the information they need to file and pay their taxes, monitor the status of refunds or payments, make corrections to their records and view their filing and payment history.
3. continuing to improve existing tax audit and collection efforts to generate added revenues from citizens and businesses that evade or under pay their tax.
4. evaluate changes in the economy, demographics and technology, and develop work plans for adapting to the changing environment.

History of Successful Tax Compliance Activities

Starting with the 2002-03 biennium, the legislature has funded several increased compliance initiatives. Through the 2008-09 biennium, these initiatives have returned an average of over \$6 for every \$1 invested.

The history of these initiatives to date is described below:

The 2002-03 biennium, the Department was appropriated \$9.7 million to generate \$60.1 million through increased tax compliance activities. Those efforts generated \$97.2 million, or \$37.1 million more than expected.

The Department also received \$12.8 million in the 2004-05 biennium to generate an added \$59.8 million. This effort has generated \$92.2 million, or \$32.4 million more than anticipated.

In the 2006-07 biennium, the legislature appropriated \$17.8 million to generate \$90.7 million. This effort has generated \$114.3 million, or \$23.6 million more than anticipated.

In the 2008-09 biennium, the legislature appropriated \$20.5 million to generate \$102.4 million. As of November 30, 2008, this effort has generated \$87.9 million – or 86 percent of the amount anticipated for the biennium.

Budget change items

The Department's budget change items focus on two priorities: modernizing the agency's tax processing systems and improving tax compliance.

Modernize tax processing systems. The Department is requesting \$16.45 million for the 2010-11 biennium to complete the integrated tax processing system that consolidates common functions and better integrates data from all tax systems. This will result in increasing the effectiveness of tax compliance activities and improve the quality and availability of electronic services to the public. This effort will also lessen the risk of the Department's obsolete systems failing, and will mitigate the high costs of maintaining our old systems. The Department is convinced that it must finish this project without delay. Any delays in the project will increase costs significantly to the Department and create confusion for our employees and taxpayers.

Improving Tax Compliance. The Department's effort to complete the integrated tax processing system project goes hand-in-hand with improving tax compliance. With improved quality and accuracy of information from consolidated sources, the department will be more effective in tracing non-compliant taxpayers. Data warehouse capabilities will be improved dramatically. Taxpayer assistance will be done more efficiently and result in better services to our taxpayers.

The Department is prepared to provide any additional information needed and welcomes further public discussions on its budget and, more important, on the challenges it confronts in making "the revenue system work well for Minnesota."

Respectfully



Ward Einess,
Commissioner of Revenue

Agency Purpose

The Department of Revenue's mission is to "make the state's revenue system work well for Minnesota." Its tax information, filing and paying services, and its enforcement activities help ensure that citizens have the information and means to fulfill their tax obligations.

Core Functions

The Department of Revenue oversees Minnesota's revenue system, which is made up of 28 state taxes and property taxes collected by local governments. State taxes include individual income, sales, corporate franchise, petroleum, environmental, gambling, cigarette and tobacco, alcohol, insurance and health care provider taxes.

The department collects approximately \$17.5 billion per year in state taxes, and oversees the uniform application of the property tax laws. Property taxes, which are administered by local governments, raise \$6 billion annually for Minnesota's communities. The department also pays out over \$1 billion in state aid to counties, cities, towns and special taxing districts through 32 different state programs.

The department's six goals are:

- ◆ **Achieve taxpayer compliance:** everyone pays the right amount of taxes, no more, no less;
- ◆ **Citizen satisfaction:** citizens have the services and information they need to meet their obligations and to be informed about the revenue system;
- ◆ **Customer satisfaction:** filing, paying and refund systems for taxpayers are fast, convenient, easy to use, secure and accurate;
- ◆ **Operational excellence:** the revenue system keeps pace with changes in the economy and technology;
- ◆ **Responsible stewardship of information:** taxpayers trust us to protect their data; and
- ◆ **Employee excellence:** employees perform meaningful and challenging work, and have opportunities to learn and grow.

In support of these goals, we carry out the following core functions:

- ◆ interpreting the law and informing taxpayers of their obligations and rights;
- ◆ providing taxpayers with the services and information they need to meet their filing and paying obligations;
- ◆ processing returns and payments, issuing refunds, and managing taxpayer accounts;
- ◆ auditing to resolve discrepancies, discourage tax evasion, and identify levels and patterns of noncompliance;
- ◆ enforcing the tax laws for those who do not comply voluntarily; and
- ◆ identifying and recommending improvements to the revenue system.

Service, Audit and Enforcement Operations

The department has five major business activities that focus on service, audit and enforcement operations. These are:

- ◆ **Individual taxes** which serve 3.6 million individual income taxpayers, 165,000 businesses that withhold income tax, and 711,000 property tax refund applicants.
- ◆ **Business taxes** which serve 277,000 sales tax permit holders and 42,000 corporate franchise taxpayers. This program also administers the S corporation, partnership, fiduciary and estate taxes; petroleum taxes; and special taxes, including alcohol, tobacco, environmental, gambling, insurance, mining and Minnesota Care taxes.

At A Glance

We serve:

- ◆ 3.6 million individual taxpayers
- ◆ 165,000 withholding taxpayers
- ◆ 539,000 taxpayers that remit corporate, sales and use, fiduciary and other taxes
- ◆ 3,300 local units of government

We respond to:

- ◆ Over 635,000 callers
- ◆ 38,000 emails

We process:

- ◆ 2.7 million income tax returns
- ◆ 1.6 million business tax returns
- ◆ 4.9 million tax payments
- ◆ 2.6 million tax refunds

We collect:

- ◆ \$17.5 billion in tax revenues and other revenue sources
- ◆ \$61.3 million from 198,000 offsets against state refunds

- ◆ **Collections** which manages tax and non-tax debt collection on behalf of the department and other clients, including state agencies and other public entities. Services include locating and contacting debtors, billing, monitoring payment plans, locating and evaluating assets, issuing liens and levies, and seizing assets.
- ◆ **Criminal investigations** which probes possible tax crimes and refers cases to prosecutors; trains auditors and collectors to deal with threats from menacing taxpayers and acts as a liaison with local, state and federal law enforcement.
- ◆ **Property Tax** which monitors local assessor performance, ensures uniform application of Minnesota's property tax laws, gathers property tax data and computes state aid payments to local governments.

Tax Compliance Support Operations

The department also has four major business activities that support tax auditing and enforcement operations. These are:

- ◆ **Information technology** activities which include strategic planning for developing and integrating technologies and systems into business operations; computer systems development; software management; and oversight and maintenance of the agency's computer network, systems and equipment.
- ◆ **Tax filing and payment** which processes close to nine million tax returns and payments, and issues 2.6 million refunds annually; it also issues tax identification numbers to businesses, manages taxpayer accounts and ensures the security of taxpayer records.
- ◆ **Appeals and Legal Services and Tax Research** activities include providing legal support to the agency and resolving disputes between the department and taxpayers; forecasting revenue sources and aid expenditures for the state budget, and developing revenue estimates for proposed tax legislation.
- ◆ **Administrative support** which provides mail distribution and receiving services; forms design, public information, website management and printing services; financial management; human resource management; and other administrative functions on behalf of the department. These functions support tax auditing and enforcement operations.

Budget

The department's budget in 2008-2009 totals \$270.2 million. Department staff includes 1,354 full-time equivalent employees. Of the total budget for the biennium, \$254.6 million (94.2%) comes from general fund tax dollars, \$8.3 million (3.1%) comes from dedicated funds and \$7.2 million (2.7%) comes from special revenue funds for administering the Local Option Sales Tax, Revenue Recapture and Cigarette Tax Stamp programs.

Contact

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Dollars in Thousands

	Current		Governor Recomm.		Biennium 2010-11
	FY2008	FY2009	FY2010	FY2011	
<u>Direct Appropriations by Fund</u>					
General					
Current Appropriation	125,291	125,539	125,539	125,539	251,078
Recommended	125,291	125,539	121,042	121,042	242,084
Change		0	(4,497)	(4,497)	(8,994)
% Biennial Change from 2008-09					-3.5%
Health Care Access					
Current Appropriation	1,693	1,734	1,734	1,734	3,468
Recommended	1,693	1,734	1,761	1,749	3,510
Change		0	27	15	42
% Biennial Change from 2008-09					2.4%
Highway Users Tax Distribution					
Current Appropriation	2,139	2,183	2,183	2,183	4,366
Recommended	2,139	2,183	2,183	2,183	4,366
Change		0	0	0	0
% Biennial Change from 2008-09					1%
Environmental					
Current Appropriation	297	303	303	303	606
Recommended	297	303	303	303	606
Change		0	0	0	0
% Biennial Change from 2008-09					1%
<u>Expenditures by Fund</u>					
Direct Appropriations					
General	118,562	132,099	121,042	121,042	242,084
Health Care Access	1,623	1,804	1,761	1,749	3,510
Highway Users Tax Distribution	2,080	2,242	2,183	2,183	4,366
Environmental	270	330	303	303	606
Open Appropriations					
General	1,142	1,900	1,900	1,900	3,800
Statutory Appropriations					
General	0	0	2,117	2,117	4,234
Miscellaneous Special Revenue	4,231	7,568	4,223	4,223	8,446
New Fund	0	0	8,500	8,000	16,500
Total	127,908	145,943	142,029	141,517	283,546
<u>Expenditures by Category</u>					
Total Compensation	91,727	107,156	102,785	102,773	205,558
Other Operating Expenses	35,984	37,822	36,262	35,762	72,024
Capital Outlay & Real Property	1	665	665	665	1,330
Local Assistance	196	300	200	200	400
Other Financial Transactions	0	0	2,117	2,117	4,234
Total	127,908	145,943	142,029	141,517	283,546
<u>Expenditures by Program</u>					
Tax System Management	106,269	119,649	116,049	115,537	231,586
Debt Collection Management	21,639	26,294	25,980	25,980	51,960
Total	127,908	145,943	142,029	141,517	283,546
Full-Time Equivalents (FTE)	1,355.0	1,428.5	1,335.7	1,294.2	

REVENUE DEPT

Change Summary

<i>Dollars in Thousands</i>				
	FY2009	Governor's Recomm.		Biennium
		FY2010	FY2011	2010-11
Fund: GENERAL				
FY 2009 Appropriations	125,539	125,539	125,539	251,078
Technical Adjustments				
One-time Appropriations		(315)	(315)	(630)
Pt Contract Base Reduction		(52)	(52)	(104)
Subtotal - Forecast Base	125,539	125,172	125,172	250,344
Change Items				
Operating Budget Reduction	0	(4,130)	(4,130)	(8,260)
Total Governor's Recommendations	125,539	121,042	121,042	242,084
Fund: HEALTH CARE ACCESS				
FY 2009 Appropriations	1,734	1,734	1,734	3,468
Technical Adjustments				
One-time Appropriations		27	15	42
Subtotal - Forecast Base	1,734	1,761	1,749	3,510
Total Governor's Recommendations	1,734	1,761	1,749	3,510
Fund: HIGHWAY USERS TAX DISTRIBUTION				
FY 2009 Appropriations	2,183	2,183	2,183	4,366
Subtotal - Forecast Base	2,183	2,183	2,183	4,366
Total Governor's Recommendations	2,183	2,183	2,183	4,366
Fund: ENVIRONMENTAL				
FY 2009 Appropriations	303	303	303	606
Subtotal - Forecast Base	303	303	303	606
Total Governor's Recommendations	303	303	303	606
Fund: GENERAL				
Planned Open Spending	1,900	1,900	1,900	3,800
Total Governor's Recommendations	1,900	1,900	1,900	3,800
Fund: GENERAL				
Planned Statutory Spending	0	0	0	0
Change Items				
Completion of Integrated Tax System	0	2,117	2,117	4,234
Total Governor's Recommendations	0	2,117	2,117	4,234
Fund: MISCELLANEOUS SPECIAL REVENUE				
Planned Statutory Spending	7,568	4,223	4,223	8,446
Total Governor's Recommendations	7,568	4,223	4,223	8,446
Fund: NEW FUND				
Planned Statutory Spending	0	0	0	0
Change Items				
Completion of Integrated Tax System	0	8,500	8,000	16,500
Total Governor's Recommendations	0	8,500	8,000	16,500
<u>Revenue Change Items</u>				
Fund: NEW FUND				
Change Items				
Completion of Integrated Tax System	0	16,500	0	16,500

REVENUE DEPT**Change Item: Completion of Integrated Tax System**

Fiscal Impact (\$000s)	FY 2010	FY 2011	FY 2012	FY 2013
General Fund				
Expenditures	\$2,117	\$2,117	\$2,117	\$2,117
Revenues	0	0	0	0
New Fund				
Expenditures	\$8,500	\$8,000	0	0
Revenues	\$16,500	0	0	0
Net Fiscal Impact	(\$5,883)	\$10,117	\$2,117	\$2,117

Recommendation

The Governor recommends that \$16.45 million be appropriated to complete the implementation of “GenTax”, an integrated tax processing software product that consolidates into a single integrated system all tax administration functions, including taxpayer registration, tax return and payment processing, accounting, auditing, and delinquent tax collection and reporting for the 28 tax types administered by the Department of Revenue.

Funding to date for this \$39.9 million, five-year project has included \$12 million from the 2007 legislature, the redirection of \$11 million of agency funds that would otherwise have been spent to maintain existing systems over the course of the project, and \$450,000 from carry-forward funds appropriated to the Commissioner of Finance. The requested \$16.45 million is the amount needed to complete the project. Because the GenTax system is key to the state’s basic IT infrastructure, and is expected to have a lifespan longer than many more transitory systems, the Governor recommends spreading the cost over ten years using lease purchase financing. The lease purchase model also allows for this critical project to be completed even in spite of the budget deficit, reducing the FY 2010–11 general fund cost to \$4.234 million; this amount will be provided by a standing appropriation lasting ten years.

Background

Recognizing the vulnerabilities of mission-critical tax processing systems on which we rely to collect \$17.5 billion in state revenue each year, the Governor asked the 2007 legislature to fund a more modern, stable and integrated tax processing system. At the completion of a competitive bidding process, a contract was awarded to FAST Enterprises for the acquisition and installation of “GenTax”, a comprehensive off-the-shelf tax administration and processing software package. Work on the project began soon thereafter. The department is currently nearing completion of “rollout one” of the project, involving the sales and use tax and special taxes (Motor fuels, Insurance taxes, etc.). Progress has been on -time and on-budget.

Starting in December of 2008, Minnesota’s sales and use taxes, insurance taxes and all “special taxes” will be administered using GenTax. Future rollouts will include the individual income tax, withholding, and businesses taxes. To reap the many benefits of the new system (better customer service, more uniform internal procedures and more consistent and reliable data), and to avoid the costs of running both systems, it is imperative that we complete all four project rollouts in the next biennium.

The original motivation to undertake this ambitious project was based on the following deficiencies:

- ◆ Multiple applications for separate tax types that perform the same business processes.
- ◆ Escalating support to maintain multiple technologies, platforms, and development languages; some of which have been in use since 1968.
- ◆ Numerous aging mission critical systems, which had to be replaced within the next five years (just replacing our obsolescent Supra and FoxPro systems, would cost about \$7 to \$9 million with no gain in functionality or efficiency).
- ◆ Lagging ability to respond to taxpayers needs for services and information.
- ◆ An inability to respond to the needs of department employees for easy access to meaningful, comprehensive information from a single source.
- ◆ Employees needing to learn different systems upon transfer or promotion to another tax type.

- ◆ A growing risk of system disruptions or failures as employees with highly-specialized skills and knowledge of legacy systems retire.
- ◆ A lack of systems, information and analytical tools to more effectively improve tax compliance.

Advantages of an Integrated Tax System

When fully implemented, the project will deliver the following benefits:

- ◆ Accurate, timely and complete information from a single system, and more comprehensive data for making more informed business decisions.
- ◆ Provides citizens and employees with a single source of information; eliminating the need to seek information from multiple sources.
- ◆ Permits taxpayers to directly access tax account information from one source, and the department to greatly expand and enhance services to them.
- ◆ Substantial mitigation of the risk of system failures and disruptions; estimated delivery of the Registration, Processing, Compliance, and Collection modules for 28 tax types will be completed within four years.
- ◆ Enhances our ability to maintain systems and will have built-in capabilities for future enhancements.
- ◆ Provides the same functionality for all the tax types, and easier implementation of tax law changes.
- ◆ Enhances capabilities to detect non-compliance and increases tax collections.
- ◆ Significant post-implementation revenue increases based on the experience of other states that implemented integrated tax systems

Lease Purchase Financing

This change item requests a total of \$16.45 million for development and implementation of the new system during FY 2010 – 11. To reduce the budgetary impact during the current biennium, this proposal spreads the cost over ten years using lease purchase financing. Under a lease purchase arrangement, the state would secure up-front project capital in exchange for regular lease payments. The state would incur an estimated \$50,000 in lease administration expenses, which would be added to the principal on the lease. Including interest at an estimated rate of 5 percent, the lease payments on the total principal of \$16.5 million are estimated to be \$2.117 million per year over 10 years.

Relationship to Base Budget

As noted above, the department is committed to redirecting \$11 million of agency funds toward this project over the next four years. Other funding to date has come from the legislature (\$12 million) and from carry-forward funds (\$450,000) via Commissioner of Finance legislative language (Chapter 148, Section 31). Funding needed for the remainder of the project is \$16.45 million in the 2010-11 biennium.

Key Goals and Measures

The key goals for this system will be:

- ◆ Increased revenue growth
- ◆ Increased number of audits

Two key quantifiable performance measures for this change item:

- ◆ Audit and Enforcement Revenue Growth
- ◆ Number of Audits

Alternatives Considered

Besides purchasing a commercial off-the-shelf product, the department considered in-house development and upgrading the current systems to today's technical standards. The commercial off-the-shelf product was favorable to the in-house development option due to the length of time it would take to build a DOR developed integrated tax system - over 10 years. The option of bringing current systems up to today's technical standards was not favorable because it would cost just as much as a commercial off-the-shelf product integrated tax system and DOR would not gain any efficiencies or new abilities.

REVENUE DEPT

Change Item: Completion of Integrated Tax System

Statutory Change: Not Applicable**Technology Funding Detail***

(dollars in thousands)

*table displays direct project expenditures only, not including debt service and lease costs.

Funding Distribution	FY 2010-11 Biennium		FY 2012-13 Biennium		FY 2014-15 Biennium	
	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Personnel	\$	\$	\$	\$	\$	\$
Supplies						
Hardware	\$600	\$600				
Software	\$2,000	\$2,000				
Facilities						
Services	\$5,850	\$5,400				
Training						
Grants						
TOTAL	\$8,450	\$8,000	\$	\$	\$	\$

REVENUE DEPT**Change Item: Operating Budget Reduction**

Fiscal Impact (\$000s)	FY 2010	FY 2011	FY 2012	FY 2013
General Fund				
Expenditures	\$(4,130)	\$(4,130)	\$(4,130)	\$(4,130)
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	\$(4,130)	\$(4,130)	\$(4,130)	\$(4,130)

Recommendation

The Governor recommends a budget reduction of \$4.130 million in FY 2010 and \$4.130 million in FY 2011 for the Department of Revenue. This equates to a ten percent reduction of the department's compliance support budget.

Background

The proposed reduction will be made in the following areas, none of which directly impact the department's growing emphasis on enforcing tax compliance.

Cuts in services include:

- ◆ Saving office rent by shifting employees from smaller offices to telecommuting arrangements;
- ◆ Eliminating approximately 51 positions through attrition or lay-off;
- ◆ Selectively reducing the following support services: informational and instructional services to taxpayers, employees, local government officials, and tax practitioners; data recording, analysis, and retrieval services; and legal, human resource, payroll, mail, and purchasing services in ways that minimize impacts on tax compliance.
- ◆ Restricting the purchase of information technology to mission-critical needs and the mitigation of risks associated with older equipment and systems, while advancing our highest priority project, the installation of an integrated tax processing system.

Relationship to Base Budget

The apportionment of the Department's budget between voluntary and enforced tax compliance has been shifting over time. Prior to 2002, about 52% of our budget was committed to taxpayer services that support voluntary compliance by citizens and businesses. Voluntary compliance accounts for 90 to 95% of the state's tax revenues. However, increases in funding for enforced compliance (tax auditing and enforcement activities) combined with budget reductions in service and processing activities has reduced the portion of our budget that is devoted to voluntary compliance from 52% to 33%. If these trends continue, the percentage of tax revenues from voluntary compliance could fall, forcing an increase in expenditures for enforced compliance.

Key Goals and Measures

The Department's goal for this operating reduction is to have the least amount of negative impact on our customers, the citizens of Minnesota. The measures the Department will use to capture this information are:

- ◆ Service-level indicators
- ◆ Taxpayer surveys

Alternatives Considered

The agency considered reductions in direct compliance activities, but rejected them because of their negative impacts on revenue collections.

Statutory Change: Not Applicable.

Program Description

The tax system management program provides the infrastructure that enables the revenue system to work well for Minnesota. This infrastructure includes tax information services, filing and paying services and enforcement activities.

Budget Activities

- ◆ Compliance Support
- ◆ Appeals, Legal Services, and Tax Research
- ◆ Property Tax Administration and State Aid
- ◆ Tax Payment and Return Processing
- ◆ Technology Development, Operations, and Support
- ◆ Tax Compliance & Enforcement (Individual and Business Taxes)

Historical Perspective

In this biennium, the agency will continue to face several major challenges that have developed in the wake of sweeping and rapid changes in the economy, the job market, demographics and technology.

Demographic changes

The agency continues to face the challenge of delivering services to a more diverse population, especially to those with limited English speaking skills. To help non-English speakers become full participants in Minnesota's revenue system, the agency must expand its services beyond the specialized outreach programs it now offers.

Eroding state revenues

State revenue systems are challenged by the globalization of commerce, the growth of the digital economy, the aging of the population, the transformation of the telecommunication industry from desk-based to integrated-mobile systems, and the growth in federal preemptions of state tax laws. Responding to these challenges requires a concerted effort to identify key economic, demographic and technological factors faster, to measure their effect on state tax collections, and to develop tax policy options that respond to the changes.

The trend toward globalization and digitalization of the economy is clear. According to Jupiter Research, about 30% of U.S. households made purchases online in 2004; that number is expected to grow to 50% by 2008. Most online purchases escape the state sales tax and contribute to the growing tax gap.

The aging of Minnesota's population will also take its toll on the revenue system. Between 2000 and 2030, the growth rate in the elderly population is expected to climb dramatically. With retirements, come economic shifts: more income is exempt from the income tax and purchasing patterns shift from goods to services. These shifts will reduce state revenues.

Other developments will continue to weaken state revenue systems. In particular, the rapid changes in technology are rendering many of the state's traditional gross receipt taxes on telephone and utility services obsolete.

Increased challenges to state tax laws by taxpayers

More and more, taxpayers are minimizing taxes through questionable tax shelters and challenges to state tax laws. Some tax law and accounting firms solicit clients by offering to reduce or eliminate their taxes through challenges to tax laws and the agency's interpretations.

Increasingly complex tax laws

Minnesota's tax laws have grown increasingly complex. Due to the addition of many credits and deductions, plus policy decisions not to fully conform to federal changes, Minnesota went from a simple one-page tax form in 1988 to a complex two-page form requiring a host of schedules and worksheets. Similarly, the number of sales tax exemptions has almost doubled – from 88 in 1995 to 153 in 2006. Growing complexity increases demand for taxpayer information and support, and results in more difficult and time-consuming audits.

Computer systems overhaul

The agency is currently in the process of replacing more than 142 computer applications and 11 different platforms that are currently used to process 28 different state taxes, with a fully integrated tax processing system. When completed, the new system will consolidate functions common to all tax types and provide better, more accurate and consistent data from all tax types. This will increase productivity, improve quality and availability of electronic services to taxpayers, and eventually increase revenues generated from audits. Most importantly, this effort will eliminate the risks of system failures and the growing costs associated with our current, obsolete systems.

Internet commerce has grown dramatically over the last several years, and citizens expect similar services from government. One of the agency's major challenges is to continue to develop information systems that take advantage of the new technology while maintaining traditional paper-based systems for those who need them.

Steep competition for accountants

The agency continues to grapple with the need to attract and retain entry-level tax accountants in the face of steep competition from private sector employers. This competition was spurred by the passage of the federal Sarbanes Oxley law in 2002 which created tough new record keeping and reporting requirements for public companies. According to the Job Outlook 2005 survey by the National Association of Colleges and Employers, accounting majors are the most sought-after graduates. USA Today also reported that during the last three months of 2004, the demand for accountants grew nearly five times faster than the rate of growth for all other jobs. The Minnesota job market mirrors the national pattern.

The high demand for accountants has resulted in exceedingly high turnover rates, especially among newly-hired employees. Overall, about one out of every three exits the agency within one to three years. This turnover diminishes the agency's ability to generate revenue and improve compliance in two ways. First, studies show that more experienced employees generate dramatically more revenue than their less experienced peers. Secondly, the ongoing hiring, training, and mentoring associated with the turnover of new employees necessarily diverts supervisors and senior employees from performing more complex, high-return audits.

Aging workforce

In the next five years, nearly 250 employees, or approximately one-fifth of the agency's staff, will reach retirement age; replacing their collective experience and knowledge will be extremely difficult. Although the agency has hired younger employees for special projects and new tax enforcement initiatives, retaining them in a competitive and shrinking labor market has been especially challenging.

The agency is pursuing several means to retain employees. These include examining the competitiveness of salaries, improving reward and recognition programs, providing learning and professional growth opportunities, and paying attention to life/work balance issues important to employees.

The threat of workplace disruptions

Due to potential pandemics, terrorist attacks or natural disasters, the agency needs to continually plan for the continuation of critical services or functions and the back-up of essential records in the event of the destruction of facilities or the temporary absence of a major portion of the workforce.

The growing challenges and cost of safeguarding taxpayer information

To properly administer the tax system, the agency must collect, house, and manipulate a massive amount of confidential taxpayer information. This must be done in a way that protects the rights of all taxpayers. Unfortunately, the need to keep up with the ever-changing technology of data security and IRS mandates in this area has forced the agency to expend funds for up-to-date encryption tools and data management methods. This is expected to be a constantly growing concern over the next several years.

Key Program Goals

To help ensure that citizens have the following:

- ◆ The information and means they need to easily and conveniently fulfill their tax filing and paying obligations.
- ◆ The confidence that everyone is paying the proper amount of taxes, no more or no less.

- ◆ Accurate, impartial and complete information to make informed decisions about the structure and operation of the state revenue system.

REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Program Summary

Dollars in Thousands

	Current		Governor Recomm.		Biennium
	FY2008	FY2009	FY2010	FY2011	2010-11
<u>Direct Appropriations by Fund</u>					
General					
Current Appropriation	104,969	101,853	101,853	101,853	203,706
Technical Adjustments					
One-time Appropriations			(315)	(315)	(630)
Pt Contract Base Reduction			(52)	(52)	(104)
Subtotal - Forecast Base	104,969	101,853	101,486	101,486	202,972
Governor's Recommendations					
Operating Budget Reduction		0	(4,130)	(4,130)	(8,260)
Total	104,969	101,853	97,356	97,356	194,712
Health Care Access					
Current Appropriation	1,693	1,734	1,734	1,734	3,468
Technical Adjustments					
One-time Appropriations			27	15	42
Subtotal - Forecast Base	1,693	1,734	1,761	1,749	3,510
Total	1,693	1,734	1,761	1,749	3,510
Highway Users Tax Distribution					
Current Appropriation	2,139	2,183	2,183	2,183	4,366
Subtotal - Forecast Base	2,139	2,183	2,183	2,183	4,366
Total	2,139	2,183	2,183	2,183	4,366
Environmental					
Current Appropriation	297	303	303	303	606
Subtotal - Forecast Base	297	303	303	303	606
Total	297	303	303	303	606
<u>Expenditures by Fund</u>					
Direct Appropriations					
General	98,459	108,194	97,356	97,356	194,712
Health Care Access	1,623	1,804	1,761	1,749	3,510
Highway Users Tax Distribution	2,080	2,242	2,183	2,183	4,366
Environmental	270	330	303	303	606
Statutory Appropriations					
General	0	0	2,117	2,117	4,234
Miscellaneous Special Revenue	3,837	7,079	3,829	3,829	7,658
New Fund	0	0	8,500	8,000	16,500
Total	106,269	119,649	116,049	115,537	231,586
<u>Expenditures by Category</u>					
Total Compensation	73,169	85,884	81,255	81,243	162,498
Other Operating Expenses	32,903	33,465	32,477	31,977	64,454
Capital Outlay & Real Property	1	0	0	0	0
Local Assistance	196	300	200	200	400
Other Financial Transactions	0	0	2,117	2,117	4,234
Total	106,269	119,649	116,049	115,537	231,586

REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Program Summary

<i>Dollars in Thousands</i>					
	Current		Governor Recomm.		Biennium
	FY2008	FY2009	FY2010	FY2011	2010-11
<u>Expenditures by Activity</u>					
Compliance Support	3,965	4,452	3,701	3,701	7,402
Appeals, Legal Serv & Tax Res	4,747	5,413	4,802	4,802	9,604
Tax Payment & Return Processing	13,519	14,185	11,829	11,829	23,658
Tax Compliance & Enforcement	53,576	70,718	64,955	64,943	129,898
Tech Development & Support	27,144	21,195	27,578	27,078	54,656
Property Tax Admin & State Aid	3,318	3,686	3,184	3,184	6,368
Total	106,269	119,649	116,049	115,537	231,586
Full-Time Equivalent (FTE)	1,060.4	1,116.9	1,033.5	1,001.0	

Activity Description

This activity provides overall direction to the agency. Its services include human resource management, facilities and contracts management, budget planning, financial and performance reporting, tax policy development, and tax publication and informational services for taxpayers and employees.

Population Served

This activity serves the state's 3.6 million individual income tax filers and 647,000 registered businesses, the Department's nearly 1,400 employees, and state policymakers, including the Governor and legislature.

Services Provided

The compliance support activity includes six major categories of services:

Human resource management serves department managers, supervisors, and employees in staffing, recruitment, and selection; job classification; labor relations; policy administration and consultation; performance evaluation; compensation and benefits administration; personnel transactions; personnel records; workforce planning; and employee training and development.

Facilities management services include building security, office space planning, and general building services.

Financial reporting and contract management services include coordinating the Department's biennial budget and annual spending plans; monitoring annual budget plans; preparing financial reports; overseeing all budget and accounting functions for the Department's operating and property tax aids and credits budget; ensuring that adequate financial controls are in place; and conducting internal audits to ensure the integrity of internal financial and operating systems. Services also include the development of performance measures for the agency's activities; preparation of financial reports; transferring of funds to other agencies or funds; equipment, supplies and professional and technical service procurement; and negotiation of leases for the Department's facilities.

Tax forms and informational services activities include forms and instruction design for individual and business taxes; website design, maintenance and oversight; publication and report design and editing; printing coordination for all of the Department's publications, including forms and instructions; media relations; and internal communications.

Management leadership activities provide direction to the agency's work units through business planning, which includes the development of the agency's strategic plan, strategic information systems management plan, biennial budget, division business plans, and annual spending plans. It ensures that the agency's resources, support systems and training systems are aligned with the direction set through the business planning process. It also monitors agency performance through the development and use of performance measurements.

Tax policy support activities include developing policies for all tax types; identifying obstacles in taxpayer compliance with tax laws; and identifying unclear, ambiguous or conflicting provisions of tax laws. This service area also develops proposals to improve tax law understandability, fairness, ease of compliance and administration.

Activity at a Glance

- ◆ More than 300 tax forms and instruction booklets written and designed
- ◆ 15 million pieces printed and mailed
- ◆ 183,000 forms and instructions for individual income tax downloaded from website in April 2008
- ◆ 12,000 pages of information available on website
- ◆ Over 1,000 cases resolved each year by the Taxpayer's Advocate Office
- ◆ Manages facilities for nearly 1,400 employees in 17 locations
- ◆ Manages 107 contracts amounting to over \$16 million

Historical Perspective

This activity provides informational services to taxpayers and policy makers and support to tax compliance functions within the agency. Specifically, it faces the following challenges:

- ◆ an increasing exodus of experienced, knowledgeable workers;
- ◆ a more linguistic and culturally diverse population;
- ◆ higher service expectations;
- ◆ the growing erosion of the state tax structure; and
- ◆ the threat of workplace disruptions

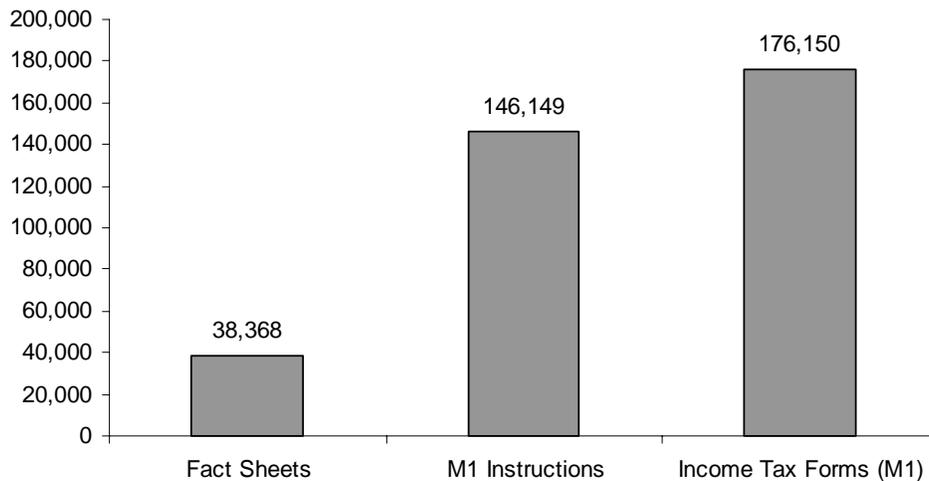
Key Activity Goals

- ◆ Citizens have the services and information they need to meet their obligations and to be informed about the revenue system.
- ◆ Employees perform meaningful and challenging work, and have opportunities to learn and grow.

Key Activity Measures

Taxpayers are relying heavily on the Department's website to obtain income tax forms, instructions and fact sheets.

Website Downloads for Income Tax
FY 2008



Activity Funding

The compliance support budget activity constitutes 3.0% of the department's budget. Of the total budget for the biennium for the administrative support budget activity, \$8.0 million (97.1%) comes from general fund tax dollars, \$163,000 (2.1%) comes from dedicated funds and \$68,000 (0.8%) comes from special revenue funds for administering the Local Option Sales Tax and the Revenue Recapture program.

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REVENUE DEPT
 Program: TAX SYSTEM MANAGEMENT
 Activity: COMPLIANCE SUPPORT

Budget Activity Summary

<i>Dollars in Thousands</i>					
	Current		Governor's Recomm.		Biennium
	FY2008	FY2009	FY2010	FY2011	2010-11
<u>Expenditures by Fund</u>					
Direct Appropriations					
General	3,813	4,278	3,543	3,543	7,086
Health Care Access	73	90	83	83	166
Statutory Appropriations					
Miscellaneous Special Revenue	79	84	75	75	150
Total	3,965	4,452	3,701	3,701	7,402
<u>Expenditures by Category</u>					
Total Compensation	3,352	3,622	3,328	3,328	6,656
Other Operating Expenses	613	830	373	373	746
Total	3,965	4,452	3,701	3,701	7,402
Full-Time Equivalents (FTE)	43.6	45.6	36.2	35.0	

Activity Description

This activity includes legal, legislative, tax appeal, and tax research services.

Population Served

Taxpayers, tax administrators, legislators and their staff, tax professionals, public policymakers, local elected officials, state agencies, local governments, nonprofit organizations, businesses, and professional and trade associations.

Services Provided**Legal Services**

- ◆ Provides in-house legal counsel and conducts legal analysis and research of tax laws and policies.
- ◆ Provides updated information on law changes and court decisions to taxpayers, business trade organizations, and tax practitioner groups.
- ◆ Works with legislators, legislative staff, taxpayers, and practitioner groups in drafting legislation, interpreting tax laws, and providing expert testimony at hearings.
- ◆ Drafts rules and revenue notices that announce the Department's interpretation of tax laws.
- ◆ Provides support to the Attorney General's staff in tax litigation.
- ◆ Monitors federal tax changes that affect Minnesota's tax system.
- ◆ Negotiates and oversees state tax agreements with tribal governments.

Appeal Services

- ◆ Resolves taxpayer disputes over tax audit assessments and denials of tax refunds and provides an independent, impartial work unit that offers taxpayers an informal and inexpensive alternative to litigation in resolving disputes.

Tax Research Services

- ◆ Forecasts revenues from various taxes and property tax aids and credits for the state's November and February forecasts.
- ◆ Develops the state's official revenue estimates and analyses for proposed state tax legislation and the impact of federal law changes.
- ◆ Prepares legislatively mandated studies and reports, including the *Minnesota Tax Incidence Study* and the *Minnesota Tax Expenditure Budget*.
- ◆ Develops databases and tax simulation models for use by the legislature and the executive branch for revenue forecasting and for evaluating the effect of tax proposals.
- ◆ Assists in measuring tax compliance and identifying data sources for detecting noncompliance.
- ◆ Disseminates economic and tax information to legislative staff, administration officials, executive branch officials, businesses, associations, nonprofit groups, all of the agency's divisions, and the public.
- ◆ Maintains an in-house library for tax research and the study of tax laws.

Historical Perspective

This activity continues to face high demand for its services due to the growing complexity of tax laws, the fast pace of state and federal tax law changes, increased challenges to tax laws, expanded compliance activities in all major tax types and numerous law proposals that require revenue estimates, drafts of legislation, and legal analysis.

Activity at a Glance

In FY 2008, this activity:

- ◆ Prepared seven revenue notices and spent over 4,400 hours on preparing or analyzing legislative bills and over 9,900 hours providing legal advice to the agency
- ◆ Completed about 1754 administrative appeals
- ◆ Developed approximately 300 formal revenue estimates

REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Activity: APPEALS, LEGAL SERVICES & TAX RESEARCH

Narrative

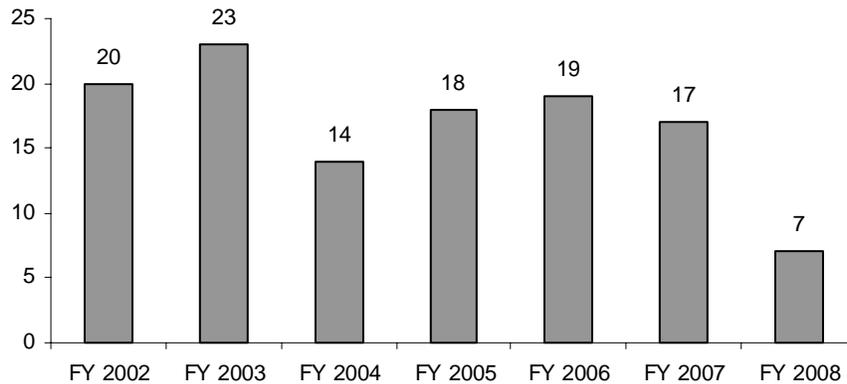
Key Activity Goals

- ◆ Citizens have the services and information they need to meet their obligations and to be informed about the revenue system.

Key Activity Measures

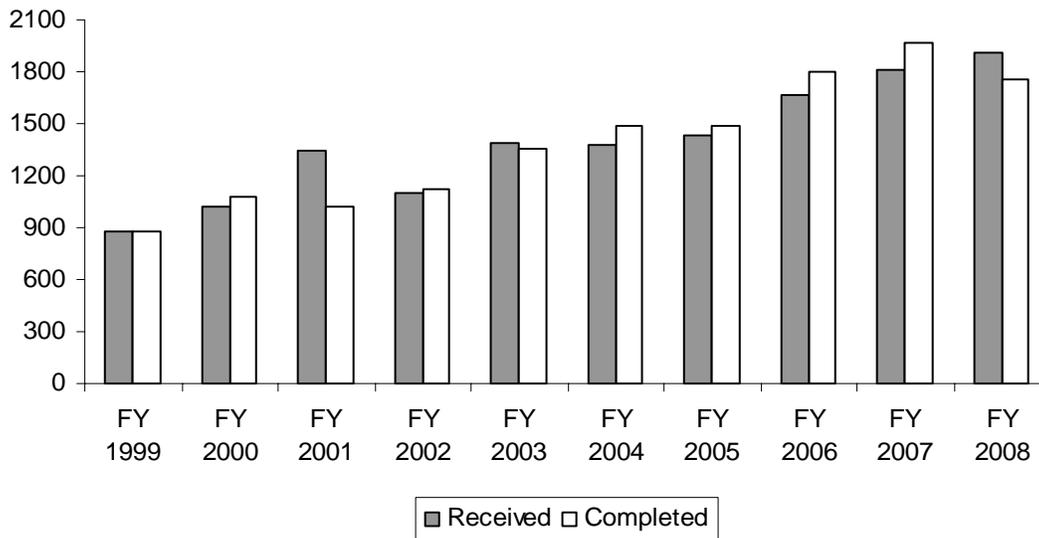
Legal: The department publishes revenue notices which advise taxpayers on how tax laws will be administered. Revenue notices are one measure of the legal counsel provided by legal staff.

Revenue Notices Published



Appeals: The number of administrative appeals continues to increase as a result of the Department's expanded compliance activities and the increased complexity of tax laws.

Administrative Appeals Received and Completed



REVENUE DEPT

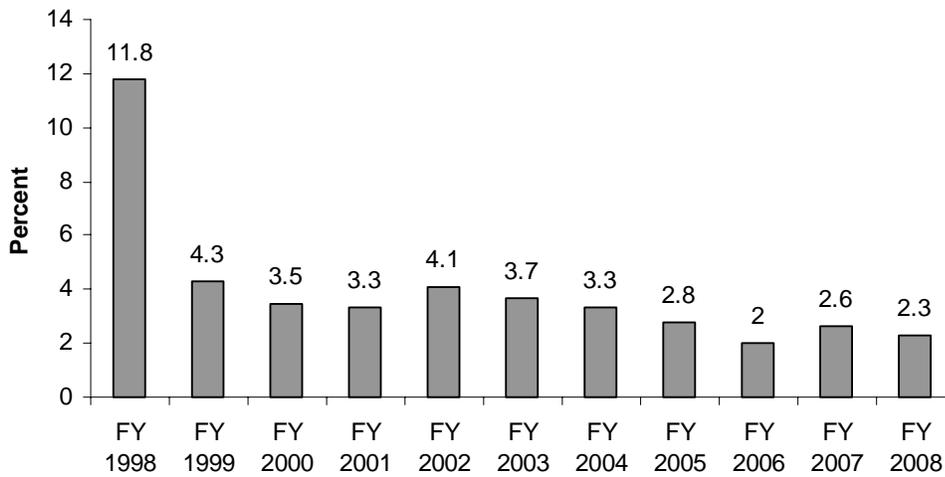
Program: TAX SYSTEM MANAGEMENT

Activity: APPEALS, LEGAL SERVICES & TAX RESEARCH

Narrative

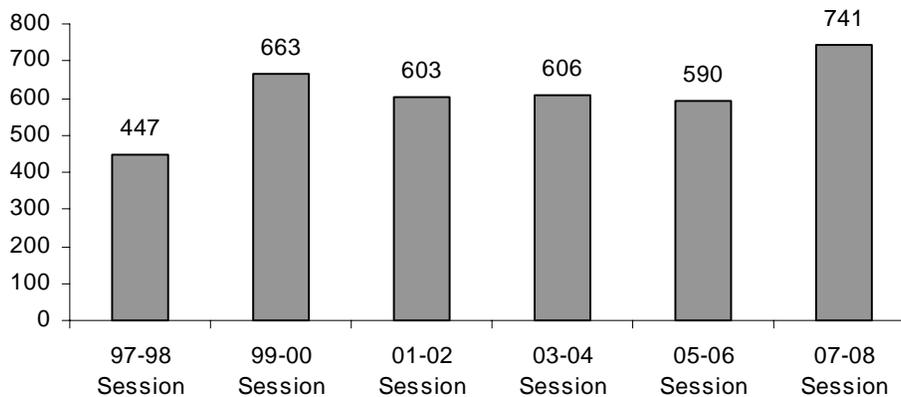
Taxpayers are becoming more assertive in challenging state tax laws. However, this activity attempts to resolve many of these challenges through a low-cost dispute resolution process rather than a formal, higher cost litigation process. The number of cases that are subsequently appealed to tax court is used to measure the effectiveness of the taxpayer dispute resolution process.

Percent of Administrative Appeals
Subsequently Appealed to Tax Court



Research: The number of bill analyses prepared by the Research Division in connection with tax legislation has remained at a high level. This activity is the largest resource management issue for the division.

Bill Analysis Provided to Tax Committees by Legislative
Session



REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Activity: APPEALS, LEGAL SERVICES & TAX RESEARCH

Narrative

Activity Funding

This activity's biennial budget is \$9.8 million, or about 3.6% of the department's total budget. Of the total budget for the biennium for the legal and research budget activity, \$9.4 million (95.8%) comes from general fund tax dollars, \$338,000 (3.4%) comes from dedicated funds and \$ 76,000 (0.8%) comes from special revenue funds for administering the Local Option Sales Tax program.

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REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Activity: APPEALS, LEGAL SERV & TAX RES

Budget Activity Summary

<i>Dollars in Thousands</i>					
	Current		Governor's Recomm.		Biennium
	FY2008	FY2009	FY2010	FY2011	2010-11
<u>Expenditures by Fund</u>					
Direct Appropriations					
General	4,514	5,120	4,513	4,513	9,026
Health Care Access	163	173	172	172	344
Statutory Appropriations					
Miscellaneous Special Revenue	70	120	117	117	234
Total	4,747	5,413	4,802	4,802	9,604
<u>Expenditures by Category</u>					
Total Compensation	3,999	4,684	4,427	4,427	8,854
Other Operating Expenses	747	729	375	375	750
Capital Outlay & Real Property	1	0	0	0	0
Total	4,747	5,413	4,802	4,802	9,604
Full-Time Equivalents (FTE)	47.6	50.2	46.1	44.6	

Activity Description

This activity processes all state electronic and paper filed tax returns and payments; issues tax refunds; and manages taxpayer records. It also establishes tax accounts for new businesses, updates taxpayer records for changes, including address changes, and offsets income tax refunds for tax and non-tax debts owed to state agencies and local units of government.

Population Served

- ◆ 3.6 million individual income taxpayers who file 2.7 million individual income tax returns
- ◆ 165,000 employers and 806 third-party bulk filers who remit income tax withholding payments
- ◆ 711,000 property tax refund applicants
- ◆ 277,000 businesses that collect and remit sales and use tax
- ◆ 42,000 corporations and 149,000 S corporations and partnerships that pay corporate franchise and income taxes
- ◆ 50,000 fiduciary income taxpayers
- ◆ 1,800 estate taxpayers who pay and submit \$116 million in estate taxes
- ◆ 641 petroleum product distributors who pay \$652 million in gasoline, special and aviation fuel taxes and various fees
- ◆ 48 cigarette and 77 tobacco distributors who remit \$425 million in cigarette and tobacco taxes and fees
- ◆ 81 wine and liquor distributors, 188 brewers and beer importers, and 16 alcohol commercial carriers, who pay approximately \$73 million in liquor, wine and beer taxes
- ◆ 1,459 insurance companies who pay \$282 million in gross premium taxes
- ◆ 8,485 hospitals, health care providers and prescription drug wholesalers who collect approximately \$658 million in health care taxes
- ◆ 1,309 organizations that conduct lawful gambling and 13 gambling equipment distributors who collect approximately \$44 million in lawful gambling taxes
- ◆ 6,000 hazardous waste generators; 4,000 water quality and 2,250 air quality permit holders and 800 solid waste management services who collect approximately \$68 million in solid waste taxes and fees
- ◆ 6 mining companies that pay approximately \$85.6 million in taconite production taxes and \$11.5 million in taconite and iron ore occupation taxes
- ◆ 190 dry cleaning facilities that pay dry cleaner taxes and five solvent distributors who pay approximately \$225,000 in dry cleaner fees
- ◆ 87 counties that remit approximately \$200 million in deed and mortgage registry taxes
- ◆ 993 state and county agencies whose debts are collected through revenue recapture

Activity at a Glance

- ◆ Processes 2.7 million income tax returns annually
- ◆ Processes over 1.6 million business tax returns
- ◆ Processes 4.9 million payments
- ◆ Issues 2.6 million refunds
- ◆ Registered 34,000 new businesses in FY2008
- ◆ Receives and sorts over 4.2 million pieces of incoming mail annually

Services Provided

This activity processes all electronic and paper state tax returns and payments. Services include:

- ◆ receiving and sorting over 4.2 million pieces of incoming mail annually
- ◆ scanning and imaging paper-filed individual income tax returns and correspondence
- ◆ recording and depositing tax payments
- ◆ verifying tax return accuracy
- ◆ auditing returns that exceed normal thresholds for credits, deductions and exemptions
- ◆ issuing refunds to individuals and businesses
- ◆ receiving and acknowledging electronic tax returns and payments
- ◆ offsetting refunds for tax and non-tax debt owed to government entities

- ◆ issuing tax identification numbers to new businesses
- ◆ recording address and name changes to individual and business tax accounts
- ◆ procuring and dispensing cigarette tax stamps

Historical Perspective

This activity continues to transform individual income tax and business tax filing and payment transactions from paper to electronic media. This activity now has in place:

- ◆ electronic filing systems for sales and use tax, withheld income taxes, corporate franchise tax, S-Corporation tax, fiduciary tax, partnerships, MinnesotaCare tax, and motor fuel taxes; and the ability to accept payment for all tax types, including estimated individual income taxes;
- ◆ a web-based business registration system;
- ◆ a modernized individual income tax computer system that is regularly adding features that permit taxpayers to serve themselves; and
- ◆ scannable individual income tax and property tax forms, which has eliminated the need for storage of paper returns.

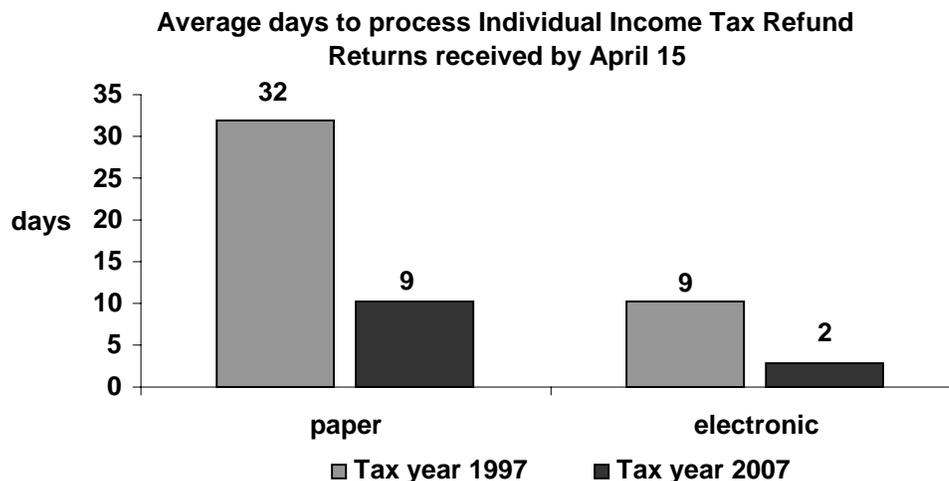
In 2007, over 1.74 million individual income tax returns were filed electronically, and over 1.2 million tax refunds were issued within five days. Over 3.9 million business tax filing and payment transactions were processed electronically in FY 2008.

Key Activity Goals

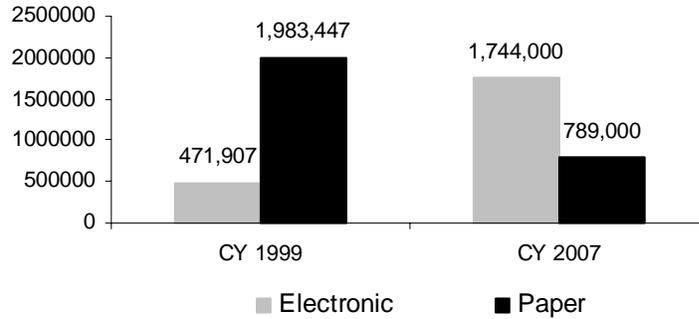
- ◆ Increase the speed, accuracy, convenience, and ease of tax filing and payment.
- ◆ Increase e-services for citizens.

Key Activity Measures

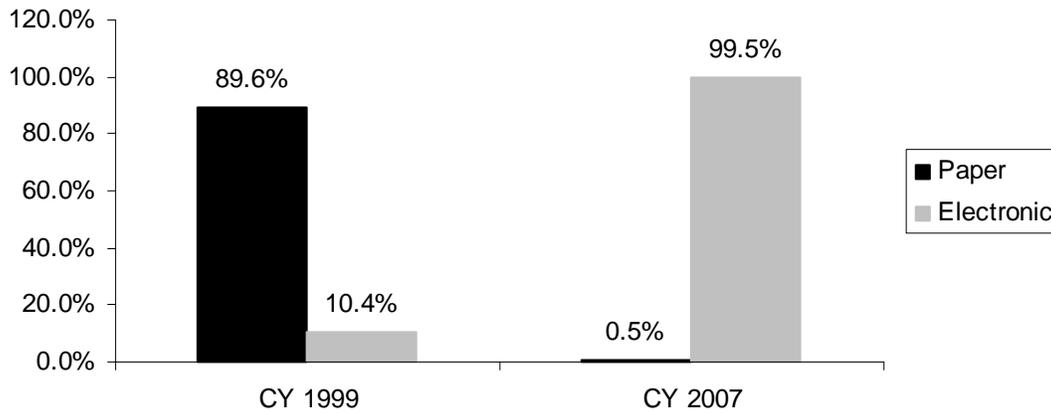
Average days to process individual income tax refund returns calculated from the date the return is received to the date the refund is issued.



Individual Income Tax
Paper vs Electronic Returns



Business Tax - Paper vs Electronic
For Sales & Use and Withholding Tax



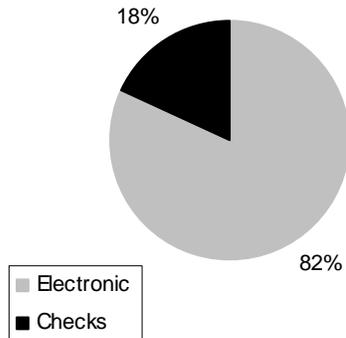
REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

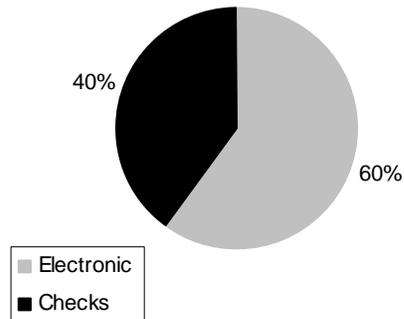
Activity: TAX PAYMENT & RETURN PROCESSING

Narrative

Taxpayer Payments by Dollars FY 2008



Taxpayer Payments by Type FY 2008



Activity Funding

This activity's biennial budget is \$28.3 million, or about 10.5% of the department's total budget. Of the total budget for the biennium for the Tax Filing and Payments budget activity, \$27.6 million (97.8%) comes from general fund tax dollars, \$123,000 (0.4%) comes from dedicated funding, and \$503,000 (1.8%) comes from special revenue funds for administering the Local Option Sales Tax and Revenue Recapture program.

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REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Activity: TAX PAYMENT& RETURN PROCESSING

Budget Activity Summary

<i>Dollars in Thousands</i>					
	Current		Governor's Recomm.		Biennium
	FY2008	FY2009	FY2010	FY2011	2010-11
<u>Expenditures by Fund</u>					
Direct Appropriations					
General	13,160	13,792	11,515	11,515	23,030
Health Care Access	27	96	62	62	124
Statutory Appropriations					
Miscellaneous Special Revenue	332	297	252	252	504
Total	13,519	14,185	11,829	11,829	23,658
<u>Expenditures by Category</u>					
Total Compensation	11,349	11,943	10,535	10,535	21,070
Other Operating Expenses	2,170	2,242	1,294	1,294	2,588
Total	13,519	14,185	11,829	11,829	23,658
Full-Time Equivalent (FTE)	206.7	208.6	168.4	162.4	

Activity Description

The compliance activity administers and enforces Minnesota's 28 individual and business taxes. These taxes raise \$17.5 billion annually, which amounts to 62.4% of the state's total revenue.

Population Served

- ◆ 3.6 million individual income taxpayers
- ◆ 711,000 homeowner and renter property tax refund applicants
- ◆ 8,000 professional tax preparers
- ◆ 277,000 businesses that collect and remit sales and use tax
- ◆ 50,000 fiduciary and 1,800 estate taxpayers
- ◆ 165,000 employers that withhold tax and 806 third-party bulk withholding filers
- ◆ 42,000 corporations, 95,000 S corporations, and 54,000 partnerships
- ◆ 700 petroleum product distributors
- ◆ 48 cigarette and 77 tobacco distributors
- ◆ 81 wine and liquor distributors; 188 brewers and beer importers, and 16 alcohol commercial carriers
- ◆ 1,459 insurance companies
- ◆ 8,485 hospitals, health care providers, and prescription drug wholesalers
- ◆ 1,309 organizations that conduct lawful gambling, and 13 gambling equipment distributors
- ◆ 6,000 hazardous waste generators and 800 solid waste management service providers
- ◆ 6 iron ore mining companies
- ◆ 195 dry cleaning facilities
- ◆ 4,500 unrelated business income tax (UBIT) filers
- ◆ 87 county treasurers and recorders
- ◆ County attorneys and other law enforcement agencies
- ◆ 674 individuals who file and pay consumer use tax
- ◆ 2,677 individuals and businesses who file sales and use tax refund claims

Activity at a Glance

- ◆ Respond to over 635,000 phone calls
- ◆ Perform 115,800 tax audits
- ◆ Perform 102,000 pre-audit adjustments
- ◆ Provide tax forms, instructions, and other information to more than 4 million taxpayers
- ◆ Respond to 38,000 e-mail inquiries

This activity also administers local option sales and use tax on behalf of 19 cities, two counties and one metro-wide transit tax.

Services Provided

This activity ensures that individuals and businesses pay the proper amount of tax by:

- ◆ informing taxpayers of their obligations and rights;
- ◆ providing paper and web-based forms and instructions;
- ◆ offering online access to free electronic income tax filing for low and modest income taxpayers, students, senior citizens, and members of the armed forces;
- ◆ responding to email, written and telephone inquiries;
- ◆ conducting audits to identify and resolve tax filing and payment discrepancies, identifying non-residents and non-filers, detecting tax evasion, and measuring levels of compliance;
- ◆ interpreting laws and making recommendations for law changes; and
- ◆ providing training courses and seminars to tax preparers and businesses.

Historical Perspective

The agency continues to rely on two landmark studies that measured the gap between the amount of tax paid and the amount that should have been paid. The first of the two studies, conducted in 2002, revealed a sales tax gap of about \$500 million; that is expected to grow to \$700 million by 2007. In 2004, the agency, in consultation with the State Demographer's Office and the Internal Revenue Service (IRS), conducted a study of the individual income tax, which revealed a gap of about \$604 million. The agency continues to monitor trends in this area, but because the tax gap is not expected to change dramatically from year to year (except for the impact of our legislative compliance initiatives) the frequency of these costly studies will be reduced.

To help mitigate a state budget shortfall, the legislature appropriated \$12.8 million to the agency in 2004-05 biennium to generate \$59.8 million through stepped-up tax auditing and enforcement activities. Those efforts generated \$92.2 million, or \$32.4 million more than expected. The agency also received \$17.8 million in the 2006-07 biennium to generate an added \$90.7 million. This effort generated \$114.3 million, or \$23.6 million more than anticipated. In the 2008-09 biennium, the legislature appropriated funds for two separate initiatives; one provided \$20.47 million to generate \$102.4 million, the other provided \$7 million for a return of \$21 million. As of 7-31-2008, these efforts have generated \$68.6 million – or about \$20.1 million ahead of the \$48.5 million that the agency had expected to generate by this date. The fact that these expanded tax auditing and enforcement initiatives have yielded much more revenue than expected is further evidence of the substantial gap between the amount of tax paid and the amount that should be paid.

The increase in appropriations for stepped-up tax enforcement activities has been partially offset by decreased funding in all other agency activities, including those activities that provide direct support services to tax enforcement activities. Prior to 2002, about 48% of the agency's budget was devoted to tax enforcement, and the remaining 52% to tax processing and taxpayer services that promote voluntary compliance. As added funds have been appropriated for tax enforcement activities and funding decreases imposed on processing and service activities, the portion of the agency's budget now devoted to tax enforcement activities constitutes 67%, with the remaining 33% allotted to processing, education and service activities.

Although expanded tax compliance activities are generating substantial revenue, uncovering tax avoidance remains a difficult task. Here are some reasons why:

- ◆ As businesses move from paper to electronic records and transactions, the agency's employees need more training to enable them to understand and access various computer systems to ensure the accuracy of the systems, as well as the transactions.
- ◆ As taxpayers convert to electronic records, they are reducing the types of information included in the records. Therefore, less data is available for employees to review; increasing the difficulty of auditing taxpayer records.
- ◆ Consolidations and mergers among businesses have resulted in the merging of computer systems, making it more difficult to identify transactions and determine who is responsible for paying the tax.
- ◆ Globalization of commerce increases the number of transactions that cross state and national borders. As more transactions are made through mail-order firms and the Internet, it is more difficult and expensive for the activity to identify them and determine who is responsible for paying the taxes.
- ◆ Significant growth in the state's economy has increased the number of retail businesses from 178,000 in 1995 to 277,000 in 2007 – or 56%. This growth limits the activity's ability to redirect resources from taxpayer support services to more direct tax enforcement activities. This growth has also increased the number of applications for capital equipment sales tax refunds that must be processed and audited.
- ◆ Sales and use tax laws have not kept pace with changes in technology. In the past, products such as musical recordings, software programs and books solely existed in the form of tangible personal property. Today

REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Activity: TAX COMPLIANCE & ENFORCEMENT

Narrative

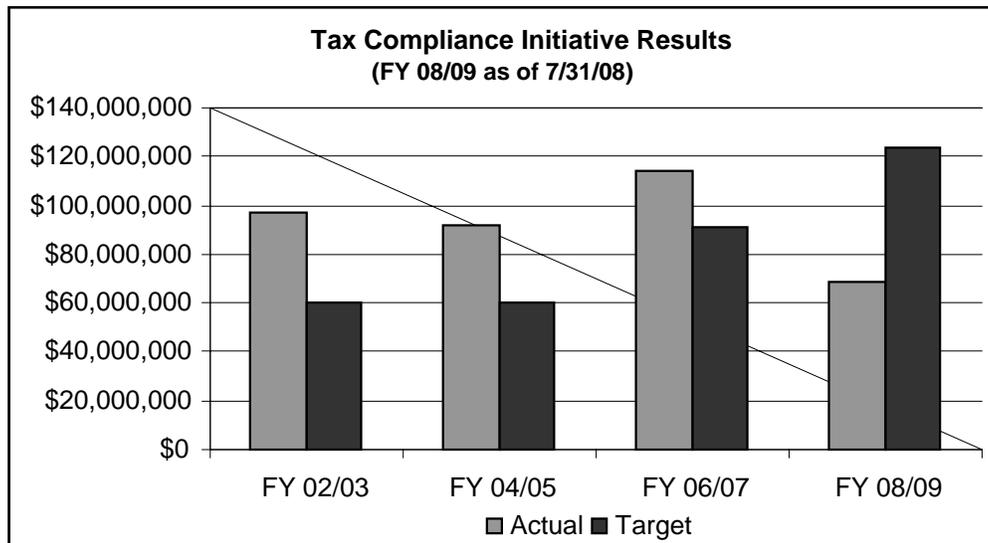
these products are delivered electronically to customers, making it difficult for the agency to determine the taxability of the sale. Only a few court decisions have been rendered to guide the agency.

- ◆ Individual income tax does not completely conform to the federal income tax which leads to complex forms and additional steps.

Key Activity Goals

- ◆ Improve compliance with the tax system.
- ◆ Everyone pays the right amount, no more, no less.

Key Activity Measures



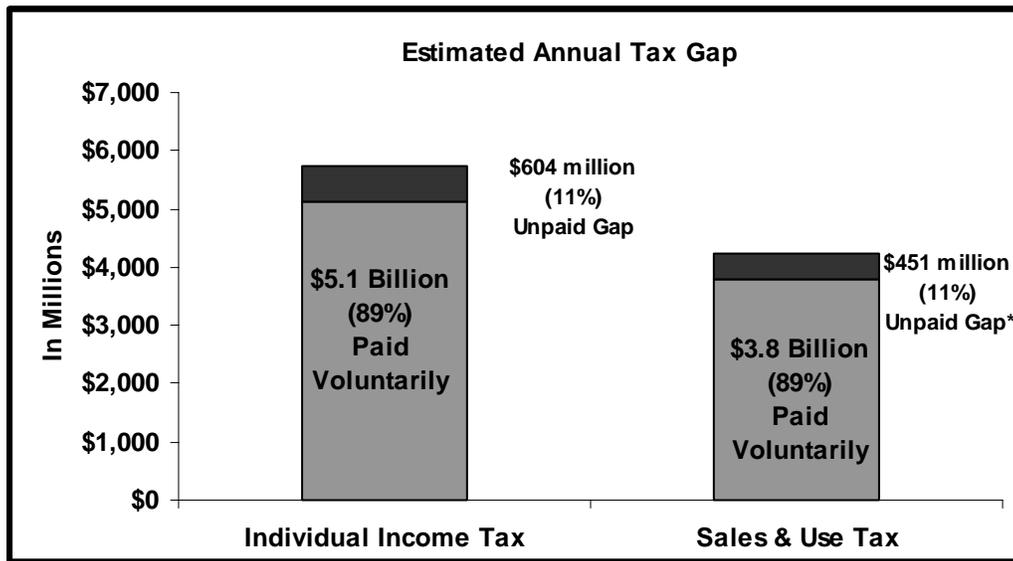
The dollars collected have exceeded our targeted goals during each biennium; \$37.1 million over target for FY 2002-03, \$32.4 million over for FY 2004-05 and \$23.6 million over for FY 2006-07 biennium. As of 7-31-08 \$68.6 million has been generated for FY 2008-09, \$20.1 million ahead of forecasted revenue by this date.

REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Activity: TAX COMPLIANCE & ENFORCEMENT

Narrative



** Individual income tax statistics are for tax year 1999

** Sales & Use tax statistics are for calendar year 2000 and include motor vehicle sales tax

Source:

Minnesota Department of Revenue, *Individual Income Tax Gap: Tax Year 1999* (6-7-2004).
American Economics Group, Inc., *Minnesota Sales and Use Tax Gap Project: Final Report*
(Prepared for the Minnesota Department of Revenue, November 19, 2002).

Activity Funding

This activity's biennial budget is \$135.1 million, or about 50.0% of the department's total budget. Of the total budget for the biennium for the tax compliance budget activity, \$123.4 million (91.4%) comes from general fund tax dollars, \$7.5 million (5.5%) comes from dedicated funds, and \$4.2 million (3.1%) comes from special revenue funds for administering the Local Option Sales Tax, Revenue Recapture and Cigarette Stamp account activities.

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REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Activity: TAX COMPLIANCE & ENFORCEMENT

Budget Activity Summary

<i>Dollars in Thousands</i>					
	Current		Governor's Recomm.		Biennium
	FY2008	FY2009	FY2010	FY2011	2010-11
<u>Expenditures by Fund</u>					
Direct Appropriations					
General	48,616	61,143	58,535	58,535	117,070
Health Care Access	1,313	1,398	1,397	1,385	2,782
Highway Users Tax Distribution	2,021	2,183	2,124	2,124	4,248
Environmental	253	313	286	286	572
Statutory Appropriations					
Miscellaneous Special Revenue	1,373	5,681	2,613	2,613	5,226
Total	53,576	70,718	64,955	64,943	129,898
<u>Expenditures by Category</u>					
Total Compensation	43,672	53,340	51,192	51,180	102,372
Other Operating Expenses	9,708	17,078	13,563	13,563	27,126
Local Assistance	196	300	200	200	400
Total	53,576	70,718	64,955	64,943	129,898
Full-Time Equivalent (FTE)	641.6	692.1	669.5	649.4	

Activity Description

This activity oversees the development and maintenance of computer systems for all major state taxes administered by the department. It maintains 129 business computer applications, and 212 software tools running on nine different platforms or operating systems that serve more than 1,354 employees. It is responsible for strategic planning for integrating technologies and systems into the agency's business operations; computer systems development; information security and data privacy; continuity of operations; emergency planning; and for managing day-to-day maintenance of the agency's computer infrastructure, including the overall network, operating systems and equipment.

Activity at a Glance

- ◆ 1,354 employees served in 17 different office locations
- ◆ 129 business computer applications, and 212 software tools running on 9 different platforms or operating systems
- ◆ Most agency provided service and information for citizens is available on-line or by other electronic means
- ◆ over four million electronic filing and payment transactions

Population Served

This activity serves policymakers, citizens and businesses that interact with or are served by our tax systems, local units of government, other state agencies, and the department's 1,354 employees.

Services Provided

The information technology activity is responsible for:

- ◆ strategic planning for aligning technologies and systems with the agency's business needs;
- ◆ systems planning, development, implementation and maintenance of computer applications;
- ◆ ensuring the security of all computer applications and privacy of data;
- ◆ ensuring that department information systems and networks are efficient, reliable, accessible and responsive;
- ◆ directing, coordinating and maintaining the continuity of operations (business continuation) and emergency response plans for the department;
- ◆ leadership of the agency business systems planning team, which is the department's process for aligning and integrating business needs with computer operations and systems;
- ◆ establishing and maintaining standards for computer architecture and technology; and
- ◆ monitoring investments in computer applications, projects and systems.

Historical Perspective

Since the 1990s, the department has been transforming its tax processing from mainframe systems that supported internal, paper-based procedures to electronic filing and paying systems. For taxpayers, these new systems mean faster, easier, and more convenient and accurate filing and paying. To achieve this transformation, the department shifted funds from other activities in order to invest in technology. However, past funding reductions have reduced this activity's budget by about \$2 million (7%). Yet, the demands for technology have increased as we have added compliance personnel to meet our compliance commitments.

To strengthen compliance, enhance taxpayer service and help to address our constrained technology budget, Department of Revenue (DOR) was able to secure from the legislature the initial funding for a comprehensive Integrated Tax system. With this initial \$12 million appropriation and significant internal resource commitments, DOR has begun to implement a proven Commercial-Off-The-Shelf (COTS) software product designed for tax and revenue operations. This initial funding has been used to cover the first two years of a five-year, \$40 million effort.

Key Activity Goals

- ◆ Increase e-services for citizens.
- ◆ Keep the revenue system in pace with changes in the economy and in technology.
- ◆ Make sure that taxpayers trust us to protect their data.

Key Activity Measures

To measure its success in implementing information technology applications, this activity uses a self-assessment process developed by the Pawlenty Administration for evaluating effectiveness in four major categories, including the overall use and management of technology.

Using a scale from one to five, the agency graded itself according to the criteria in the following four categories in the *Government Reform through Technology* area. (A grade of one is considered “below minimum standards” while a grade of five is deemed “world class excellence.” The criteria associated with a specific score appear immediately after the grade.)

Electronic Government Services – Grade: 4 – We lead the nation in Individual Income tax electronic filings and have a 99% e-file adoption rate for sales and withholding taxes. Most of our core services for citizens, businesses, and governmental groups are available on-line.

Enterprise Orientation – Grade: 4 – For the past two years we have been the most significant player in the Office of Enterprise Technology’s data center consolidation initiative. The department has a standing team in place that promotes sharing and collaboration initiatives. Additionally, we actively lead or participate in the exploration of shared service opportunities with state agencies and other partners.

Customer Focus – Grade: 4 – We develop strategic business technology and process improvement plans in collaboration with our customers. We approach the management of our agency and our projects from a collaborative perspective and have successfully used a shared approach on our projects. We have defined and consistently used processes for gathering business partner/customer (user) feedback. We continue to have many successes on the delivery of service within our agency and in collaboration with others.

Strategy and Standards – Grade: 5 – Internally, we develop and support strategies and standards designed to meet agency business needs. We also collaborate with the Office of Enterprise Technology in support of state-wide technology standards. We provide leadership and are recognized by our peers in the development and advocacy of architectural direction and standards for the greater good of the state enterprise.

Activity Funding

This activity’s biennial budget is \$35.4 million, or about 13.1% of the department’s total budget. The sources of the activity’s total biennial budget are: \$33.6 million (95.0%) from general fund tax dollars, \$245,000 (.6%) from dedicated funds and \$ 1.5 million (4.4%) from special revenue funds for administering the Local Option Sales Tax and the Revenue Recapture program.

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REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Activity: TECH DEVELOPMENT & SUPPORT

Budget Activity Summary

<i>Dollars in Thousands</i>					
	Current		Governor's Recomm.		Biennium
	FY2008	FY2009	FY2010	FY2011	2010-11
<u>Expenditures by Fund</u>					
Direct Appropriations					
General	25,198	20,292	16,066	16,066	32,132
Health Care Access	47	47	47	47	94
Highway Users Tax Distribution	59	59	59	59	118
Environmental	17	17	17	17	34
Statutory Appropriations					
General	0	0	2,117	2,117	4,234
Miscellaneous Special Revenue	1,823	780	772	772	1,544
New Fund	0	0	8,500	8,000	16,500
Total	27,144	21,195	27,578	27,078	54,656
<u>Expenditures by Category</u>					
Total Compensation	8,015	9,231	8,878	8,878	17,756
Other Operating Expenses	19,129	11,964	16,583	16,083	32,666
Other Financial Transactions	0	0	2,117	2,117	4,234
Total	27,144	21,195	27,578	27,078	54,656
Full-Time Equivalents (FTE)	84.1	83.8	81.6	79.0	

Activity Description

This activity ensures the uniform application of Minnesota's property tax laws, oversees the performance of local assessors, provides information to taxpayers and policymakers about the property tax system, and computes and disburses state aid to local governments.

Population Served

This activity serves 3,000 individual taxing jurisdictions and over 2.6 million property taxpayers each year. It also serves state policymakers and state agencies such as the departments of Education, Human Services, Economic Development, Agriculture and Corrections.

Services Provided

These activities cover two major programs: State and local property tax administration (valuation, classification, and tax calculations) and state aids to local governments.

Activity at a Glance

- ◆ Administers over \$1 billion in state aids to local governments and property tax credit programs
- ◆ Oversees the statewide property tax levy, which raised over \$700 million payable in 2008
- ◆ Provides compliance and assistance to local government officials who assess and calculate property taxes for 2.6 million parcels of property and generate over \$7 billion in tax revenue.
- ◆ Responds to 15,000 phone and 21,000 email inquiries from taxpayers and administrators

Local property tax administration activities include:

- ◆ Assisting county and local assessors in the complete and accurate identification of taxable property, its proper classification and valuation, and equalization of assessments among taxing districts.
- ◆ Providing information to individual taxpayers, legislators and local government officials about the property tax system.
- ◆ Providing support to the State Board of Assessors, which is responsible for assessor education and licensing.
- ◆ Conducting annual assessment-to-sales ratio studies to measure assessment levels, ensure their uniformity, and determine the basis for state aid payments to school districts and cities.
- ◆ Staffing the State Board of Equalization which is responsible for monitoring assessment levels for accuracy and uniformity and for issuing corrective orders when necessary.
- ◆ Assisting and monitoring local governments in implementing the annual Truth in Taxation process.
- ◆ Educating county auditors and treasurers on requirements and procedures for tax computation and collection, and providing consultation as requested.
- ◆ Estimating the value of railroads, public utilities, and airlight properties on a statewide basis.

State aids to local governments activities include:

- ◆ Collecting and maintaining assessment and levy information from all local taxing authorities each year.
- ◆ Determining state aid and credit reimbursement payments for each county, city, town, and special taxing district under a variety of statutory formulas, including County Program Aid, Local Government Aid (LGA), Market Value Homestead Credit Reimbursement Aid, and many other smaller programs.
- ◆ Setting the statewide general fund property tax rates for business and cabin properties.
- ◆ Making aid payments by statutory deadlines each year.
- ◆ Issuing state deeds for tax-forfeited property.

Historical Perspective

The activity's role in overseeing the performance of county and city assessors has taken on greater importance in recent years. As part of the property tax reform, the 2001 Legislature adopted a statewide property tax levy. This levy is imposed on properties that are classified and valued by a host of county and city assessors. The levy raises about \$700 million annually in state funds, and has become an important component in the overall state revenue system. As a consequence the activity's role in ensuring business properties are correctly classified and valued has taken on critical importance.

REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Activity: PROPERTY TAX ADMIN & STATE AID

Narrative

This activity's ability to gather property tax information quickly and efficiently is hampered by the failure of the division and local governments to invest in new technologies and computer systems. However, the division is in the process of aggressively modernizing business processes and computer systems that should result in the timelier gathering of property data and will lay the groundwork for improving property tax administration.

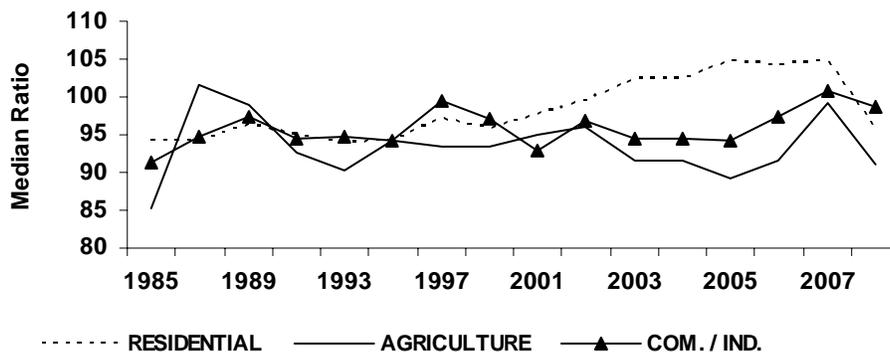
Key Activity Goals

- ◆ Property values are fair and equitable and classifications are applied uniformly throughout the state.

Key Activity Measures

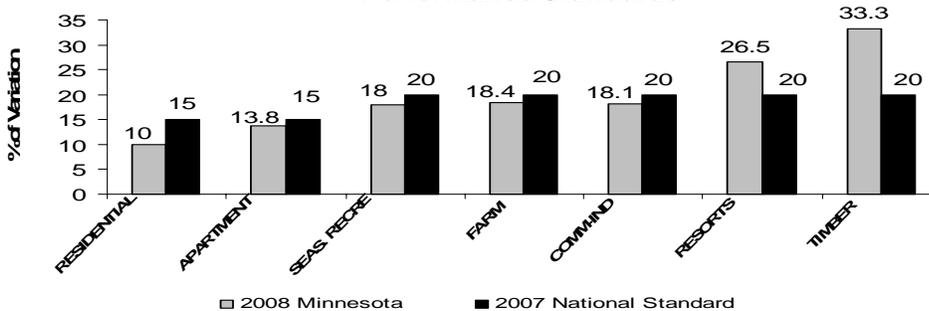
The key measure for this activity is the assessment-to-sales ratio study. In valuing a property, assessors seek to estimate a value that is as close as possible to what the property would sell for in the current market. The division conducts an annual study for each of the state's 87 counties that compare the selling price of all properties sold with the assessor's estimated market value of the property. The following table shows that Minnesota assessors have been estimating the value of residential, farm and commercial property at about 98% of the selling price.

Equalization Results



Using the sales ratio data, the following measure shows the degree of variation in individual assessments from the average for the various classes of property in Minnesota, and compares it to the national standard established by the International Association of Assessing Officers. Overall, Minnesota assessors are fairly close to the national standard on farm property, and actually beat the standard on residential and apartment properties. Commercial-industrial and timber sales are difficult to estimate because the value tends to differ according to the type and use of the property. With few resort properties (defined as commercial seasonal properties) in the state, the small sample size makes it difficult to accurately measure assessed value against actual sales.

National Assessment Performance Standards vs Minnesota Performance Standards



REVENUE DEPT**Program: TAX SYSTEM MANAGEMENT****Activity: PROPERTY TAX ADMIN & STATE AID**

Narrative

Administration of Local Government Aids: The following table identifies the amount of payments made to local government for a variety of aid programs.

**Aids and Credits Paid to Local Government Units
(Dollars in Thousands)**

Payments to Cities, Counties, Towns and Special Jurisdictions	2007	2008 Preliminary*	2009 Budgeted*
Local Government Aid	\$484,558	\$484,558	\$484,148
County Program Aid (incl. Court Aid Adj, Transition Aid)	205,847	205,383	204,919
Residential Homestead MV Credit	213,030	218,581	212,674
Agricultural Homestead MV Credit	19,248	19,321	19,263
DNR-PILT	19,657	20,338	21,017
Disparity Reduction Aid	10,328	10,208	10,974
Supplemental Taconite Aid Reimbursement	5,160	5,205	5,257
Border City Credit (DRC)	4,176	4,332	4,711
Indian Casino County Aid	668	644	644
Public Defender Costs	500	500	500
Disaster Credit/Revenue	0	75	522
Enterprise Zone Credit	<u>0</u>	<u>0</u>	<u>0</u>
Sub Total	\$963,172	\$969,145	\$964,629
Payment to Schools			
Residential Hmstd MV Credit-School	\$59,817	\$56,909	\$52,785
Agricultural Hmstd MV Credit - School	5,567	5,752	5,658
Disparity Reduction Aid-School	7,997	8,058	8,640
Border City Credit (DRC) - School	782	817	883
Disaster Credit/Rev - School	0	21	147
Enterprise Zone Credit - School	<u>0</u>	<u>0</u>	<u>0</u>
Sub Total	\$74,163	\$71,557	\$68,113
Pension Related Payments (payments made to jurisdiction or pension plan)			
Police, Fire, & Ins. Sur. Aid	\$82,284	\$85,165	\$91,207
PERA Rate Increase Aid	<u>14,560</u>	<u>14,534</u>	<u>14,534</u>
Sub Total	<u>96,844</u>	<u>99,699</u>	<u>105,741</u>
TOTAL	\$1,134,179	\$1,140,401	\$1,138,483

REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Activity: PROPERTY TAX ADMIN & STATE AID

Narrative

Activity Funding

This activity's biennial budget is \$6.8 million, or about 2.5% of the department's total budget. Of this total, \$6.8 million (100%) comes from the general fund.

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REVENUE DEPT

Program: TAX SYSTEM MANAGEMENT

Activity: PROPERTY TAX ADMIN & STATE AID

Budget Activity Summary

<i>Dollars in Thousands</i>					
	Current		Governor's Recomm.		Biennium
	FY2008	FY2009	FY2010	FY2011	2010-11
<u>Expenditures by Fund</u>					
Direct Appropriations					
General	3,158	3,569	3,184	3,184	6,368
Statutory Appropriations					
Miscellaneous Special Revenue	160	117	0	0	0
Total	3,318	3,686	3,184	3,184	6,368
<u>Expenditures by Category</u>					
Total Compensation	2,782	3,064	2,895	2,895	5,790
Other Operating Expenses	536	622	289	289	578
Total	3,318	3,686	3,184	3,184	6,368
Full-Time Equivalent (FTE)	36.8	36.6	31.7	30.6	

Program Description

The Department's Debt Collection Management activities are carried out by the Collections Division. The division collects both tax and non-tax debt owed to various state agencies and boards by individuals and corporations. Overall, the division manages a tax debt portfolio of \$459 million and non-tax debt of \$131 million in FY 2008. It collected a total of nearly \$226 million in tax debt and \$22 million in non-tax debt.

The Collection division has collected non-tax debt on behalf of other agencies since 1994, when legislation created a centralized debt collection service within the Department of Revenue. Some agencies use the Department of Revenue's collection service for all debt; some refer selected debts and others do not refer any of their debts. Of the current inventory, 38% of the debtors also have tax debt with the Department of Revenue or have at least two debts with different agencies.

Once the division exhausts all measures to collect a debt, it can refer the amount to a private for-profit collection agency for further action. However, the division retains the right to recall a case from an agency if circumstances warrant. Currently, the division contracts three private collection agencies, which receive a percentage of the total dollars they collect: 20% for first referrals, 25% for second referrals and 30% for litigated cases. In FY 2008, these agencies collected \$5.2 million, of which \$2.4 million constituted delinquent taxes.

Budget Activities Included:

- ◆ Collection

Population Served

Taxpayers, tax administrators, legislators and staff, tax professionals, public policymakers, local elected officials, state agencies, local governments and other public entities.

Services Provided

This activity collects 171 types of fees, fines, taxes, and payments for:

- ◆ **Thirty-five State Agencies:** including the departments of Administration, Agriculture, Corrections, Commerce, Employment & Economic Development, Health, Human Rights, Human Services, Labor and Industry, Military Affairs, Natural Resources, Public Safety, Revenue, Transportation, Veterans Affairs, and the Pollution Control Agency.
- ◆ **Four State Boards:** the State Campaign Finance Disclosure Board, Minnesota Client Security Board, Iron Range Resource Rehabilitation Board, and the State Veterans Home Board.
- ◆ **Two Public Employee Retirement Associations:** the Minnesota State Retirement System and the Public Employees Retirement Association.
- ◆ **Six Independent State Government Entities:** the Attorney General's Office, the Secretary of State's Office, the Minnesota Indian Affairs Council, the Minnesota Office of Higher Education, the Minnesota State Lottery, and the Minnesota State Colleges and Universities system.

Services include locating debtors, billing, contacting debtors by phone, arranging and receiving payment, monitoring payment plans, locating and evaluating assets, issuing liens and levies, and seizing assets. Other services to agencies include consulting on effective debt management and productive collection practices, and evaluation of the potential for debt collection.

Program at a Glance

- ◆ Managed an average of 120,604 delinquent tax debt cases and an average of \$459 million in delinquent tax debt in FY 2008
- ◆ Managed an average of 36,275 delinquent non-tax debt cases and an average of \$131 million in delinquent non-tax debt in FY 2008
- ◆ Collected \$226 million in delinquent tax debt in FY 2008

Historical Perspective

This activity has always been responsible for collecting delinquent taxes owed to the Department of Revenue. Starting in 1994, its responsibilities were expanded to include the collection of debt owed to other state agencies and boards. Today, of the total \$247.6 million collected during FY 2008 by this activity, approximately \$21.9 million was collected on behalf of non-tax debt clients. The collection costs for non-tax debt are recovered through fees assessed against the debtors. Currently, the fee is 15%, with an additional 10% charged if legal action is required to collect the debt.

The average tax debt portfolio managed by this activity has climbed from \$439 million in FY 2005 to about \$459 million in FY 2008. About \$113 million of the \$459 million is being collected through payment plans or is considered uncollectible. Uncollectible debt includes bankruptcies, amounts owed by deceased debtors, debts in which the statute of limitations has expired, or debts in which all collection efforts have been exhausted. The activity collected about \$226 million of the \$459 million tax debt managed during FY 2008 – up from \$181 million collected in FY 2005.

Other factors that have contributed to the rise in the tax debt portfolio include increased financial pressures on individuals and businesses due to the transition from a local to a global economy, an increase in bankruptcy filings, and expanded tax auditing activities undertaken by the agency.

This activity has been able to make significant gains on debt collection as a result of several developments, including the appropriation of added funds by the legislature to expand collection activities, law changes to streamline the collection process, the automation of manually intensive processes, the expansion of databases, and reorganization to improve work processes.

Key Program Goals

- ◆ Collect the correct amount of debt and promote future compliance at the lowest cost to the public.

Key Program Measures

FY 2008	
Total dollars collected	\$ 247.6 Million
Tax collections	\$ 197.4 Million
Non-tax collections	\$ 21.9 Million
2008 Tax Compliance Init.	\$ 28.3 Million
Total cases closed	184,445
Tax cases	157,000
Non-tax cases	27,445

Program Funding

This activity's biennial budget is \$46.6 million, or about 17.3% of the department's total budget. Of the total budget for the biennium for the Collection budget activity, \$45.9 million (98.3%) comes from general fund tax dollars, and \$790,000 (1.7%) comes from special revenue funds for administering the Local Option Sales Tax and the Revenue Recapture program.

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REVENUE DEPT

Program: DEBT COLLECTION MANAGEMENT

Program Summary

<i>Dollars in Thousands</i>					
	Current		Governor Recomm.		Biennium
	FY2008	FY2009	FY2010	FY2011	2010-11
<u>Direct Appropriations by Fund</u>					
General					
Current Appropriation	20,322	23,686	23,686	23,686	47,372
Subtotal - Forecast Base	20,322	23,686	23,686	23,686	47,372
Total	20,322	23,686	23,686	23,686	47,372
 <u>Expenditures by Fund</u>					
Direct Appropriations					
General	20,103	23,905	23,686	23,686	47,372
Open Appropriations					
General	1,142	1,900	1,900	1,900	3,800
Statutory Appropriations					
Miscellaneous Special Revenue	394	489	394	394	788
Total	21,639	26,294	25,980	25,980	51,960
 <u>Expenditures by Category</u>					
Total Compensation	18,558	21,272	21,530	21,530	43,060
Other Operating Expenses	3,081	4,357	3,785	3,785	7,570
Capital Outlay & Real Property	0	665	665	665	1,330
Total	21,639	26,294	25,980	25,980	51,960
 <u>Expenditures by Activity</u>					
Collection	21,639	26,294	25,980	25,980	51,960
Total	21,639	26,294	25,980	25,980	51,960
 Full-Time Equivalents (FTE)	 294.6	 311.6	 302.2	 293.2	

Activity Description

This activity manages the collection of delinquent tax and non-tax debts on behalf of state agencies and other public entities.

Population Served

Taxpayers, tax administrators, legislators and staff, tax professionals, public policymakers, local elected officials, state agencies, local governments and other public entities.

Services Provided

This activity collects 171 types of fees, fines, taxes, and payments for:

- ◆ **35 State Agencies:** including the departments of Administration, Agriculture, Corrections, Commerce, Employment & Economic Development, Health, Human Rights, Human Services, Labor and Industry, Military Affairs, Natural Resources, Public Safety, Revenue, Transportation, Veterans Affairs, and the Pollution Control Agency;
- ◆ **Four State Boards:** the State Campaign Finance Disclosure Board, Minnesota Client Security Board, Iron Range Resource and Rehabilitation Board, and the State Veterans Home Board;
- ◆ **Two Public Employee Retirement Associations:** the Minnesota State Retirement System and the Public Employees Retirement Association;
- ◆ **Six Independent State Government Entities:** the Attorney General's Office, the Secretary of State's Office, the Minnesota Indian Affairs Council, the Minnesota Office of Higher Education, the Minnesota State Lottery, and the Minnesota State Colleges and Universities system;

Services include locating debtors, billing and contacting debtors by phone, arranging and receiving payment, monitoring payment plans, locating and evaluating assets, issuing liens and levies, and seizing assets. Other services to agencies include consulting on effective debt management and productive collection practices, and evaluation of the potential for debt collection.

Historical Perspective

This activity has always been responsible for collecting delinquent taxes owed to the Department of Revenue. Starting in 1994, its responsibilities were expanded to include the collection of debt owed to other state agencies and boards. Today, of the total \$247.6 million collected during FY 2008 by this activity, approximately \$21.9 million was collected on behalf of non-tax debt clients. The collection costs for non-tax debt are recovered through fees assessed against the debtors. Currently, the fee is 15%, with an additional 10% charged if legal action is required to collect the debt.

The average tax debt portfolio managed by this activity has climbed from \$439 million in FY 2005 to about \$459 million in FY 2008. About \$113 million of the \$459 million is being collected through payment plans or is considered uncollectible. Uncollectible debt includes bankruptcies, amounts owed by deceased debtors, debts in which the statute of limitations has expired, or debts in which all collection efforts have been exhausted. The activity collected about \$226 million of the \$459 million tax debt managed during FY 2008 – up from \$181 million collected in FY 2005.

Activity at a Glance

- ◆ Managed an average of 120,604 delinquent tax debt cases and an average of \$459 million in delinquent tax debt in FY 2008
- ◆ Managed an average of 36,275 delinquent non-tax debt cases and an average of \$131 million in delinquent non-tax debt in FY 2008
- ◆ Collected \$226 million in delinquent tax debt in FY 2008

REVENUE DEPT

Program: DEBT COLLECTION MANAGEMENT

Activity: Collection

Narrative

Factors that have contributed to the rise in the tax debt portfolio include increased financial pressures on individuals and businesses due to the transition from a local to a global economy, an increase in bankruptcy filings, and expanded tax auditing activities undertaken by the agency. This activity has also been able to make significant gains on debt collection as a result of several developments, including the appropriation of added funds by the legislature to expand collection activities, law changes to streamline the collection process, the automation of manually intensive processes, the expansion of databases, and reorganization to improve work processes.

Key Activity Goals

- ◆ Collect the correct amount of debt and promote future compliance at the lowest cost to the public.

Key Activity Measures

FY 2008

Total dollars collected	\$ 247.6 Million
Tax collections	\$ 197.4 Million
Non-tax collections	\$ 21.9 Million
2008 Tax Compliance Init.	\$ 28.3 Million

Total cases closed	184,250
Tax cases	156,805
Non-tax cases	27,445

Activity Funding

This activity's biennial budget is \$46.6 million, or about 17.3% of the department's total budget. Of the total budget for the biennium for the Collection budget activity, \$45.9 million (98.3%) comes from general fund tax dollars, and \$790,000 (1.7%) comes from special revenue funds for administering the Local Option Sales Tax and the Revenue Recapture program.

Contact

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REVENUE DEPT
 Program: DEBT COLLECTION MANAGEMENT
 Activity: COLLECTION

Budget Activity Summary

<i>Dollars in Thousands</i>					
	Current		Governor's Recomm.		Biennium
	FY2008	FY2009	FY2010	FY2011	2010-11
<u>Expenditures by Fund</u>					
Direct Appropriations					
General	20,103	23,905	23,686	23,686	47,372
Open Appropriations					
General	1,142	1,900	1,900	1,900	3,800
Statutory Appropriations					
Miscellaneous Special Revenue	394	489	394	394	788
Total	21,639	26,294	25,980	25,980	51,960
<u>Expenditures by Category</u>					
Total Compensation	18,558	21,272	21,530	21,530	43,060
Other Operating Expenses	3,081	4,357	3,785	3,785	7,570
Capital Outlay & Real Property	0	665	665	665	1,330
Total	21,639	26,294	25,980	25,980	51,960
Full-Time Equivalent (FTE)	294.6	311.6	302.2	293.2	

REVENUE DEPT

Agency Revenue Summary

Dollars in Thousands

	Actual FY2008	Budgeted FY2009	Governor's Recomm.		Biennium 2010-11
			FY2010	FY2011	
<u>Non Dedicated Revenue:</u>					
Other Revenues:					
General	637	632	632	632	1,264
Total Non-Dedicated Receipts	637	632	632	632	1,264
<u>Dedicated Receipts:</u>					
Departmental Earnings:					
Miscellaneous Special Revenue	661	570	570	570	1,140
New Fund	0	0	16,500	0	16,500
Other Revenues:					
Miscellaneous Special Revenue	4,044	3,653	3,653	3,653	7,306
Total Dedicated Receipts	4,705	4,223	20,723	4,223	24,946
Agency Total Revenue	5,342	4,855	21,355	4,855	26,210